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NOTES

SUPREME COURT'S HIGHER STANDARD OF REVIEW INVALIDATES TREAS. REG. 1.1563-1(a)(3) AND NARROWS SCOPE OF BROTHER-SISTER CONTROLLED GROUPS— UNITED STATES V. VOGEL FERTILIZER COMPANY

Congress has enacted various tax provisions to stimulate the growth and development of small corporations.¹ One significant example is the graduated corporate tax structure.² This structure subjects the first \$100,000 of corporate earnings to lower tax rates, thereby, reducing the tax burden on small income corporations. Two or more corporations which are substantially owned by the same five or fewer shareholders, however, may be classified as component members of a "brother-sister controlled group" and, consequently, required to share numerous tax benefits otherwise available to each corporation individually.³ Section 1563(a)(2) of the Internal Revenue

1. For a general discussion of the tax aspects of the closely held corporation, see Dan, *An Updated Analysis of Tax Planning for Closely Held Corporations and Their Shareholders*, 56 TAXES 897 (1978); Eustice, *The Tax Reform Act of 1976: Loss Carryovers and Other Corporate Changes*, 32 TAX L. REV. 113 (1977); Monyek, *Withdrawing Funds from Closely Held Corporations (At the Lowest Cost)*, 49 TAXES 802 (1971); Ness, *Tax Developments Affecting Closely Held Corporations*, 1 J. CORP. TAX'N 71 (1974); Note, *Taxation: Tax Aspects of Incorporating the Closely Held Corporation*, 14 WASHBURN L.J. 280 (1975).

2. I.R.C. §§ 11 (a)-(b) (Law. Co-op. Supp. 1983) imposes an annual tax on the taxable income of every corporation. For 1982 and subsequent years the tax is the sum of:

- (1) 15 percent (16 percent for taxable years beginning in 1982) of so much of the taxable income as does not exceed \$25,000;
- (2) 18 percent (19 percent for taxable years beginning in 1982) of so much of the taxable income as exceeds \$25,000 but does not exceed \$50,000;
- (3) 30 percent of so much of the taxable income as exceeds \$50,000 but does not exceed \$75,000;
- (4) 40 percent of so much of the taxable income as exceeds \$75,000 but does not exceed \$100,000; plus
- (5) 46 percent of so much of the taxable income as exceeds \$100,000.

Id.

For tax years 1979 through 1981 the 15% and 18% rates were 17% and 20%, respectively. *Id.* Prior to 1979 the normal and surtax corporate tax structure was in effect. For a discussion of this system, see *infra* notes 14-24 and accompanying text.

3. I.R.C. § 1561(a) treats a brother-sister controlled group of corporations as a single taxpayer for purposes of the graduated corporate tax system. I.R.C. § 1561(a)(1) (Law. Co-op. 1982). In addition, § 1561(a) limits a brother-sister controlled group to a single accumulated earnings credit under I.R.C. § 535(c)(2)-(3) and to one small business deduction for life insurance companies under § 804(a)(3) and § 809(d)(10). Examples of other limited deductions and credits which are applied to a brother-sister controlled group as a single corporation include: the \$25,000 investment credit limitation under § 46(a)(6); the limitation on amount of used property eligible for the investment tax credit under § 48(c)(3)(C); the \$10,000 tax preference

Code⁴ (Code) objectively defines a brother-sister controlled group with a two-part test.⁵

Two or more corporations are members of a brother-sister controlled group if five or fewer persons⁶ own⁷ at least eighty percent of the total voting power or stock value of each corporation and more than fifty percent of the total voting power or stock value of each corporation considering only each person's "identical stock ownership"⁸ in the corporations.⁹ In an attempt to clarify an apparent ambiguity regarding the application of the eighty percent test, the Treasury Department issued Treasury Regulation section

exemption under § 58(b) from the add-on minimum tax; and the first year bonus depreciation deduction under § 179.

For a discussion of other Code sections treating a brother-sister controlled group as a single taxpayer, see Golub & Weber, *What Supreme Court's Liberal Decision on Controlled Groups Means to Practitioners*, 27 TAX'N FOR ACCT. 208, 208 (1982) [hereinafter cited as Golub & Weber]; Welz & Minasian, *Supreme Court in Vogel Voids IRS' 80% Brother-Sister Group Test: Wide Impact Seen*, 56 J. TAX'N 202, 204 n.20, 205 (1982).

4. I.R.C. § 1563(a)(2) (Law. Co-op. 1974). Unless otherwise indicated, all references to "Code" or "section(s)" refer to the Internal Revenue Code of 1954 as amended.

5. The text of I.R.C. § 1563(a)(2) provides, in relevant part:

Brother-sister Controlled Group - Two or more corporations if 5 or fewer persons who are individuals, estates or trusts own. . . stock possessing—

(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and

(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each person only to the extent such stock ownership is identical with respect to each such corporation.

I.R.C. § 1563(a)(2) (Law. Co-op. 1974).

6. For purposes of § 1563(a)(2) the word "persons" includes individuals, estates, or trusts.

I.R.C. § 1563(a)(2) (Law. Co-op. 1974).

7. In computing the 80% and 50% tests under § 1563(a)(2), stock ownership includes stock owned directly or indirectly. Indirect ownership is determined under the attribution rules of § 1563(e). I.R.C. § 1563(e) (Law. Co-op. 1974). For a thorough discussion of the application of these complicated attribution rules, see J. MERTENS, *THE LAW OF FEDERAL INCOME TAXATION, CODE COMMENTARY* § 1563:3 (rev. ed. 1982) [hereinafter cited as MERTENS]; Slayen & Ayers, *Tax Planning for Multiple Corporations: Definitions and Applications*, 8 TAX ADVISOR 396, 400-01 (1977). For suggestions on circumventing the attribution rules through gifts, sales, and redemptions, see Chiasson, *Tax Advantages of Multiple Corporations After Vogel Fertilizer*, 13 TAX ADVISOR 388, 392 (1982).

In addition, § 1563(c) excludes certain types of stock. For example, nonvoting preferred stock and treasury stock are not counted for purposes of the 80% and 50% requirements. I.R.C. § 1563(c)(1) (Law. Co-op. 1974). For a general discussion regarding other types of excluded stock, see MERTENS, *supra*, at § 1563:2.

8. The meaning of "identical stock ownership" is best illustrated by an example. If A owns 50% of corporation X and 20% of corporation Y, A's identical stock ownership with respect to each corporation is 20%. Similarly, if B owns 50% of corporation X and 0% of corporation Y, B's identical stock ownership with respect to each corporation is 0%.

1.1563-1(a)(3).¹⁰ This regulation provides that a person's stock interest may be included in the eighty percent ownership computation even though that individual does not own stock in each corporation comprising the alleged brother-sister controlled group.¹¹ The Treasury's construction of the eighty percent test has come under judicial scrutiny, and the issue of its validity has divided the lower federal courts.¹² The Supreme Court's recent decision in *United States v. Vogel Fertilizer Company*,¹³ resolved the conflict contrary to the Treasury's construction by holding that a person must own stock in each corporation of the alleged brother-sister controlled group before that person may be included for purposes of the eighty percent ownership test.

A close examination reveals that the *Vogel* decision significantly affects

9. The application of this technical provision is illustrated by the following example:

SHAREHOLDERS	Percentage of Stock Ownership (80% Test) Corporations			Percentage of Identical Stock Ownership (50% Test)
	<i>P</i>	<i>Q</i>	<i>R</i>	
<i>A</i>	30%	75%	50%	30%
<i>B</i>	70%	25%	50%	25%
TOTAL	100%	100%	100%	55%

Corporations *P*, *Q*, and *R* are members of a brother-sister controlled group. Together *A* and *B* own 100% of each corporation and thus satisfy the 80% ownership test of I.R.C. § 1563(a)(2)(A). In addition, the more than 50% identical stock ownership requirement of § 1563(a)(2)(B) is satisfied because collectively *A* and *B* have a 55% identical stock interest in each corporation. Shareholder *A*'s stock interest in each corporation is identical to the extent of 30%. Similarly, *B*'s stock interest in each corporation is identical to the extent of 25%.

10. Treas. Reg. § 1.1563-1(a) (1972).

11. *Id.* See *infra* notes 32-36 and accompanying text.

12. The United States Courts of Appeals for the Second, Fourth, and Eighth Circuits have upheld the regulation as a reasonable construction of the statute. See, e.g., *Allen Oil Co. v. Commissioner*, 614 F.2d 336 (2d Cir. 1980); *T.L. Hunt, Inc. v. Commissioner*, 562 F.2d 532 (8th Cir. 1977); *Fairfax Auto Parts, Inc. v. Commissioner*, 548 F.2d 501 (4th Cir.) (per curiam), *cert. denied*, 434 U.S. 904 (1977). The Court of Appeals for the Fifth Circuit, the United States Court of Claims, and the United States Tax Court have invalidated the regulation by holding that § 1563(a)(2) was intended to apply only where each person in the five or fewer group owns stock in each corporation. See, e.g., *Delta Metalforming Co. v. Commissioner*, 632 F.2d 442 (5th Cir. 1980); *Vogel Fertilizer Co. v. United States*, 634 F.2d 497 (Cl. Ct. 1980), *aff'd*, ___ U.S. ___, 102 S. Ct. 821 (1982). The United States Tax Court has held its position firmly despite reversals by the United States Courts of Appeals for the Second, Fourth, and Eighth Circuits. See, e.g., *Davidson Chevrolet Co. v. Commissioner*, 39 T.C.M. (CCH) 299 (1979); *Allen Oil Co. v. Commissioner* 38 T.C.M. (CCH) 355 (1979), *rev'd*, 614 F.2d 336 (2d Cir. 1980); *Delta Metalforming Co. v. Commissioner*, 37 T.C.M. (CCH) 1485 (1978), *aff'd*, 632 F.2d 442 (5th Cir. 1980); *Baloian Co. v. Commissioner*, 68 T.C. 620 (1977), *appeal docketed*, Nos. 78-2438, 78-2508 (9th Cir. Apr. 19, 1978); *Fairfax Auto Parts, Inc. v. Commissioner*, 35 T.C.M. (CCH) 966 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977); *T.L. Hunt v. Commissioner*, 35 T.C.M. (CCH) 966 (1976), *rev'd*, 562 F.2d 532 (8th Cir. 1977).

13. ___ U.S. ___, 102 S. Ct. 821 (1982).

two areas of law. First, the majority's analysis in *Vogel* indirectly confirms a recent trend toward subjecting interpretative regulations to a higher standard of judicial review. More specifically, the *Vogel* opinion suggests that interpretative regulations which are issued contemporaneously with the enactment of a Code section and which construe an ambiguous statutory definition rather than a broad statutory term deserve little, if any, deference. Second, the Court's narrow construction of section 1563(a)(2) will enable many close corporations to avoid classification as component members of a brother-sister controlled group, thus resulting in substantial tax savings to these corporations.

BACKGROUND

The Development and Statutory Scheme of Section 1563(a)(2)

Since the enactment of the surtax exemption in 1950,¹⁴ the corporate tax scheme has been consistently structured to reduce the tax burden on small businesses. Before the present graduated tax structure was enacted in 1978,¹⁵ the corporate tax scheme imposed a normal tax on all corporate earnings plus an additional surtax on taxable income exceeding a \$25,000 surtax exemption.¹⁶ Abuse soon arose, however, because large corporations were able to obtain multiple surtax exemptions by subdividing and forming multiple corporations.¹⁷

Prior to 1964, the Internal Revenue Service (IRS) used a subjective test to curtail the abuse of surtax exemptions by multiple incorporation.¹⁸ The

14. Revenue Act of 1950, ch. 994, § 15(b), 64 Stat. 915 (repealed 1978). The surtax exemption was created to give small business as a tax advantage by reducing the corporate tax rate on the first \$25,000 of corporate earnings. See H.R. REP. NO. 413, 91st Cong., 1st Sess. 97, reprinted in 1969 U.S. CODE CONG. & AD. NEWS 1645, 2165.

15. Act of November 6, 1978, Pub. L. No. 95-600, § 301(a), 92 Stat. 2820 (codified at I.R.C. § 11 (Law. Co-op. Supp. 1982)).

16. The Revenue Act of 1950, ch. 994, § 15(b), 64 Stat. 915 (repealed 1978), imposed a normal tax of 23% on all taxable corporate income and a surtax of 20% on taxable corporate income in excess of \$25,000. Thus, the value of the surtax exemption was 20% of \$25,000 or \$5,000.

17. The House Ways and Means Committee Report noted that "large organizations have been able to obtain substantial benefits . . . by dividing the organization's income among a number of related corporations." H.R. REP. NO. 413, 91st Cong., 1st Sess. 98, reprinted in 1969 U.S. CODE CONG. & AD. NEWS 1645, 2166. See also H.R. REP. NO. 749, 88th Cong., 1st Sess., reprinted in 1964 U.S. CODE CONG. & AD. NEWS 1313, 1425 (noting that some medium and large enterprises have taken advantage of the lower rates afforded small business by organizing their corporate structure in the form of multiple corporations).

