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Tax Planning and Policy Drift

SLOAN G. SPECK*

I. INTRODUCTION

The U.S. administrative state often relies on private actors to implement public policy.¹ Taxation provides an archetypical example. The Internal Revenue Service describes the U.S. tax system as one of “voluntary compliance,” in which taxpayers calculate, report, and pay their own taxes and timely file their own tax returns.² In doing so, taxpayers and their advisors consult statutes, regulations, and other guidance to determine their obligations under the Code and regulations. Taxpayers face more than just a choice to “comply or defy”; they and their expert advisors also must interpret the law to determine the scope and content of compliance.³ The government passes judgment on these private legal interpretations only after the fact, in audit or litigation, if at all.⁴ Tax scholarship generally has addressed questions of tax compliance within a comply-or-defy framework.⁵ Less attention, however, has been given to the effects on tax law and policy of the private legal interpretations that are intrinsic to a system predi-

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¹ For example, when government outsources functions to private parties by contract, they often have significant discretion about implementation, with attendant policy effects. See Jody Freeman, *Private Role in Public Governance*, 75 N.Y.U. L. Rev. 543, 545 (2000); Gillian E. Metzger, *Privatization as Delegation*, 103 Colum. L. Rev. 1367, 1369 (2003); Sidney A. Shapiro, *Outsourcing Government Regulation*, 53 Duke L.J. 389, 418 (2003).

² See, e.g., Rev. Rul. 2007-20, 2007-1 C.B. 863.

³ See Michael P. Vandenbergh, *The Private Life of Public Law*, 105 Colum. L. Rev. 2029, 2036–37 (2005) (“Missing from this view is a recognition that private actors, not just agencies, play a regulating role.”).

⁴ See Sidney I. Roberts, *Viewpoint of the Tax Lawyer*, 34 Tax L. Rev. 5, 6 (1978) (“[T]o a considerable extent, the law that is legislated is simply not applied [by Treasury or courts].”). The government never reviews many taxpayers’ legal positions. See IRS Data Book tbl.9a & b (2015), <http://www.irs.gov/pub/irs-soi/15databk.pdf> (showing overall audit rates of 0.8% for individuals and 1.3% for corporations). Although high-income individuals and large corporations face substantially higher audit rates, the complexity of these filers’ returns hinders the detection of errors or evasion. See *id.* (showing audit rates of 34.69% for individuals with income over \$10 million and 64% for corporations with assets over \$20 billion).

⁵ See, e.g., Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 Va. L. Rev. 1781, 1783–85 (2000) (discussing voluntary compliance).

cated on self-reporting.⁶ This Article explores the ways in which private legal interpretations can influence the development of public policy, impeding a return to the state of law prior to such interpretations—a process this Article defines as “planning drift.”

The power of private legal interpretations is evident in the tax practitioner adage that the IRS does not challenge transactions “if there is a long-standing and generally accepted understanding of [their] expected tax treatment.”⁷ This informal norm is sometimes called the “Wall Street Rule,” since these types of transactions often involve securities issued through New York investment banks.⁸ For example, assume that Congress and Treasury prefer Policy A. Congress enacts a statute designed to implement Policy A, but the statute is incomplete and ambiguous as it does not clearly specify legal outcomes for all situations. Private experts advise their clients that the statute permits transactions that are consistent with an alternative Policy B and inconsistent with Policy A. Policy B might be a permutation of Policy A, or Policy B could incorporate ideas unrelated to Policy A. These transactions, and the legal interpretations that justify them, become commonplace among private experts and known among their public counterparts at Treasury.⁹ When Treasury finally issues regulations or conducts audits, it may accept the legal interpretations that implement Policy B to avoid upsetting markets or taxpayers’ expectations, or because it finds private experts’ legal arguments compelling.¹⁰ If Treasury accepts Policy B either explicitly through rulemaking or implicitly through selective enforcement, private experts’ legal interpretations result in a policy other than that preferred by the enacting Congress. This example becomes more complicated if Congress and Treasury (or internal factions of either) have divergent policy preferences, or if congressional or administrative policy preferences change over time.

Underlying the U.S. tax system is a general acceptance that taxpayers may structure their affairs to minimize taxes within the constraints

⁶ Much tax scholarship focuses on the negative aspects of private tax planning and advocates legislative or administrative action, but does not consider whether private tax planning constrains Congress or Treasury. See, e.g., Mark P. Gergen & Paula Schmitz, *The Influence of Tax Law on Securities Innovation in the United States: 1981–1997*, 52 *Tax L. Rev.* 119, 124–25 (1997).

⁷ See Emily A. Parker, Acting Chief Counsel, IRS, *Speech to the TEI/LMSB Financial Services Industry Conference* (Sept. 22, 2003), at 1, available at <http://www.irs.gov/pub/irs-utl/tei-92203.pdf>.

⁸ See Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 *UCLA L. Rev.* 1629, 1654–55 (2009); Victor Fleischer, *Regulatory Arbitrage*, 89 *Tex. L. Rev.* 227, 286–87 (2010).

⁹ See David A. Weisbach, *Formalism in the Tax Law*, 66 *U. Chi. L. Rev.* 860 (1999); see also Subsection II.A.1.

¹⁰ For a real-world example that traces this pattern, see text accompanying notes 71–73.

of the law.¹¹ The Wall Street Rule provides one vehicle through which private actors and their expert advisors influence public policy by “creat[ing] law through their own practices.”¹² Although many IRS officials publicly disavow the Wall Street Rule’s legal relevance,¹³ the rule’s “widespread acceptance in the tax world”¹⁴ affects how the IRS approaches administration and enforcement.¹⁵ This Article formalizes and elaborates the intuitions behind phenomena such as the Wall Street rule—the mechanisms by which private legal interpretations can alter the course of public policy—as well some implications of these mechanisms for policymakers.

This Article introduces the concept of planning drift to describe policy changes that result from private legal interpretations, and proposes a framework for analyzing how private legal interpretations influence the development of public policy. Planning drift occurs when private experts, such as lawyers, interpret law in the service of their clients, in the context of actual or contemplated private activity, and under the constraints of professional norms and ethics.¹⁶ This Article contributes to the literature on policy drift, which explores how public policy enacted by a legislature can be vitiated by administrative rulemaking and subsequent legislation. Bureaucratic drift occurs when agencies

¹¹ See *Gregory v. Helvering*, 293 U.S. 465 (1935) (“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.”); *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934) (“Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury.”). But see David A. Weisbach, *Ten Truths About Tax Shelters*, 55 *Tax L. Rev.* 215, 220–22 (arguing that, although the *Gregory* doctrine is “well-embedded” in current law, there is no principled reason why the doctrine must exist).

¹² Bradley Bordon & David Reiss, *Wall Street Rule Applied to REMIC Classification*, 18 *Westlaw J. Sec. Litig. & Reg.* 1 (2012).

¹³ *Id.*; see also Fleischer, note 8, at 286–87 (“Once deals are completed, the advantageous tax treatment is rarely overturned, even in cases where the legal argument is weak.”); David M. Schizer, *Enlisting the Tax Bar*, 59 *Tax L. Rev.* 331, 337 (2006) (“[B]y the time [the IRS] does discover the technique, it will feel constrained not to challenge it, given the heavy volume of transactions that already have taken advantage of it, and the political clout behind those transactions.”).

¹⁴ Parker, note 7, at 2.

¹⁵ See Heather C. Maloy, *Where the Rubber Hits the Road: A View of the Tax System from a Tax Administrator’s Perspective*, Woodworth Memorial Lecture (May 10, 2012), in 39 *Ohio N.U. L. Rev.* 1, 5–6 (2012):

[J]ust because the IRS has the legal right to challenge a transaction or make an adjustment . . . , I believe a real question still exists related to when it is in the best interest of sound tax administration for the Commissioner to challenge a position taken by a taxpayer when the law is uncertain.

¹⁶ This insight is similar to the observation that private litigants shape the development of case law, both by their choices of which claims to bring and the legal arguments they make before the court. See David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 *Yale L.J.* 616 (2013). This Article expands this observation beyond the courtroom and into transactional law.

promulgate rules that diverge from the enacting legislature's policy preferences,¹⁷ while legislative drift takes place when future legislative coalitions amend or replace the enacting legislature's statutes.¹⁸ This Article newly identifies planning drift as a type of policy drift that occurs when private interpretations of existing law deviate from the enacting legislature's policy preferences; by doing so, this Article advances the positive political theory literature by situating private actors and their expert advisors within the policymaking process.¹⁹ Planning drift also bridges scholarship on taxation and administrative law. Tax scholarship generally acknowledges the role of private experts in creating legal interpretations but gives less attention to the effects of these interpretations on policy development.²⁰ By contrast, administrative law scholarship explores the private sector's role in shaping public policy but largely ignores everyday legal interpretations by private experts.²¹ As a concept, planning drift emphasizes the

¹⁷ See Mathew D. McCubbins, Roger G. Noll & Barry R. Weingast, *Administrative Procedures as Instruments of Political Control*, 3 *J.L. Econ. Org.* 243 (1987) [hereinafter *Administrative Procedures*]; Mathew D. McCubbins, Roger G. Noll & Barry R. Weingast, *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 *Va. L. Rev.* 431 (1989) [hereinafter *Structure and Process*]. Bureaucratic drift occurs not only through affirmative interpretations but also through agency "shirking" (by delaying rules or issuing ineffectual rules), see Jacob E. Gersen & Anne Joseph O'Connell, *Deadlines in Administrative Law*, 156 *U. Pa. L. Rev.* 923, 932–33 (2008), and agency inaction or nonenforcement, see Jonathan R. Macey, *Separated Powers and Positive Political Theory: The Tug of War Over Administrative Agencies*, 80 *Geo. L.J.* 671, 683–84 (1992); Matthew C. Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 *Va. L. Rev.* 93, 110 (2005).

¹⁸ See Murray J. Horn & Kenneth A. Shepsle, *Commentary on "Administrative Arrangements and the Political Control of Agencies": Administrative Process and Organizational Form as Legislative Responses to Agency Costs*, 75 *Va. L. Rev.* 499 (1989). One other type of policy drift, "epistemic drift," is not relevant to this Article. See Stuart Shapiro & David Guston, *Procedural Control of Bureaucracy, Peer Review, and Epistemic Drift*, 17 *J. Pub. Admin. Res. & Theory* 535 (2007).

¹⁹ For this purpose, "policy" is the (abstract) objective of government action, and "law" is one of the (concrete) instruments that manifest this objective. This Article refers to the enacting legislature's policy preferences rather than to legislative intent in order to distinguish these abstract preferences from more lawyerly understandings of legislative intent as used in statutory interpretation.

²⁰ See, e.g., Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 *Colum. L. Rev.* 1939, 1939–41 (2005); Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 *Va. Tax Rev.* 1, 2–4 (2004); Weisbach, note 11, at 215.

²¹ For formal mechanisms of privatization, see, e.g., *Government by Contract: Outsourcing and American Democracy* (Jody Freeman & Martha Minow eds., 2009) (contractual outsourcing); Stephen B. Burbank, Sean Farhang & Herbert M. Kritzer, *Private Enforcement*, 17 *Lewis & Clark L. Rev.* 637 (2013) (same); Shapiro, note 1 (same); Stephenson, note 17 (private enforcement). For regimes where the state is absent, such as private ordering, see, e.g., Steven L. Schwarcz, *Private Ordering*, 97 *Nw. L. Rev.* 319, 324 (2002); Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* (1991).

importance of private legal interpretations in the development of public policy.²²

In a general sense, planning drift can occur with respect to legislation, agency rulemaking, or even judicial decisions—any legal authority that applies to private parties. This Article focuses on planning drift between the enactment of a statute by the legislature and the first government intervention post-enactment, through either agency rulemaking or subsequent legislation. The drift literature generally approaches policy change from the perspective of the enacting legislature, and this Article does as well, in order to juxtapose planning drift with bureaucratic drift and legislative drift. In addition, the enacting legislature has a significant stake in the magnitude and direction of planning drift.²³ In many cases, the legislature may find planning drift problematic, and this Article offers several strategies that the enacting legislature can use to manage planning drift where it is not wanted. From the legislature's perspective, however, planning drift is not always undesirable. As this Article shows, the enacting legislature (or particular members thereof) may tolerate or even welcome planning

See also Vandenberg, note 3, at 2032–34 (discussing the “shadow law of second-order agreements” in which private parties contract over regulatory imperatives and risk).

²² Planning drift also complicates the sociological literature on “legal endogeneity.” Lauren Edelman and others argue that organizations, such as businesses, construct internal procedures to evidence compliance with legal regimes. These procedures “create ritualized ideas about what constitutes a rational response to law,” and these procedures function to convince courts, legislatures, and agencies that the internal procedures themselves, rather than substantive outcomes, suffice to demonstrate legal compliance. Lauren B. Edelman, Christopher Uggen & Howard S. Erlanger, *The Endogeneity of Legal Regulation: Grievance Procedures as Rational Myth*, 105 *Am. J. Soc.* 405, 406–07 (1999). In this way, “organizations are involved in the social construction of legal meaning.” Lauren B. Edelman & Shauhin A. Talesh, *To Comply or Not to Comply—That Isn’t the Question: How Organizations Construct the Meaning of Compliance*, in *Explaining Compliance: Business Responses to Regulation* 103, 114 (Christine Parker & Vibeke Lehmann Nielsen eds., 2011). The literature on legal endogeneity focuses on the substitution of internal procedures for external oversight (for example, private dispute resolution for consumer products claims instead of judicial or administrative adjudication). *Id.* at 111–13. By contrast, planning drift highlights how private legal interpretations affect the development of substantive law. In addition, Edelman and others view managerial structure (of businesses, in particular) as the mechanism through which government actors adopt private processes into the law. *Id.* at 105. This Article looks to policy communities, comprised of experts, as the drivers of planning drift. These policy communities span the public-private divide and function as a network for the development and dissemination of ideas, rather than as a unidirectional conduit to incorporate ideas of managerial efficiency into the law. The literature on legal endogeneity treats ideas as instrumental, while planning drift takes ideas on their own terms. Finally, Edelman casts legal endogeneity as a pernicious process by which private interests co-opt the law. *Id.* at 108–10. As elaborated in this Article, planning drift may have either harmful or beneficial effects, depending on context.

²³ This Article sets aside the issue of whether the enacting legislature's policy preferences deserve independent normative weight.

drift, depending on how planning drift interacts with other types of policy drift and the enacting legislature's politics and purpose.

Most broadly, planning drift emphasizes the difficulty of drawing hard lines between public and private, and between state and society. This Article argues that private interpretations play an important role in policy development—a role anticipated by the structure of the U.S. administrative state, which in practice devolves significant authority to actors outside the public sector.²⁴ Private interpretations represent an essential but often overlooked step in the implementation of public policy, and mapping the potential effects of private interpretations has implications for how the U.S. administrative state does and should function. By emphasizing private actors' role in implementing public policy, a focus on planning drift encourages a more nuanced view of policy development and complicates scholarly conceptions of the U.S. administrative state.

This Article proceeds as follows. Part II defines planning drift and describes factors that facilitate planning drift. Part III develops the possible harms and benefits of this type of policy drift. Examples from tax law illustrate these two Parts. Part IV explores techniques that legislators could use to limit planning drift. Part V concludes. As an appendix, this Article includes a detailed historical case study, focusing on the development of the rules governing corporate net operating losses (NOLs), that shows concretely how planning drift can occur and how it affects public policy.

II. PLANNING DRIFT

This Part outlines the general features and mechanisms of planning drift and then develops factors that facilitate planning drift with respect to legislation. Although these factors are not dispositive by themselves, they serve as indicators for when planning drift might occur.

A. *Mechanisms of Planning Drift*

In order for planning drift to occur, private legal interpretations must influence the development of public policy. From a purely formalistic perspective, the legislature, administrative agencies, and courts can overrule private practitioners' legal interpretations at any time and without deference. Under this view, government sets policy

²⁴ See Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 *Harv. L. Rev.* 1285 (2003); Freeman, note 1; Kenneth A. Bamberger, *Regulation as Delegation: Private Firms, Decisionmaking, and Accountability in the Administrative State*, 56 *Duke L.J.* 377 (2006).

and writes laws that private practitioners simply implement, like a transmission belt connecting an engine to an axle. In practice, however, the distinction between policymaking and implementation is less clear.²⁵ Just as administrative agencies may not faithfully implement the legislature's preferred policy, private experts may interpret the law in ways not anticipated by the legislature.²⁶ In effect, lawmakers must negotiate, explicitly or implicitly, with the private parties—and, in many cases, their expert advisors as well—that they seek to regulate.²⁷ With respect to planning drift, this interdependency matters not only because lawmakers often take private interpretations into account when writing statutes and regulations, but also because the contingencies of the legislative and regulatory processes mean that the relevant governmental actors may be unable to generate the political will to intervene and correct private interpretations that fail to align with those actors' policy preferences.

This Section develops the mechanisms of planning drift by first detailing two general modes of legal interpretation—*interstitial* and *reconstructive*—that private experts employ with respect to statutes and regulations. One expert rendering a single interpretation, however,

²⁵ See, e.g., Bamberger, note 24, at 392 (arguing that private parties play an active role in implementing laws by helping to set regulatory standards). In administrative law, scholarship has moved away from a “transmission belt” theory of agency accountability, in which agencies are viewed as mechanically and faithfully implementing legislation. See Richard B. Stewart, *The Reformation of American Administrative Law*, 88 Harv. L. Rev. 1669, 1675–77 (1975) (arguing that broad delegations to agencies during the New Deal drew the transmission belt model into question); Lisa Schultz Bressman, *Procedures as Politics in Administrative Law*, 107 Colum. L. Rev. 1749, 1758–67 (2007) (describing as alternatives the “expertise,” “interest group representation,” and “presidential control” models that superseded the transmission belt model).

²⁶ In this sense, planning drift proceeds from an implicit principal-agent relationship between lawmakers and private experts. As an outgrowth of positive political theory, the policy drift literature models policy change using a formal principal-agent relationship between the legislature and administrative agencies. Recent scholarship has added nuance to the basic principal-agent model by, for example, exploring the effects of multiple legislative principals, multiple administrative agents, and more complex political processes. See, e.g., J.R. DeShazo & Jody Freeman, *The Congressional Competition to Control Delegated Power*, 81 Tex. L. Rev. 1443, 1444–46 (2003) (arguing that committees and committee members act as potentially contradictory principals with respect to agencies); Terry M. Moe, *Political Control and the Power of the Agent*, 22 J.L. Econ. & Org. 1, 25–26 (2006) (noting that the political activities of organized bureaucrats, such as school teachers, complicate simple understandings of the principal-agent relationship between the legislature and agencies); Matthew C. Stephenson, *Legislative Allocation of Delegated Power: Uncertainty, Risk, and the Choice Between Agencies and Courts*, 119 Harv. L. Rev. 1035, 1054 (2006) (arguing that the legislature may prefer to delegate to agencies rather than courts if agency delegation reduces the variation in expected policy outcomes).

²⁷ See Freeman, note 1, at 548–49, 633 (“[P]ublic and private actors negotiate over policy making, implementation, and enforcement.”). This interdependency has prompted a movement toward “responsive regulation,” in which lawmakers take private relationships and motivations into account when crafting statutes and regulations. See notes 261–63 and accompanying text.

rarely shifts the course of public policy. Expert interpretations carry more weight within policy networks of private practitioners, regulators, and other experts. These experts share information, debate ideas, and develop norms that inform their legal interpretations and policy preferences. Drawing on terminology from political science, this Section describes these networks of public and private actors as “policy communities,” and these policy communities allow for the circulation of ideas that can enable planning drift.

This Section then turns to two specific mechanisms that can result in planning drift. The timing of planning drift gives private practitioners a first-mover advantage with respect to subsequent regulation and legislation, leaving administrative agencies and legislators to react and respond to private experts’ interpretations of the law. Where private legal interpretations deviate from the enacting legislature’s policy preferences, there is *de facto* policy change. If the legislature or an administrative agency cannot or does not summon the political will to intervene, this policy change can be permanent. Furthermore, even if the legislature or regulators act to correct private interpretations, the coalitional nature of governmental decisionmaking means that these interventions may not restore the enacting legislature’s policy preferences. The content of subsequent legislation or regulation depends on the then-existing policy landscape, including any private interpretations of the law.