18. I.R.C. §§ 269, 482, and 1551 (Law. Co-op. 1974 & Supp. 1982), formed the basis of the Government's subjective test. Section 269 provides that where an individual or corporation acquires or acquired control of a corporation for the "purpose" of avoiding federal income tax, the Secretary of the Treasury may disallow any resulting deduction, credit, or allowance which such person or corporation would not otherwise have enjoyed. "Control" constituted ownership of at least 50% of the voting stock or value of stock of the corporation. *Id.* § 269. Section 482 authorizes the Secretary to allocate deductions, credits, or allowances among two or more corporations controlled by the same interest, if necessary to prevent the evasion of taxes or to clearly reflect the income of the corporations. *Id.* § 482. Section 482, however,

taxpayers, however, were often successful in withstanding an IRS challenge¹⁹ because the Commissioner had the burden of establishing a tax avoidance purpose for the taxpayer's use of multiple corporations.²⁰ In 1964, Congress responded to the continued abuse of multiple surtax exemptions with the enactment of Code sections 1561 and 1563.²¹ Section 1561 limits a controlled

does not define "control." Finally, § 1551 empowers the Secretary to disallow a transferee corporation a surtax exemption and an accumulated earnings credit where: (1) a corporation transfers non-monetary property to the transferee corporation; (2) the transferee corporation was created for the purpose of acquiring such property or was not actively engaged in business at the time of the transfer; (3) the transferee corporation is controlled by the transferor corporation or its shareholders; and (4) the transferee cannot "establish by the clear preponderance of the evidence" that the securing of the surtax exemption or accumulated earnings credit was not a "major purpose" of the transfer. *Id.* § 1551. Section 1551 defines "control" with substantially the same language as § 1563(a)(2) defines a brother-sister controlled group. *See supra* note 5 (quoting the text of § 1563(a)(2)). Although § § 269, 482, and 1551 are still in effect, they are rarely employed because the objective tests of §§ 1561-1563 have proven more effective. *See United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821, 829 n.9 (1982) (noting that §§ 269, 482, and 1551 are still in effect but rarely utilized); H.R. REP. NO. 749, 88th Cong., 1st Sess., reprinted in 1964 U.S. CODE CONG. & AD. NEWS 1313, 1427 (the enactment of I.R.C. § 1563 was not intended to affect the application of §§ 269, 482, and 1551 if the multiple corporations formed to avoid taxes).

For a detailed analysis of how §§ 269, 482, and 1551 have been applied to limit the abuse of multiple incorporations, see Carruthers, *The Treasury's Attack Upon the Tax Benefits of the Multi-Corporate Complex*, 28 INST. FED. TAX'N 555 (1970); Dreher, *Federal Income Tax Aspects of Multiple Corporations*, 9 HOUS. L. REV. 8, 15-19 (1971); Thomas, *Brother-Sister Multiple Corporations—The Tax Reform Act of 1969 Reformed by Regulation*, 28 TAX L. REV. 65, 66-67 (1972) [hereinafter cited as Thomas].

19. Under these subjective provisions, courts generally allow the taxpayer multiple benefits if there is a valid business purpose for operating in the form of multiple corporations. The most common "business purposes" justifying the use of multiple corporations include differences in location, business activities, and the need for limited liability. *See, e.g.*, *Green Light Co. v. United States*, 405 F.2d 1068 (5th Cir. 1968) (I.R.C. § 269 inapplicable because corporations were created in different geographic locations and a need existed for limited liability); *Sno-Frost, Inc. v. Commissioner*, 81 T.C. 1058 (1959) (avoiding tax was not a "major purpose" of creating another corporation where there was a need for limited liability and the corporation handled products requiring different merchandising methods). For a discussion of business purposes advanced in various cases and the success of each, see F. O'NEAL, *CLOSE CORPORATIONS LAW AND PRACTICE* § 2.05 at 48 (2d ed. 1971 & Supp. 1982) [hereinafter cited as O'NEAL]; Cuddihy, *Obtaining Multiple Deductions and Credits for Multiple Corporations*, 1961 TUL. TAX INST. 564; Ekman, *How Many Corporations Can Conduct a Business?*, 19 INST. FED. TAX'N 391 (1961); Emmanuel & Lipoff, *Commissioner v. Corporate Complex: An Expanding Attack*, 15 U. FLA. L. REV. 352 (1962-63); Paley, *Multiple Corporations Face Ever-Increasing Attack; Realty Development Vulnerable*, 18 J. TAX'N 130 (1963).

20. *See supra* note 18. Under § 269 the Commissioner is required to establish that the acquisition was for the "principal purpose" of evading federal income taxes. I.R.C. § 269 (Law Co-op. 1974). Section 482 requires the Commissioner to demonstrate that disallowance of a deduction is necessary to prevent the evasion of taxes. *Id.* § 482. Section 1551, however, places the burden on the taxpayer to establish "by clear preponderance of the evidence" that the securing of a surtax exemption or accumulated earnings credit was not a "major purpose" of the transfer. *Id.* § 1551.

21. Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19 (current version at I.R.C. §§ 1561-1563 (Law. Co-op. 1974 & Supp. 1982)). For commentary discussing the development of I.R.C. §§ 1561-1563, see Comment, *Brother-Sister Controlled Groups: Tax Court Stands Firm In The Face of Reversal*, 13 CREIGHTON L. REV. 543 (1979) [hereinafter cited as *Tax Court*

group of corporations to a single surtax exemption,²² and section 1563 determines which corporations are members of a "controlled group."²³ These sections set forth an objective test which permits one surtax exemption per group of small corporations that are component members of a large enterprise, while still affording the full surtax exemption to bona fide small businesses.²⁴

Although Congress replaced the surtax and surtax exemption with the present graduated corporate tax scheme in 1978, Code sections 1561 through 1563 are still relevant today. Like the surtax exemption, the graduated rate structure favors small income corporations and, thus, encourages large corporations to operate, in form, as a number of smaller corporations. Section 1561 deters abuse of this rate structure by dividing benefits of the lower tax rates equally among the individual control group members unless they consent to an apportionment plan providing otherwise.²⁵

The substantive problem under either the surtax or graduated tax schemes is objectively defining a controlled group of corporations. Section 1563(a)(2) originally provided that two or more corporations were component members of a brother-sister controlled group if at least eighty percent of each corporation was owned by the same person.²⁶ Because this narrow provision was easily circumvented, the Treasury Department proposed an amendment

Stands Firm]; Note, *The Brother-Sister Controlled Group Under I.R.C., § 1563(a)(2)*, 67 VA. L. REV. 751 (1981).

See generally Note, *Fairfax Auto Parts, Inc. v. Commissioner: Definitional Requirements of the Multiple Corporation for Purposes of Exclusion from Surtax Exemptions*, 32 U. MIAMI L. REV. 461, 476-78 (1978) (criticizing these sections as a defective mechanical device).

22. I.R.C. § 1561 (Law. Co-op. 1974 & Supp. 1982). Prior to 1975, however, a component member of a controlled group of corporations could obtain a full \$25,000 surtax exemption by paying a six percent penalty tax on its first \$25,000 of income. Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19 (phased out 1969 through 1975) (formerly codified at I.R.C. § 1562 (Law. Co-op. 1974)). For an analysis of the mechanics of this provision, see White, *The Tax Reform Act of 1969: Demise of Multiple Surtax Exemptions—When Too Much of a Good Thing Proved Its Own Undoing*, 16 WAYNE L. REV. 1353, 1356-60 (1970)[hereinafter cited as White].

23. I.R.C. § 1563 (Law. Co-op. 1974 & Supp. 1982). In addition to a brother-sister controlled group, § 1563(a) defines a parent-subsidiary controlled group and a "combined group". See *id.* § 1563(a).

24. See S. REP. NO. 552, 91st Cong., 1st Sess. 133-36, reprinted in 1969 U.S. CODE CONG. & AD. NEWS 2027, 2166; H.R. REP. NO. 749, 88th Cong. 1st Sess., reprinted in 1964 U.S. CODE CONG. & AD. NEWS 1313, 1426. Sections 1561-1563 apply despite legitimate business reasons for operating in a multiple corporate form. *Id.*

25. I.R.C. § 1561(a)(1) (Law. Co-op. Supp. 1982), as amended by Act of November 6, 1978, Pub. L. No. 95-600, § 301(b)(19)(A), 92 Stat. 2820, 2823. See also *supra* note 3.

26. Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19 (amended 1969) (current version at I.R.C. § 1563(a)(2) (Law. Co-op. 1974)). The statute defined a brother-sister controlled group as:

[t]wo or more corporations if stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent

expanding the scope of section 1563(a)(2).²⁷ The proposal increased the eighty percent ownership group from one to five or fewer persons and added a fifty percent identical ownership test.²⁸ According to the Treasury Department's General Explanation, the fifty percent test insures that this expanded definition applies only to corporations operating as one economic unit.²⁹ Congress adopted the Treasury's proposal verbatim in 1969.³⁰

As amended, however, the eighty percent test of section 1563(a)(2) contained an inherent ambiguity. It was unclear whether a shareholder must own stock in each corporation of the alleged brother-sister controlled group before that person's stock interest could be considered for purposes of the eighty percent test.³¹ Shortly after the 1969 amendment was enacted, the Treasury Department issued Temporary Regulation section 13.16-1(a)³² which provided that the eighty percent and fifty percent tests of section 1563(a)(2) could be satisfied by five or fewer persons considered "singly or in combination."³³ An example set forth in the temporary regulation demonstrated that the phrase "singly or in combination" did not require common ownership for purposes of the eighty percent test.³⁴ Final Treasury

of the total value of shares of all classes of stock or each of the corporations is owned . . . by one person who is an individual, estate, or trust.

Id.

27. *Hearings Before the House Comm. On Ways and Means on the Subject of Tax Reform*, 91st Cong., 1st Sess. 5050, 5396 (1969) [hereinafter cited as Treasury Department's General Explanation].

28. *Id.* at 5394.

29. *Id.*

30. Tax Reform Act of 1969, Pub. L. No. 91-172, § 401(c), 83 Stat. 487 (1969) (codified at I.R.C. § 1563(a)(2) (Law. Co-op. 1974)).

31. For an illustration of this ambiguity, see *infra* note 102. One commentator has suggested that the language of the 80% test is open to four possible interpretations. A "literal" interpretation requires 80% of each corporation to be owned by any 5 or fewer persons. If the 80% test is met, using this interpretation, the 50% test will be met. A "sweeping" interpretation requires that some combination of a group of five or fewer persons own at least 80% of the two or more corporations to compose a controlled group. This interpretation limits the number of persons counted. An "intermediate" interpretation requires that the composition of the 80% ownership contains no conflicting counterpart in other groups. A narrow interpretation requires each corporation to be composed of the same 5 or fewer persons. Libin & Abramowitz, *Multiple Corporations: A Surprising Interpretation of Section 1563(a)(2) in Temporary Regulations*, 2 TAX ADVISOR 326, 327-28 (1971) [hereinafter cited as Libin & Abramowitz].

32. Temporary Treas. Reg. § 13.16.1(a), T.D. 7101, 1971-1 C.B. 269 (1971) (adopted without change in Treas. Reg. § 1.1563-1(a)(3) (1972)).

33. The temporary regulation added to § 1563(a)(2) the words "singly or in combination" as follows: "The term 'brother-sister controlled group' means two or more corporations if the same five or fewer persons who are individuals, estates, or trusts own . . . singly or in combination, stock possessing. . . ." Temporary Treas. Reg. § 13.16-1(a), T.D. 7101, 1971-1 C.B. 269 (1971).

34. The regulation contained the following example:

Example (1). The outstanding stock of corporations *P*, *Q*, *R*, *S*, and *T*, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Regulation section 1.1563(a)(3)³⁵ was issued without change, despite criticism that the Treasury Department had misinterpreted the language and history of section 1563(a)(2).³⁶

Judicial Standard of Review of Treasury Regulations

In reviewing Treasury Regulations,³⁷ courts distinguish between "legislative" regulations and "interpretative" regulations.³⁸ Legislative regulations are issued pursuant to a specific congressional delegation of authority granted

Individuals	Corporations					Identical Ownership
	P	Q	R	S	T	
A	60%	60%	60%	60%	100%	60%
B	40%	...	...	...	...	...
C	...	40%	...	...	...	...
D	...	...	40%	...	...	...
E	...	...	...	40%	...	...
Total	100%	100%	100%	100%	100%	60%

Corporations P, Q, R, S, and T are members of a brother-sister controlled group.

Id. (example adopted without change in Treas. Reg. § 1.1563-1(a)(3)(1972)). The significance of this example is that B, C, D, and E's stock interest are counted in the 80% ownership test even though they do not own stock in each corporation. Without considering their stock interest, P, Q, R, S, and T would not constitute members of a brother-sister controlled group because A's 60% stock interest in P, Q, R, and S is insufficient to satisfy the 80% ownership test.

35. Treas. Reg. § 1.1563-1(a)(3) (1972).

36. See, e.g., Bonovitz, *Brother-Sister Controlled Groups Under Section 1563: The 80 Percent Ownership Test*, 28 TAX LAW. 511 (1975); Libin & Abramowitz, *supra* note 31, at 328; Weisman, *Brother-Sister Controlled Corporations: On and Off The Road To The Supreme Court With an Edsel*, 56 TAXES 475 (1978) [hereinafter cited as Weisman]; Note, *Disallowance of Surtax Exemption to Brother-Sister Corporations-Stock Ownership Test Under Sections 1551 and 1563*, 1976 B.Y.U.L. REV. 1000; Note, *The Brother-Sister Controlled Group Under IRC § 1563(a)(2)*, 67 VA. L. REV. 751 (1981).

37. Treasury Regulations are issued by the Secretary of the Treasury Department. For a general discussion of the Treasury's goals and promulgation procedures, see Williams, *Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954*, 1956 MAJOR TAX PLAN. 733 [hereinafter cited as Williams].

For an extensive discussion of the authoritative effect of administrative rulings, see generally 2 K. DAVIS, *ADMINISTRATIVE LAW TREATISE* §§ 7:8-7:16 (2d ed. 1979 & Supp. 1982) [hereinafter cited as DAVIS].

38. The Supreme Court, in *United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821 (1982), stated:

The framework for analysis is refined by consideration of the source of the authority to promulgate the regulation at issue. . . . Accordingly, "we owe [interpretative regulations] less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision."

Id. at 827 (quoting *Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981)). See also *United Telecommunications, Inc. v. Commissioner*, 589 F.2d 1383, 1387 (10th Cir. 1978) (legislative regulations enjoy a greater presumption of validity than interpretative regulations), *cert. denied*, 442 U.S. 917 (1979); *Bates v. United States*, 581 F.2d 575, 580 (6th Cir. 1978) (legislative regulations are accorded greater weight than that given to interpretative regulations).

Before *Vogel* and *Rowan*, some courts treated legislative regulations and interpretative regulations in a similar fashion. See *infra* notes 180-84 and accompanying text.

under a particular Code section.³⁹ A properly issued legislative regulation⁴⁰ carries the force of law⁴¹ against the Commissioner and the taxpayer⁴² unless the regulation exceeds the scope of the delegated authority,⁴³ contradicts the Code, or is unreasonable.⁴⁴

Interpretative regulations, on the other hand, are issued pursuant to section 7805 of the Code⁴⁵ which authorizes the Secretary of the Treasury Department to "prescribe all needful rules and regulations for the enforcement"⁴⁶ of the tax laws unless such authority has been explicitly delegated to another governmental department. Courts have held that inter-

39. For example, I.R.C. § 1502 authorizes the Secretary to promulgate "such regulations as he may deem necessary" to determine the tax liability of affiliated corporations filing consolidated federal income tax returns. I.R.C. § 1502 (Law. Co-op. 1974).

40. Sections 553(b), (c), and (d) of the Administrative Procedure Act require that notice of proposed rulemaking be published in the Federal Register 30 days prior to the adoption of a legislative regulation. *Id.* § 553 (Law. Co-op. Supp. 1980). The administrative agency must also give interested members of the public an opportunity to comment on the proposed regulation. *Id.* § 553(c). Legislative regulations failing to comply with these procedures are invalid. *See, e.g., American Standard, Inc. v. United States*, 602 F.2d 256, 267-69 (Ct. Cl. 1979).

41. *See United Telecommunications, Inc. v. Commissioner*, 589 F.2d 1383, 1387 (10th Cir. 1978) (legislative regulations enjoy a greater presumption of validity than interpretative regulations); *Bates v. United States*, 581 F.2d 575, 580 (6th Cir. 1978) (legislative regulations are accorded even greater weight than that accorded interpretative regulations); *Lykes Bros. Steamship Co. v. United States*, 513 F.2d 1342, 1350 (Ct. Cl. 1975) (legislative regulations are entitled to more than the usual great weight accorded interpretative regulations). *See also* J. CHOMMIE, *FEDERAL INCOME TAXATION* 13 (2d ed. 1973) (legislative regulations are regarded as having the status of law); Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity*, 43 *TAXES* 756, 758-59 (1965) (legislative regulations are generally given the force and effect of law) [hereinafter cited as Rogovin]; Westin, *Dubious Interpretative Rules For Construing Federal Taxing Statutes*, 17 *WAKE FOREST L. REV.* 1, 7-20 (1980) (legislative regulations carry the force of law) [hereinafter cited as Westin].

42. *See Lansons, Inc. v. Commissioner*, 622 F.2d 774, 776 (5th Cir. 1980) (taxpayers and tax officials are both required to abide by Treasury Regulations); *Miller v. Commissioner*, 333 F.2d 400, 403 (8th Cir. 1964) (Treasury Regulations are binding on both the Commissioner and taxpayer); *McCord v. Granger*, 201 F.2d 103, 106 (3d Cir. 1952) ("[i]t is well-settled that Treasury Regulations . . . are as binding on the Government as they are on the taxpayer"); *Weyerhaeuser Co. v. United States*, 395 F.2d 1005, 1008 (Ct. Cl. 1968) (regulations bind both the Government and the taxpayer).

43. The Supreme Court has stated that an administrator's power to prescribe rules and regulations is not the power to make law, but is only the power to adopt regulations effectuating the will of Congress as expressed in the statute. *See Miller v. United States*, 294 U.S. 435, 439-40 (1935); *Lynch v. Tilden Produce Co.*, 265 U.S. 315, 320-22 (1924). *Accord* *General Electric Co. v. Burton*, 372 F.2d 108, 110-11 (6th Cir. 1967) (Treasury only possesses authority to make regulations to carry out the purposes of the statute, not to amend it).

44. *See Sanford v. Commissioner*, 412 F.2d 201, 202 (2d Cir.) (per curiam) (legislative regulations must be upheld unless unreasonable and plainly inconsistent with the statute), *cert. denied*, 396 U.S. 841 (1969); *Estate of Willett v. Commissioner*, 365 F.2d 760, 770 (5th Cir. 1966) (legislative regulations must be reasonable and consistent with the revenue statute).

45. I.R.C. § 7805(a) (Law. Co-op. 1974). *See Faygo Beverages, Inc. v. United States*, 640 F.2d 27, 28 (6th Cir. 1981) (per curiam) (§ 7805(a) authorizes the Secretary of Treasury to promulgate regulations to enforce the Internal Revenue laws).

46. I.R.C. § 7805(a) (Law. Co-op. 1974).

pretative regulations are appropriate only where a statute is ambiguous⁴⁷ or so general in its terms as to require interpretation.⁴⁸ Consequently, interpretative regulations may not restrict or enlarge the scope of a statute, supply a supposed omission, create an exemption, or limit any rights under the statute.⁴⁹

Although they are not given the same force of law as legislative regulations, interpretative regulations issued contemporaneously with the statute traditionally have been accorded great weight.⁵⁰ The Supreme Court has repeatedly stated that as contemporaneous constructions of the Code, interpretative regulations must be sustained unless unreasonable and clearly inconsistent with the revenue statute.⁵¹ In applying this standard, courts have

47. See *Koshland v. Helvering*, 298 U.S. 441, 447 (1936) (Treasury may not amend an unambiguous statute by regulation); *H. Wetter Mfg. Co. v. United States*, 458 F.2d 1033, 1035 (6th Cir. 1972) (regulations are improper if the statute is unambiguous); *United States v. D.I. Operating Co.*, 362 F.2d 305, 309 (9th Cir. 1966) ("conducted for profit" is not so clear as to be closed to construction); *Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1045 (Ct. Cl. 1978) (sole purpose of an interpretative regulation is to reconcile statutory ambiguities with reasoned interpretations).

48. See *United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821, 827 (1982); *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 476 (1976); *Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 114 (1939).

49. The Supreme Court has stated that neither the courts nor "the Commissioner may rewrite the statute simply because [they] . . . feel that the scheme it creates could be improved upon." *United States v. Calamaro*, 354 U.S. 351, 357 (1957). See also *Bates v. United States*, 581 F.2d 575, 579 (6th Cir. 1978) (Treasury may not issue regulations to supply a supposed omission or to enlarge the scope of the revenue act); *Poirier & McLane Corp. v. Commissioner*, 547 F.2d 161, 171 (2d Cir. 1976) (Mansfield, J., dissenting) (a regulation cannot add a condition or restriction not contemplated by Congress); *Busse v. Commissioner*, 479 F.2d 1147, 1152 (7th Cir. 1973) (Commissioner has no power to rewrite a statute so as to give Code symmetry); *Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1045 (Ct. Cl. 1978) (Treasury cannot supply omissions or create exceptions to a statute).

50. The Supreme Court recognized this principle as early as 1827. In *Edwards' Lessee v. Darb*, 25 U.S. (12 Wheat.) 206 (1827), the Court acknowledged that 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. See also *Brewster v. Gage*, 280 U.S. 327, 336 (1930) (it is well settled that the Treasury's interpretation of an ambiguous or doubtful statute will not be disturbed except for strong reasons); *Carle Found. v. United States*, 611 F.2d 1192, 1196 (7th Cir. 1979) (interpretative regulations must be given great weight absent a showing that they are unreasonable or inconsistent with congressional intent), *cert. denied*, 449 U.S. 824 (1980); *Holman v. Commissioner*, 564 F.2d 283, 284 (9th Cir. 1977) ("an interpretative regulation, not unreasonable and not obviously inconsistent with the statute, should be given effect").

But no deference, however, is warranted where the regulations are vague, *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1034 (D.C. Cir. 1980), or where Congress expressly agreed with a case holding contrary to the regulation during a subsequent reenactment of the statute, *Texas Instruments, Inc. v. United States*, 551 F.2d 599, 610 (5th Cir. 1977).

51. In *Commissioner v. South Texas Lumber Co.*, 333 U.S. 494 (1948), the Supreme Court stated that "[t]his Court has many times declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." *Id.* at 501 (citing *Fawcus Machine Co.*

upheld Treasury Regulations despite the existence of more reasonable interpretations of the statute.⁵² Such deference has been justified on two grounds.

First, under Code section 7805, Congress has delegated the task of prescribing rules and regulations necessary for the enforcement of the Code to the Treasury Department and not the courts.⁵³ As contemporaneous interpretations of the Code, interpretative regulations provide the best indication of the congressional intention at the time of a statute's enactment and the concerns of the persons active in drafting the statute.⁵⁴ Second, an interpretative regulation may acquire the force of law if applied consistently over a long time period⁵⁵ or if Congress has knowledge of the regulation and reenacts

v. United States, 282 U.S. 375, 378 (1931)). *Accord* Fulman v. United States, 434 U.S. 528, 533 (1978); Bingle v. Johnson, 394 U.S. 741, 749-50 (1969).

52. In upholding the Commissioner's "overnight rule" concerning the deductibility of meals consumed during business travel, the Supreme Court stated:

But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustment." The rule of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

United States v. Correll, 389 U.S. 299, 306-07 (1967) (citations omitted). *See also* Ruehlmann v. Commissioner, 418 F.2d 1302, 1304 (6th Cir. 1969) (the courts are not at liberty to second guess the Commissioner's choice of a third criterion if it is reasonable), *cert. denied*, 398 U.S. 950 (1970); Howell v. United States, 414 F.2d 45, 48 (7th Cir. 1969) (where there are several valuation methods possible, any permissible one chosen by the Commissioner may not be set aside); Kern v. Granquist, 291 F.2d 29, 32 (9th Cir. 1961) ("[h]owever logical we may think our interpretation to be, it was not the interpretation placed on the statute by the government in its Regulations . . . and this is entitled to weight in our consideration of the matter").

53. *See supra* note 52. *See also* Continental Equities, Inc. v. Commissioner, 551 F.2d 74, 82 (5th Cir. 1977) (because Congress has expressly delegated rulemaking authority to the Treasury, Treasury Regulations are valid legislative rules if within the granted power, issued pursuant to proper procedure, and reasonable); Caterpillar Tractor Co. v. United States, 589 F.2d 1040, 1043 (Ct. Cl. 1978) (courts will defer to a reasonable interpretative regulation "because it was made by the agency Congress has entrusted with carrying out its purpose").

54. *White v. Winchester Country Club*, 315 U.S. 32, 41 (1942). *See Williams, supra* note 37, at 741. Williams, as head of the Legal Advisory Staff to the Secretary of Treasury, explained that the contemporaneous doctrine is founded in fact because Treasury personnel frequently take an active role in formulating statutes and committee reports. *Id.*

55. The Supreme Court, in *Helvering v. Winmill*, 305 U.S. 79 (1938), stated that "[t]reasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Id.* at 83. *See also* Faygo Beverages, Inc. v. United States, 640 F.2d 27, 29 (6th Cir. 1981) (per curiam) (stressing that the regulation was in effect since 1953 and Congress has amended the statute a number of times without invalidating the regulation); *Home Mut. Ins. Co. v. Commissioner*, 639 F.2d 333, 339-40 (7th Cir. 1980) (regulations in effect since 1944 were deemed to have received congressional approval and have the effect of law); *Hanover Ins. Co. v. Commissioner*, 598 F.2d 1211, 1219 n.17 (1st Cir. 1979) (regulation in force for 34 years was deemed to have the force of law).

But even long-standing regulations will not be upheld if inconsistent with the statute. *See,*

the statute interpreted by the regulation.⁵⁶

Two Supreme Court cases typify the traditional respect afforded interpretative regulations. In *United States v. Correll*,⁵⁷ the Court sustained an interpretative Treasury Regulation even though it noted that more reasonable constructions of the statute existed.⁵⁸ Under section 162(a)(2),⁵⁹ taxpayers "traveling . . . away from home in the pursuit of trade or business" may deduct amounts expended for meals and lodging.⁶⁰ The challenged regulation construed the phrase "away from home" to include only those trips requiring sleep or rest.⁶¹ Although the Treasury's interpretation is hardly appropriate in determining when travel is away from home considering the supersonic travel of today,⁶² and a more reasonable statutory construction would measure travel away from home in distance instead of time,⁶³ the

e.g., *Rowan Cos. v. United States*, 452 U.S. 247 (1981) (invalidating a regulation in force for 40 years); *Schudel v. Commissioner*, 563 F.2d 1300 (9th Cir. 1977) (per curiam) (invalidating a regulation in force for almost 40 years).