1. Modes of Legal Interpretation

Planning drift begins with legal interpretations rendered by private practitioners for their clients. These interpretations result from the U.S. administrative state’s reliance on private actors to implement public policy, including the tax system’s dependence on self-reporting and voluntary compliance. These private practitioners’ methods of statutory and regulatory interpretation fall into two broad categories, which this Article calls interstitial interpretation and reconstructive interpretation.²⁸ Statutes and regulations generally do not speak unequivocally to all factual situations, regardless of whether they are cast as rules with *ex ante* content or as standards for which content is determined *ex post*.²⁹ Rules cannot anticipate all factual predicates,

²⁸ Interstitial interpretation draws on H.L.A. Hart’s use of “interstitial” to describe judges’ “law-creating powers.” See H.L.A. Hart, *The Concept of Law* 272–73 (2d ed. 1994). Interstitial interpretation and reconstructive interpretation differ in degree rather than in kind, and, in practice, some interpretations may not fall clearly into one category or the other.

²⁹ See *id.* at 272 (“[I]n any legal system there will always be legally unregulated cases.”); John Braithwaite, *Markets in Vice, Markets in Virtue* 144–49 (2005) (“It is only in domains that are complex, dynamic, and where litigants may find the economic stakes high enough

while standards intentionally rely on interpretation for implementation.³⁰ Interstitial interpretation fills these gaps in the law. Not only do private experts interpolate meaning where rules are unclear, but they also make judgments about whether a client's facts fall within or outside of a given standard.³¹ Through their encounters with statutes and regulations in their everyday practice, private practitioners elaborate the law's content when they advise clients.

Private practitioners do not have unbridled discretion to make interstitial interpretations. Instead, private practitioners' interpretive prerogatives are constrained by the facts before them, the strictures of existing law as understood by them, and the need to justify their interpretations to others, including their clients and colleagues, as well as governmental officials.³² For this reason, interstitial interpretations may or may not advance client interests. Expert advisors sometimes say no. Even if interstitial interpretations do not advance client interests, they may not be consistent with the legislature's policy preferences. Statutes are imperfect proxies for the underlying public policy, and interstitial interpretations, produced in the ordinary course of private practitioners' activities, can unlock the potential for planning drift.

Reconstructive interpretations represent an affirmative use of the law by private parties—a form of “creative legal engineering” or “creative compliance,” in which practitioners deploy statutes and regulations in novel ways to design structures that accomplish their clients' goals while avoiding or taking advantage of legal regimes.³³ Tax shel-

to invest in legal advice to see if there is a way around the law, that precise rules fail to deliver consistency on their own.”); Frederick Schauer, *Playing by the Rules: A Philosophical Examination of Rule-Based Decision Making in Law and Life* 218–19 (Tony Honoré & Joseph Raz eds., 1991) (“[U]nder any plausible and non-question-begging conception of a rule, there will be some cases plainly encompassed by the rule, some plainly not encompassed by the rule, and some whose coverage is doubtful.”); Doreen McBarnet, *When Compliance Is Not the Solution But the Problem: From Changes in Law to Changes in Attitude*, in *Taxing Democracy: Understanding Tax Avoidance and Evasion* 229, 230 (Valerie Braithwaite ed., 2003) (“[I]t is in the nature of law that it is open to different interpretations, and that its meaning and application are arguable.”).

³⁰ See Weisbach, note 9, at 861–62.

³¹ See Joseph Bankman, *The Business Purpose Doctrine and the Sociology of Tax*, 54 *SMU L. Rev.* 149, 150–52 (2001) (describing generational and lawyer-accountant differences in level of comfort with standards); Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 *SMU L. Rev.* 131, 136–37 (2001) (“Good tax lawyers know when they are pushing hard at the edge of the envelope.”); Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 *U. Chi. L. Rev.* 859, 883 (1982) (book review) (“The development of an exquisite set of intuitions about what kinds of transactions the courts ‘like’ and ‘don’t like’ has become a large part of what tax lawyers sell.”).

³² In this sense, private practitioners are like Hart's judges. See Hart, note 28, at 272–73.

³³ Reconstructive interpretations generally are associated with formalism and rule-bound methods of interpretation. See Doreen McBarnet, *It's Not What You Do But the Way You Do It: Tax Evasion, Tax Avoidance, and the Boundaries of Deviance*, in *Unrav-*

ters provide the most extreme examples of reconstructive interpretations, but not all reconstructive interpretations project such impropriety. Practitioners, for example, have combined the partnership tax rules with the rules for real estate investment trusts (REITs) to develop widely accepted legal strategies that give property owners both liquidity and tax deferral in transactions with a REIT.³⁴ Compared to interstitial interpretations, reconstructive interpretations give practitioners more control over the facts they face, within the boundaries of the underlying economics and the extent to which legally relevant facts must reflect those economics.³⁵ Unlike interstitial interpretations, reconstructive interpretations result in client-favorable positions, since clients only implement legal strategies that are expected to provide net benefits, after taking into account development costs, opportunity costs, and the costs of any unfavorable or overcautious advice bundled into the larger plan.³⁶

Reconstructive interpretations also increase lawmakers' costs in designing new rules (and increase the complexity of those rules), since lawmakers must police and anticipate interactions among rules when drafting.³⁷ As a result, many commentators view reconstructive interpretation as intrinsically negative, although private practitioners may see themselves as simply taking advantage of legal regimes that legislators or regulators intended to create.³⁸ Indeed, the line between permissible and impermissible reconstructive interpretation often emerges only after the interpretations have occurred, as courts decide liminal cases. Before courts resolve these cases, private experts may

eling Criminal Justice: Eleven British Studies 257 (David Downes ed., 1992); McBarnet, note 29; Sol Picciotto, *Constructing Compliance: Game Playing, Tax Law, and the Regulatory State*, 29 *Law & Pol'y* 11 (2007). A third category of interpretations, emphasized in the literature on legal endogeneity, involves the development of private procedures that serve to signal compliance with particular public policy. To the extent that government actors explicitly or implicitly accept these private procedures as substitutes for corresponding public processes, the private procedures become the law. See note 22; see also Subsection.A.2.

³⁴ See Michael K. Carnivale, James P. de Bree, Jr., Mark N. Schneider, Charles B. Temkin & Fred T. Witt, Jr., *Real Estate Investment Trusts*, 742 *Tax Mgmt. Portfolio* (BNA) §§ V.A., VI. (2008) (discussing UPREITS and downREITs).

³⁵ Any changes to these underlying facts, however, may represent frictions with respect to the proposed business deal. See David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 *Colum. L. Rev.* 1312, 1326–27 (2001).

³⁶ See Braithwaite, note 29, at 147–49; Picciotto, note 33, at 14–19.

³⁷ See Weisbach, note 9, at 870–71 (noting the “uncommon becoming common” problem).

³⁸ Compare, e.g., Weisbach, note 11, at 224–25 & n.22, with Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 *Tax L. Rev.* 325, 386–87 (2002).

coalesce around general views of acceptable and unacceptable legal interpretations.³⁹

The dynamics of private interpretation affect the speed and substantive direction of planning drift. Planning drift can begin immediately after legislation, depending on client demand for expert interpretations and whether entrepreneurial practitioners develop novel legal strategies using the new law.⁴⁰ For example, wealthy individuals historically have paid only token estate and gift taxes, notwithstanding consistently high statutory rates and periodic loophole-closing legislation. Among experts in estate and gift tax, the conventional wisdom is that private planning is highly responsive to legislative change.⁴¹ Alternatively, consensus may emerge slowly among private practitioners about how to read a statute, and, if these advisors are risk-averse, they may give systematically overcautious advice.⁴² In addition, private parties' demand for specific legal interpretations may rise and fall based on economic conditions. As a result, planning drift may evolve slowly or in periods of punctuated equilibrium. This point is illustrated by the periodic waves of corporate inversions since the early 1980's, in which new legal strategies emerged idiosyncratically in response to market conditions.⁴³ For these reasons, planning drift is highly situational and depends heavily on the relevant public and private actors, as well as the policy at stake.

2. *Policy Communities*

Although private interpretations represent the building blocks for planning drift, these interpretations still must translate into policy

³⁹ See Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 *SMU L. Rev.* 47, 51–52 (2001) (“[E]xperienced tax professionals can usually readily distinguish tax shelters from real transactions.”).

⁴⁰ See Michael J. Powell, *Professional Innovation: Corporate Lawmakers and Private Lawmaking*, 18 *L. & Soc. Inquiry* 423 (1993) (discussing the evolution of “poison pills”). Private practitioners also may affect policy through direct contact with legislators and regulators—that is, through lobbying. To the extent that lobbying activities inform government actors about the content of, or persuade them about the rationale behind, private interpretations, these activities may play a role in planning drift. If lobbying activities represent a more straightforward purchase and sale of legislation, as under a public choice model, then planning drift is not implicated.

⁴¹ See George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 *Colum. L. Rev.* 161, 162–63 (1977) (arguing that, after statutory reforms in 1976, “today’s multimillionaires, as well as persons of lesser wealth, no more need pay a stiff estate and gift tax than did their predecessors”).

⁴² See Donald C. Langevoort & Robert K. Rasmussen, *Skewing the Results: The Role of Lawyers in Transmitting Legal Rules*, 5 *S. Cal. Interdisc. L.J.* 375 (1997).

⁴³ See Hal Hicks, *Overview of Inversion Transactions: Selected Historical, Contemporary, and Transactional Perspectives*, 30 *Tax Notes Int'l* 899 (June 2, 2003); see also text accompanying notes 108–10.

change, and the concept of policy communities helps bridge this gap.⁴⁴ Policy communities are networks of public and private political actors that facilitate planning drift by allowing the circulation of private practitioners' legal interpretations and policy judgments.⁴⁵ To the extent these interpretations and judgments become known and accepted within a policy community, they can affect community members' practices. These practices can lead to de facto policy change, unless the legislature or an agency intervenes. Even if government intervenes, these practices can shape public policy by affecting the substantive content of the intervention, resulting in planning drift.⁴⁶ In addition, if public-sector experts and private-sector experts belong to the same policy community, public-sector experts may be persuaded by private legal interpretations (and any concomitant policy positions) that circulate within the policy community.⁴⁷ Again, planning drift occurs. In these ways, policy communities represent an important part of the mechanism of planning drift, and their existence across the public-private divide distinguishes planning from phenomena such as agency capture, in which private actors exert unidirectional influence over

⁴⁴ The policy community literature has both a British strand, see David Marsh & R.A.W. Rhodes, *Policy Networks in British Government* 13–14, 249–68 (1992); Grant Jordan & Paul Cairney, *What Is the “Dominant Model” of British Policymaking? Comparing Majoritarian and Policy Community Ideas*, 8 *Brit. Pol.* 233, 238 (2013), and a U.S. strand, see John W. Kingdon, *Agendas, Alternatives, and Public Policies* 124 (1984); Hugh Hecló, *Issue Networks and the Executive Establishment*, in *The New American Political System* 87 (Anthony King ed., 1978). The British strand has developed the concept more completely, and this Article draws significantly on this scholarship, as well as Julian Zelizer's work on the post-World War II tax policy community and the insights of the new institutionalism in political science and history. See Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945–1975*, at 8–11, 117–18, 362–65 (1998); *The Democratic Experiment: New Directions in American Political History* (Meg Jacobs, William J. Novak & Julian E. Zelizer eds., 2003). For general reviews of the policy community literature, see Keith Dowding, *Model or Metaphor? A Critical Review of the Policy Network Approach*, 43 *Pol. Stud.* 136 (1995); Grant Jordan, *Policy Community Realism Versus “New” Institutional Ambiguity*, 38 *Pol. Stud.* 470 (1990). To some extent, policy communities provide an alternative to more deterministic political science models such as “iron triangles,” which describe rigid alliances among members of Congress, administrative agencies, and special interests. See Hecló, *supra*, at 88 (“[T]he iron triangle concept is not so much wrong as it is disastrously incomplete.”); Anne Joseph O’Connell, *Political Cycles of Rulemaking: An Empirical Portrait of the Modern Administrative State*, 94 *Va. L. Rev.* 889, 977–78 (2008) (“The idea that the President better represents the public interest because he faces a national electorate and that members of Congress operate only in ‘iron triangles’ with special interests lacks needed complexity.”).

⁴⁵ The idea of experts forming influential, semi-autonomous groups draws on the literature on historical institutionalism. See Daniel P. Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862–1928* (2001); Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (1982).

⁴⁶ See Subsection II.A.4.

⁴⁷ See Gergen, note 31, at 138 (“In a novel case the best guide may well be professional common knowledge.”).

regulators. This Subsection discusses policy communities and the ways in which they affect planning drift, and then concludes with an example from taxation.

Policy communities are stable, restricted networks of people oriented toward, and connected by their interest in, a specific area of public policy. Policy communities are characterized by their membership, organization, distribution of authority, and autonomy, although not every policy community has all of these traits to the same degree. Unlike other informal networks of political actors, policy communities have limited membership. Although not regulated in a formal sense, policy communities' membership typically reflects shared professional or economic backgrounds and interests, as well as expertise on specific policy issues. In terms of organization, policy communities are highly integrated, in the sense that they are bound together by similar political values, language, and culture, which are disseminated and reinforced by interpersonal interactions and community institutions. Notwithstanding these common interests, policy communities are not necessarily ideologically homogeneous or static in their prevailing beliefs. Rather than dictating members' policy positions, policy communities recognize the legitimacy of outcomes generated through members' common intellectual framework. Authority within a policy community is distributed and nonhierarchical. All members have some voice in the community, though some members' voices may carry more weight than others. Policy communities are substantially autonomous, in that they operate outside of ordinary electoral politics and majoritarian influence. While policy communities may engage with and respond to the broader political environment, they are more accountable to internal forces than external ones.⁴⁸ Finally, it is important to note that policy communities are like unhappy families: Each community functions in idiosyncratic ways that depend on its membership, policy focus, history, and relationship to other political institutions.⁴⁹

Policy communities affect public policy through internal debates, the sharing of information, and the development of interpretive norms. Internal debates and information sharing may be formal or informal and mediated by individual members or community institu-

⁴⁸ See Zelizer, note 44, at 10 (arguing that a "culture of tax policy" gave "a considerable degree of coherence" to the tax policy community); Kingdon, note 44, at 124 (arguing that a policy community "hums along on its own, independent of such political events as changes of administration and pressure from legislators' constituencies").

⁴⁹ These idiosyncrasies, in part, motivate this Article's case study approach. See, e.g., Marsh & Rhodes, note 44 (presenting eight case studies on various substantive topics).

tions.⁵⁰ Critical is that practitioners' interpretations and policy judgments circulate among a receptive group of experts. Policy communities also can function as "interpretive communities," groups with "mutuality of interpretation" and "shared and informed understandings" about the law's meaning and application.⁵¹ These understandings, which themselves are negotiated and contested within the community, can apply to both interstitial interpretations (creating "certainty") and reconstructive interpretations (precluding "creative compliance").⁵² Practitioner interpretations, if crafted in accordance with community norms, may persuade other members to adopt similar views. For planning drift to occur, these interpretations do not have to dominate the community but instead only need to be plausible and justifiable under community norms. For example, influential practitioners' views may be prominent enough to affect subsequent government responses, even if they represent a minority position within the policy community. Similarly, minority positions may affect practice to an extent that government must either respond to or effectively permit such interpretations. Both of these outcomes can result in planning drift. Policy communities may, but do not have to, include experts from both the private and public sectors. In this case, information sharing, debates, and prevailing interpretations can transmit private practitioners' legal interpretations to public officials. Where public officials adopt these private interpretations and the policy positions they entail, planning drift occurs.⁵³

An example of a policy community is the group of lawyers and other experts, inside and outside of government, involved with tax policy in the United States.⁵⁴ This tax policy community reflects a strong substantive focus, and is characterized by personal, professional, and intellectual connections, some of which cross the traditional boundary between public and private. Although legal training and bar passage initiate lawyers into a closed community of like-

⁵⁰ Information sharing also may include formal political activities, such as lobbying. See note 40.

⁵¹ See Julia Black, *Rules and Regulators* 30-37 (1997).

⁵² See *id.* (drawing on Stanley Fish's term).

⁵³ Officials can influence rulemaking directly, when, for example, they themselves work on a regulatory initiative, or indirectly, by circulating their policy views within the relevant agency—or by not acting at all.

⁵⁴ These experts include nonlawyer interpreters of the Code such as accountants, who frequently make judgments when determining reporting positions that require the interpretation of statutes, regulations, and other legal authorities. For current and historical examples of these types of judgments, see Susan B. Schwab, *Bringing Down the Bar: Accountants Challenge Meaning of Unauthorized Practice*, 21 *Cardozo L. Rev.* 1425, 1425-27 (2000) ("For the past decade, accountants have been slowly encroaching into territory that was once within the sole domain of the legal profession.").

mindful professionals,⁵⁵ training in tax law is even more specialized. Members of the tax policy community are connected by professional affiliations with bar associations, such as the tax sections of the American Bar Association and the New York State Bar Association, discussion groups such as the Tax Club and Tax Forum, and employment or partnership at elite law firms.⁵⁶ The tax policy community is close-knit and integrated, both through the exchange of personnel among the public and private sectors (sometimes called a “revolving door”) and through common institutions, such as tax-specific practitioner publications, conferences, and educational events.⁵⁷ Many voices carry weight in the tax policy community, which makes it reasonably democratic.⁵⁸ Finally, the tax policy community operates largely autonomously from conventional political cycles. These features give coherence to the tax policy community and also enable the dissemination of ideas that can lead to planning drift.

3. *First-Mover Advantage*

Once private practitioners’ legal interpretations gain currency within the relevant policy community, these interpretations can lead to planning drift by giving private practitioners a first-mover advantage in the interpretation of new legislation. This first-mover advantage manifests itself in three ways, discussed below. Private practitioners’ first-mover advantage can allow private parties to capture benefits with respect to new statutes—benefits that accrue only because private practitioners take the first interpretive cut at legislation.

First, significant time often elapses between legislation and rulemaking, and this period gives private practitioners an opportunity to make initial attempts at legal analysis. In order to issue regulations, agencies not only must develop substantive expertise, but they

⁵⁵ See Jonathan R. Macey, *Lawyers in Agencies: Economics, Social Psychology, and Process*, 61 *Law & Contemp. Probs.* 109, 113 (1998) (arguing that legal training “brings with it a complex socialization process in which ‘civilians’ are transformed not only into lawyers, but also into members of an elite, powerful, highly selective, special interest group: the legal profession.”).

⁵⁶ See W. Bradley Wendel, *Professionalism as Interpretation*, 99 *Nw. U. L. Rev.* 1167, 1215–16 (2005).

⁵⁷ See, e.g., Schizer, note 14, at 348–49 (advocating increased personnel exchange between private practice and public service). *Tax Notes*, a periodical for the tax community, publishes a biweekly summary of “personnel changes within the tax community.” These summaries illustrate the flows of people between the public and private sectors, as well as among law and accounting firms. See, e.g., Andy Sheets, *Moves and Appointments*, 2016 *TNT* 117–12 (Jun. 17, 2016), available in LEXIS, *Tax Analysts File*.

⁵⁸ For example, *Tax Notes and Taxes: The Tax Magazine* publish articles by a wide range of practitioners from across the United States.

also must become versed in the underlying statute, including its scope, content, and purpose. Agencies, however, face resource constraints in developing this type of knowledge, especially compared to larger and better-funded groups of private practitioners.⁵⁹ The legislature also may impose procedures that build delay into the rulemaking process through, for example, notice and comment requirements.⁶⁰ Because planning drift can begin at any time after the legislature enacts a statute, while formal rulemaking generally occurs only after some delay, private practitioners have an opportunity to develop statutory interpretations before regulators.⁶¹ These interpretations may circulate within the policy community, potentially crossing public-private lines, and practitioners may draw on these interpretations to advocate for their preferred policies before regulators or legislators.⁶² In this way, practitioners' early interpretations of statutes can set the trajectory for agency rulemaking and any subsequent legislative correction, leading to planning drift.

A second first-mover advantage is that private practitioners' legal interpretations also operate as a form of agenda control with respect to subsequent rulemaking and legislative interventions. Again, the timing of these legal interpretations is important. Assume that, when legislation is enacted, the agency charged with implementation prefers Policy A, the same policy preferred by the enacting legislature. The agency is resource-constrained, and procedural requirements impose a delay between enactment and rulemaking. During this delay, private practitioners produce interstitial and reconstructive interpretations of the statute for their clients, and some of these interpretations implement Policy B, which differs from Policy A. If these interpretations become known within the policy community, the relevant agency risks the implication that these interpretations "work" unless addressed

⁵⁹ See Schizer, note 14, at 334–35, 338–39.