56. See *Commissioner v. Flowers*, 326 U.S. 465, 469 (1946) (a regulation surviving subsequent reenactments of the statute is deemed to possess implied legislative approval and have the effect of law); *Maurer v. United States*, 284 F.2d 122, 124 (10th Cir. 1960) (there is a presumption of validity of regulation which was in force when a statute was reenacted).

A few commentators, however, have criticized the reenactment doctrine and have suggested that it be abolished. See *Griswold, A Summary of the Regulations Problem*, 54 HARV. L. REV. 398, 399-404 (1941) (considering the infinite number of regulations on the books, it is unlikely that the legislators are aware of each regulation when they reenact a statute); *Westin, supra* note 41, at 2-4, 21 (the rule's numerous qualifications permit it to be used as a means for achieving a result already decided upon rather than as a true basis for decision).

57. 389 U.S. 299 (1967).

58. *Id.* at 306 (noting that alternatives were available and improvements might be imagined).

59. I.R.C. § 162(a)(2) (Law. Co-op. Supp. 1982).

60. I.R.C. § 162(a)(2) provides, in relevant part:

(a) In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

. . . .

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of trade or business.

61. Treas. Reg. §§ 1.162-17(b)(3)(ii), -17(b)(4), -17(c)(2) (1959). The Treasury's sleep or rest rule is commonly known as the "overnight rule". For a general discussion of the travel expense deduction and, in particular, the overnight rule, see 4A J. MERTENS, *THE LAW OF FEDERAL INCOME TAXATION* § 25.92 (rev. ed. 1979) [hereinafter cited as MERTENS].

The taxpayer in *Correll* was a traveling salesman for a wholesale grocery company. He routinely ate breakfast and lunch while on the road, but returned home in time for dinner. The cost of these morning and noon meals was deducted by the taxpayer from his 1960 and 1961 income tax returns as "traveling expenses" under § 162(a)(2) of the Code. The Commissioner disallowed the deductions as personal expenses because the taxpayer's daily trips did not require sleep or rest. *Correll*, 389 U.S. at 300.

62. See *id.* at 307 (Douglas, J., dissenting). Based on this reasoning the lower court invalidated the regulations upheld in *Correll* finding that the Commissioner's "sleep or rest" rule bears "no rational relation to the business necessity of the meal expense." *Correll v. United States*, 369 F.2d 87, 89-90 (6th Cir. 1966), *rev'd*, 389 U.S. 299 (1967).

63. For example, the *Correll* Court noted that § 162(a)(2) can be construed to cover those

Correll Court upheld the regulation because it implemented Congress' intent in a reasonable manner.⁶⁴ The Court emphasized that Congress delegated the task of prescribing all necessary regulations for the enforcement of the tax laws to the Commissioner and not the courts.⁶⁵ Furthermore, the *Correll* Court concluded that the regulation received implicit congressional approval because it was consistently applied over a substantial period of time.⁶⁶

In *Fulman v. United States*,⁶⁷ the Court again sustained an interpretative Treasury Regulation despite arguments that the regulation was illogical and inconsistent with the Code's purpose. In computing its taxable income, a personal holding company⁶⁸ may deduct dividends paid to its shareholders.⁶⁹ The contested regulation⁷⁰ continued to apply the adjusted basis measure, which was explicitly contained in the 1939 Code but inexplicably excluded from the 1954 Code,⁷¹ in valuing a personal holding company's dividend deduction paid in appreciated property.⁷² The taxpayer argued that because the shareholders were required to report the property's fair market value

taxpayers traveling outside their home town or beyond a number of miles from their "principal post of duty". 389 U.S. at 303 n.14.

64. 389 U.S. at 307. The dissenters argued that the regulation's overnight rule improperly narrowed the statute by adding a time element to the statute's geographic test. *Id.* (Douglas, J., dissenting).

65. *Id.* at 306-07. The Court's language is reprinted at *supra* note 52.

66. 389 U.S. at 305-06. Although the challenged regulations were adopted in 1958, the overnight rule has been consistently applied since 1940. See I.T. 3395, 1940-2 C.B. 64 (1940). The Commissioner's overnight rule, however, was not contemporaneously issued with the statute because the relevant statutory language was first enacted in 1921. Revenue Act of 1921, ch. 136, § 214(a)(1), 42 Stat. 239 (1921) (currently codified at I.R.C. § 162(a)(2) (Law. Co-op. Supp. 1982)). See *Correll*, 389 U.S. at 301 n.6.

67. 434 U.S. 528 (1978).

68. High-income individuals have abused the advantages of the lower corporate tax rates by forming corporations solely to avoid taxes on passive income. To prevent the accumulation of passive income at the corporate level, I.R.C. § 541 imposes a penalty tax on a personal holding company's undistributed personal holding company income. I.R.C. § 541 (Law. Co-op. Supp. 1982). The personal holding tax rate is 70% for tax years beginning before January 1, 1982 and 50% for future tax years. *Id.*

A corporation is considered a personal holding company if at least 60% of its adjusted gross income is personal holding income and more than 50% of its stock is owned by five or fewer persons. I.R.C. § 542(a) (Law. Co-op. 1974 & Supp. 1982). Personal holding income is income from passive investment property such as dividends, rents, or royalties. *Id.* § 543.

For a general discussion of the personal holding company penalty tax and its history, see 7 MERTENS, *supra* note 61, §§ 40.01-40.68; Libin, *Personal Holding Companies and the Revenue Act of 1964*, 63 MICH. L. REV. 421, 421-29 (1965).

69. I.R.C. § 561(a) (Law. Co-op. 1974).

70. See Treas. Reg. § 1.562-1(a)(1974).

71. For a discussion of this statutory scheme, see *Fulman v. United States*, 434 U.S. 528, 536-38 (1978).

72. Treasury Regulation § 1.562-1(a) provides that "[i]f a dividend is paid in property (other than money) the amount of the dividends paid deduction with respect to such property shall be the adjusted basis of the property in the hands of the distributing corporation at the time of the distribution. . . ." Treas. Reg. § 1.562-1(a)(1974).

as dividend income,⁷³ the personal holding company should correspondingly receive a deduction equal to the property's fair market value.⁷⁴ The Court recognized the logical force of the taxpayer's view⁷⁵ but stressed that the issue was not how the statutory ambiguity might be resolved in the first instance, but whether there was any reasonable basis for the regulation.⁷⁶ The *Fulman* Court upheld the regulation, reasoning that the House and Senate Reports did not compel the conclusion that Congress intended to abandon the adjusted basis valuation rule.⁷⁷

Recently, however, the Supreme Court has expressed this traditional deference with less enthusiasm and seemingly has applied a higher standard of review. Although the Court has stated that Treasury Regulations will be sustained if they implement Congress' intent in some reasonable manner,⁷⁸ the Court appears to be attaching a greater significance to the distinction between legislative regulations and interpretative regulations.⁷⁹ Legislative regulations enjoy a presumption of validity and will be sustained unless clearly inconsistent with the revenue statute.⁸⁰ Arguably, interpretative regulations no longer merit such deference.

*National Muffler Dealers Associations v. United States*⁸¹ and *Rowan Companies v. United States*,⁸² indicate that interpretative regulations will be subjected to a higher standard of review and, thus, given less deference than previously afforded. In reviewing the validity of an interpretative regulation, the Court in *National Muffler* declared that to be reasonable, a regulation must harmonize with the statute's language, history, and purpose.⁸³ Further-

73. Property received by noncorporate shareholders as dividends are taxable to the shareholders at the property's fair market value. I.R.C. § 301(b)(1)(A) (Law. Co-op. 1974).

74. *Fulman*, 434 U.S. at 534.

75. *See id.* at 534 (citing I.R.C. § 301(b)(1)(A) (Law. Co-op. 1974)).

76. *Id.* at 536.

77. *Id.* at 538. The Court's deference in *Fulman* is emphasized by the dissent's statement that "[t]he Court simply resolves the statutory jumble in favor of the Treasury Regulation." *Id.* at 540 (Powell, J., dissenting).

The dissent in *Fulman* asserted that the regulation was contrary to logic and the statutory purpose. The personal holding company tax was created solely to encourage personal holding companies to distribute all of their income to the shareholders. *Id.* *See supra* note 68. Requiring shareholders to include the appreciated property's fair market value as dividend income while limiting the personal holding company's dividend deduction to a lesser value, the property's adjusted basis, will hinder rather than promote the statutory purpose. 434 U.S. at 540 (Powell, J., dissenting).

78. *See, e.g.,* *Rowan Cos. v. United States*, 452 U.S. 247, 252-53 (1981); *Commissioner v. Portland Cement Co.*, 450 U.S. 156, 169 (1981); *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 476-77 (1979).

79. *See* *Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981) (interpretative regulations are afforded "less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision").

80. *See infra* note 184 and accompanying text.

81. 440 U.S. 472 (1979).

82. 452 U.S. 247 (1981).

83. 440 U.S. at 477.

more, the Court articulated several factors that correlate the degree of validity a regulation will be accorded. One factor, whether the interpretative regulation is a contemporaneous statutory construction by those presumed to have been aware of the congressional intent, may be given particular force.⁸⁴ Other factors include 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 devoted to the regulation during subsequent reenactments of the statute.⁸⁵

Applying the *National Muffler* test, the *Rowan* Court invalidated interpretative regulations that had been in force for forty years and that had survived Congress' recodification of the 1939 Code. The challenged regulations⁸⁶ construed the term "wages" contained in the Federal Unemployment Tax Act⁸⁷ (FUTA) and the Federal Insurance Contribution Act⁸⁸ (FICA) to include the value of meals and lodging the taxpayer provided to its employees,⁸⁹ even though these benefits were excluded from the employees' gross income⁹⁰ and from the employee income tax withholding provision of

84. *Id.*

85. *Id.* These factors are an aberration from past law in several important respects. Prior to *National Muffler*, contemporaneity automatically invoked great judicial deference. See *supra* notes 50-54 and accompanying text. After *National Muffler*, however, a contemporaneous statute may have particular force. Furthermore, in determining whether an interpretative regulation had the force and effect of law, the courts previously considered the length of time the regulation had been in effect and the degree of scrutiny Congress had devoted to the regulation during subsequent reenactments of the statute. Under this standard, regulations would acquire the force of law if applied consistently over a long time period or if Congress reenacted a statute with knowledge of how the regulation construed the statute. See *supra* notes 55-56 and accompanying text. In articulating these two factors under the rubric of "[o]ther relevant considerations", the *National Muffler* Court suggests a diminished role for these factors. 440 U.S. at 477. The Court's subsequent decision in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), further supports this conclusion. In *Rowan* the Court invalidated interpretative Treasury Regulations that had been in force for forty years and which had survived Congress' recodification of the 1939 Code. For a discussion of the Court's analysis in *Rowan*, see *infra* notes 86-95 and accompanying text.

86. See Treas. Reg. § 31.3306(b)-1(e)-(f) (1961) (construing wages as defined in the Federal Unemployment Tax Act); Treas. Reg. § 31.3121(a)-1(e)-(f) (1960) (construing wages as defined in the Federal Insurance Contribution Act).

87. I.R.C. § 3306(b) (Law. Co-op. 1980 & Supp. 1982) [hereinafter cited as FUTA]. FUTA imposes a tax on certain employers based on the wages paid to their employees. *Id.* § 3301.

88. *Id.* § 3121(a) [hereinafter cited as FICA]. FICA imposes a tax upon employers and employees based on employee wages. *Id.* §§ 3111, 3101(a). These taxes fund the various Social Security programs.

89. The taxpayer, Rowan Companies, Inc., owned and operated offshore oil and gas rigs. Because of the high cost involved in transporting its employees to and from the rigs for each work shift, Rowan Companies provided its employees with meals and lodging. 452 U.S. at 248-49. In computing its employee wages for purposes of FICA and FUTA, Rowan Companies did not include the value of meals and lodging provided to its employees. Relying on the contested Treasury Regulations, the Commissioner disagreed and assessed the additional taxes. *Id.* at 249-50.

90. I.R.C. § 119 excludes from an employee's gross income the value of meals or lodging furnished by his or her employer for the employer's convenience if:

section 3402(a).⁹¹ After noting that Congress has consistently defined "wages" under FICA, FUTA, and section 3402 in substantially the same language,⁹² the Court concluded that Congress intended "wages" to have the same meaning under each provision.⁹³ The legislative history which revealed a congressional concern for simplicity and for administrative convenience further supported this conclusion.⁹⁴ The *Rowan* Court refused to accord these longstanding regulations the force of law because they were inconsistent with the 1936 contemporaneous regulations and with a 1938 Treasury ruling which inexplicably remained on the books until 1962.⁹⁵

THE *VOGEL* DECISION

Facts and Procedural History

Vogel Fertilizer Company is an Iowa corporation engaged in the business of retailing farm fertilizer products.⁹⁶ From 1973 through 1975, Arthur Vogel held 77.49% of the corporation's common stock and Richard Crain owned the remaining 22.51%.⁹⁷ Vogel Popcorn Company, another Iowa corporation, sold popcorn in the wholesale and retail markets.⁹⁸ During the same period, Arthur Vogel held a 87.5% interest in this corporation and the Alex

(1) in the case of meals, the meals are furnished on the business premises of the employer; or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

I.R.C. § 119 (Law. Co-op. Supp. 1982).