⁶⁰ Scholars have cited the delay caused by administrative procedures, such as those under the Administrative Procedure Act (APA), as a possible constraint on bureaucratic drift. See McCubbins et al., *Structure and Process*, note 17, at 440–43. This delay, however, generally empowers future legislatures and risks legislative drift. This tension has been described as the "drift trade-off." See Kenneth A. Shepsle, *Bureaucratic Drift, Coalitional Drift, and Time Consistency: A Comment on Macey*, 8 *J.L. Econ. & Org.* 111, 115 (1992).

⁶¹ The speed of planning drift depends on the specifics of legal interpretation, including client demand, as well as the dynamics of the relevant policy community. See text accompanying notes 40–43, 50–53.

⁶² For example, in informal agency rulemaking, lawyers often "provide legal arguments for interpreting the relevant statute consistently with their clients' positions, present technical and economic studies in the light most favorable to their positions, and marshal policy arguments to support their preferred outcomes." Thomas O. McGarrity, *Administrative Law as Blood Sport: Policy Erosion in a Highly Partisan Age*, 61 *Duke L.J.* 1671, 1748 (2012); see also note 40.

specifically in rulemaking. Reconstructive interpretations create loopholes that require targeted fixes, while interstitial interpretations can cause practitioners to focus the agency's attention on specific gaps in the law to the exclusion of other ambiguities. The agency cannot simply promulgate rules consistent with Policy A; it also must repudiate Policy B. These remedial efforts have opportunity costs, in that they divert the agency's finite resources away from efforts to implement its preferred policy, as well as potential structural costs, in that legal or policy mistakes in remedial rulemaking may have unintended or adverse consequences going forward. These additional costs lead to planning drift.⁶³

Finally, once an interpretation becomes prevalent among private practitioners, they and their clients may develop a sense of entitlement to that legal rule.⁶⁴ Private parties often advance reliance arguments to justify a continuation of the status quo, even when those same parties previously played a role in constructing that status quo.⁶⁵ This resistance to legal change is consistent with theories in behavioral economics that legal entitlements may cost more to remove than to create.⁶⁶ Private parties may fight to maintain existing legal interpretations even when, under a public choice approach to legislation and regulation, they would not have been willing to spend the capital necessary to achieve these interpretations through the formal political process.

Private practitioners' first-mover advantage is evident in the Wall Street Rule,⁶⁷ which stands for the proposition that the IRS will not

⁶³ Similarly, future legislatures must account for planners' interpretations when crafting subsequent legislation in the same policy space.

⁶⁴ See, e.g., Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. Pa. L. Rev. 47, 74–75 (1977) (discussing and dismissing the idea of “fairness as reliance” for taxpayers’ “institutionally induced expectations”); David M. Hasen, *Legal Transitions and the Problem of Reliance*, 1 Colum. J. Tax Law 120, 155–56 (2010) (responding to Graetz’s critique).

⁶⁵ For example, tax lawyers and their clients have used reliance arguments to resist carried interest reform, which would deny favorable tax treatment to returns on certain partnership interests held by investment fund managers. See, e.g., Michael J. de la Merced, *Dealbook: Schwarzman’s Unfortunate War Analogy*, N.Y. Times, Aug. 16, 2010. Similarly, tax practitioners have argued against contractions in the scope of activities that can be conducted by publicly traded partnerships, citing the potential for such changes to “roil markets.” See Amy S. Elliott, *ABA Section of Taxation Meeting: PTP Ruling Pause Expected to Be Short*, 143 Tax Notes 769 (May 19, 2014) (quoting Robert J. Crnkovich).

⁶⁶ Under the endowment effect, individuals value an object that they possess more than the same object held by someone else. See Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 1 J. Econ. Persp. 193, 194 (1991). For an argument that legal compliance itself implicates the endowment effect, see David E. DePianto, *Sticky Compliance: An Endowment Account of Expressive Law*, 2014 Utah L. Rev. 327, 349–56.

⁶⁷ See text accompanying notes 8–12.

challenge tax positions accepted within the private practitioner community.⁶⁸ Under the classic formulation of the Wall Street Rule with respect to financial products, once issuers have released a substantial dollar amount of a financial instrument to the public, private practitioners assume that the IRS will defer to the issuers' treatment of the instrument for federal income tax purposes.⁶⁹ By taking the initiative with respect to a legal position, private practitioners in effect can foreclose the IRS's preferred policy.⁷⁰ Sometimes, the IRS explicitly accepts private legal interpretations by issuing formal guidance consistent with "Wall Street practice," even when the guidance does not clearly follow from either a plain reading of the relevant statute or general policy principles. For example, in Revenue Ruling 2002-31,⁷¹ the IRS essentially adopted some practitioners' treatment of certain contingent convertible debt instruments. This treatment granted significantly higher interest deductions to issuers than alternative treatments that also had significant support within the tax policy community.⁷² Although commentators and the IRS acknowledged the complexity of the underlying policy issues, the IRS hewed towards a more generous position, even as it called for further comments from practitioners on the issue.⁷³ The Wall Street Rule illustrates how practitioners' ability to interpret statutes immediately after enactment can generate planning drift.

4. *Legislative and Agency Interventions*

Where private practitioners' legal interpretations diverge from an enacting legislature's policy preferences with respect to a statute, a subsequent legislature and the relevant administrative agency may

⁶⁸ The Wall Street Rule in taxation also is known as the "de Kosmian rule." See Jasper L. Cummings, Jr., Letter to the Editor: A Short History Lesson, 86 Tax Notes 1169 (Feb. 21, 2000).

⁶⁹ See Blank, note 8, at 1654-55; Fleischer, note 8, at 286-87.

⁷⁰ Indeed, IRS protests against the Wall Street Rule and practitioners' outrage when the rule is violated both speak to the rule's power. But see Sam Young & Lee A. Sheppard, Korb Slams Textron Ruling, Wall Street Rule, 117 Tax Notes 204, 204 (Oct. 15, 2007) (quoting IRS Chief Counsel Donald Korb as saying, "Nothing is too big or too old," although he had no specific targets in mind); Robert S. Bernstein, Wall Street Rule Broken; IRS Challenges Commodity Mutual Funds, 33 Corp. Tax'n 36 (2006) (arguing that Rev. Rul. 2006-1, 2006-1 C.B. 261, which reversed some practitioners' opinions that commodity derivative swaps were qualifying assets and produced qualifying income for purposes of the regulated investment company tests under § 851, "had the effect of drawing into question the continued tax qualification of one or more of the nation's largest and fastest growing mutual funds").

⁷¹ Rev. Rul. 2002-31, 2002-1 C.B. 1023.

⁷² See Dana L. Trier & Lucy W. Farr, Rev. Rul. 2002-31 and the Taxation of Contingent Convertibles, Part 1, 95 Tax Notes 1963, 1964 (June 24, 2002).

⁷³ See Notice 2002-36, 2002-1 C.B. 1029.

adopt the divergent interpretations, either expressly or through inaction, or intervene to correct the divergent interpretations. Express adoption by the legislature or an agency leads to planning drift; the more interesting situations involve government inaction and interventions. This Subsection first addresses government inaction, and then turns to legislative and administrative interventions.

Planning drift does not require express government action by either an agency or the legislature. Instead, inaction with respect to private practitioners' legal interpretations can result in policy change. Critical to the analysis are the facts that government decisionmaking is coalitional and that government preferences are heterogeneous. These facts make it less likely that the legislature or an agency will be able to summon the collective impetus to act. The basic model of bureaucratic drift illustrates this point with respect to legislative action. In a simplified version of the legislative process, called the "statute game," the legislature is composed of three members—the House, the Senate, and the President—each of which effectively has veto power over new legislation. In order to pass, a statute must improve on existing public policy from each member's perspective.⁷⁴ Under the reasonable assumption that each member has different policy preferences, the statute's content depends on each member's relative bargaining power and—critically—existing law, which determines the value of the new policy to each member. That is, the starting point of existing law, including any private legal interpretations of that law, determines how much better or worse the new policy is for each member of the legislature.⁷⁵ If private practitioners interpret the statute in a way inconsistent with the new policy, legislative correction is possible only if the policy represented by the practitioners' interpretations is undesirable for each of the three members. Because each member can veto, no legislative correction is possible if at least one member prefers the practitioners' interpretations.⁷⁶ If no legislative correction occurs, then these interpretations are *de facto* incorporated into public policy, and planning drift results. Although administrative agencies typically lack members with formal veto authority, inaction by agencies—a

⁷⁴ That is, the statute must fall within the legislature's Pareto optimal set, in which all three members are better off and no member is worse off. See McCubbins et al., *Structure and Process*, note 17, at 439.

⁷⁵ See *id.* at 432–33. This simplified model ignores features of the legislative process, such as committees and constitutional constraints (including the requirement that revenue bills originate in the House), as well as the possibility that the Senate and House themselves require internal coalitions. Adding these features only reinforces the path dependence of policy change. See DeShazo & Freeman, note 26, at 1517 (arguing "that agency policy decisions might track the multiple and potentially contradictory messages they receive from Congress" with the result that bureaucratic drift presents less of a problem).

⁷⁶ The same is true for legislative corrections of bureaucratic drift.

very real phenomenon—also allows practitioners' interpretations to continue uncorrected.

If legislative action is possible, the policy content of the legislative intervention depends on another round of the statute game. In the interim, the legislative coalition may have changed, preventing the prior coalition's policy from being re-enacted.⁷⁷ Furthermore, the legislature plays the second round of the statute game with a new starting point: the first round's law as interpreted by private practitioners. Even if the first round's coalition remains intact, the second round of the statute game will produce different results to the extent coalition members have different preferences with respect to practitioners' interpretations.⁷⁸ According to McCubbins, Noll, and Weingast:

[T]his is the problem of “history dependence” or “reactive enforcement” in legislative processes. . . . [T]he outcome of a legislative attempt to rectify an act of noncompliance by an agency [or, in this case, private actors] will not, in general, reproduce the policy outcome that was sought by the winning coalition, even if the preferences of the members of the legislative body remain unchanged.⁷⁹

In this sense, policy change is path dependent, and changes in law, even through private interpretation, can preclude a full recovery of the enacting legislature's policy preferences.⁸⁰

⁷⁷ It is possible that planning drift (or bureaucratic drift, or a combination of the two) can exactly compensate for changes in the enacting coalition, with the result that the new coalition's policy preferences match those of the enacting coalition. This outcome requires extraordinary coincidence. See McCubbins et al., *Structure and Process*, note 17, at 439.

⁷⁸ See Horn & Shepsle, note 18, at 502.

⁷⁹ *Id.* at 433.

⁸⁰ In taxation, some scholars have described the promulgation-planning-correction process as a “cat-and-mouse” game between the government and taxpayers. See, e.g., George K. Yin, *Getting Serious About Corporate Tax Shelters: Taking a Lesson from History*, 54 *SMU L. Rev.* 209, 216–17 (2001); Cunningham & Repetti, note 20, at 33; see also Schizer, note 35, at 1314–15 (arguing that incremental reforms “[s]ometimes . . . stop the targeted transaction” but “in other cases taxpayers press on, tweaking the deal just enough to sidestep the reform.”). The cat-and-mouse metaphor implies a stalemate in which both parties' goals are fixed and unachievable. The cat (Congress or Treasury) cannot capture the mice (taxpayers), and the mice reciprocally cannot escape the cat. This Article argues that this iterative interaction is not a stalemate, but instead can lead to policy change. For example, the cat is not a unitary decisionmaker but instead a coalition of political actors. See text accompanying notes 77–84. Because private practitioners and government actors are in dialogue with each other, this iterative process affects how law and policy develop. See, e.g., Picciotto, note 33, at 19–21 (“The various interactions between the tax authorities and the professional advisers of internationally operating businesses over a long period of time helped to *construct* the international tax system”) (emphasis in the original).

Agency rulemaking also can correct private practitioners' legal interpretations.⁸¹ These administrative corrections are unlikely, however, to reflect the agency's preferred policy in the absence of private practitioners' interpretative efforts, even if the corrections disallow or reverse practitioners' interpretations. Like legislation, rulemaking emerges from a coalition of interests. Agency organization and rulemaking processes, accountability to different legislative and administrative principals, and personal policy convictions combine to make rulemaking a heterogeneous process.⁸² Although agency officials may not be able to veto regulations, they can affect regulations' timing and content through their formal or informal roles in the rulemaking process.⁸³ Officials whose policy preferences align with private interpretations of a statute have an advantage in the regulatory process, since agency inaction and delay represent "good" outcomes from these officials' perspectives. For this reason, the starting point for rulemaking matters, and administrative interventions are likely to differ from the agency's preferred rulemaking in the absence of any private interpretations. Agency heterogeneity implies that regulation is path dependent, and that, as in legislation, agency corrections reflect private interpretations between the enactment of a statute and rulemaking.⁸⁴ In this way, private interpretations affect the path of agency rulemaking and lead to planning drift.⁸⁵

⁸¹ These corrections, of course, can result in bureaucratic drift.

⁸² See DeShazo & Freeman, note 26; James T. Hamilton & Christopher H. Schroeder, Strategic Regulators and the Choice of Rulemaking Procedures: The Selection of Formal vs. Informal Rules in Regulating Hazardous Waste, 57 *L. & Contemp. Probs.* 111 (1994); Terry M. Moe, The Politics of Structural Choice: Toward a Theory of Public Bureaucracy, in *Organization Theory: From Chester Barnard to the Present and Beyond* 116, 143–46 (Oliver E. Williamson ed., 1990).

⁸³ In taxation, the Office of Chief Counsel, formally located in the IRS, prepares the initial draft of regulations, often with input from an attorney-advisor from Treasury's Office of Tax Policy and other personnel at Treasury or the IRS. One or more reviewers (typically, attorney-advisors or supervisory personnel at Treasury) must approve the draft. Next, the draft is circulated for comment to other personnel at the IRS and Treasury, as well as front-office IRS officials. Then, the draft goes to the Chief Counsel, the Commissioner of Internal Revenue, and the Assistant Secretary of the Treasury for Tax Policy for final sign-off, after which proposed regulations are published in the Federal Register. Proposed regulations often reflect a consensus among these various constituents that emerges through debate and compromise. See IRC § 7803(b); Reg. § 601.601(a)(1); IRM 32.1.1 (Sept. 23, 2011), available at http://www.irs.gov/irm/part32/irm_32-001-001.html; Michael Saltzman & Leslie Book, *IRS Practice and Procedure* ¶ 3.02 [3] (2013); see also Amy S. Elliott, Treasury Officials Explain New Bottom-Dollar Guarantee Rules, 142 *Tax Notes* 904 (Mar. 3, 2014) (quoting a Treasury official who stated that "[t]here were a lot of internal debates" on the proposed regulations regarding bottom-dollar guarantees in leveraged partnerships).

⁸⁴ If agencies are unitary actors, then the starting point does not matter, and agencies can make rules that reflect any policy (subject to correction by the legislature).

⁸⁵ Given the modern administrative state's extensive reliance on private parties to implement legislation, a savvy legislature may anticipate planning drift and adjust legislation

The foregoing analysis, like much of the drift literature, treats law and public policy as continuous, while in practice either may be discrete or discontinuous.⁸⁶ In these situations, legislative and administrative interventions are more likely to be able to recover the enacting legislature's preferred policy. For example, assume that a policy domain has only two options, Policy A and Policy B, with no intermediate positions. The legislature intends to enact Policy A using a particular statute, but private interpretations of the statute implement Policy B. If the relevant agency's reaction to these private interpretations is to promulgate rules reflecting Policy A, then, after agency rulemaking, there is no net policy drift with respect to the enacting legislature's preferences. Administrative action intended to stop tax shelters may follow this pattern.⁸⁷ Whether law and policy is continuous or discrete is a question of degree and context, but the menu of options is rarely as narrow as in the foregoing example. In many situations, the range of policy and legal choices available to legislatures and agencies means that private interpretations are likely to affect the content of these actors' corrections and thus policy development.

B. Factors that Facilitate Planning Drift

Planning drift does not affect all legislation or areas of law equally.⁸⁸ This Section discusses various factors that facilitate plan-

accordingly. As a positive matter, however, Congress and the President generally do not enact legislation that explicitly anticipates planning drift, and, in practice, this legislative strategy is complicated and risky. To anticipate planning drift, the legislature must know private practitioners' policy preferences and interpretive predilections. Accurate information may be costly or difficult to obtain. Furthermore, *ex ante* predictions of planning drift may have a high variance, yielding a substantial range of potential policy outcomes. Because planning drift occurs over time, the legislature also must tolerate some period of suboptimal policy following enactment. For these reasons, a risk-averse legislature may prefer strategies that limit or avoid planning drift to strategies that anticipate and incorporate private interpretations. See Matthew C. Stephenson, *Optimal Political Control of the Bureaucracy*, 107 Mich. L. Rev. 53 (2008); see also Sections II.C and IV.A. Finally, for this legislative strategy to work, a policy position that incorporates planning drift must exist and also be political palatable. Unless the electorate also accounts for planning drift, the legislature may be unable to enact legislation that anticipates planning drift without facing adverse political consequences.

⁸⁶ Cf. McCubbins et al., *Structure and Process*, note 17, at 494 (discussing EPA regulations and arguing that if they "were imposed discontinuously—in the form of a one-time substantial cost shock—some firms could be bankrupted and some facilities closed.").

⁸⁷ For example, the IRS designates "listed" transactions that taxpayers must disclose, effectively preventing these or similar transactions from occurring. See IRC § 6707A; see also Notice 99-55, 1999-2 C.B. 761.

⁸⁸ The same is true for bureaucratic drift and legislative drift. See, e.g., David Schoenbrod, *Goals Statutes or Rules Statutes: The Case of the Clean Air Act*, 30 UCLA L. Rev. 740, 783-89 (1983) (differentiating between "goals statutes" and "rules statutes" in terms of interpretive discretion and flexibility).

ning drift. This list is representative rather than exclusive; it provides guidance about where planning drift may occur. To confirm whether planning drift affects specific legislation or an area of law, it is necessary to perform a more in-depth study of the facts, policy, and people involved.

1. *Technical Areas of Law*

In general, the more technical an area of law, the more likely that planning drift will affect it.⁸⁹ Technical areas of law have two important characteristics: They are complex, and they foster specialization by the experts charged with their interpretation. Complex areas of law have many interrelated pieces expressed through esoteric terminology within an intricate structure. Legal consequences depend on detailed, comprehensive analysis, and small changes in inputs or legal interpretations may cause large variations in outcomes.⁹⁰ In addition, complexity increases opportunities for legal interpretations by fostering gaps that require interstitial interpretations and interrelated provisions that facilitate manipulation through reconstructive interpretations. If government actors, such as administrative agencies, face resource constraints, they may have trouble policing private legal interpretations that involve technical areas of law. Technical areas of law increase the opportunities for interpretation as well as the potential benefits of favorable interpretations.

The choice between rules and standards in legislation also has implications for complexity, and therefore for planning drift. As categories of legal instruments, rules provide *ex ante* guidance, while standards are developed *ex post*. Legal complexity does not necessarily depend on the choice between rules and standards. If the law's essential content is complex, then both rules and standards will reflect this complexity after full development.⁹¹ In certain situations, however, the rules or standards choice has implications for complexity. If private practitioners are especially active in an area of law, they may take advantage of the certainty surrounding rules to develop reconstructive interpretations that contravene the enacting legislature's policy preferences. These interpretations may become common, requiring additional rules to guide private practitioners and foreclose these

⁸⁹ Like the other items discussed in this Section, the technical nature of law falls on a continuum rather than a binary.

⁹⁰ See Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 *L. & Contemp. Probs.* 673 (1969); see also Weisbach, note 9, at 867–68 (describing complexity “as the number of lines or the degree to which the lines match the underlying terrain in a topological map”).

⁹¹ See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 *Duke L.J.* 557 (1992).

reconstructive interpretations. The result is a vicious circle of increasingly complex rules. The intrinsic uncertainty surrounding standards can interrupt this positive feedback loop, depending on how the relevant policy community interprets the standard.⁹² To the extent that rules correlate with complexity (and they may in areas of law otherwise subject to planning drift), planning drift is more likely to occur with respect to rule-bound areas of law.⁹³

Technical areas of law also encourage specialization by practitioners, and this specialization nurtures the policy communities that mediate planning drift. Specialization binds a policy community together in several ways. Specialization-specific credentials, experience, and affiliations identify members of the policy community and effectively exclude nonmembers, creating a collar on community membership. Too few participants preclude a cognizable and meaningful community, while too many members risk a breakdown of community bonds. In this way, specialization provides a vehicle for integrating the policy community. Shared subject matter—inaccessible to outsiders—creates a foundation for the types of interactions and institutions that encourage a cohesive policy community. Specialization also reinforces a policy community's autonomy. As members consolidate authority within their specialization, outsiders may defer to the policy community's judgments or reasoning on the basis of this expertise. Even if outsiders do not defer to the policy community, they may find the debate difficult or impossible to engage. Voices within the policy community may carry more weight relative to outsiders, and the policy community may gain separation and independence from formal political institutions. Out of these types of specialized policy communities come the private interpretations that drive planning drift.