91. *Id.* § 3402(a). This section requires employers to withhold a specified amount of income tax from its employees' "wages". Treasury Regulation § 31.3401(a)-1(b)(9)-(10) (1982), construed "wages" contained in Code § 3402(a) to exclude all items excluded from an employee's gross income.

92. 452 U.S. at 262-63. FICA and FUTA were enacted in 1935. Social Security Act of 1935, ch. 531, 49 Stat. 620, 636, 639. Code § 3402(a) was enacted in 1943. Revenue Act of 1942, ch. 619, § 172, 56 Stat. 798, 884. Congress has defined the term "wages" in all three provisions with substantially the same language, specifically, all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash. *See* I.R.C. §§ 312(a) (FICA), 3306(b) (FUTA), 3402(a) (Law. Co-op. 1980 & Supp. 1982).

93. 452 U.S. at 263.

94. *Id.* at 255. Although the Court's analysis supports one possible interpretation, it does not demonstrate that the Treasury's interpretation is incorrect. Quite possibly, Congress could have intended to subject employers to FICA and FUTA taxes on the value of meals and lodging furnished to its employees even though these benefits were excluded from the employee's gross income.

95. *Id.* at 261-62. *See also supra* note 85 (noting that *National Muffler* indicates that long continued regulations will no longer automatically be accorded the force of law, but that the length of time the regulation has been in effect will be only one of various factors to consider).

96. *United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821, 825 (1982).

97. *Id.* *Vogel Fertilizer Company* had only one class of common stock issued and outstanding. Of the total 146,575 outstanding shares, Arthur Vogel owned 113,575 shares (77.49%) and Richard Crain held the remaining 33,000 shares (22.51%). Brief for Petitioner at 2, *United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821 (1982) [hereinafter cited as *Petitioner's Brief*].

98. 102 S. Ct. at 825.

Vogel Family Trust owned the remaining 12.5%.⁹⁹ Richard Crain did not own any stock in Vogel Popcorn.¹⁰⁰

Relying on Treasury Regulation section 1.1563-(1)(a)(3),¹⁰¹ Vogel Fertilizer Company considered itself a member of a brother-sister controlled group with Vogel Popcorn¹⁰² and did not claim a full surtax exemption for the tax years 1973 through 1975.¹⁰³ Under Treasury Regulation section 1.1563-(1)(a)(3), Richard Crain's 22.51% stock interest in Vogel Fertilizer was counted for purposes of the eighty percent requirement of section 1563(a)(2) even though Richard Crain did not own any stock in Vogel Popcorn, the other alleged member of the brother-sister controlled group.¹⁰⁴ Without con-

99. *Id.* Vogel Popcorn Company had issued and outstanding 440,062 shares of common stock, all of which was owned by Arthur Vogel, and 62,866 shares of voting preferred stock, all of which was held by the Alex Vogel Family Trust. As a result, Arthur Vogel owned 87.5% of the total voting stock of Vogel Popcorn Company and the Alex Vogel Trust owned the remaining 12.5%. Furthermore, Arthur Vogel held between 90.66% and 93.42% of the total stock value of Vogel Popcorn. Brief for Respondant at 2, United States v. Vogel Fertilizer Co., 102 S. Ct. 821 (1982).

100. 102 S. Ct. at 825. Richard Crain was unrelated to Arthur Vogel and, thus, did not own any stock indirectly under the attribution rules of I.R.C. § 1563(e). See generally *supra* note 7 (citing authorities that discuss the application of the attribution rules of § 1563(e)).

101. Treas. Reg. § 1.1563-1(a)(3) (1972). For the relevant text of this regulation, see *supra* note 33.

102. The application of I.R.C. § 1563(a)(2) to the *Vogel* facts is illustrated by the following table.

SHAREHOLDERS	Percentage of Ownership (80% Test)		Percentage of Identical Stock Ownership (50% Test)
	Vogel Fertilizer Co.	Vogel Popcorn Co.	
Arthur Vogel	77.49%	87.5%	77.49%
Richard Crain	22.51%		
TOTAL	77.49 or 100%	87.5%	77.49%

Vogel Fertilizer Co. and Vogel Popcorn Co. are members of a brother-sister controlled group only if Richard Crain's 22.51% stock interest in Vogel Fertilizer is considered for purposes of the 80% ownership test. Treasury Regulation § 1.1563(a)(3) would include Crain's stock interest even though he does not own stock in Vogel Popcorn. Thus, under the regulations's construction of I.R.C. § 1563(a)(2), Vogel Fertilizer and Vogel Popcorn would be considered members of a brother-sister controlled group because together Arthur Vogel and Richard Crain own at least 80% of each corporation (actually 100% of Vogel Fertilizer and 87.5% of Vogel Popcorn) and have more than a 50% identical stock interest in each corporation (77.49% identical stock interest). If the 80% test is interpreted as requiring common ownership, however, Richard Crain's stock interest would not be counted and the 80% test would not be satisfied with respect to Vogel Fertilizer.

103. For its taxable years ending November 30, 1973 and 1974, Vogel Fertilizer Co. elected under I.R.C. § 1562 to claim a full surtax exemption and to pay the six percent surtax penalty imposed by I.R.C. § 1562(b). For the tax year ending November 30, 1975, Vogel Fertilizer elected to allocate the single surtax exemption allowed to members of a brother-sister controlled group entirely to Vogel Popcorn Company. 102 S. Ct. at 825 n.5. See *supra* note 23 and accompanying text (discussing the surtax limitation and I.R.C. § 1562).

104. See *supra* notes 32-36 and accompanying text.

sidering Richard Crain's stock interest, Vogel Fertilizer and Vogel Popcorn would not have constituted a brother-sister controlled group because five or fewer persons did not own eighty percent of each corporation.¹⁰⁵

Subsequently, the United States Tax Court in *Fairfax Auto Parts, Inc. v. Commissioner*,¹⁰⁶ invalidated Treasury Regulation section 1.1563-1(a)(3) concluding it was an unreasonable statutory construction. Contrary to the regulation, the Tax Court in *Fairfax* held that the eighty percent test of Code section 1563(a)(2) contains a common ownership requirement.¹⁰⁷ Relying on *Fairfax*, Vogel Fertilizer filed timely tax refund claims for the years 1973 through 1975, claiming that it was entitled to a full surtax exemption because it was not a member of a brother-sister controlled group.¹⁰⁸ Vogel Fertilizer contended that Richard Crain's interest should not have been included for purposes of the eighty percent test because he did not own stock in Vogel Popcorn.¹⁰⁹ The Internal Revenue Service refused to follow *Fairfax* and relied on Treasury Regulation section 1.1563-1(a)(3) to reject the claims.¹¹⁰

Vogel Fertilizer Company, however, successfully brought suit for refund in the United States Court of Claims.¹¹¹ Although acknowledging that the regulation was not a totally unreasonable construction of the statutory language of section 1563(a)(2), the Court of Claims held the regulation invalid because it was inconsistent with the statute's legislative history and purpose.¹¹² The United States Supreme Court granted certiorari¹¹³ to resolve the existing conflict among the lower federal courts.¹¹⁴

Holding and Analysis

The sole issue before the *Vogel* Court concerned the validity of Treasury Regulation section 1.1563-1(a)(3).¹¹⁵ The Court found that despite the long

105. See *supra* note 102.

106. 65 T.C. 798 (1976)(5-4 decision), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977).

107. 65 T.C. at 803. Based on the language and history of § 1563(a)(2), the Tax Court concluded that Code § 1563(a)(2) was intended to apply only where each person in the five or fewer group owned stock in each corporation. *Id.* The dissent, however, stressing that contemporaneous regulations are entitled to great weight, believed the regulation to be entirely consistent with the statute and its legislative history. *Id.* at 807-08 (Simpson, J., dissenting).

108. 102 S. Ct. at 825.

109. *Id.*

110. *Id.*

111. *Vogel Fertilizer Co. v. United States*, 634 F.2d 497 (Ct. Cl. 1980).

112. *Id.* at 503. The dissent criticized the majority's analysis contending that the issue was not whether the Treasury's construction was as reasonable as the taxpayer's view, but whether the taxpayer "had carried its heavy burden of showing the regulation to be unreasonable and plainly inconsistent with the statute." *Id.* at 513 n.1, 514 (Smith, J., dissenting).

113. *United States v. Vogel Fertilizer Co.*, 450 U.S. 994 (1981).

114. See *supra* note 12 and accompanying text.

115. 102 S. Ct. at 827. The Court recognized that Arthur Vogel's stock interest in each corporation satisfied the 50% identical stock ownership requirement but was insufficient to satisfy the 80% test without also considering Richard Crain's 22.51% stock interest in Vogel

standing policy of deferring to regulations which implement Congress' intent in some reasonable manner, less than traditional deference was owed to the regulation in question.¹¹⁶ The Court emphasized that the regulation was interpretative rather than legislative¹¹⁷ and that it construed an ambiguous statutory definition rather than a broad statutory term.¹¹⁸ Applying the *National Muffler* test, the Court found the regulation's phrase "singly or in combination" invalid because it was inconsistent with the language, history, and purpose of Code section 1563(a)(2).¹¹⁹ The Court concluded that Congress intended for the statute to apply only where each person owned stock in each corporation of the alleged brother-sister controlled group.¹²⁰

The Court acknowledged that the statutory language is not completely unambiguous, but nevertheless concluded that it is in closer harmony with the taxpayer's view.¹²¹ Noting that the phrase "five or fewer" is the conjunctive subject of the eighty percent and fifty percent requirements, the Court reasoned that precisely the same five or fewer shareholders must satisfy both tests.¹²² Because the fifty percent test considers only those shareholders who own stock in each corporation,¹²³ the Court determined that the eighty percent test also requires common ownership.¹²⁴

Fertilizer. Noting that the phrase "singly or in combination" in Treasury Regulation § 1.1563(a)(3) did not explicitly require common ownership, the Court concluded that its validity was the sole issue. *Id.* at 826-27.

116. 102 S. Ct. at 827. The Court further stated that the "general principle of deference, while fundamental, only sets 'the framework for judicial analysis, it does not displace it.'" *Id.* (quoting *United States v. Cartwright*, 411 U.S. 546, 550 (1973)).

117. 102 S. Ct. at 827. *See also supra* note 38.

118. The Court stated that:

Treas. Reg. § 1.1563(a)(3) purports to do no more than add a clarifying gloss on a term—"brother-sister controlled group"—that has already been defined with considerable specificity by Congress. The Commissioner's authority is consequently more circumscribed than would be the case if Congress had used a term "so general . . . as to render an interpretive regulation appropriate."

102 S. Ct. at 827 (quoting *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 476 (1979)).

119. 102 S. Ct. at 827-28. The Court acknowledged that a regulation must harmonize with the statute's language, history, and purpose to be valid. *Id.* (citing *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979)).

120. 102 S. Ct. at 827.

121. *Id.*

122. *Id.* The Court further noted that the phrase "brother-sister controlled group" connotes a close horizontal relationship between two or more corporations, suggesting that the same indivisible group of five or fewer must satisfy both the 80% and 50% tests. *Id.*

123. The 50% test only considers a person's identical stock ownership in each corporation. Thus, if a person does not own stock in one or more of the corporations, that individual will have a zero identical stock ownership interest and consequently will not be considered for purposes of the 50% requirement. *See supra* note 8 and accompanying text.

124. 102 S. Ct. at 827. The Court also noted that the phrase "each such person" in I.R.C. § 1563(a)(2)(B) (the 50% test) further supports this conclusion. This phrase refers back to the five or fewer ownership group and thus suggests that each shareholder in the ownership group must be considered for both the 80% and 50% requirements. *Id.* at 827 n.8 (citing *Fairfax*

The Court further held that the legislative history and purpose of section 1563(a)(2) resolves any ambiguity in the statutory language and clearly demonstrates that Treasury Regulation section 1.1563-1(a)(3) is an unreasonable statutory interpretation.¹²⁵ The Court deduced that the Treasury's construction of the eighty percent test failed to accomplish the congressional purpose of identifying and regulating the interrelationship between two or more corporations. Noting that section 1563(a)(2) was enacted to curb the abuse of multiple incorporation by large organizations,¹²⁶ the majority reasoned that the intended targets of section 1563(a)(2) were groups of interrelated corporations characterized by common control and ownership.¹²⁷ Based on the statute's legislative history, the Court further concluded that the eighty percent test was intended to serve as the primary test for defining the interrelationship between the corporations.¹²⁸ The Court stressed the fact that the original definition of a brother-sister controlled group in 1964 contained only the eighty percent requirement and implicitly required common ownership.¹²⁹ In addition, the Treasury Department's General Explanation of the 1969 amendment to section 1563(a)(2) demonstrated that the eighty percent test was to remain the primary indicia of interrelationship.¹³⁰ The Treasury Department explained that the 1969 amendment expanded the ownership group from one to "five or fewer" persons simply to prevent easy avoidance of the eighty percent test, while the fifty percent test was created merely to insure that this expanded definition applies only to corporations operating as one economic entity.¹³¹

Auto Parts, Inc. v. Commissioner, 65 T.C. 798, 803 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977)).