Tax law provides an example of how a technical area of law can lead to planning drift. With its nuanced structure, jargon, and interconnected provisions, tax law generally meets the criteria of complexity.⁹⁴ The tax provisions for corporations may be complex not only as a positive matter but perhaps also structurally.⁹⁵ Corporate tax law has

⁹² If practitioners develop their own interpretations of standards, the uncertainty surrounding standards may be overstated. As a result, the differences in complexity between rules and standards may be overstated under Weisbach's "common becoming uncommon" argument. See Weisbach, note 9, at 869.

⁹³ See *id.* at 872–77; Kaplow, note 91.

⁹⁴ See Tanina Rostain & Milton C. Regan, Jr., *Confidence Games: Lawyers, Accountants, and the Tax Shelter Industry* 7 (2014) ("Tax practice is extremely complex, and tax lawyers inevitably must exercise considerable discretion.").

⁹⁵ See David A. Weisbach, *The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in the Corporate Tax*, 60 *Tax L. Rev.* 215, 215 (2007) (arguing that "[t]here is no way out" of the dilemma between theoretically pure corporate taxation and an administrable system).

produced a robust policy community of public and private experts—a policy community evidenced by significant barriers to entry, circulation of ideas through both formal and informal means, and ready exchange of personnel between public service and private practice. Private experts' legal interpretations have influenced the contours of corporate tax law. Private practitioners, for example, have interpreted pro-taxpayer corporate tax regimes, such as the rules exempting qualifying REITs from corporate-level tax, in expansive ways that have garnered acceptance among both public and private experts.⁹⁶

2. *Sophisticated Targets*

Planning drift is more likely when legislation affects sophisticated targets.⁹⁷ For this purpose, sophistication implies an active awareness of and engagement with the legal environment, either in general or on specific issues. Sophisticated targets often view the law as a tool rather than an imperative, and they may hire specialized experts to plan and structure their activities.⁹⁸ Legislation does not have to target sophisticated taxpayers specifically for planning drift to occur. In corporate taxation, for example, a relatively small number of highly sophisticated taxpayers drive demand for high-level legal interpretations and tax planning.⁹⁹ The resulting planning drift has implications for the entire corporate sector. In this way, a few sophisticated targets can produce planning drift with respect to generally applicable areas of law.

3. *Delay Before Agency Interpretation*

One of the central findings of the drift literature is that the legislature can use delay between legislation and agency interpretation to manage bureaucratic drift.¹⁰⁰ More onerous administrative procedures give the legislature time to intervene before a wayward agency

⁹⁶ See text accompanying note 34.

⁹⁷ See Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. Chi. L. Rev. 601, 668–71 (2007) (“Sophisticated taxpayers are more likely to develop tax-driven contractual norms [that facilitate tax planning] than those lacking tax and financial acumen.”)

⁹⁸ See Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 Tax Notes 1775 (June 21, 1999); Fleischer, note 8, at 281–82. But see Raskolnikov, note 97, at 670 (“It is not [always] crystal clear who is sophisticated and who is not.”).

⁹⁹ For example, in 2011, the top 0.05% of corporate taxpayers earned more than half of the gross receipts reported by the entire corporate sector. See IRS, *Statistics of Income 2011: Corporation Income Tax Returns 35–36 tbl.2* (2013), available at <https://www.irs.gov/pub/irs-soi/11coccr.pdf>.

¹⁰⁰ Delay also may result from shirking by the relevant agency, which leads to bureaucratic drift. See Gersen & O’Connell, note 17, at 932–33.

promulgates final rules.¹⁰¹ Process-driven delays also allow diffuse interest groups to educate themselves, organize, and lobby for their preferred policy.¹⁰² If the legislature uses delay to manage bureaucratic drift, one cost may be increased planning drift, which operates in the same temporal space between legislation and agency rulemaking.¹⁰³ Significant delay also may allow tax practitioners to overcome any risk aversion associated with filling statutory gaps and implementing novel transactional structures. As legislation ages, tax practitioners may become comfortable with their peers' more aggressive legal interpretations, both interstitial and reconstructive, and these minority interpretations may become mainstream within the tax policy community.¹⁰⁴

As a result, statutes that impose delay-causing procedures on agencies, either under the APA or in addition to it, are more likely to produce planning drift. By contrast, the legislature may constrain planning drift by delegating to agencies that engage in significant amounts of informal rulemaking (that is, agency actions not subject to formal APA procedures).¹⁰⁵ Treasury, for example, takes the position that most of its regulations are interpretive and not subject to APA requirements, and Treasury also issues substantial amounts of informal guidance. For example, before *Mayo Foundation for Medical Education and Research v. United States*,¹⁰⁶ Treasury frequently engaged in informal rulemaking procedures, taking the position that many of its regulations were interpretive and exempt from formal APA procedures. In addition, Treasury historically has issued substantial amounts of informal guidance, as well as solicited input from regulated parties before finalizing its position.¹⁰⁷ Prompt formal or infor-

¹⁰¹ McCubbins et al., Structure and Process, note 17, at 441–43.

¹⁰² Macey, note 17, at 675–76; see Emily Hammond Meazell, Presidential Control, Expertise, and the Deference Dilemma, 61 Duke L.J. 1763, 1795–96 (2012) (discussing how delay can result when one agency regulates another).

¹⁰³ Delay has other costs. Delay defers the potential benefits of good (or uncontroversial) rulemaking. McCubbins et al., Structure and Process, note 17, at 443. Diffuse interest groups also may dissipate in the interim, leaving only well-organized, persistent special interests to participate in the administrative process. Macey, note 17, at 675–76.

¹⁰⁴ This process is idiosyncratic, in that the tax policy community does not adopt all aggressive positions.

¹⁰⁵ The containment of planning drift may be a salutary effect of the “ossification” of administrative rulemaking, in which agencies eschew cumbersome notice-and-comment rulemaking in favor of informal rulemaking. See Thomas O. McGarity, Some Thoughts on “Deossifying” the Rulemaking Process, 41 Duke L.J. 1385 (1992).

¹⁰⁶ 562 U.S. 44 (2011).

¹⁰⁷ Informal rulemaking includes actions ranging from policy statements to administrative adjudication. In practice, the line between formal and informal rulemaking frequently is unclear. See Kristin E. Hickman, Coloring Outside the Lines: Examining Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements, 82 Notre Dame L. Rev. 1727 (2007).

mal rulemaking, however, does not necessarily prevent planning drift, the speed of which depends on the area of law and the relevant policy community. Delay facilitates planning drift but is not necessary for it to occur.

4. *Unsettled Policy*

To the extent that the policy underlying new legislation remains unsettled among private practitioners and government actors, planning drift is more likely to occur. Policy communities are not homogeneous, and their internal logic and processes can support multiple legitimate views on the relevant policy. If legislation does not settle these internal policy debates, private interpretations are more likely to gain currency within the policy community. Furthermore, unsettled policy may divide legislators, regulators, and private practitioners in different ways. The legislature or regulators (or both) may disagree with private practitioners, or vice versa. Finally, all three parties may agree about policy, in which case no (or only limited) planning drift occurs. Examples from taxation below illustrate each of these three scenarios.

Legislative and regulatory efforts to deter corporate inversions, in which multinational corporations organized in the United States effectively reincorporate in low-tax foreign jurisdictions, show the effects of unsettled policy that divide the legislature and private practitioners. Commentators have compared the struggle against corporate inversions to a game of “whack-a-mole,” in which planners devise new inversion strategies that the government then shuts down.¹⁰⁸ This cycle of private innovation and public response began in 1983, repeated in 1994 and 2002, and began again in 2014.¹⁰⁹ The evolution of corporate inversions reflects an ongoing policy debate over the line between permissible and impermissible cross-border transactions—a line that practitioners have shaped through their legal interpretations. In each cycle, the government response prohibited specific transactional techniques, and, by doing so, clarified the scope of permissible cross-border transactions.¹¹⁰ For example, legislation in 2004 required certain inverting corporations to have a “substantial business presence” in

¹⁰⁸ See, e.g., Bret Wells, *Corporate Inversions and Whack-a-Mole Tax Policy*, 143 *Tax Notes* 1429 (June 23, 2014).

¹⁰⁹ See Hicks, note 43. For regulatory responses to the current cycle of inversions, see Notice 2014-52, 2014-42 C.B. 712; Notice 2015-79, 2015-49 C.B. 775. See also note 132 (discussing proposed regulations under § 385); see generally Donald J. Marples & Jane G. Gravelle, *Cong. Research Serv.*, R43568, *Corporate Expatriation, Inversions, and Mergers: Tax Issues 5-12* (Apr. 27, 2016), available at <http://fas.org/sgp/crs/misc/R43568.pdf>.

¹¹⁰ Another consequence of these efforts is that the international reorganization rules contain a significant body of over-inclusive and under-inclusive provisions that target inversions.

their new jurisdiction.¹¹¹ Practitioners advocated for a quantitative safe harbor with respect to this standard, which Treasury granted in 2006.¹¹² Private-sector gamesmanship caused Treasury to eliminate this safe harbor in 2009¹¹³ and reinstate a more stringent safe harbor in 2012.¹¹⁴ Inversions are a policy concept rather than a technical legal concept, and public and private actors held (and continue to hold) diverse views on which transactions should be permissible. The deep disagreements over inversion policy allowed (and continues to allow) private interpretations to carry more weight in the policymaking process, even in a politically charged environment.

Unsettled policy that divides private practitioners and regulators also can result in planning drift. In 1994, Treasury proposed and finalized broad anti-abuse regulations that applied to partnerships, known as the partnership anti-abuse rule.¹¹⁵ Treasury historically has used targeted anti-abuse rules to backstop specific provisions in the Code and regulations, but the partnership anti-abuse rule applied to the entire partnership tax regime—all of subchapter K. Furthermore, the partnership anti-abuse rule required consistency with “the intent of subchapter K,” as outlined in the regulations.¹¹⁶ Although practitioners criticized the partnership anti-abuse rule on several grounds, one objection was that subchapter K lacked a singular theoretical basis that could be construed as intent. Instead, the partnership tax rules embodied compromises among the view of partnerships as distinct entities, the view of partnerships as aggregates of their partners, and administrative considerations. After promulgation, the partnership anti-abuse rule remained controversial, and Treasury rarely deployed the rule in publicly available analysis.¹¹⁷ Although the partnership anti-abuse rule likely deterred some transactions, practitioners interpreted the rule generously to permit practice to continue virtually as it had before promulgation.¹¹⁸ To the extent that the partnership anti-abuse

¹¹¹ American Jobs Creation Act of 2004, Pub. L. No. 108–357, § 7801(a), 118 Stat. 1418, 1562–66.

¹¹² See T.D. 9265, 2006-2 C.B. 1.

¹¹³ See T.D. 9453, 2009-2 C.B. 114.

¹¹⁴ Treasury issued all of these rules as temporary regulations; the 2012 safe harbor was finalized in 2015. See T.D. 9720, 2015-25 C.B. 1070 (finalizing Reg. § 1.7874-3); see also Wells, note 108.

¹¹⁵ Reg. § 1.701-2; T.D. 8588, 1995-1 C.B. 109.

¹¹⁶ See Reg. § 1.701-2(a).

¹¹⁷ See Cunningham & Repetti, note 20, at 34.

¹¹⁸ See James B. Sowell, *The Partnership Anti-Abuse Rules: Where Have We Been and Where Are We Going?*, 89 *Taxes* 69, 75 (2011). Although the partnership anti-abuse rule rarely appears in published guidance or Freedom of Information Act (FOIA) materials, the rule may affect taxpayers' behavior in more subtle ways. IRS agents may threaten to apply the rule on audit to encourage taxpayer cooperation, even if the IRS would not formally assert the rule in a formal assessment or court proceeding. This strategy is un-

rule is consistent with the legislature's policy preferences, Treasury's failure to correct any favorable practitioner interpretations resulted in planning drift.

Sometimes, the legislature enacts policy that both private practitioners and regulators find unsettled. In 2004, Congress enacted rules under § 704(c)(1)(C) that attempted to prevent the inappropriate duplication or shifting of built-in losses on the contribution of property to a partnership.¹¹⁹ These rules could produce inconsistent outcomes under relatively common fact patterns.¹²⁰ Furthermore, other partnership tax rules, also enacted in 2004, eliminated the benefits of certain abusive loss-duplication transactions through other means.¹²¹ At the time, it was not clear how § 704(c)(1)(C) fit into this larger scheme. Although neither Treasury nor private practitioners objected to the general idea that certain partnership transactions involving losses should not occur, the precise policy at stake in § 704(c)(1)(C) remained unsettled. Congress explicitly authorized Treasury to issue clarifying regulations to integrate § 704(c)(1)(C) into the partnership tax rules,¹²² but, after years of promising guidance, Treasury did not issue proposed regulations until 2014.¹²³ During the interim period, practitioners implemented § 704(c)(1)(C) in a variety of ways that influenced and affected Treasury's proposed interpretations. Treasury's difficulty in implementing the policy concepts of the 2004 legislation, as well as practitioners' skepticism about the provision, facilitated planning drift.

Finally, the legislature's policy preferences may align with those of Treasury and private practitioners. For example, in 1986, Congress enacted the § 469 anti-tax shelter rules that effectively settled a policy debate and produced only limited planning drift. By segregating suspect tax losses from other types of income, § 469 targeted a wave of

likely to be used because, under internal Treasury directives, national-level approval is required for field agents to invoke the rule. See Cunningham & Repetti, note 20, at 28, 33–34. Alternatively, practitioners may invoke the rule to cast doubts on transactional structures or legal interpretations proposed by rivals, as a way of protecting their authority with clients or the tax policy community. Cf. Bankman, note 98, at 1783–84 (describing the ways in which outside counsel serves as a “brake” on tax shelter transactions). Finally, the anti-abuse rule may constrain the behavior of in-house tax lawyers, who may be more risk-averse than their large firm counterparts. See Sowell, *supra*, at 76.

¹¹⁹ American Jobs Creation Act of 2004, Pub. L. No. 108–357, §? 833(a), 118 Stat. 1418, 1589 (enacting IRC § 704(c)(1)(C)).

¹²⁰ William S. McKee, William F. Nelson, Robert L. Whitmire, Gary R. Huffman & James P. Whitmire, *Federal Taxation of Partnerships & Partners* ¶ 11.04[1][b] (3d ed. 2005).

¹²¹ See, e.g., IRC § 704(C)(1)(B).

¹²² IRC § 704(c)(1)(C)(ii).

¹²³ See Prop. Reg. § 1.704-3(f). Interim guidance in 2005 did not address many integration issues involving § 704(c)(1)(C). See Notice 2005-32, 2005-1 C.B. 895.

personal tax shelters that began in the 1970's and peaked in the mid-1980's.¹²⁴ At the time of enactment, some practitioners speculated that § 469 would prove porous and that individual tax sheltering would continue.¹²⁵ Instead, the individual tax shelter wave virtually ended after 1986.¹²⁶ Although practitioners criticized aspects of § 469,¹²⁷ the provision remained largely immune from private interpretations that diverged from the enacting legislature's policy preferences.¹²⁸ As a clear statement that certain types of personal tax shelters needed to end, the 1986 tax reforms effectively dampened any policy drift with respect to the provisions.

III. HARMS AND BENEFITS OF PLANNING DRIFT

This Part considers the potential harms and benefits of planning drift. The effects of planning drift depend on the circumstances in which it occurs, as well as the ways in which it interacts with bureaucratic drift and legislative drift. In isolation, planning drift results in deviations from the legislature's preferred policy, imposes transaction costs, and has potentially adverse distributional effects. Nevertheless, planning drift may represent the lesser of evils, after taking into account other types of policy drift and the public costs of implementing policy.

¹²⁴ See Yin, note 80, at 214, 218-19 ("[T]he consensus is that the passive activity loss rules have been a major factor, if not the single most critical factor, in the curbing of tax shelter activity [since 1986]."). But see Lawrence Zelenak, *When Good Preferences Go Bad: A Critical Analysis of the Anti-Tax Shelter Provisions of the Tax Reform Act of 1986*, 67 *Tex. L. Rev.* 499, 558-59 (1989) ("Congress may not have already won the battle against abusive shelters at the time of section 469's enactment, but it was far too early to say that existing weapons against abusive shelters had been fully tried and that they had failed.").

¹²⁵ For example, Lee Sheppard cites Richard Lipton, a prominent Chicago practitioner, as arguing that tax sheltering would continue using "paired" gain and loss investments. Lee A. Sheppard, *Beating the Passive Loss Limitations*, 32 *Tax Notes* 733, 733-34 (Aug. 25, 1986). Lipton also predicted that REITs would go "the way of the dinosaur" because of the use of real estate in tax shelters. This prediction proved incorrect, and the increase in REIT investment in the early 1990's gives indirect evidence of the effectiveness of the anti-tax shelter provisions in the Tax Reform Act of 1986. See Carnivale et al., note 34.

¹²⁶ See Calvin H. Johnson, *Why Have Anti-Tax Shelter Legislation? A Response to Professor Zelenak*, 67 *Tex. L. Rev.* 591, 625 (1989) ("The passive loss limitations have been successful beyond any reasonable expectation."); Yin, note 80, at 218-19.

¹²⁷ See, e.g., A. Timothy Scott, *Public Comments on Regulations: L.A. County Bar Members Criticize Complexity of Passive Loss Rules* (Aug. 31, 1989), 89 *TNT* 183-25, Sept. 7, 1989, available in LEXIS, Tax Analysts File.

¹²⁸ One possible exception may be the more technical aspects of the regulations, such as the grouping rules in Reg. § 1.469-4.

A. *Fidelity to Legislative Preferences*

The policy drift literature generally takes the perspective of the enacting legislature, asking how the enacting legislature acts to constrain bureaucratic drift on the one hand and legislative drift on the other.¹²⁹ Ordinarily, the legislature must trade a reduction in bureaucratic drift for increased legislative drift and vice versa.¹³⁰ Like bureaucratic drift and legislative drift, planning drift moves public policy away from the enacting legislature's preferences. The overall effects of planning drift, however, must be considered in the broader context of subsequent agency rulemaking and the legislature's underlying motivations for enacting legislation.

When evaluating planning drift, the aggregate effects of all types of policy drift, including planning drift, must be considered. If the enacting legislature seeks to minimize the aggregate long-term consequences of policy drift, it may be indifferent about the precise path to this result. The enacting legislature may welcome planning drift that counters the effects of bureaucratic drift and legislative drift, and the enacting legislature may resist planning drift that amplifies the effects of other types of policy drift. A coalitional model of government decisionmaking adds further texture to these legislative preferences. Different legislative factions, with different bargaining power, may prefer different combinations of planning drift, legislative drift, and bureaucratic drift.¹³¹ Information constraints also complicate a simple view of legislative preferences. If the legislature cannot accurately or cost-effectively predict private practitioners' policy preferences and planning opportunities, both at enactment and over time, the legislature may not know when to allow planning drift. For these reasons, a risk-averse legislature may prefer to limit planning drift.

Planning drift also can function as an affirmative tool for legislatures to encourage prompt agency action. Bureaucratic drift occurs

¹²⁹ Implicit in this approach is that the legislature's policy preferences are valuable, either because they reflect broader democratic preferences or because they result from a political process that itself is legitimizing. From this perspective, legislative drift harms the enacting legislature but may not result in social harm. By contrast, planning drift may result in social harm to the extent it affects subsequent agency rulemaking or legislation.

¹³⁰ See note 60. Techniques such as agency design may constrain both bureaucratic drift and legislative drift. Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 8 *J.L. Econ. & Org.* 93, 108 (1992).