125. 102 S. Ct. at 828. The Court emphasized that a regulation which is fundamentally at odds with the manifest congressional design will not be sustained although it is not "technically inconsistent" with the statutory language. *Id.* (citing *United States v. Cartwright*, 411 U.S. 546, 557 (1973)).

126. 102 S. Ct. at 828. For a discussion of the multiple incorporation abuse and Congress' attempt to curb it through Code §§ 1561-1563, see *supra* notes 14-24 and accompanying text.

127. 102 S. Ct. at 828.

128. *Id.* The Court noted that the 50% requirement also measures, to a lesser degree, the overlap between two or more corporations, but stressed that Congress intended the 80% requirement to be the primary test for defining the interrelationship between the corporations. *Id.*

129. *Id.* at 829. For the full text of the original 1964 definition of a brother-sister controlled group, see *supra* note 26.

130. 102 S. Ct. at 829-30.

131. In explaining the respective roles of the expanded 80% test and the new 50% requirement, the Treasury Department stated:

This provision expands present law by considering the combined stock ownership of five individuals, rather than one individual, in applying the 80 percent test However, in order to insure that this expanded definition of brother-sister controlled group applies only to those cases where the five or fewer individuals hold their 80 percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation.

Treasury Department's General Explanation, *supra* note 27, at 5394.

The majority concluded that the contested regulation was contrary to the congressional purpose of identifying the interrelationship between two or more corporations.¹³² Without a common ownership requirement, the eighty percent test would determine only whether the corporations are closely held¹³³ and, thus, would fail to identify the interrelationship between the corporations.¹³⁴

The Court also noted that the Treasury Department's General Explanation explicitly corroborates the taxpayer's view. In setting forth the Technical Explanation for the 1969 amendment, the Treasury Department stated that the "same five or fewer persons [must] own at least 80% of the voting stock or value of shares of each corporation and . . . these five or fewer individuals must satisfy the 50% requirement in Part(B)."¹³⁵ According to the Court, this statement unequivocally mandates that the eighty percent test requires common ownership.¹³⁶

Although it is Congress' intent which ultimately controls,¹³⁷ the Court attached great weight to the Treasury Department's General Explanation because the Treasury drafted the 1969 proposal and directly expressed its position to Congress in committee hearings.¹³⁸ This attachment certainly seems appropriate because the legislative history of section 1563(a)(2) confirms that Congress adopted not only the Treasury's proposal but also its position.¹³⁹

CRITIQUE

Recent Supreme Court cases, applying greater judicial scrutiny, have

132. 102 S. Ct. at 830.

133. *Id.* The Commissioner described the respective roles of the 80% and 50% requirements as follows:

[T]he 80% test is designed to assure that within the group of five persons or fewer the overall control of or financial interest in each of the corporations will beyond question be substantially more than 50% (i.e., 80%), whereas the 50% test is intended to assure that there will be a minimum commonality or community of interest between members of the five or fewer persons in control; otherwise there might be no tie between persons controlling one corporation and those controlling another.

Petitioner's Brief, *supra* note 97, at 77 (quoting *Allen Oil Co. v. Commissioner*, 614 F.2d 336, 340 (2d Cir. 1980)).

134. 102 S. Ct. at 830.

135. Treasury Department's General Explanation, *supra* note 27, at 5168 (emphasis added by the Court except "five" was emphasized in the original).

136. 102 S. Ct. at 829 (citing the Treasury Department's General Explanation, *supra* note 27, at 5168).

137. 102 S. Ct. at 830.

138. *Id.* at 830-31. The Court reiterated the rule that "great weight" is attached to "agency representations to Congress when the administrators 'participated in drafting and directly made known their views to Congress in committee hearings.'" *Id.* (quoting *Zuber v. Allen*, 396 U.S. 168, 192 (1969)).

139. 102 S. Ct. at 831. The Court summarily dismissed three other arguments. First, the Commissioner contended that Congress approved of the Treasury's construction of the 80% test when it enacted the 1969 amendment to § 1563(a)(2). *Id.* The expanded definition of a brother-sister controlled group was copied verbatim from § 1551's definition of "control" and

deviated from the traditional standard of review of Treasury Regulations.¹⁴⁰ The *Vogel* decision is commendable because it continues this trend and indirectly requires interpretative regulations to satisfy a higher threshold standard of reasonableness.¹⁴¹ Indeed, Treasury Regulations should be subject to a higher standard of review¹⁴² because they are issued by a biased administrative agency.¹⁴³ Regulations are an intergral source of a taxpayer's understanding of the tax law¹⁴⁴ and, consequently, have a significant impact

the regulations thereunder contained an example indicating that no common ownership was required for purposes of the 80% test. See *supra* note 18 (discussing § 1551). The Court rejected this argument because § 1551 only applies to transferors and there is no method for determining which brother-sister corporation is to be regarded as the transferor and which as the transferee. 102 S. Ct. at 831 n.13.

Second, the Commissioner asserted that Congress implicitly approved of the regulation when it expressly incorporated § 1563(a)(2) in the Employee Retirement Act of 1974. I.R.C. § 414 (Law. Co-op. Supp. 1982). The Court, however, declared that it is the intent of the Congress that amended § 1563(a)(2), not of a subsequent Congress, that is controlling. 102 S. Ct. at 832.

Finally, the Court refused to uphold the regulation merely because a common ownership requirement would lead to the nonsensical result that ownership of only one share could be determinative. The Court emphasized that an objective test inherently has sharp dividing lines. Furthermore, ownership of one share insures that each of the five or fewer shareholders knows which corporations are potential members of a brother-sister controlled group. 102 S. Ct. at 832.

140. See *supra* notes 78-95 and accompanying text.

141. See *infra* notes 174-79 and accompanying text.

142. There are conflicting policy considerations regarding the proper standard of judicial review and the degree of validity a treasury regulation should be accorded. Ostensibly, courts should be able to utilize the benefit of hindsight and experience to develop sounder constructions of a statute. This interest, however, must be weighed against the need for certainty and predictability in our tax laws. Compare Westin, *supra* note 41, at 22 (presumption of validity should not be a substitute for logic and recently promulgated regulations should be closely scrutinized and held to high standards of good sense) with Rogovin, *supra* note 41, at 756 ("[o]ur complex tax law, with its 'invisible boomerangs,' makes the need for certainty a primary requisite of good administration").

143. One author notes that "[i]n determining the effect of Treasury Regulations it is important to keep in mind that the Treasury's interest is in revenue and naturally its Regulations are favorable to its maintenance rather than unbiased." 1 MERTENS, *supra* note 61, § 3.21, at 38-39 (rev. ed. 1981).

Moreover, there appears to be a growing distrust of administrative agencies in general. Not long before his elevation to the highest bench, Chief Justice Burger referred to the theory that an agency such as the FCC effectively represents the public interest as:

one of those assumptions we collectively try to work with so long as they are reasonably adequate. When it becomes clear, as it does to us now, that it is no longer a valid assumption which stands up under the realities of actual experience, neither we nor the Commission can continue to rely on it.

Office of Communication of United Church of Christ v. FCC, 359 F.2d 994, 1003-04 (D.C. Cir. 1966). See also Schwartz, *Administrative Law and the Burger Court*, 8 HOFSTRA L. REV. 325, 399 (1980) (noting that the Supreme Court's increased judicial activism in administrative law cases is a direct response to the growing distrust of administrative agencies); Schwartz, *Califano v. Sanders and Administrative Procedure Act Interpretation: Has the Supreme Court's "Hospitable" Attitude Given Way to a More Restrictive Approach?*, 55 TEX. L. REV. 1323, 1339 (1977) (stating that the "[g]rowing distrust of agencies and calls for effective controls over administrative abuses emanate from all sides").

144. Considering the complexity of the present Federal Income Tax Code and its numerous

on the determination of tax liability.¹⁴⁵ Furthermore, greater judicial scrutiny may encourage the Treasury Department to promulgate reasonable regulations and inspire Congress to enact unambiguous statutes.

In reaching its decision, however, the *Vogel* Court misconstrued the language, history, and purpose of section 1563(a)(2), perhaps to avoid an explicit statement that a higher standard of review was being imposed. The majority erroneously held that the regulation was wholly incompatible with the statute's language, history, and purpose. Although the Court's analysis supports one possible statutory interpretation, it does not establish that the Treasury's interpretation of section 1563(a)(2) is incorrect.¹⁴⁶ To the contrary, the language, history, and purpose of section 1563(a)(2) support the regulation as it previously was applied.

The plain language of section 1563(a)(2) does not require that each of the five or fewer shareholders must own stock in each corporation before being considered for purposes of the eighty percent test. Section 1563(a)(2)(A), which contains the eighty percent test, does not explicitly require common

ambiguities, the regulations' general explanation and examples provide an essential source of information to the taxpayer. The complexity of the Code and the significance of the regulation system was articulated eloquently by Learned Hand:

In my own case the words of such an act as the Income Tax, for example, 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.

Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947). See Rogovin, *supra* note 41, at 757 (Rogovin, as Chief Counsel of the Internal Revenue Service, declared that “[p]roper tax administration requires that the Service provide reliable and timely information to aid taxpayers in interpreting this complex statute”). See also Westin, *supra* note 41, at 21 (criticizing the “Code [as] simply too complex, its ambiguities are too numerous, and the legislative direction is too faint”).

145. For example, many corporations similar to those in *Vogel*, relying on Treasury Regulation § 1.1563(a)(3), characterized themselves as members of a brother-sister controlled group and, thus, did not claim a full surtax exemption or accumulated earnings credit. Consequently, many corporate taxpayers filed refund claims after the United States Tax Court invalidated the regulation in *Fairfax Auto Parts, Inc. v. Commissioner*, 65 T.C. 798 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir. 1977). At the time of the *Vogel* decision, an estimated 223 cases were pending in the lower courts involving approximately \$3.5 million in refund claims. Petition for a Writ of Certiorari to the United States Court of Claims at 6, *United States v. Vogel Fertilizer Co.*, 102 S. Ct. 821 (1982). Unfortunately, however, the taxpayers are only able to recover their erroneous tax payments for the previous three years. See *infra* note 194.

146. Under traditional analysis, contemporaneous regulations are valid despite sounder constructions of the statute, unless they are unreasonable and clearly inconsistent with the statute. See *supra* notes 50-77 and accompanying text. Thus to invalidate the challenged regulation the Court must demonstrate that it is not a possible or reasonable statutory interpretation and not merely that the taxpayer's view is a better construction. *Id.*

The dissent in *Vogel* conceded that the majority's analysis supports one possible conclusion but argued that it “totally failed” to establish that the Commissioner's interpretation is incorrect. Because the regulation is not inconsistent with the statute, the dissent would defer to the Treasury's judgment. 102 S. Ct. at 832, 834 (Blackmun, J., dissenting).

ownership.¹⁴⁷ In contrast, section (a)(2)(B) clearly imposes a common ownership requirement for the fifty percent test. This latter section specifically states: "taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation."¹⁴⁸ The *Vogel* Court concluded, however, that because the controlling group of shareholders is defined as "five or fewer" for both the eighty percent and fifty percent tests, precisely the same shareholders must satisfy both tests. Thus, the Court reasoned that because the fifty percent test requires common ownership, the eighty percent test also must require such ownership.¹⁴⁹ Nevertheless, a plain reading of the statute would not apply the common ownership requirement explicitly contained in section 1563(a)(2)(B) to the eighty percent test contained in section 1563(a)(2)(A).¹⁵⁰ At most, the language of section 1563(a)(2) only requires that the total number of shareholders considered for both the eighty percent and fifty percent tests cannot exceed five.¹⁵¹ Absent some clear illumination from the legislative history, it is reasonable to conclude that if Congress intended to impose a common ownership requirement on the eighty percent test, it would have explicitly provided so.¹⁵²

Furthermore, the legislative history and purpose of section 1563(a)(2) are not as evident as the *Vogel* Court asserts.¹⁵³ Ironically, the Court relied on the Treasury Department's Technical Explanation for support. In explaining its 1969 proposal, the Treasury Department stated that "the *same five or fewer* persons [must] own at least 80% . . . of each corporation and . . . these five or fewer persons must also satisfy the 50% requirement in part (B)."¹⁵⁴ The Court concluded that this statement explicitly corroborates that only those shareholders considered for the fifty percent test can be counted

147. For the full text of § 1563(a)(2), see *supra* note 5.

148. I.R.C. § 1563(a)(2)(B) (Law. Co-op. 1974).

149. See *supra* notes 121-24 and accompanying text.

150. In upholding Treasury Regulation § 1.1563(a)(3) as a reasonable statutory construction, the Eighth Circuit in *Hunt, Inc. v. Commissioner*, 562 F.2d 532 (8th Cir. 1977), concluded:

Thus it is apparent that Congress was aware of the language necessary to require that each person whose holdings are considered in applying the 80% test must own stock in each of the controlled corporations. We find nothing in the plain words of the statute which warrants applying such standard with respect to the § 1563(a)(2)(A) test.