¹³¹ See DeShazo & Freeman, note 26, at 1517; Jacob E. Gersen, *Temporary Legislation*, 74 *U. Chi. L. Rev.* 247 (2007). These effects are similar to those observed by scholars studying delegations of authority to multiple agencies and the choice between agency implementation and judicial enforcement by private rights of action. See Anne Joseph O'Connell, *The Architecture of Smart Intelligence: Structuring and Overseeing Agencies in the Post-9/11 World*, 94 *Calif. L. Rev.* 1655, 1704 (2006) (multiple agencies); Engstrom, note 16, at 638 n.72 (private enforcement); see also Stephenson, note 26 (choice between courts and agencies in the context of temporal versus cross-issue stability).

not only when agencies make rules, but also when agencies shirk by delaying or failing to issue guidance.¹³² If the legislature cannot distinguish shirking from real effort at a time-consuming task, planning drift may force an agency's hand by shaming the agency into action. An agency also may feel compelled to intervene if private practitioners are construing legislation in a manner blatantly inconsistent with the enacting legislature's preferences.¹³³ Agencies, however, may not always respond to divergent private interpretations. For example, agencies' policy preferences may align with those of private practitioners (and not with those of the legislature), eliminating agencies' incentives to intervene. Certain regulatory projects may be difficult or time-consuming, and the additional pressure of planning drift may encourage hasty rulemaking or distort the final policy when the agency issues regulations.¹³⁴ In these ways, planning drift can lead to agency

¹³² In taxation, for example, in 1969 Congress directed Treasury to enact regulations distinguishing debt from equity in the corporate context. See IRC § 385. After more than a decade of study, Treasury issued final debt-equity regulations in January 1981, with a delayed effective date. See T.D. 7747, 1981-1 C.B. 141. Practitioners excoriated these regulations. See, e.g., Treasury Tax Correspondence: Attorneys Comment on Debt-Equity Regulations, 13 Tax Notes 284 (Aug. 3, 1981). Furthermore, Treasury extended their effective date three times in 1981 and 1982, then withdrew them in 1983. See T.D. 7774, 1981-1 C.B. 1968; T.D. 7801, 1982-1 C.B. 60; T.D. 7822, 1982-2 C.B. 84; T.D. 7920, 1983-2 C.B. 69. The regulations never took effect, and Treasury effectively tabled the project. See Gergen & Schmitz, note 6, at 161 & n.164.

In 2016, Treasury proposed regulations under § 385 that targeted "earnings stripping" within multinational corporate groups by limiting related-party debt following acquisitions and reorganizations that constitute corporate inversions, allowing the IRS to treat instruments as part-equity and part-debt, and increasing information reporting requirements for related-party instruments. See Treatment of Certain Interests in Corporations as Stock or Indebtedness, 81 Fed. Reg. 20,911 (Apr. 8, 2016). The targeted nature of these proposed regulations implicates bureaucratic drift, since Congress' initial grant of regulatory authority occurred before inversions were politically salient. In addition, these proposed regulations illustrate the power of policy communities to circulate ideas and build consensus. For example, Treasury officials acknowledged Stephen Shay's influence on their choice to draw on § 385's regulatory authority to combat inversions, stating that "the academic community [and] the tax policy community . . . help inform our [Treasury's] judgments" about policy. See Andrew Verlarde, Treasury Moves on Earnings Stripping, 151 Tax Notes 150 (Apr. 11, 2016). Not surprisingly, practitioners dispute the appropriateness of Treasury's proposed regulations, and this debate has yet to be resolved. See, e.g., Amy S. Elliott, Little Dialogue, Much Vetting at Debt-Equity Reg Hearing, 152 Tax Notes 321 (July 18, 2016) ("At no point in the legislative history does Congress give to or suggested it's giving to Treasury the authority to make per se rules that automatically recast debt as equity simply because Treasury doesn't like a particular type of transaction.") (quoting Joseph B. Judkins); Amy S. Elliott & Lee A. Sheppard, D.C. and New York Bars Submit Comments on Debt-Equity Regs, 152 Tax Notes 25 (July 4, 2016) (the D.C. Bar's position is that "'there is no evidence' that Congress intended for section 385 to be used as a tool to achieve Treasury's stated motivation for the rules"). See generally text accompanying notes 109-14 (discussing inversions).

¹³³ See Stephenson, note 17, at 110.

¹³⁴ See Gersen & O'Connell, note 17.

action that supports legislative policy preferences, but this positive role for planning drift is not without risks for the legislature.

The foregoing analysis assumes that the enacting legislature's policy preferences have independent normative value.¹³⁵ From a public choice perspective, however, legislation is "bought" by interest groups and "sold" by coalitions of legislators.¹³⁶ Planning drift affects the economic deal between these interest groups and legislators. If the "purchased" legislation targets the "buying" interest group (or the lawyers for the targets are themselves the interest group), then planning drift may be desirable for both legislators and interest groups. For example, assume that special interests successfully lobby the legislature for a statute that embodies Policy A. Both sides recognize that the relevant agency will interpret the statute to implement Policy B, which would result in bureaucratic drift inconsistent with the original deal. The legislature could attempt to preserve the original deal by requiring the relevant agency to include certain special interests in the rulemaking process, allowing the special interests to influence any bureaucratic drift that occurs. This strategy may be ineffective or risky for legislators and special interests, depending on political and institutional constraints, as well as existing agency attitudes and preferences.¹³⁷ Planning drift offers an alternative: Special interests can devote resources to creating private interpretations of the statute and building consensus within the relevant policy community, rather than lobbying the agency directly. To the extent these private interpretations affect agency rulemaking, planning drift allows these interests to indirectly influence policy development in situations when lobbying is difficult because of negative press, access, or institutional constraints. In this way, planning drift may represent a tool to facilitate deals between the legislature and interest groups.

In order for this tool to work, planning drift must be accurately priced into the original explicit or implicit arrangement between the legislature and special interests. That is, the legislature must adjust the statute's content to ensure that the post-drift policy reflects the hypothetical arrangement with special interests in the absence of planning drift. In practice, this adjustment may be difficult. In order for pricing to work, the legislature must anticipate the speed and magni-

¹³⁵ For example, the legislature's policy preferences may reflect the broader public interest. See Daniel N. Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. Pa. L. Rev. 1 (1990).

¹³⁶ See *id.* at 64-65.

¹³⁷ See Horn & Shepsle, note 18, at 504 n.9 (noting that "private interests represented in the enacting coalition [often have] certain participatory rights and advantages in the process of administrative implementation").

tude of planning drift at the time it enacts a statute. If planning drift has a larger effect than anticipated, the legislature will have demanded too little from the special interests. If planning drift is more restrained than expected, then the special interests will have “paid” too much. Because special interests likely have better information about potential private legal interpretations than the legislature, undercharging by the legislature is more likely than overcharging of special interests. Similar problems emerge if both the legislature and special interests agree on the amount of expected planning drift, but the variance in potential outcomes is significant. Depending on the risk tolerances of public and private actors, high variance planning drift may distort the legislative deal. If the effects of planning drift are uncertain, or if private parties systematically have better information about planning drift than legislators, the price of the legislation will be wrong.

Finally, the legislature may enact statutes as symbolic gestures to constituents or to enhance legislators’ power and prestige.¹³⁸ If planning drift works to restore the pre-enactment status quo, legislators may prefer planning drift to the real policy costs of implementing a purely symbolic statute. In particular, the legislature may prefer planning drift if the applicable agency takes the (purely symbolic) legislative mandate seriously and the legislature has no alternative methods of precluding agency interpretation. To the extent planning drift is unpredictable, erratic, or variable over time, this strategy is risky. Furthermore, *ex ante* information about planning drift may be costly, difficult to acquire, or unreliable. For these reasons, the enacting legislature may not know whether planning drift will be beneficial or harmful from its perspective, and a risk-averse legislature may choose to limit or control planning drift.¹³⁹

B. Planning Costs and Rulemaking Costs

Planning drift generates transaction costs, both the private costs of creating legal interpretations and the public costs incurred by government actors in evaluating and responding to these legal interpretations.¹⁴⁰ The private costs of planning drift—the costs of creating private legal interpretations—fall into two categories. To the extent that planning costs stem from interstitial interpretations, they may simply reflect the costs of implementing policy—similar to the costs to the government of writing, implementing, and enforcing positive law. These costs may be acceptable, depending on the social benefits of the

¹³⁸ See Shaviro, note 135, at 8–9, 81–82.

¹³⁹ See Part IV.

¹⁴⁰ See Gergen & Schmitz, note 6, at 174 (discussing the “the private effort in creating [private-sector innovations] and the public effort in responding to them”).

underlying public policy after taking into account these interstitial interpretations.¹⁴¹ By contrast, reconstructive interpretations implicate more than just costs to implement policy. Although reconstructive interpretations always result in net private gains, they may result in an overall social loss to the extent they are costly to produce and inconsistent with public policy.¹⁴² These transaction costs compound if private parties expend additional effort in avoiding governmental attempts to correct or redirect planning drift.¹⁴³

Costs that relate to interstitial interpretation may be acceptable under several different scenarios. The key trade-off is the choice between government implementation and private implementation. Private practitioners' interstitial interpretations may cost less than comparable public action, especially if government actors have trouble predicting which legal issues require additional guidance. If private implementation is less expensive than comparable government implementation, private interpretation—and some attendant policy drift—may be preferred. This strategy, however, risks private interstitial interpretations that are lower quality than the corresponding public interpretations, either systematically or in specific circumstances.

Allowing private practitioners to develop legal interpretations may confer other advantages beyond a reduction in costs. Existing private enforcement regimes rely on private actors to initiate actions to enforce public policy through agency or court adjudication.¹⁴⁴ Scholars argue that private enforcement encourages “legal innovation” by developing “novel legal theories, creative approaches to dispute settlement, or new techniques of investigation and proof.”¹⁴⁵ Planning drift also can serve as a “policy laboratory” in which agencies pick and choose among private interpretations after seeing those interpreta-

¹⁴¹ See Weisbach, note 11, at 224 (“[T]ax lawyers acting as return preparers help interpret the law and ensure compliance, and these functions are socially valuable.”).

¹⁴² See, *id.* at 222–25. But see Schler, note 38, at 385–87 (arguing, in effect, that certain reconstructive interpretations are “intended” by Congress and so such planning does not result in a social loss).

¹⁴³ See Yin, note 80, at 216–17. This analysis assumes that legislative policy is beneficial. The efficiency analysis is more nuanced if legislation can be socially detrimental. Daniel N. Shaviro, *When Rules Change: An Economic & Political Analysis of Transition Relief and Retroactivity* 64–66 (2000).

¹⁴⁴ See Sean Farhang, *The Litigation State: Public Regulation and Private Lawsuits in the United States* 3–4 (2010).

¹⁴⁵ Stephenson, note 17, at 112–13 (noting that private suits produced several landmark antitrust decisions after the early 1980's). These innovations also may directly interfere with agency policymaking by, for example, “set[ting] the enforcement agenda” though the types of actions filed and “skew[ing] agency enforcement priorities” to the extent the agency must pursue remedial action. *Id.* at 118; see also Engstrom, note 16, at 638 (“Relentless pursuit of profit thus yields a form of statutory drift and mission creep as private enforcers drive law enforcement efforts in new and democratically unaccountable directions.”).

tions put into practice. In addition, planning drift may develop agency expertise by eliciting information and augmenting administrative engagement with the underlying policy issues. The private sector, by developing legal interpretations with respect to a statute, can generate expertise that the agency otherwise would have to develop on its own. If private practitioners collect this information and develop these interpretations more cheaply than regulators, the overall costs of public policy may fall.

The effects of planning drift on agency rulemaking also depend on the relationship between private practitioners' policy preferences and those of the relevant agency. If practitioners' policy preferences align with regulators' preferences (perhaps because of shared values within a policy community), it may be less costly for agencies to permit some degree of planning drift than to implement their preferred regulations wholesale.¹⁴⁶ This difference in costs can result from external pressure by other interest groups or adverse legislators, or from internal pressure by factions within an agency. Because private legal interpretations can decrease the costs of certain regulatory options, planning drift can facilitate agency rulemaking or help one faction within an agency promulgate its preferred policy. If planners' policy preferences do not align with regulators' preferences, however, planning drift may increase the costs of rulemaking, both the cost to design and implement rules reversing the drift and the cost of forgoing the agency's preferred policy. Furthermore, the relationship between practitioner and agency preferences may evolve during the period between legislation and rulemaking, possibly through changes in the relevant policy community. Although the ties between private practitioners and agencies may give some sense as to how this analysis plays out, the net costs or benefits of planning drift depend on a detailed analysis of the relevant policy community and rulemaking environment.

C. Distributional Considerations

As a process, planning drift allows certain private actors to achieve benefits that are inconsistent with public policy from the perspective of the enacting legislature. These benefits mean that planning drift has distributional consequences—it affects who has what in society. The beneficiaries of planning drift have the means, opportunity, and inclination to engage experts to render legal advice; those who do not

¹⁴⁶ Similarly, if a statute is socially detrimental (or has a "wart"), then planning drift that obviates the statute or removes its warts may be socially beneficial. See Weisbach, note 11, at 225 (describing this strategy as "a dangerous path").

engage such experts suffer, in a relative sense. If the enacting legislature passes laws that reflect social consensus about distributive justice, then planning drift disturbs this consensus and has harmful effects. Social consensus, however, is elusive for issues of distribution, and the legislature may represent an imperfect vehicle for advancing any consensus that does exist.¹⁴⁷ Furthermore, policymakers may be limited in their ability to gather information needed to identify planning drift's beneficiaries and determine the extent of their benefits. For these reasons, a rational legislature may adopt a general presumption against adjusting other tax or regulatory instruments to compensate for planning drift's distributional effects.

On a more basic level, planning drift may contravene norms of progressivity, in that the beneficiaries of planning drift may have substantial economic income and ability to contribute (or forgo) resources to support government activities. Planning drift relies on policy communities composed of experts that typically serve elite individuals and large businesses.¹⁴⁸ Furthermore, planning drift is facilitated by legislation that targets sophisticated persons.¹⁴⁹ These factors indicate that planning drift operates to reduce the overall progressivity of the tax and transfer system, and this intuitive approach to progressivity implies that the legislature should enact relatively higher statutory marginal tax rates for high earners and the wealthy in order to maintain appropriate effective marginal tax rates in the face of tax-base eroding planning drift.

Such an approach to progressivity, however, is complicated by uncertainties about tax incidence and the shifting of tax burdens. For corporate-level taxes, economists' estimates of incidence vary significantly under both general equilibrium models and quantitative empirical approaches, but there is general agreement that labor bears at least some portion of entity-level taxes.¹⁵⁰ If corporations benefit from planning drift in a nominal sense (and it seems very likely that they do), then planning drift's implications for progressivity depend on the specific proportion in which labor and capital bear corporate taxes. After taking into account the uncertainties associated with tax

¹⁴⁷ See Liam Murphy & Thomas Nagel, *The Myth of Ownership: Taxes and Justice* ch. 2 (2002) (critiquing traditional metrics of distributional justice).

¹⁴⁸ See Subsection II.A.2.

¹⁴⁹ See Subsection II.B.2.

¹⁵⁰ See William M. Gentry, *A Review of the Evidence on the Incidence of the Corporate Income Tax 4–6* (U.S. Treas. Dep't Office of Tax Analysis, Paper 101, 2007), <http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/ota101.pdf> (analyzing empirical approaches); Jennifer Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis*, 66 *Nat'l Tax J.* 185, 204–05, 211 (2013) (discussing various models). For a general overview, see Daniel N. Shaviro, *Decoding the U.S. Corporate Tax 61-62, 67-70* (2009).

incidence, it seems reasonable for policymakers to table remedies for planning drift's distributional effects, absent specific and compelling information as to what these effects are.

IV. MANAGING PLANNING DRIFT

From the enacting legislature's perspective, planning drift can have positive or negative effects, depending on its interaction with other types of policy drift and the preferences of the enacting legislature, either in the aggregate or with respect to specific factions. The enacting legislature may not object to planning drift if it mitigates the consequences of bureaucratic drift and legislative drift. Planning drift, however, may be unpredictable, erratic, or variable over time, and ex ante information about planning drift may be costly, difficult to acquire, or unreliable.¹⁵¹ For these reasons, a risk-averse or poorly informed legislature may want to limit or control planning drift.¹⁵² Without taking a position on the normative value of the enacting legislature's policy preferences, this Part discusses techniques that the enacting legislature could use to manage planning drift. The first two strategies are more general: legislate elsewhere and build consensus with planners. Then, this Part considers several specific structural techniques that may limit planning drift.

A. *Legislate Elsewhere*

The agents of planning drift are private practitioners engaged in policy communities. Because policy communities are specialized, the legislature can manage planning drift by implementing a given policy through different areas of law.¹⁵³ If the legislature's preferred statute implicates an area of law associated with a strong, adverse policy community, the legislature may choose to enact the same substantive policy in an area of law where planning drift is less likely. One example of this choice involves tax expenditures, which are tax laws designed to implement social policy rather than raise revenue. The legislature could manage planning drift with respect to tax law by replacing tax expenditures with equivalent spending provisions. For example, the legislature enacts faster-than-economic depreciation to encourage

¹⁵¹ See Subsection II.C.1.

¹⁵² See McCubbins et al., *Structure and Process*, note 17, at 437 ("If legislators are risk averse, unpredictability in the nature of agency noncompliance will be regarded by all as undesirable."); Stephenson, note 26, at 1045 ("Legislators may care not only about the expected values of the policy lotteries represented by the delegation to agencies and delegation to courts, but also about the variance of those lotteries.").

¹⁵³ Similarly, the legislature can manage bureaucratic drift by delegating to sympathetic agencies. See, e.g., Macey, note 130, at 108-09.

capital investment, and these depreciation rules may enable tax planning techniques that lead to planning drift.¹⁵⁴ Direct incentives for capital formation (with appropriate recapture provisions) could accomplish the same policy objective but avoid engaging the tax policy community. Another example is the use of tax increases to regulate taxpayer behavior.¹⁵⁵ Starting in the 1980's, lawmakers used the Code to regulate executive compensation with the goal of improving corporate governance.¹⁵⁶ These Code-based restrictions proved largely ineffective, in part because private practitioners developed legal strategies that preserved executives' pay within the framework of the new laws. For this reason, commentators suggest moving the regulation of executive compensation out of the Code.¹⁵⁷ These two examples illustrate the potential costs of legislating in an area of law in which planning drift is common.

There are potential disadvantages to legislating elsewhere, however. Legislating elsewhere may lead to suboptimal policy, and these costs may outweigh the benefits of avoiding planning drift. That is, the legislature may have good reasons for choosing to legislate in areas of law where planning drift is likely. Existing legal rules, agency expertise, and institutional structures may make one area of law preferable to others, and shifting to the second-best statute may be costly in terms of administration and politics, as well as policy. Tax expenditures, for example, may have administrative or participatory advantages over corresponding spending programs, and, in some situations, redundant tax and spending programs may ameliorate principal-agent

¹⁵⁴ For example, one strategy involves a taxpayer that holds property, then transfers that property to a tax-exempt business entity, such as a REIT, in a transaction that does not trigger gain (or that triggers gain at a reduced rate, such as with certain real property, or only at the shareholder level for assets held in corporate solution). See Russell J. Singer, *Understanding REITs, UPREITS and DOWN-REITS and the Tax and Business Decisions Surrounding Them*, 16 Va. Tax Rev. 329 (1996), for an explanation of the strategy involving REITS. The taxpayer can offset income using the faster-than-economic depreciation deductions without sacrificing comparable economic value on the transfer to the tax-exempt entity. The tax-exempt entity can either use the property or sell the property, subject to limitations imposed by provisions such as § 1374. Essentially, this strategy divides the economic and tax benefits of the property unequally between the taxpayer and the tax-exempt entity, with a disproportionate share of the tax benefits going to the taxpayer. Neither Congress nor Treasury has directly responded to this strategy.

¹⁵⁵ These situations arise both with respect to Pigouvian taxes, which eliminate externalities through price adjustments rather than direct regulation, and revenue-raising provisions that advance other policy aims.

¹⁵⁶ See IRC § 280G (parachute payments), § 4999 (parachute payments), § 162(m) (cap on nonperformance-based pay), § 409A (deferred compensation), and § 457A (deferred compensation).

¹⁵⁷ See, e.g., Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 Cornell J.L. & Pub. Pol'y 383, 420-27 (2008).

concerns between the legislature and administrative agencies.¹⁵⁸ The legislature also may choose an area of law for political economy reasons.¹⁵⁹ Politicians may enact tax provisions because parallel spending provisions are aesthetically or ideologically unpalatable to their constituents or party.¹⁶⁰ Furthermore, legislating elsewhere may be impossible for reforms that relate to a specific area of law, such as anti-abuse or loophole-closing provisions. Indeed, the benefits of legislating elsewhere may be overwhelmed by the costs of transitioning between areas of law. For example, commentators argue that the corporate-level income tax should be removed and replaced with changes to the individual income tax rate structure, but existing integration proposals, which would eliminate the current corporate tax, could open new avenues for tax planning through both their structure and on the transition to the new regime.¹⁶¹ Finally, planning drift is dynamic, not static, and legislating elsewhere may cause a shift in planning resources to that new area of law.¹⁶²

B. *Build Consensus with Planners*

For more than twenty years, legal scholars have promoted responsive regulation as a means to encourage compliance by regulated parties. Responsive regulation refers to a “bottom-up” approach to regulation in which lawmakers use persuasion and participation, as well as punishment, to foster compliance.¹⁶³ Lawmakers could deploy these techniques during the legislative process, as well as after enactment, to constrain planning drift before or as it develops. One risk to

¹⁵⁸ See David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 *Yale L.J.* 955, 957–59 (2004); David A. Weisbach, *Tax Expenditures, Principal-Agent Problems, and Redundancy*, 84 *Wash. U. L. Rev.* 1823, 1825–27 (2006).

¹⁵⁹ See Nancy Staudt, *Redundant Tax and Spending Programs*, 100 *Nw. U. L. Rev.* 1197, 1214–22 (2006).

¹⁶⁰ Federal welfare programs, for example, may be easier to enact through the tax system than as direct spending. See Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 *Harv. L. Rev.* 533, 537–40 (1995).

¹⁶¹ See Shaviro, note 150, at 154–58.

¹⁶² The relevant factor is the elasticity of private planning in the alternative area of law. For example, professional specialization and the (strong) tax policy community makes planning drift with respect to tax law relatively inelastic over time. Even if the legislature reduces planning opportunities in tax law, existing tax lawyers may be unable to redirect their efforts to other areas of law. As long as the pool of lawyers is relatively large, others may be able to specialize in the alternative area of law.

¹⁶³ See Ian Ayres & John Braithwaite, *Responsive Regulation: Transcending the Derogulation Debate* 3–5 (1992). Similarly, negotiated rulemaking, where an agency involves private groups in the drafting of proposed regulations (rather than notice and comment), “lower[s] the costs to poorly organized groups of including themselves in the day-to-day implementation of complex legislation.” Macey, note 130, at 103. For a critique of responsive regulation in the tax context, see Leigh Osofsky, *Some Realism About Responsive Tax Regulation*, 66 *Tax L. Rev.* 121 (2012).

this strategy is that practitioners may persuade lawmakers that their views should prevail, in which case planning drift becomes integrated into the formal political process, with practitioners and their clients as an interest group.¹⁶⁴ Viewed from the perspective of planning drift, responsive regulation simply acknowledges the fact that legal understandings are co-produced by legislators, regulators, private sector experts, and regulated parties.

To a significant extent, Congress and Treasury historically have involved (and continue to involve) tax practitioners in the legislative process.¹⁶⁵ For example, the 1954 recodification grew in part from an ALI study in the early 1950's, and Congress incorporated certain ideas from the study into the final legislation.¹⁶⁶ More recently, the Installment Sales Reform Act of 1980¹⁶⁷ stemmed from discussions among bar associations, the American Institute of Certified Public Accountants, various officials at Treasury and the IRS, and congressional staffers, all spearheaded by noted practitioner and academic Martin Ginsburg. The 1980 reform substantially unified the treatment of transactions where payment is received in a later taxable year and largely displaced prior theories of installment sales, some of which were more favorable to taxpayers.¹⁶⁸ Although private practitioners developed planning techniques with respect to the new statute, they did not press to maintain even more permissive regimes, such as the open transaction doctrine, in which no amounts are taken into income until the final payment is received.¹⁶⁹ In this sense, the installment sale rules enforced a compromise that granted taxpayers the benefits of some deferral but not maximum deferral. Although these collaborative efforts raise questions about whether the resulting laws favor private interests, the legislature may prefer known concessions to private experts over the vagaries of planning drift.

¹⁶⁴ Indeed, rolling some component of planning drift into the lawmaking or rulemaking process may be worse than simply allowing planning drift, since tax practitioners have heterogeneous preferences.

¹⁶⁵ Other countries also have brought private experts into the drafting process for tax legislation. See Adam S. Hofri-Winogradow, *Professionals' Contribution to the Legislative Process: Between Self, Client, and the Public*, 39 *Law & Soc. Inquiry* 96 (2014) (trust reform in Israel).

¹⁶⁶ See Lawrence Zelenak, *The Almost-Restatement of Income Tax of 1954: When Tax Giants Roamed the Earth*, 79 *Brook. L. Rev.* 709, 717–23 (2014).

¹⁶⁷ Pub. L. No. 96-471, 94 Stat. 2247, (1980).

¹⁶⁸ See Robert R. Wootton, *Taxation of the Seller in a Multi-Year Sale or Exchange*, 81 *Taxes* 191 (2003). For the article that initiated this collaborative process, see Martin Ginsburg, *Taxing the Sale for Future Payment*, 30 *Tax L. Rev.* 469 (1975).

¹⁶⁹ For example, some practitioners advise clients to report the disbursement of payments held in escrow after closing on the installment method, while other practitioners find such treatment overly aggressive.

Congress also could direct Treasury to build practitioner support after legislation but in advance of rulemaking.¹⁷⁰ At present, Treasury often builds support informally for its preferred policies, but Congress could mandate these efforts in connection with specific tax statutes. For example, Treasury ordinarily issues a Notice of Proposed Rulemaking and requests comments before finalizing regulations. On occasion, however, Treasury has solicited comments from private practitioners before drafting proposed regulations.¹⁷¹ Congress and Treasury could go further. For example, in 2007, Donald Korb, then IRS Chief Counsel, proposed giving tax practitioners the pen when drafting certain types of regulations.¹⁷² Although the media derided Korb's proposal as "the fox designing the henhouse,"¹⁷³ legislators could use Korb's general approach in crafting tax legislation. Not only would this approach give government officials an opportunity to shape policy views and build consensus within the tax policy community, this approach also could give government officials better information on future planning drift.

Building consensus has risks. As shown by the media's reaction to Korb's proposal, the public may perceive that collaboration and consensus-building give certain private parties an unfair advantage, even if the purpose of the collaboration is to forestall planning drift. One possible remedy is to make these collaborations public and transparent. For example, the tax media criticized three accounting firms and the Institute of Chartered Accountants (Australia) for sponsoring a closed symposium on base erosion and profit shifting hosted by the Australian Treasury as part of its G20 presidency.¹⁷⁴ Similarly, in the 1980's and early 1990's, commentators criticized government officials for participating in closed retreats sponsored by NYU School of Law and involving private practitioners and academics. These retreats, which purportedly produced ideas that led to major changes in tax

¹⁷⁰ See McCubbins et al., *Structure and Process*, note 17, at 444; Horn & Shepsle, note 18, at 506–07. For example, Congress could "stack the deck" in favor of tax practitioners as an organized interest group by mandating that Treasury convene and consult with a committee of practitioners before promulgating rules.

¹⁷¹ See, e.g., Notice 2007-17, 2007-1 C.B. 748; Henry Ordower, *First Drafts of Technical Guidance: Industry Participation*, 115 *Tax Notes* 761 (May 21, 2007).

¹⁷² See David Cay Johnston, *I.R.S. Letting Tax Lawyers Write Rules*, *N.Y. Times*, Mar. 9, 2007, at C1.

¹⁷³ *Id.* The IRS also has allowed practitioners to comment on proposed revenue rulings before they are published, and the IRS sometimes receives draft revenue rulings from private experts, including bar associations. For private letter rulings, taxpayers often submit draft PLRs to the IRS, which comments on the draft. Other taxpayers can examine the final PLRs, which practitioners treat as probative of IRS thinking.

¹⁷⁴ See Kristen A. Parillo, *Australia's "Secret" International Tax Symposium?*, 143 *Tax Notes* 867 (May 26, 2016).

law, were controversial for their exclusivity and closed nature.¹⁷⁵ Had these conferences been more open, they might have attracted less criticism. The trade-off is that practitioners may not be as forthcoming about their interpretative predilections in a public or more open forum. For this reason, closed-door sessions may have value, and government actors must balance this benefit against the potential public relations costs.

C. Structural Techniques

Congress also could use various structural techniques to limit planning drift. Specifically, congressional hearings and investigations, temporary legislation, and statutory deadlines for regulations each may constrain planning drift. Like the strategies discussed above, these structural techniques have drawbacks, and their appeal also depends on whether, on balance, planning drift is desirable or undesirable.

1. Hearings and Investigations

Congressional hearings and investigations represent a long-standing but often criticized method of controlling bureaucratic drift. Hearings and investigations discipline agencies by serving a monitoring function and producing information that informs subsequent legislative sanctions, which can include reductions in an agency's budget or the impeachment or prosecution of individual administrators. In addition, hearings and investigations can publicly chasten officials who testify, which can damage their credibility or careers.¹⁷⁶ Similarly, congressional hearings and investigations can limit planning drift by eliciting information about planning drift and calling private practitioners to task for interpretations inconsistent with the legislature's preferred policy. Although attorney-client privilege and community norms about confidentiality generally protect specific private interpretations from the public eye, these interpretations may become publicly known through indirect means, such as public company disclosure and the informal circulation of information within the relevant policy community, or through the direct testimony of taxpayers or advisors such as

¹⁷⁵ See Jonathan Barry Forman, *Eagle Lodge 11: How I Taught the Treasury to Keep a Secret*, 46 *Tax Notes* 1065 (Feb. 26, 1990). But see Ljubomir Nacev, *The Elitist Nature of Tax Policymaking*, 42 *Tax Notes* 1141 (Feb. 27, 1989).

¹⁷⁶ See McCubbins et al., *Administrative Procedures*, note 17, at 244, 248–49; see also Jack M. Beerman, *Congressional Administration*, 43 *San Diego L. Rev.* 61 (2006); Brian D. Feinstein, *Avoiding Oversight: Legislator Preferences and Congressional Monitoring of the Administrative State*, 8 *J.L. Econ. & Pol'y* 23 (2011).

accountants.¹⁷⁷ Just as hearings and investigations can rein in bureaucrats, similar strategies can restrain private practitioners.

As a means to control agencies, hearings and investigations have several deficiencies that also apply to planning drift. First, hearings and investigations are costly, and these costs limit opportunities for legislators to pursue other activities. Second, as a monitoring device, hearings and investigations operate only after the fact. Any planning drift that has occurred must be corrected, with the caveats to such corrections discussed in this Article.¹⁷⁸ The fear of ex post sanctions may encourage ex ante fidelity to legislative preferences, but, like regulators, rational private practitioners will discount any sanction by the probability that Congress will investigate and find the undesirable activity. Private practitioners may view hearings and investigations as less threatening than regulators, since no explicit principal-agent relationship or lines of accountability exist between government and private practitioners. Finally, to a significant extent, hearings and investigations rely on the parties at issue to reveal their own bad behavior. Just as agencies have little reason to be forthcoming about their infidelity to the enacting legislature's preferred policy, private practitioners may be reticent to reveal planning drift.¹⁷⁹ This disadvantage, however, can be mitigated by calling a variety of experts—public, private, and academic—to testify.

In the tax context, hearings have been used to uncover planning techniques and censure tax practitioners. As discussed in the § 382 case study in the Appendix, the 1958 and 1959 hearings on subchapter C allowed members of Congress to question tax practitioners and make public a critique of trafficking in NOL carryovers. Notably, these hearings had little practical effect on tax planning with NOL carryovers.¹⁸⁰ More recently, Senator Carl Levin's Permanent Subcommittee on Investigations has held frequent hearings on purported tax abuses, and these hearings have featured testimony from, and cri-

¹⁷⁷ In tax, attorney-client privilege may have limited applicability (unless closely monitored), if third-party accountants participate in tax-related discussions and receive copies of tax-related memoranda and other documents. See Kim J. Gruetzmacher, Note, *Privileged Communications with Accountants: The Demise of United States v. Kovel*, 86 Marq. L. Rev. 977 (2003) (discussing the limitations on privilege for accountant-client communications).

¹⁷⁸ See Subsection II.A.4. The problems with ex post corrections are why the policy drift literature looks to ex ante limitations on bureaucratic drift. See McCubbins et al., *Structure and Process*, note 17, at 440 (“[T]he most effective means for achieving policy stability are constraints on the flexibility of agencies, rather than reliance on rewards, punishments, and oversight.”).

¹⁷⁹ See McCubbins et al., *Administrative Procedures*, note 17, at 251. The existence of policy communities may mitigate this concern, since some members may be forthcoming about private interpretations that they know about but with which they disagree.

¹⁸⁰ See Subsection III.A.5.

tiques of, tax practitioners from accounting firms, law firms, and businesses.¹⁸¹ For example, in 2003, the accounting firm Ernst & Young implemented “firm-wide changes” in response to negative publicity from Levin’s investigations into the firm’s role in promoting corporate tax shelters.¹⁸² This anecdotal evidence, along with empirical studies on hearings’ effectiveness in disciplining agencies, indicates that hearings generally are a limited but plausible strategy for managing planning drift.¹⁸³

2. *Temporary Legislation*

One source of planning drift is legislative or regulatory inaction: If private practitioners’ interpretations go unchallenged, the result is de facto policy change. Temporary legislation, defined as statutes that by their terms expire (or sunset) after a fixed period of time, can function as an agenda-control device to ensure that future legislatures revisit policy issues.¹⁸⁴ This type of reconsideration may push the legislature to correct private interpretations of existing legislation, or to allow such legislation to expire, which may obviate any planning drift involving the statute.¹⁸⁵ In this way, temporary legislation potentially “restarts the clock” on private planning by facilitating ex post legislative review.¹⁸⁶

This strategy requires several caveats. While temporary legislation gives the enacting legislature agenda control over future legislatures, the future legislature is not bound by the enacting legislature’s preferred policy.¹⁸⁷ If the legislature’s composition or coalitional dynamics change, then any remedial legislation may deviate from the enacting legislature’s policy preferences.¹⁸⁸ Temporary legislation trades a potential reduction in planning drift for a possible increase in legislative drift. In addition, private actors may expect the legislature

¹⁸¹ See, e.g., Caterpillar’s Offshore Tax Strategy: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov’t Aff., 113th Cong. (2014), available at <http://www.hsgac.senate.gov/subcommittees/investigations/hearings/caterpillars-offshore-tax-strategy>.

¹⁸² See Rostain & Regan, note 94, at 346.

¹⁸³ Compare McCubbins et. al., *Administrative Procedures*, note 17, at 249, with Beerman, note 176.

¹⁸⁴ See Gersen, note 131, at 247.

¹⁸⁵ Similarly, the agenda control function of temporary legislation can constrain bureaucratic drift at the risk of increased legislative drift. See *id.* at 282–83.

¹⁸⁶ To the extent expiring temporary provisions crowd the legislature’s agenda, the quality of legislative deliberation may decline, which may prevent a review that considers the effects of private planning. See George K. Yin, *Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint*, 84 N.Y.U. L. Rev. 174, 248–51 (2009).

¹⁸⁷ See Gersen, note 131, at 281–82.

¹⁸⁸ If the future legislature is democratically accountable, then this outcome may be desirable. See Part V.

to renew temporary legislation as-is or with limited revisions, and these expectations may limit future legislatures' discretion with respect to policy.¹⁸⁹ Each year, for example, Congress renews the overwhelming majority of the temporary tax incentives known as "extenders." Although these renewals create some planning uncertainty, they may not deter planning drift.¹⁹⁰ Finally, in certain areas of law such as taxation, temporary legislation may encourage private practitioners to develop and implement planning techniques more quickly, accelerating the process of planning drift. If private practitioners and their clients expect that subsequent legislation will be less favorable and the benefits of current transactions will be grandfathered, then these practitioners have an incentive to fully develop private interpretations during the window of the temporary provision.¹⁹¹ For these reasons, temporary legislation may not always represent an attractive strategy to manage planning drift.

3. *Statutory Deadlines*

Finally, the legislature can constrain planning drift by forcing agencies to promulgate rules within a specific period after enactment.¹⁹² By reducing the time between enactment and rulemaking, the legislature limits opportunities for planning drift with respect to the statute.¹⁹³ Outside of the tax context, the Dodd-Frank Act¹⁹⁴ contained hundreds of rulemaking requirements on agencies, approximately three-fourths of which gave deadlines for final rules.¹⁹⁵ Statutory deadlines can be viewed as limiting not only planning drift, but also regulatory drift and legislative drift. The legislature can monitor

¹⁸⁹ If, under a public choice approach, temporary legislation allows members of Congress to extract additional rents from interest groups at each sunset date, the pre-existing statute still may favor clean renewal over substantive renegotiation. See Rebecca M. Kysar, *Lasting Legislation*, 159 U. Pa. L. Rev. 1007, 1051–52 (2011); see also Gersen, note 131, at 285 (arguing that temporary legislation may increase the overall social loss from rent-seeking by encouraging more market participants); Yin, note 186, at 239–44 (arguing that, for temporary legislation, reduced rent-seeking at enactment may offset increased rent-seeking at renewal).

¹⁹⁰ See Kysar, note 189, at 1016–17, 1043–44; see also Yin, note 186, at 246–48 (noting that uncertainty depends on the expected, rather than the nominal, duration of legislation).

¹⁹¹ See Yin, note 186, at 244–46.

¹⁹² See O'Connell, note 44, at 977 ("Deadlines imposed at the time of delegation that fall before a congressional transition do not create the same problem of legislative drift as oversight hearings about an old statute in a new Congress."); see also Jacob E. Gersen & Eric A. Posner, *Timing Rules and Legal Institutions*, 121 Harv. L. Rev. 543 (2007).

¹⁹³ See Jacob E. Gersen, *Administrative Law Goes to Wall Street: The New Administrative Process*, 65 Admin. L. Rev. 689 (2013); Gersen & O'Connell, note 17.

¹⁹⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

¹⁹⁵ Gersen, note 193, at 724–25. Many of these deadlines were not met.

agency shirking and bureaucratic drift by setting a (reasonable) statutory deadline. If this deadline falls before the next election cycle, then final regulations will exist before a subsequent legislature can amend the statute, limiting legislative drift.¹⁹⁶ Since delays between enactment and rulemaking generally facilitate planning drift, shorter statutory deadlines can have the opposite effect.

Statutory deadlines have potential drawbacks. Producing high-quality regulations requires time and resources, such as money and personnel, and statutory deadlines operate as a hard cap on the time available to an agency to craft regulations. This cap may force agencies to allocate resources away from other projects, and the quality of those other projects may suffer. In addition, time and resources may not be substitutable factors in the production of regulations. For example, certain activities may require a minimum amount of time (perhaps to satisfy procedural requirements), or overall agency resources may be strictly limited (as is the case at the Treasury). In this case, the quality of the regulations subject to the deadline will decline. Furthermore, the remedy for missed deadlines often is unclear. Finally, procedural requirements, such as those under the APA, may impose a de facto minimum time between statutory enactment and regulation.¹⁹⁷ These caveats limit the utility of statutory deadlines as a constraint on planning drift.

V. CONCLUSION

This Article introduces a new concept, planning drift, to explore the ways in which private legal interpretations influence the development of public policy. Planning drift contributes to scholarship on taxation and administrative law, including the literature on policy drift, by emphasizing the role of private experts in producing lasting policy change. In developing the concept of planning drift, this Article frequently takes the enacting legislature's perspective, proposing strategies that the enacting legislature can use to restrict planning drift. Implicit in this approach is that the legislature's policy preferences carry greater normative weight than the preferences of other participants in the lawmaking process. The legislature, for example, may respond more readily to voters, and this responsiveness may have

¹⁹⁶ *Id.* at 727.

¹⁹⁷ Although courts have upheld exemptions from the notice and comment process for regulations produced under statutory deadlines, these exemptions increase the likelihood of bureaucratic drift and potentially affect the legislative deal under which the statute was enacted. See Gersen & O'Connell, note 17, at 933.

independent value in a majoritarian democracy.¹⁹⁸ Relaxing these assumptions complicates the role of planning drift in policymaking. If government institutions do not respond readily to the electorate, or if majoritarian policy preferences themselves are suspect, then planning drift can act as a corrective to misguided legislative action.¹⁹⁹ To the extent that the norms of private experts and their policy communities can be aligned with broader conceptions of social welfare, planning drift can advance public policy goals, even in the face of breakdowns or dysfunction in other aspects of the formal political process.