Id. at 535. Accord *Vogel*, 102 S. Ct. 821, 833 (1982) (Blackmun, J., dissenting); *Fairfax Auto Parts, Inc. v. Commissioner*, 65 T.C. 798, 811-12 (Simpson, J., dissenting), *rev'd per curiam*, 548 F.2d 501 (4th Cir. 1977).

151. See *Vogel*, 102 S. Ct. 821, 833 (1982) (Blackmun, J., dissenting).

152. See *Allen Oil Co. v. Commissioner*, 614 F.2d 336, 339 (2d Cir. 1980); *Hunt, Inc. v. Commissioner*, 562 F.2d 532, 535 (8th Cir. 1977). See also *supra* note 150.

153. Noting the legislative history's lack of any explicit statement on the common ownership issue, the *Vogel* dissenters found the Court's analysis speculative and its certainty "somewhat surprising". 102 S. Ct. at 833 n.2 (Blackmun, J., dissenting).

154. Treasury Department's General Explanation, *supra* note 27, at 5168 (emphasis added by the Court except "five" was emphasized in the original).

for the eighty percent test.¹⁵⁵ Again, however, this language suggests only that the total number of shareholders considered for both tests cannot exceed five.¹⁵⁶ In direct opposition to the *Vogel* Court's holding, the Treasury's interpretation of section 1563(a)(2) is supported by a portion of the Treasury Department's Technical Explanation which states that the eighty percent test "is satisfied if the group of five or fewer persons *as a whole* owns at least 80% of the voting stock or value of shares of each corporation, *regardless of the size of the individual holdings of each person.*"¹⁵⁷ The Treasury Department proposed the 1969 amendment to section 1563(a)(2), which was adopted verbatim by Congress, and wrote the General Explanation.¹⁵⁸ It seems likely therefore, that the Treasury Department knew its own intent when it issued Treasury Regulation 1.1563-1(a)(3).

The *Vogel* Court further stated that the challenged regulation undermined the purpose of the eighty percent test. The majority concluded that without a common ownership requirement, the eighty percent test simply measures whether the corporations are closely held and, thus, thwarts the congressional purpose of identifying the interrelationship between two or more corporations.¹⁵⁹ The Court's analysis is based on the premise that Congress intended for the eighty percent test, rather than the fifty percent test, to be the primary mechanism for defining the interrelationship between the corporations.¹⁶⁰ The legislative history, however, does support this conclusion.

The legislative history never explicitly addressed this issue.¹⁶¹ Instead, the *Vogel* Court based its conclusion on the fact that the original definition of a brother-sister controlled group contained only an eighty percent test and the 1969 amendment simply expanded this definition to prevent circumvention of the statute.¹⁶² This fact, standing alone, does not indicate that Congress intended for the eighty percent test to remain as the primary indicia

155. See *supra* notes 135-36 and accompanying text.

156. See *Vogel*, 102 S. Ct. 821, 834 (1982) (Blackmun, J., dissenting). The *Vogel* dissent believed that the legislative history was ambiguous at most. The dissenters stressed the fact that the Treasury Department's General Explanation never specifically addressed the 80% common ownership issue. Furthermore, it emphasized that various lower court decisions have drawn conflicting conclusions from precisely the same portions of the Treasury Department's General Explanation. *Id.* at 834 & n.3.

157. Treasury Department's General Explanation, *supra* note 27, at 5169 (emphasis added). In response, the *Vogel* majority asserted that this language further supports the taxpayer's view "since it appears to assume that each person has holdings in each corporation." 102 S. Ct. at 830 n.11. The majority emphasized that in each of three examples following the Treasury Department's statement all the fictitious shareholders owned stock in each corporation. *Id.* at 830 n.11.

158. See *supra* notes 27-30 and accompanying text.

159. See *supra* notes 125-34 and accompanying text.

160. *Id.*

161. See *Vogel*, 102 S. Ct. 821, 833-34 (1982) (Blackmun, J., dissenting).

162. *Id.* at 829-30. For a discussion of the *Vogel* Court's analysis on this point, see *supra* notes 125-31 and accompanying text.

of interrelationship.¹⁶³ To the contrary, Congress' purpose of preventing easy avoidance of the brother-sister controlled group definition is best served if the eighty percent test is construed without a common ownership requirement. As the facts in *Vogel* demonstrate, the Court's decision will permit close corporations, controlled by the same five or fewer persons, to circumvent the brother-sister controlled group restrictions.¹⁶⁴ More specifically, Vogel Fertilizer Company and Vogel Popcorn Company are not considered members of a brother-sister controlled group even though Arthur Vogel has complete control of both corporations.¹⁶⁵

Another criticism of *Vogel* is that the decision seriously diminishes the significance of the fifty percent identical ownership requirement. The fifty percent test was enacted to assure that the corporations were operating as one economic unit.¹⁶⁶ As the *Vogel* Court admits, the fifty percent identical ownership requirement measures the interrelationship between the corporations.¹⁶⁷ Thus, requiring the eighty percent test to serve as the primary requirement for defining the interrelationship between corporations would render the fifty percent test superfluous.¹⁶⁸

A final flaw in the *Vogel* analysis is the Court's misapplication of the test articulated in *National Muffler*.¹⁶⁹ The *National Muffler* Court stated that an interpretative regulation may have particular force if it is a contemporaneous statutory construction by those presumably aware of the congressional intent.¹⁷⁰ Although the drafters of the 1969 statutory amendment contemporaneously promulgated the contested regulation in *Vogel*,¹⁷¹ the Court

163. In his dissent, Justice Blackmun noted that the legislative history never stated that the 80% test was to remain the primary requirement for defining the interrelationship between the corporations. Moreover, the dissent asserted that the legislative materials are not inconsistent with the Commissioner's view that the newly devised 50% test was to be the primary indicium for assessing the interrelation. 102 S. Ct. at 833 n.2 (Blackmun, J., dissenting).

164. See *infra* notes 195-202 and accompanying text.

165. See *supra* notes 99-102. Under the *Vogel* Court's analysis, Vogel Fertilizer and Vogel Popcorn would be members of a brother-sister controlled group if Richard Crain owned one share in Vogel Popcorn. 102 S. Ct. at 832. It is difficult to imagine, however, that Congress intended for the statute to depend upon such minute distinctions which make no economic difference.

166. See *supra* notes 27-29 and accompanying text.

167. 102 S. Ct. at 828.

168. In upholding the validity of Treasury Regulation § 1.1563-1(a)(3), the Second Circuit rejected the taxpayer's argument as a highly strained and convoluted reading of the statute. The Second Circuit declared:

To read such a requirement into the 80% test would seriously weaken subparagraph (2)(B) and its 50% test since the 80% requirement if subjected to common ownership on the part of the group of five or fewer, would then tend to overlap or swallow the 50% requirement.

Allen Oil Co. v. Commissioner, 614 F.2d 336, 339 (2d Cir. 1980). See also *Vogel*, 102 S. Ct. at 833 (Blackmun, J., dissenting) (noting that the 50% identical ownership test already serves to measure the overlap between corporations).

169. 440 U.S. 472 (1981).

170. *Id.* at 477. See *supra* notes 83-85 and accompanying text.

171. The Treasury Department promulgated the regulation in temporary form in March of

never addressed this factor. Furthermore, the Court failed to recognize that deference was owed to Regulation 1.1563-1(a)(3) because the Treasury had consistently applied it since 1971.¹⁷²

In summary, the *Vogel* Court premised its holding upon a strained analysis of the statute's language, history, and purpose and a misapplication of the *National Muffler* test. The decision, however, more appropriately reflects the Court's utilization of an unarticulated higher standard of review for interpretative regulations. Until a definitive standard of review is firmly established, inconsistent lower court analyses of interpretive regulations is likely.¹⁷³

IMPACT

Vogel Court Applies a Higher Standard of Review of Treasury Regulations

Despite the traditional deference afforded contemporaneous interpretative Treasury Regulations, the *Vogel* Court afforded little, if any, deference to Treasury Regulation section 1.1563-1(a)(3). The Court's misapplication of the *National Muffler* test and its extensive review and strained analysis of

1971 and the regulation constituted the Treasury's first and only construction of the statute. See *supra* notes 32-36 and accompanying text. The lower courts reviewing Treasury Regulation § 1.1563-1(a)(3) never disputed its contemporaneity. See, e.g., *Hunt, Inc. v. Commissioner*, 562 F.2d 532, 535 (8th Cir. 1977) (emphasizing that the Treasury's contemporaneous constructions of a statute are entitled to great weight); *Fairfax Auto Parts, Inc. v. Commissioner*, 65 T.C. 798, 807 (1976) (Simpson, J., dissenting) (Treasury Regulation § 1.1563-1(a)(3) constitutes a contemporaneous construction of the statute), *rev'd per curiam*, 548 F.2d 501 (4th Cir. 1977). Cf. *Griswold*, *supra* note 56, at 408-09 (after a few years at the most, a regulation should be accorded great weight to preserve certainty and predictability of the tax laws).

172. The *National Muffler* Court articulated various factors to consider in reviewing the validity of a Treasury Regulation including, among others, the length of time the regulation has been in effect and the consistency of the Commissioner's interpretation. See *supra* notes 83-86 and accompanying text. The contested regulation in *Vogel* has been consistently applied since 1971 and did not come under judicial review until 1976. Furthermore, Congress failed to act on a 1974 proposed statutory amendment eviscerating the regulation's construction of the 80% test. See *supra* note 36. The *Vogel* Court, however, failed to discuss these factors.

173. In fact, the confusion surrounding the proper standard of judicial review of Treasury Regulations already exists and is illustrated by the lower courts' inconsistent rulings on the validity of Treasury Regulation § 1.1561-1(a)(3). See *supra* note 145. According to a number of critics, the already existing qualifications to the deference principle allow it to be used as a means rather than as a true basis for decision. Professor Davis interestingly states:

Unquestionably one of the most important factors in each decision on what weight to give an interpretive [regulation] is the degree of judicial agreement or disagreement with the [regulation]. When a court agrees with it, the court is likely to utter words that it is controlling, that it has great weight, or that it must be given effect unless it is unreasonable or inconsistent with the statute. When the court disagrees, that is, when the [regulation] seems to the court to be inconsistent with the statute or calls for a result the court would not reach, the court may take the position that the interpretive [regulation] is entitled to no weight. Even if the court finds that the policy embodied in the [regulation] is neither required nor prohibited by the statute, the court is free to reject the [regulation] if it prefers a different result.

DAVIS, *supra* note 37, at 60.

the statute's language, history, and purpose evidence this fact. The *Vogel* decision, therefore, suggests that contemporaneous interpretative regulations which construe an ambiguous statutory definition rather than a broad statutory term¹⁷⁴ are not entitled to a presumption of validity, and it is unlikely such regulations will be upheld if there are more reasonable interpretations of the statute in question.

Furthermore, the majority's analysis in *Vogel* indirectly confirms a recent trend toward subjecting interpretative regulations to a higher standard of judicial review.¹⁷⁵ As the *Vogel* decision illustrates, the appropriate framework of review for interpretative regulations considers whether the regulation harmonizes with the statutes' language, history, and purpose.¹⁷⁶ If it does, the regulation is reasonable and will be upheld. However, the degree of inconsistency and evidence that is needed to invalidate an interpretative regulation inversely depends on the presumption of validity accorded the regulation.¹⁷⁷ The factors articulated in *National Muffler* and the distinction set forth in *Vogel* between regulations construing an ambiguous statutory definition rather than a broad statutory term apparently determine this presumption.¹⁷⁸ In adopting a more scrutinizing standard, however, the *Vogel* decision confirms that contemporaneity, a factor accorded particular force in *National Muffler*, will no longer invoke a higher level of judicial deference but is only one of a number of factors to be considered in determining a regulation's validity.¹⁷⁹ Thus, it will be easier for courts to justify the invalidation of interpretative regulations.

Finally, the *Vogel* decision conclusively establishes that interpretative regulations are owed less deference than legislative regulations.¹⁸⁰ Previously, legislative regulations were accorded the force of law unless they were beyond the Treasury's delegated authority or unreasonable.¹⁸¹ Because reasonableness was also the test for interpretative regulations, many courts accorded both types of regulations the same degree of deference.¹⁸² The *Vogel* Court,

174. See *supra* notes 116-18 and accompanying text.

175. See *supra* notes 78-95 and accompanying text.

176. See *supra* note 119 and accompanying text.

177. Cf. *supra* note 173 (observing that the inconsistent application of the deference principle divided the courts on Treasury Regulation § 1.1561-1(a)(3)'s validity); *infra* notes 183-84 and accompanying text (legislative regulations enjoy a greater presumption of validity and are thus subject to less judicial review).

178. See, e.g., *First Charter Fin. Corp. v. United States*, 669 F.2d 1342, 1348 (9th Cir. 1982) (stating that deference is particularly appropriate here since Congress used such language as to render an interpretive regulation appropriate) (citing *Vogel*, 101 S. Ct. 1693 (1981)).

179. See *supra* note 85.

180. See, e.g., *First Charter Fin. Corp. v. United States*, 669 F.2d 1342, 1346 (9th Cir. 1982) (citing *Vogel*, 101 S. Ct. 1693 (1981)).