This Article discusses legislative strategies to limit planning drift where it is not desired, but administrative agencies also may have an interest in managing planning drift both before and after rulemaking. If planning drift prevents agencies from implementing their preferred policy, agencies have an incentive to constrain planning drift between legislation and rulemaking. Agencies may want to prevent private practitioners from interpreting newly promulgated rules in ways that diverge from those agencies' policy preferences. On the other hand, an agency may welcome planning drift if private practitioners' policy preferences align with the agency's preferences, especially if the agency faces high costs of rulemaking. Even if an agency's policy preferences diverge from those of practitioners, the agency may benefit from planning drift in situations where its jurisdiction either overlaps that of a competing lawmaking body or fails to cover (that is, underlaps) a substantive area that the agency would like to regulate.²⁰⁰ This picture becomes complicated if agencies have heterogeneous preferences and internal factions, and if policy communities include both regulators and private practitioners. Questions of institutional design and policymaking, whether focused on the legislature or administrative agencies, should engage planning drift.

A central theme in this Article is the relationship between private sector expertise and public policy change. In particular, the concept of policy communities—an important factor in planning drift—challenges conventional divisions between public and private and between state and society. In introducing the idea of planning drift and emphasizing the role of policy communities, this Article advocates for a more

¹⁹⁸ See Stephenson, note 85, at 56–58 (describing this approach as “the conventional view”); O’Connell, note 44, at 977–78 (arguing that, in some cases, Congress may be better suited than the President to promote democratic accountability).

¹⁹⁹ See Stephenson, note 85, at 57 & n.4, 82–83 (arguing that “majoritarian interests are often best served not by maximizing the influence of an electorally accountable politician but rather by ensuring a degree of bureaucratic insulation that makes political control of agencies costly but not impossible”); see also Subsection II.C.3 (discussing corporate tax incidence).

²⁰⁰ See Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 Sup. Ct. Rev. 201 (2006).

holistic approach to public policy development, one that opens additional normative opportunities for advancing policy aims. Just as scholars argue that privatization of government functions can advance the public good beyond efficiency gains, planning drift provides a possible means to further public policy goals by leveraging private practitioners' interpretive norms as mediated by the relevant policy community. In taxation, scholars have decried perceived changes in the tax bar that have made corporate tax shelters and aggressive international tax planning acceptable as a matter of practice,²⁰¹ but scholars have spent less time exploring how and why practitioners justify the positions they take. Self-interest has some explanatory power, but too little attention has been paid to professional and norm-based constraints on practitioners' legal positions. Planning drift suggests that one route to curtailing overly aggressive tax planning involves working with the tax policy community to change norms. To do this, more must be known about policy communities' structure and function. As a concept, planning drift highlights how private legal interpretations shape public policy and reinforces the idea that "implementation is politics by other means."²⁰² By focusing attention on the private experts who create these legal interpretations, this Article attempts to expand our understanding of how public policy develops in the modern U.S. administrative state.

²⁰¹ See Rostain & Regan, note 94.

²⁰² See Eric M. Patashnik, *Reforms at Risk: What Happens After Major Policy Changes Are Enacted* 5 (2008).

APPENDIX
A CASE STUDY OF PLANNING DRIFT

This Appendix uses a qualitative, historical case study to show specific processes of planning drift over time.²⁰³ Because planning drift depends heavily on context—the area of law, the economic environment, the specific statute, and the relevant policy community—a case study approach is well-suited to the study of planning drift. Not all planning drift, however, follows the pathways outlined in this case study. The case study method is not experimental; there is no control group. For this reason, it is not possible to know the counterfactual public policy desired by the enacting Congress or Treasury in the absence of private interpretation. In order to show deviations from congressional and agency policy preferences, this Appendix carefully traces changes in law and policy and interpolates motivation and intentions from what people do and say.

This case study, drawn from taxation, explores planning drift through government efforts in the 1950's and 1960's to limit the "trafficking" in loss corporations, which are corporations with NOL carryovers available to offset positive income in the future. Specifically, this case study describes the development of a market in NOL carryforwards in the 1940's and early 1950's, then outlines legislative efforts to restrict the market in NOL carryforwards that culminated in the enactment of § 382 as part of the Internal Revenue Code of 1954. Private practitioners' interstitial and reconstructive interpretations involving § 382 preserved a robust market in NOL carryovers. These private interpretations reflected alternative policy understandings with respect to when NOL carryovers could be transferred—the driving force of planning drift. This case study explores Congress and Treasury's responses to the private interpretations that preserved the transferability of NOL carryovers, as well as how those responses reflected planning drift.²⁰⁴

²⁰³ Quantitative studies generally do not permit this type of analysis. *Id.* at 12 (arguing that the use of case studies "permits a nuanced examination of the relationship between distinct configurations of ideas, institutions, and interests on the one hand, and reform outcomes on the other"); see also Reuven S. Avi-Yonah, *Tax Stories and Tax Histories: Is There a Role for History in Shaping Tax Law?*, 101 *Mich. L. Rev.* 2227, 2234–35 (2002) (book review).

²⁰⁴ For general (and roughly contemporaneous) overviews of the changing law of NOL carryovers during this period, see Note, *Net Operating Loss Carryovers and Corporate Adjustments: Retaining an Advantageous Tax History Under Libson Shops and Sections 269, 381, and 382*, 69 *Yale L.J.* 1201 (1960); James B. Loken, *Loss Carryovers and Corporate Alterations: Toward a Uniform Approach*, 52 *Minn. L. Rev.* 571 (1968). For an example of how § 382 is perceived after the Tax Reform Act of 1986, see Calvin H. Johnson, *The Shelf Project: Revenue-Raising Projects that Defend the Tax Base*, 117 *Tax Notes* 1077, 1077 (Dec. 10, 2007) (arguing that the 1986 version of § 382 "ended trafficking in net operating losses that had also gone on for decades"). See also Robert R. Wootton, *Section 382*

In general, the U.S. tax system treats gains and losses asymmetrically. For each annual accounting period, the Code imposes tax on net profits but provides no compensation for net losses. If a corporation loses money during a taxable year, it is not entitled to a cash payment of negative taxes solely because of that loss. As a form of legislative grace, NOL carryovers mitigate this asymmetry by allowing taxpayers to net gains and losses over a statutory period, presently twenty-three years.²⁰⁵ During this statutory period, a corporate taxpayer may change its business activities, shareholders, customers, or employees, or another corporation may acquire it. These changes can affect which specific stakeholders—shareholders, customers, suppliers, or employees—ultimately bear the burden of the corporate income tax. That is, the economic value of NOL carryovers can be “transferred” if the carryovers survive a change in the corporation that incurred the underlying losses. If economic consideration is paid for these NOL carryovers in connection with a corporate change (for example, if the tax benefit is capitalized into the corporation’s share price on a sale of stock), there is trafficking of the carryovers. Policy judgments are required to determine whether a corporate change (in, for example, ownership or business activities) should prevent a corporation from using some or all pre-change NOL carryforwards to reduce post-change tax liabilities.

Tax planning for NOL carryovers is distinguishable from tax sheltering—there is more than bare tax minimization at stake. Unlike paradigmatic tax shelters, the underlying activities that generate NOL carryforwards typically have *ex ante*, risk-adjusted social value, notwithstanding the *ex post* negative economic outcome. People in business do not invest to lose money.²⁰⁶ In addition, restrictions on the transfer of NOL carryovers and free transferability each can be justified under legitimate but competing conceptions of the corporate tax base.²⁰⁷ Not only was § 382 a political issue, but it also had stakes for

after the Tax Reform Act of 1986, 64 *Taxes* 874, 876 (1986) (claiming that, “[m]ore often than not, the consolidated return regulations [rather than § 382] provided the binding limitation” on the transfer of NOL carryovers before 1986).

²⁰⁵ See IRC § 172.

²⁰⁶ See Mark Campisano & Roberta Romano, *Recouping Losses: The Case for Full Loss Offsets*, 76 *Nw. U. L. Rev.* 709, 733 (1981). Private practitioners have, of course, developed techniques to generate artificial losses. During the 1950’s, however, few raised questions about the provenance of corporate NOLs and, based on case law and other sources, most if not all corporate NOLs involving in trafficking reflected real business losses.

²⁰⁷ See *id.* at 710–11 (proposing full refundability of operating losses); ALI, *Federal Income Tax Project*, Subchapter C 27-28 (Tent. Draft No. 5, 1980); see also Jacob Nussim & Avraham Tabbach, *Tax-Loss Mechanisms*, 81 *U. Chi. L. Rev.* 1443 (2014).

economic views of tax law.²⁰⁸ With regard to § 382, the private interpretations that drove planning drift were not simply aggressive tax planning but also were part of a larger policy conversation.

A. *Making a Market in NOL Carryovers*

In the early 1940's, newspapers and business publications began to advertise the sale of corporate shells that contained only liquid assets and NOL carryovers. In 1943, a *New York Times* classified and extolled a "tax savings opportunity" for prospective purchasers of a corporation holding a "1943 tax loss deduction of \$120,000" (equal to an approximately \$1.5 million deduction today) and "[s]ole assets [of] \$80,000 in cash and equivalent."²⁰⁹ These advertisements represented only the most brazen efforts to wed one corporation's unused NOL carryovers to another's taxable income.²¹⁰ By the mid-1950's, tax practitioners recognized that NOL carryovers could "be just as important an asset as a trade-name, a trade-mark, a profitable executory contract, or a favorable lease."²¹¹ In the years bracketing World War II, practitioners' understanding of NOL carryovers evolved from an accounting device, designed to average income over a statutory period, to a valuable intangible. This case study describes the economic and legal developments between 1939 and 1954 that encouraged this "new source of trade in American financial circles."²¹² This market in loss corporations both shows what Congress sought to curtail in 1954 and illustrates practitioners' interpretations of what was and was not permissible going into the 1954 reform.

²⁰⁸ See Campisano & Romano, note 206, at 733–34 (arguing that "recoupment" of operating losses encourages efficient capital investment); Nussim & Tabbach, note 207, at 1526 (arguing that "[e]ven though carrying losses back allows the immediate cashing of tax benefits, it affects taxpayer incentives in a fundamentally different manner than straightforward refundability").

²⁰⁹ Ad, *N.Y. Times*, Oct. 31, 1943 at S11.

²¹⁰ See Theodore Berger, *Purchase of Loss Companies: Code Section 382(a)*, 32 *Taxes* 876, 876 (1954) ("With more candor than might be expected, the offer to sell a 'tax loss' has often been advertised in the financial journals."); James A. Cuddihy, *Tax, Legal and Practical Considerations in Acquisition of a Loss Corporation*, 1958 *S. Cal. Tax Inst.* 303, 303 ("It is no great secret that for many years, particularly in the post World War II period, loss corporations were quite freely bought and sold."); Harry J. Rudick, *Acquisitions to Avoid Income or Excess Profits Tax: Section 129 of the Internal Revenue Code*, 58 *Harv. L. Rev.* 196 (1944) (similar).

²¹¹ Norman Harris, *Acquisition of Loss Corporations Under the New Revenue Code*, 60 *Com. L.J.* 72, 74 (1955); see Berger, note 210, at 878 (describing a view of NOL carryovers, "to the extent [they are] marketable, [as] asset[s] of the corporation, not essentially different from a favorable lease").

²¹² Harris, note 211, at 72.

Between 1939 and 1954, Congress expanded the period to which NOL carryovers could be applied from three years to eight years.²¹³ As the duration of NOL carryforwards increased, so did their attractiveness to prospective purchasers, which had more time to earn income that could absorb the stored loss. The 1940's also saw dramatic increases in corporate tax rates, which rose from 19% to 40% during World War II, with a supplemental excess profits tax that pushed some corporations' marginal rates as high as 95%.²¹⁴ After 1945, inflation ebbed and Congress allowed the excess profits tax to expire, but the Revenue Act of 1951 raised normal corporate rates to 52%.²¹⁵ Rising corporate rates made NOL carryovers more desirable, since their value is directly proportional to the taxpayer's marginal rate. Based on the statutory top marginal corporate tax rate of 52% between 1951 and 1963, one dollar of usable NOL carryovers produced a nominal economic benefit of fifty-two cents. Purchasers of loss corporations, however, generally paid between ten and twenty-five cents per dollar of NOL carryovers, which reflected discounting for the probability of use within the statutory carryover period, the legal risk of disallowance or changes in law, and buyers' market power.²¹⁶ Although economic conditions encouraged the marketing of NOL carryovers, practitioners remained wary of transactions that transferred these types of tax assets. The practitioner community eventually coalesced,

²¹³ See Mark H. Leff, *The Limits of Symbolic Reform: The New Deal and Taxation, 1933–1939*, at 273–74 (1984); John F. Witte, *The Politics and Development of the Federal Income Tax 84–86* (1985). Mark Wilson argues that NOL and excess profits tax carrybacks provided an implicit subsidy to business in the years after 1945. See Mark R. Wilson, *The Advantages of Obscurity: World War II Tax Carryback Provisions and the Normalization of Corporate Welfare*, in *What's Good for Business: Business and American Politics Since World War II*, at 16, 17–19 (Kim Phillips-Fein & Julian E. Zelizer eds., 2012).

²¹⁴ See Witte, note 213, at 138–41; IRS, *Corporation Income Tax Brackets and Rates, 1909–2002*, at 287–88, available at <http://www.irs.gov/pub/irs-soi/02corate.pdf>. The excess profits tax not only fueled a market in loss corporations, but also encouraged the purchase and sale of corporate shells with histories of high earnings. These high earnings served as the baseline against which the excess profits tax was measured. See Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 14.41[1] (7th ed. 2006).

²¹⁵ Revenue Act of 1951, Pub. L. No. 82-183, § 121, 65 Stat. 452, 465-69.

²¹⁶ Indeed, brokers “actually used formulas to fix the sales price” of loss corporations, and “shell corporations with no asset other than the loss carry-over were sold at from 20 per cent to 25 per cent of the total amount of the loss available.” Cuddihy, note 210, at 320–21 (noting, however, that it is “extremely difficult to give a specific value to a loss carryover” and “each carryover will probably uniquely differ from the last”); Advisory Group Recommendations on Subchapters C, J, and K of the Internal Revenue Code: Hearing Before the H. Comm. on Ways & Means, 86th Cong. 840 (1959) [hereinafter 1959 Hearings] (statement of Bernard Wolfman) (pricing NOL carryovers at 10% to 20% of face amount); *id.* at 889 (statement of George E. Lent) (stating that NOL carryovers cost “no more than 10 to 15 cents on each dollar of loss”); Berger, note 210, at 876 n.1 (citing a 1952 estimate that NOL carryovers traded at roughly 25% of the tax savings they could bring).

however, around a view, based on interpretations of legal authority, that permitted these types of transactions.

For practitioners, the critical legal authority that unlocked the transfer NOL carryovers came from the judicial branch, principally in *Alprosa Watch Corp. v. Commissioner*,²¹⁷ which the Tax Court decided in 1948. In *Alprosa Watch*, two individuals purchased a loss corporation that manufactured gloves. After the purchase, the loss corporation sold its glove-making equipment, changed its name, relocated, and reopened as a jewelry retailer.²¹⁸ The Tax Court held that, because the corporation's legal identity remained the same (and there was a nontax business purpose for the transaction), tax credit carryovers from the glove business could reduce taxes due on income from the jewelry business.²¹⁹ Underlying *Alprosa Watch* was an entity-oriented formalism, and the decision ushered in a new consensus among practitioners that moved the line between permissible tax planning and impermissible tax evasion. This consensus depended less on the outcome in *Alprosa Watch* than on practitioners' perception that the decision validated a specific perspective on what was or was not permissible under tax law. As one commentator noted, "[t]he traffic [in NOL carryovers] started in earnest" after *Alprosa Watch*.²²⁰ These new legal interpretations, coupled with the growing economic value of

²¹⁷ 11 T.C. 240 (1948).

²¹⁸ *Id.* at 242–43. *Alprosa Watch* gives some flavor of how these types of transactions were brokered. Before the acquisition, both the glove-making business and the unincorporated jewelry retailer were headquartered in the same building. The owner of the glove-making business had recently died, and the owner's estate undertook the sale as part of its winding-down of affairs. See *id.* at 242. The price of the glove-making business' NOL carryforwards was effectively zero: The price received for the glove-making business was the book value of its assets, which were resold immediately after the acquisition, again at book value. See Berger, note 210, at 876 n.3.

²¹⁹ *Alprosa Watch*, 11 T.C. at 244–46. The court held that § 129, discussed below, did not apply because tax avoidance was not *the* principal purpose of the transaction. See Ralph S. Rice, Internal Revenue Code, Section 269: Does the Left Hand Know What the Right Is Doing?, 103 U. Pa. L. Rev. 579, 582–83 (1955) (describing the taxpayer-favorable "principal purpose" cases); Thomas N. Tarleau, Acquisition of Loss Companies, 31 Taxes 1050, 1059 (1953) (finding a business purpose to be "all important" for avoiding § 129). In dicta, *Alprosa Watch* also implied that § 129 did not apply to the purchase of a loss corporation in order to conduct a profitable business through that corporate shell. See *Alprosa Watch*, 11 T.C. at 246 (expressing "considerable doubt" that § 129 would have applied, had the provision been effective for the taxable years at issue). But see *British Motor Car Distrib. v. Commissioner*, 278 F.2d 392, 394–95 (9th Cir. 1960) (resolving this issue under § 129 in the government's favor).

²²⁰ See Berger, note 210, at 876. Similarly, with respect to § 129, *Alprosa Watch* caused one practitioner to observe that "there exists in the business community an understanding that acquisitions of the kind covered by Section 129 are now 'all right.'" Tarleau, note 219, at 1050; David Susser, The Tax Consequences of the Net Operating Loss Deduction, 5 Tax L. Rev. 211, 222 (1949–1950) ("The effect of section 129 on net operating losses seems to be very limited."). With respect to § 129, the evolving practitioner consensus led to planning drift.

NOL carryovers, enabled the market in loss corporations that Congress addressed in 1954.

B. *Legislative Reform and Loss Corporations*

Congress made two efforts to curtail the market in NOL carryovers in the 1940's and 1950's, both of which proved largely unsuccessful. In 1943, Congress enacted § 129, an anti-avoidance rule that disallowed deductions, credits, and other tax benefits that inured to a person because that person acquired "control" of a corporation with "the principal purpose [of] evasion or avoidance of federal income or excess profits tax."²²¹ Although Congress intended § 129 to codify pre-existing judicial doctrines with respect to the purchase and sale of tax attributes, the provision proved ineffectual after courts read the provision narrowly and practitioners developed techniques—accepted within the tax policy community—to establish a sustainable nontax business purpose for transactions involving the transfer of NOL carryovers.²²² Drawing on favorable judicial authorities, practitioners developed community interpretations that maintained the market in NOL carryovers in the face of § 129. In this way, practitioners vitiated the congressional policy underlying § 129, resulting in planning drift.

The failure of § 129 shaped Congress' later legislative efforts to limit trafficking in loss corporations. In 1954, Congress enacted § 381 and § 382, which represented more robust and concrete attempts to address the transfer of NOL carryovers and other tax attributes. Standard-based § 129 remained in the Code as § 269 but played a secondary role to the new rules.²²³ While § 381 generally liberalized the treatment of NOL carryovers, § 382 restricted the survival of those tax attributes following changes in a corporation's equity ownership. Section 381 resolved an ongoing debate in the tax policy community about whether a successor corporation acquired a predecessor corporation's tax attributes, when, for example, the predecessor merged into the successor and ceased to exist.²²⁴ By contrast, § 382 repudiated the entity-based formalism expressed in *Alprosa Watch* by denying the use of NOL carryovers after certain changes in equity ownership. Section 382 comprised two distinct rules, neither of which permitted taxpayers to transfer NOL carryovers freely, and both of

²²¹ IRC § 129(a) (1943).

²²² See H.R. Rep. No. 78-871, at 49 (1943), reprinted in 1944 C.B. 901; *Alprosa Watch*, 11 T.C. at 245.

²²³ The 1954 recodification strengthened § 129 by adding a presumption that the principal purpose requirement was satisfied for purchases involving a "substantially disproportionate" price. See IRC § 269(c) (1954). Treasury generally did not enforce § 269(c) and it was regarded as ineffectual until its repeal in 1976.

²²⁴ See H.R. Rep. No. 83-1337, at 41 (1954).

which broadened the corporate tax base by limiting § 381 and the formalistic, entity-based rule in *Alprosa Watch*.