181. See *supra* notes 1-44 and accompanying text.

182. Arguably, there is no fundamental difference between the Supreme Court's two standards: legislative regulations carry the force of law unless unreasonable and interpretive regulations must be sustained unless unreasonable and plainly inconsistent with the statute. Noting that both legislative regulations and interpretations must be consistent with the statute to be valid, the Fifth Circuit declared:

however, explicitly stated that interpretative regulations are owed less deference than legislative regulations.¹⁸³ Consequently, only legislative regulations will enjoy a substantial presumption of validity and be upheld unless clearly inconsistent with the revenue statute.¹⁸⁴

Vogel Narrows Scope of Brother-Sister Controlled Groups

For more than a decade, the uncertain application of the brother-sister controlled group eighty percent requirement caused inconsistent treatment of various Code provisions.¹⁸⁵ The *Vogel* decision resolved the uncertainty by holding that a person must own stock in each corporation before being considered for purposes of the eighty percent test. As a result of *Vogel's* common ownership requirement, fewer corporations will be considered component members of a brother-sister controlled group.¹⁸⁶ Furthermore, *Vogel* will have a significant tax impact because numerous Code provisions have incorporated the brother-sister controlled group definition of section 1563(a)(2).¹⁸⁷

Closely held corporations which do not satisfy the eighty percent test of section 1563(a)(2) because of *Vogel's* common ownership requirement will no longer have to share a spectrum of tax benefits. These corporations are

We term them "legislative" because they are made pursuant to a specific delegation of authority and often with the particular legislative guidance typically found in the statutes that spawn only interpretive regulations. But in a real sense they still interpret or explain existing legislation. The ideal types of legislative and interpretive regulations thus quickly break down in practice.

Anderson, Clayton & Co. v. United States, 562 F.2d 972, 985 n.30 (5th Cir. 1977). See also DAVIS, *supra* note 37, § 7:15 (a significant number of cases continue to blur the distinction between legislative and interpretive regulations); Alexander & Boshkov, *The Internal Revenue Service's Ability to Dispose of Cases: General Techniques (Regulations, Rulings and the Like)*, 31 MAJOR TAX PLAN. 1037, 1039-42 (asserting that the Supreme Court does not appear to make the distinction controlling).

183. 102 S. Ct. at 827.

184. A comparison of the Court's analysis in *Commissioner v. Portland Cement Co.*, 101 S. Ct. 1037 (1981), with its analysis in *Rowan Cos. v. United States*, 101 S. Ct. 2288 (1981), and *Vogel* demonstrates this conclusion. Applying the *National Muffler* test, the Court in *Rowan* and *Vogel* extensively reviewed the statute's language, history, and purpose to determine the validity of an interpretive Treasury Regulation. In both cases, the Court invalidated the regulations even though they were not clearly inconsistent with the statutes. See *supra* notes 86-95, 146-68 and accompanying text. In *Portland*, however, the Supreme Court attributed great deference to legislative regulations. The Court declared that these "regulations command our respect" and "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes." 101 S. Ct. at 1045 (quoting *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948)). Furthermore, the *Portland* Court did not extensively examine the statute's language, history, and purpose, but sustained the regulations because they were neither "unreasonable on their face [n]or inconsistent with the Code." 101 S. Ct. at 1045.

185. In view of the conflicting case law prior to *Vogel*, one commentator declared that it was difficult to advise clients on the proper application of the various Code sections incorporating the brother-sister controlled group definition of § 1563(a)(2). Weisman, *supra* note 36, at 485. For a list of other Code provisions dependent upon § 1563(a), see *supra* note 3.

186. See *infra* notes 195-202 and accompanying text.

187. See *supra* note 3.

now entitled to¹⁸⁸ a full accumulated earnings credit,¹⁸⁹ investment credit,¹⁹⁰ and the benefits of the graduated corporate tax structure.¹⁹¹ The graduated corporate tax structure alone can reduce a corporation's taxes by \$19,750 in 1982 and \$20,250 in future years.¹⁹² Not only are these benefits available prospectively, but corporations previously denied these benefits because of Treasury Regulation section 1.1563-1(a)(3) can file refund claims¹⁹³ for all open back years.¹⁹⁴

In addition, the Court's narrow construction of section 1563(a)(2)(A) enables a number of closely held corporations to avoid brother-sister controlled group status by restructuring their stock ownership.¹⁹⁵ This is particularly true when a person or a small group of individuals own slightly more than eighty percent of two or more corporations and the remaining stock interest of each corporation is held separately by unrelated investors. For example, assume entrepreneur *A* owns eighty percent of three separate corporations. The remaining outstanding stock of each corporation is held

188. For other tax benefits shared by members of a brother-sister controlled group, see *supra* note 3.

189. I.R.C. § 535(c)(2)(B) allows certain service corporations a \$150,000 accumulated earnings credit and I.R.C. §§ 535(c)(2)(A) and (c)(3) allow all other corporations a \$250,000 accumulated earnings credit. I.R.C. § 535(c) (Law. Co-op. Supp. 1982). Section 1561(a)(2), however, restricts a "controlled group of corporations" to one accumulated earnings credit. I.R.C. § 1561(a)(2) (Law. Co-op. Supp. 1982).

190. I.R.C. § 46(a)(6) limits a "controlled group" of corporations as defined in § 1563(a) to a single investment credit. I.R.C. § 46(a)(6) (Law. Co-op. Supp. 1982).

191. Section 1561(a)(1) treats a controlled group of corporations as defined in § 1563(a) as a single taxpayer for purposes of the graduated tax rates. I.R.C. § 1561(a)(1) (Law. Co-op. Supp. 1982). The benefits of the lower tax rates are divided equally among the corporate members, unless they agree to an appointment plan providing otherwise. *Id.* The corporate graduated tax rates are reprinted at *supra* note 2. Prior to 1978 when the normal and surtax rate structure was in effect, I.R.C. § 1561(a)(1) limited a controlled group of corporations to a single surtax exemption. See *supra* notes 21-24 and accompanying text.

192. The graduated corporate tax structure imposes a maximum tax rate of 46% on all corporate earnings in excess of \$100,000. The tax savings quoted in the text represent the difference between applying the maximum 46% tax rate and the lower tax rates applicable to the first \$100,000 of corporate earnings. For a discussion of the applicable tax rates, see *supra* note 2.

193. A refund claim notifies the Internal Revenue Service that the taxpayer has overpaid taxes and seeks a refund. The refund claim must be filed within the applicable period of limitation, see *infra* note 201, and with the service center serving the Internal Revenue district in which the tax was paid. Treas. Reg. § 301.6402-2(a)(2) (1982). However, if the tax was paid to the Director of Internal Operations the claim must be filed there. Treas. Reg. § 301.6402-2(a)(2).

Furthermore, a corporate taxpayer filing a refund claim after June 30, 1976 for an overpayment of income taxes, must use Form 1120X, "Amended U.S. Corporation Income Tax Return." Treas. Reg. § 301.6402-3(a)(3)(1982). For all other refund claims Form 843 must be utilized. Treas. Reg. § 301.6402-2(c).

194. Refund claims filed after the expiration of the prescribed statute of limitations are invalid. I.R.C. § 6511 (b)(1) (Law. Co-op. 1980). In general, a corporate taxpayer may file a refund claim within three years from the time the return was filed or within two years from the time the tax was paid, whichever period expires later. *Id.* § 6511(a). If no return is filed, the refund claim must be filed within two years from the time the tax was paid. *Id.*

195. See generally Golub & Weber, *supra* note 3, at 211 (article cites examples illustrating various capital arrangements to avoid brother-sister controlled group status).

separately by *B*, *C*, and *D*, respectively.¹⁹⁶ These corporations can escape classification as component members of a brother-sister controlled group by reducing *A*'s stock ownership below eighty percent¹⁹⁷ in any two of the three corporations.¹⁹⁸ Under *Vogel*'s construction of section 1563(a)(2)(A), *B*, *C*, and *D*'s stock interest would not be included in computing the eighty percent test because they do not own stock in each corporation. *A*'s stock interest alone is insufficient to satisfy the eighty percent test because *A* owns less than eighty percent in two of the corporations.

Similar capital arrangements may now be considered whenever a small entrepreneur group decides to initiate a new business or expand its present enterprise.¹⁹⁹ The substantial tax benefits enhance the feasibility of forming multiple corporations²⁰⁰ and of allowing unrelated outside investors to own slightly more than twenty percent of each corporation.²⁰¹ For example, *A* and *B* respectively own sixty percent and forty percent of an incorporated

196. The following chart illustrates the application of I.R.C. § 1563(a)(2) to the facts stated in the text.

SHAREHOLDERS	Percentage of Stock Ownership (80% Test)			Percentage of Identical Stock Ownership (50% Test)
	CORPORATIONS			
	1	2	3	
<i>A</i>	80	80	80	80
<i>B</i>	20	—	—	—
<i>C</i>	—	20	—	—
<i>D</i>	—	—	20	—
TOTAL	80	80	80	80

All three corporations are members of a brother-sister controlled group as defined in I.R.C. § 1563(a)(2) (Law. Co-op. 1974). *A*'s 80% stock ownership in each corporation satisfies the 80% and 50% tests. See *supra* notes 6-9 and accompanying text.

197. *A*'s stock interest can be reduced by redemption (i.e. sale of stock to the issuing corporation) or sale of stock to an outside party. The outside party must be unrelated to *A* or I.R.C. § 1563(e) would attribute *A* with indirect ownership of the stock. See *supra* note 7.

198. Nevertheless, the tax advantages of multiple incorporation may still be denied under the traditional subjective provisions of I.R.C. §§ 269, 482, and 1551. See *supra* notes 18-20 and accompanying text. Arguably, however, § 1551 is also inapplicable here because it utilizes the identical two part test adopted in § 1563(a)(2). Although no case has yet considered whether § 1551(b)(2) contains a common ownership requirement, the *Vogel* decision is persuasive authority that it does.

199. See *supra* notes 18-20 and accompanying text.

200. See *supra* note 3 and accompanying text. For a general discussion of the tax considerations involved in multiple incorporation, see DeLeoleos, *Are You Making the Proper Elections in Dealing with Related Corporate Groups?*, 24 J. TAX'N 270 (1966); Dreher, *Federal Income Tax Aspects of Multiple Corporations*, 9 Hous. L. REV. 8, 9-14 (1971); Eustice, *Corporations and Corporate Investors*, 25 TAX. L. REV. 509, 560 (1970).

In addition, there are many non-tax considerations involved in the multiple incorporation decision. See *supra* note 19. One major non-tax consideration is the need for increased limited liability. For example, it may be advisable for a corporation to market a risky new product through a separate corporation. In certain situations, however, a parent corporation may be liable for the debts of its wholly-owned subsidiary. For a general discussion of the limited liability factor, see 1 O'NEAL, *supra* note 19, §§ 1.10, 2.05.

201. Besides the tax considerations, there are numerous other factors that should be con-

clothing store. They plan to open a similiar incorporated business at a different location. Classification as component members of a brother-sister controlled group can be avoided by issuing slightly more than twenty percent of the new corporation's stock to an outside investor. Because only a greater than twenty percent outside interest is needed to avoid controlled group status, *A* and *B* are able to maintain control of each corporation, yet escape tax limitations placed on a brother-sister controlled group.²⁰² Prior to *Vogel*, a fifty percent or more outside stock interest was required to achieve the same results.

CONCLUSION

The majority's analysis in *Vogel* confirms a recent trend subjecting interpretative Treasury Regulations to a higher standard of judicial review. The *Vogel* Court invalidated a contemporaneous Treasury Regulation even though it was not clearly inconsistent with the statute's language, history, and purpose. The Court emphasized that less deference was required because the regulation was interpretative rather than legislative and it construed an ambiguous statutory definition rather than a broad statutory term. Although a higher standard of review is commendable in view of the growing distrust of administrative agencies, the *Vogel* majority misconstrued the language, history, and purpose of section 1563(a)(2) to avoid explicating this new standard. Consequently, the *Vogel* decision may lead to inconsistent analyses of interpretative regulations in the future.

Additionally, the *Vogel* decision clarified the application of the brother-sister controlled group definition in holding that the eighty percent test of section 1563(a)(2) contains a common ownership requirement. As a result of the Court's narrow construction, fewer corporations will be considered members of a brother-sister controlled group. These corporations will no longer be forced to share the spectrum of tax benefits available to small corporations. Futhermore, a group of closely held corporations may now avoid brother-sister controlled group status by allowing outside investors to separately own more than twenty percent of each corporation.

Joseph P. Karczewski

sidered in determining whether to finance a new corporation through debt or equity funding. For a thorough discussion of the financing alternative available to a closely held corporation, see 1 O'NEAL, *supra* note 19, §§ 2.08-2.17. For a general discussion of what a lawyer should know about the financing of small businesses, see S. FLINK, *EQUITY FINANCING FOR SMALL BUSINESS* (1962); Lehrman, *The Problems of Small Business Financing*, 1 TEX. SO. INTRAMURAL L. REV. 139 (1970); Newman, *The Anatomy of Commercial Financing*, 61 A.B.A. J. 352 (1975).

202. For example, if 25% of the new corporation's voting stock is issued to an outside investor, *A* and *B* together will be able to control the corporation since collectively they hold 75% of its voting stock.

To safeguard against future dissension between *A* and *B*, however, and to insure that neither will subsequently side with the outside investor, *A* and *B* should enter a shareholder's agreement or some other voting control device. For an extensive discussion of the use of such various devices, see 1 O'NEAL, *supra* note 19, §§ 5.01-5.39.