Added to the 1954 recodification by the Senate, § 382(a) addressed “those areas in which abuse has most often arisen”—namely, the cash purchase of loss corporations in order to absorb income from unrelated businesses.²²⁵ Section 382(a) precluded a corporation from using its own NOL carryovers if certain shareholders increased their ownership of the corporation by fifty or more percentage points in a span of two taxable years.²²⁶ Only acquisitions by the corporation’s ten largest shareholders counted towards the threshold, and the statute required that these acquisitions result from taxable purchases or taxable redemptions of other shareholders.²²⁷ Finally, § 382(a) did not eliminate a corporation’s NOL carryovers if the corporation “continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership.”²²⁸ Only if the corporation ceased its historic business—as in *Alprosa Watch*—did § 382(a) apply to limit NOL carryovers. In effect, § 382(a) reversed the consensus among practitioners that corporate shells could be used to transfer NOL carryovers for tax purposes. Instead, if a change in corporate ownership occurred, NOL carryovers became linked to the corporation’s business activities.

By contrast, the House included § 382(b) to prevent NOL carryovers from being “exploited by persons other than those who incurred the loss,” without regard to any business activities.²²⁹ Section 382(b) addressed tax-free, rather than taxable, transactions. In tax-free transactions to which § 381 applied, § 382(b) limited an acquiring corporation’s use of the target’s NOL carryovers, if the target’s shareholders held less than 20% of the acquiring corporation’s stock immediately after the transaction.²³⁰ Instead of completely eliminating the target’s NOL carryovers, § 382(b) reduced the carryovers proportionately based on the target shareholders’ post-transaction ownership.²³¹ For each percentage point decrease in target shareholder ownership below twenty, § 382(b) disallowed 5% of the tar-

²²⁵ S. Rep. No. 83-1622, at 53 (1954).

²²⁶ IRC § 382(a)(1)(A) (1954).

²²⁷ IRC § 382 (a)(1)(B), (2); Staff of the Joint Comm. on Tax’n, 83rd Cong., Summary of the New Provisions of the Internal Revenue Code, 1954, at 56 (Comm. Print 1955) [hereinafter 1954 Bluebook].

²²⁸ IRC § 382(a)(1)(C).

²²⁹ H.R. Rep. No. 83-1337, note 224, at 42.

²³⁰ IRC § 382(b)(1) (1959).

²³¹ IRC § 382(b)(2).

get's NOL carryovers.²³² For purposes of § 382(b), the business activities of the acquiring corporation and target were irrelevant.²³³

Although Chairman Daniel Reed of the House Ways and Means Committee listed § 382 as one of more than fifty loophole-closing provisions in the 1954 recodification, practitioners argued that § 382 presented no real bar to tax avoidance and instead opened a wealth of planning opportunities.²³⁴ Indeed, private practitioners almost immediately implemented these planning techniques to maintain the market in NOL carryovers. Public knowledge about potential loopholes in § 382 raises questions about the provision's true political purpose. As a nonincremental change to policy that ostensibly improved general welfare, the provision may represent a genuine (but ineffective) effort at reform legislation.²³⁵ Alternatively, § 382 could be viewed as a public choice story, in which private interests acquired § 381, which facilitated the transfer of NOL carryovers, only at the cost of § 382, which restricted some of those transfers. Because there is little evidence of explicit lobbying on these provisions, this interpretation has less explanatory power.²³⁶ Finally, § 382 may be symbolic legislation or legislation enacted as political grandstanding to enhance the power and prestige of Congress or the President.²³⁷ At the very least, lawmakers should have known that § 382 was susceptible to planning and avoidance, and, for this reason, § 382 may have functioned in part to enhance at least some lawmakers' prestige without imposing the legislation's full costs on its ostensible targets. These three explanations are not mutually exclusive, and they permit a range of interpretations about whether, from the perspective of Congress and the President in 1954, the planning drift that followed the enactment of § 382 was wanted or unwanted. At least publicly, however, members

²³² 1954 Blue Book, note 227, at 56–57.

²³³ The rule-bound House language was analogous to the American Law Institute's 1954 legislative proposal to limit NOL carryovers. See 2 ALI, Federal Income Statute 51, 303 (Feb. 1954 Draft) [hereinafter ALI 1954 Draft] (treating a sale of 80% of a corporation's stock within a twelve-month period as a reincorporation in which all NOL carryovers are "wiped out").

²³⁴ See 100 Cong. Rec. 3427 (1954) (statement of Rep. Daniel A. Reed) (listing as a loophole "the trafficking in net operating loss carry-overs"); Hearing on H.R. 8300 Before S. Comm. on Fin., 83d Cong. 409 (1954) (statement of Am. Bar Assn) (arguing that the new law "creates a loophole by which any well-advised person may avoid section 382"); see also Witte, note 213, at 146.

²³⁵ See Patashnik, note 202, at 16–18 (defining a general-interest reform as a "conscious, non-incremental shift in a pre-existing line of policymaking intended to produce general benefits").

²³⁶ See Shaviro, note 135 (noting this common critique).

²³⁷ See *id.* at 8–9.

of Congress decried trafficking in loss corporations and advocated for § 382 as a substantive limitation on this practice.²³⁸

C. *Understanding the Corporate Tax Base*

Provisions that police the transfer of NOL carryovers, such as § 382, define the type of corporate changes that preclude NOL carryovers' survival or usability. At stake in these provisions—and more generally in the debate about the transfer of NOL carryovers—is the design of the corporate tax base. If corporations can trade NOL carryovers without limitation, then the tax base comprises all business activities conducted in corporate form, net of aggregate losses.²³⁹ Excluding transaction costs, freely transferable NOL carryovers create the same tax base as a system in which annual losses are fully refundable.²⁴⁰ To the extent that pre-change NOL carryovers are disallowed, the corporate tax base grows. Business- or sector-specific limitations segment the tax base by netting only certain categories of income and loss.²⁴¹ For this reason, § 382 and similar limitations can be described as base broadening, at least on their face, and the debate over § 382 at its core is about the scope and meaning of corporate taxation.²⁴²

Commentators described the disjunctions between § 382(a) and § 382(b) as “technical defects” and “conflicting and uncoordinated.”²⁴³ In part, the provisions reflect political exigencies and the short timeframe in which Congress enacted the 1954 recodification. More fundamentally, the disparate provisions exhibit distinct conceptions of the corporate tax base. Section 382(a) segmented corporations' activities by business, generating a corporate tax base that netted gains and losses on a sector-by-sector or investment-by-investment basis.²⁴⁴ Contemporary commentators critiqued this approach as unprincipled, since it effectively divided taxpayers based on their

²³⁸ See Reed Statement, note 234.

²³⁹ See Campisano & Romano, note 206, at 740–42.

²⁴⁰ If the preferred tax base is all corporate activities, then transaction costs result in a deviation from the ideal base. Such a deviation could be justified if measures such as full loss refundability are infeasible. See R.H. Coase, *The Problem of Social Cost*, 3 *J.L. & Econ.* 1 (1960); see also Nussim & Tabbach, note 207, at 1520-25 (discussing the equivalence of loss offset, loss refund, and loss transfer systems).

²⁴¹ See George K. Yin, *Of Diamonds and Coal: A Retrospective Examination of the Loss Carryover Controversy*, 48 *N.Y.U. Inst. on Fed. Tax'n* 41-1, 41-21 to 41-23 (1990).

²⁴² See, e.g., Johnson, note 204, at 1077 (describing § 382 reform as a way for Congress to “do some good and defend the tax base as it raises revenue”).

²⁴³ See Yin, note 241, at 41-7 to 41-8; Advisory Group on Subchapter C, *Revised Report on Corporate Distributions and Adjustments* 89 (1958) [hereinafter 1958 Advisory Group Report] (discussed in Section III.E).

²⁴⁴ Section 382(a) was analogous to the ALI 1954 legislative proposal to limit NOL carryovers. See ALI 1954 Draft, note 233.

business activities.²⁴⁵ By contrast, § 382(b) presented a tax base that netted activities with respect to shareholders.²⁴⁶ A third understanding of the corporate tax base—one that supported free transferability—was apparent in § 269(c), also enacted in 1954. Section 269(c) provided a presumption of a tax avoidance purpose if the price paid for a corporation did not reflect the value of the corporation's tax attributions, including NOL carryovers.²⁴⁷ As Treasury officials noted, § 269(c) implied “a philosophy that all one needs to do to be in the clear is to pay for the loss”—that is, that NOL carryovers could be freely transferrable.²⁴⁸ Some private practitioners also advocated for the unfettered transferability of NOL carryovers.²⁴⁹ Although § 382(a), § 382(b), and § 269(c) did not function cohesively (and taxpayers took advantage of arbitrage opportunities), the provisions illustrate more than the vagaries of the legislative process—they show genuine uncertainty about the proper scope of the corporate tax base. Other legal authorities demonstrated additional interpretations of the corporate tax base. In 1957, the Supreme Court decided *Libson Shops, Inc. v. Koehler*,²⁵⁰ which, in effect, proposed a fourth conception of the appropriate corporate tax base that tied NOL carryovers to the specific, historic business that generated them. Labor groups, such as the AFL-CIO, and other commentators advocated this type of understanding of the corporate tax base.²⁵¹ These competing interpretations—and government's inability to settle on a unified theory of transferability for NOL carryovers—illustrates the type of unsettled policy principles conducive to planning drift.

²⁴⁵ See 1959 Hearings, note 216, at 889 (statement of George Lent) (arguing that it was incoherent for Congress to “condone[] a practice within an industry that it condemn[ed] when undertaken across industry lines”).

²⁴⁶ H.R. Rep. No. 83-1337, note 224, at A143.

²⁴⁷ IRC § 269(c) (before repeal in 1976).

²⁴⁸ Preliminary Draft of Report on Corporate Distributions and Adjustments to Accompany Advisory Group, Confidential Print No. 1, Subcomm. on Internal Revenue Taxation of the H. Comm. of Ways & Means, 111th Cong. 74 (1957) (language removed in final report per Surrey's Comments), in Stanley S. Surrey Papers, Harvard Law School Library [hereinafter Surrey Papers], box 23, folder 20-1.

²⁴⁹ See Thomas N. Tarleau, Difficulties Faced by Taxpayer Trying to Take Tax Advantage of Loss Carryover, 4 J. Tax'n 91, 94–95 (1956) (“I would propose that we consider a revision of the Code which eliminates interference with the free trade in tax loss carryovers.”); see also 1959 Hearings, note 216, at 888 (statement of George Lent) (“[I]f it were the purpose of the Government to reimburse a corporation for losses upon its winding up, this should be done directly and not through the juggling of such losses in the marketplace.”).

²⁵⁰ 353 U.S. 382 (1957).

²⁵¹ See 1959 Hearings, note 216, at 878 (statement of Stanley H. Ruttenberg) (advocating “attaching [NOL carryovers] firmly to the actual business operation that produced [them]”).

D. Tax Planning and § 382

In 1958, James Cuddihy, a well-known tax practitioner who worked with companies in the market for NOL carryovers, described a consultation with “the presidents of two large corporations with substantial continental and intercontinental holdings.”²⁵² According to Cuddihy:

The corporations had discussed merger and it seemed the most perfect of business combinations After a full explanation of the problem involved, the writer discovered that the real difficulty was that both presidents had a sense that it was not quite proper to merge or consolidate since one of the corporations had a substantial loss. They were fearful of adverse public relations if the merger was completed.

. . . . It was therefore pointed out to them [by Cuddihy] that the deductions were allowed by law and were privilege granted by Congress. . . [I]f Congress and the courts see fit to sanction the use of carryovers, and in many instances they do, there should be no question of morality involved, but rather one of mechanics to comply with the law.²⁵³

In the 1950’s, the creative development of these “mechanics” by tax practitioners drove planning drift with respect to § 382. Although tax practitioners felt that in § 382 “Congress for the first time clearly declare[d] the policy that a tax benefit should not be an article of commerce,” this conviction about congressional intent did not prevent practitioners from designing structures that transferred NOL carryovers without triggering § 382.²⁵⁴ Indeed, less than a week after President Eisenhower signed the 1954 Code into law, an attorney from Milbank, Tweed, Hope & Hadley “emphasized that business men should check carefully with tax advisers if they are relying on a loss carry-over.”²⁵⁵ Although § 382 generally limited the purchase and sale of shell corporations containing only NOL carryovers, commentators argued that, once “corporate tax experts [] had a good chance to analyze the revised rules,” they were “ready to go ahead again with

²⁵² Cuddihy, note 210, at 307.

²⁵³ *Id.* at 307. Management anxiety about the public relations effects of trafficking in loss corporations mirrors similar concerns about corporate inversions since the late 1990’s. See Hicks, note 43; Andrew Velarde, Walgreens Won’t Invert Following Alliance Boots Acquisition, 144 Tax Notes 662 (Aug. 11, 2014) (describing public and political pressure in advance of Walgreens’ announcement that it would not pursue an inversion transaction).

²⁵⁴ Berger, note 210, at 878.

²⁵⁵ Study Still Given U.S. Tax Problem, N.Y. Times, Aug. 20, 1954 at 22.

mergers involving tax-loss situation.”²⁵⁶ By 1959, the market in NOL carryovers had returned or even exceeded pre-1954 levels of activity.²⁵⁷ This resurgence spurred action by Congress and Treasury, and the content and relative ineffectiveness of these responses show how private interpretations of § 382 led to planning drift.

In the 1950's tax practitioners developed three general categories of techniques by which a profitable corporation could acquire a loss corporation's NOL carryovers.²⁵⁸ Some techniques focused on generating the factual predicate needed to fall outside of § 382(a)'s standard-driven continuity-of-business requirement. Alternatively, tax practitioners devised complex acquisition structures that adroitly avoided the rule-bound strictures of § 382(a) and (b). Finally, a few practitioners envisioned an affirmative use for § 382(b) as a means to inoculate transactions from the application of standard-based § 269. When selecting from multiple planning techniques that exploited both the rule-bound and standard-based aspects of the provisions governing NOL carryovers, tax practitioners weighed legal certainty against business needs, manufacturing favorable facts and reconfiguring deals to create the desired tax outcome. These planning techniques reflected a general view that precluded trading in corporate shells with NOL carryovers but permitted more complex techniques involving nuanced and often technical constructions of § 382. Transactional structures proliferated as practitioners designed, discussed, and deployed various tax avoidance plans, while Treasury and the courts struggled to deter undesirable practices. Although practitioners were not unified in how they viewed § 382, they generally treated these sophisticated techniques for transferring NOL carryovers as legally reasonable.

In a taxable stock purchase that met the ownership requirements of § 382(a), a loss corporation's NOL carryovers remained available if the corporation continued “substantially the same” business as before the acquisition.²⁵⁹ In effect, practitioners had complete transactional freedom, as long as the loss corporation satisfied the continuity of bus-

²⁵⁶ Topics Pertaining to the General Revision of the Internal Revenue Code: Hearing Before the H. Comm. on Ways & Means, 85th Cong. 3102 (1958) (statement of Solomon Barkin) (citing *Business Week*).

²⁵⁷ 1959 Hearings, note 216, at 880 (memorandum of Solomon Barkin) (arguing that there were “just as many profitable companies seeking loss situations today as there were before 1954—probably more”) (quoting Robert S. Holzman).

²⁵⁸ In addition, practitioners developed multiple strategies through which loss corporations could acquire potentially profitable businesses. Essentially, these techniques reversed the direction of the type of transactions targeted by § 382. And legal experts agreed that § 382 did not apply to these transactions. See, e.g., 1959 Hearings, note 216, at 887 (statement of George E. Lent) (“The code imposes no prohibition or limitation on the carryover of losses against the profits of the other business.”); Cuddihy, note 210, at 326 (similar).

²⁵⁹ IRC § 382(a)(1)(C) (1954).

iness requirement. Before Treasury issued regulations under § 382 in 1962, legislative history provided the sole guidance for practitioners making this fact-intensive determination. In 1954, the Senate Finance Committee stated that a change in business included situations in which “the [loss] corporation shifts from one type of business to another, discontinues any except a minor portion of its business, [or] changes its location.”²⁶⁰ Practitioners, however, were left to explore and develop the precise meaning of these facially restrictive factors through their own private interpretations.

After the 1954 recodification, tax practitioners speculated on the minimum facts needed to satisfy § 382(a)’s business continuity requirement.²⁶¹ These practitioners generally agreed that corporate shells containing only NOL carryovers and liquid, nonbusiness assets could not meet the requirement, since such corporations had no business activities. It was insufficient merely to continue “whatever there was” in the distressed corporation; instead, an affirmative business had to exist.²⁶² But practitioners also dismissed as absurd a strict interpretation of the Finance Committee’s language precluding changes in “location,” reasoning that it was “highly unlikely that the statute [would] be given such a narrow construction in final regulations or court decisions.”²⁶³ From this perspective, the norms of the tax policy community militated against a strict interpretation of the Finance Committee’s words.²⁶⁴ These types of private interpretations initiated the process of giving content to § 382(a)’s business continuity require-

²⁶⁰ S. Rep. No. 83-1622, note 225, at 285.

²⁶¹ Indeed, after 1954, advertisements for loss corporations began to specify a line of business. See, e.g., Ad, N.Y. Times, Feb. 7, 1960, at 24F; Ad, Barron’s Nat’l Bus. & Fin. Weekly, Feb. 13, 1956, at 62.

²⁶² Albert E. Arent, *Tax Aspects of Buying Loss Corporations Under the 1954 Code*, 33 *Taxes* 955, 957 (1955); see also Samuel J. Lanahan, *Untitled Document 6-7* (Dec. 17, 1957), in Edwin S. Cohen Papers, Arthur J. Morris Law Library, University of Virginia School of Law, Special Collections [hereinafter Cohen Papers], box 116 (arguing that such corporations were really “shell[s] in a business sense”); Rev. Rul. 58-9, 1958-1 C.B. 190 (denying the use of NOL carryovers after the acquisition of an inactive loss corporation).

²⁶³ Arent, note 262, at 957; see *Goodwyn Crockery Co. v. Commissioner*, 37 T.C. 355 (1961), *aff’d*, 315 F.2d 110 (6th Cir. 1963) (finding, with two dissents, that the taxpayer’s business remained the same for § 382(a), notwithstanding a change of location, the addition of a retail business, and changes in clients).

²⁶⁴ See *Untitled Document* (Feb. 20, 1957), in Cohen Papers, note 262, box 116 (noting, in comments from Treasury, that the business continuity test “leaves much to be desired in the way of an objective test administratively” and requesting that the Subchapter C advisory group provide “some examples of what a wise administration of the provision would be”). Taxpayers may have interpreted § 382(a)’s continuity of business requirement by reference to the more permissive standard required by courts for certain tax-free reorganizations. See *Cortland Specialty Co. v. Commissioner*, 60 F.2d 937, 940 (2d Cir. 1932) (A. Hand, J.)

ment and set baseline understandings and expectations against which Treasury later gauged its response.

Other practitioners located planning opportunities within the Finance Committee's prohibition against discontinuing "any except of a minor portion of its business."²⁶⁵ Practitioners argued that, if a loss corporation sold nearly all of its business assets before, but not in connection with, a taxable stock purchase, then the acquiring corporation could continue what remained of the loss corporation's business and use any NOL carryovers.²⁶⁶ For this reason, practitioners sometimes advised loss corporations to wind down all but a small portion of their business activities before seeking a buyer interested in NOL carryovers.²⁶⁷ Alternatively, some practitioners argued that, if a loss corporation operated multiple trades or businesses, then the acquiring corporation could "abandon[] one business after acquisition" and still preserve the loss corporation's NOL carryovers.²⁶⁸ Practitioners developed theories for tailoring taxpayers' facts to meet the standards of § 382(a)'s business continuity exception and forestall any elimination of NOL carryovers. These interpretations gave substance to the business activity standard in § 382(a) and provided the building blocks for planning drift.

In addition to fact-based techniques that filled in the gaps in § 382(a), practitioners developed technical strategies that avoided § 382 through creative use of stock instruments and complex multi-step transactions. Because the ownership test under § 382(a) ignored nonvoting preferred stock, new investors could contribute cash to a loss corporation in exchange for preferred stock, the dividends from which tracked the economic returns from a new, and hopefully profitable, business. If the loss corporation's old owners retained at least 50% of the voting common stock, § 382(a) did not apply. Furthermore, these old owners' control rights could be limited by a variety of legal arrangements. Once the new business absorbed the loss corporation's NOL carryovers, the corporation could be dissolved.²⁶⁹

In staged multi-step transactions, an acquiring corporation might acquire the target's stock in a series of taxable purchases that ex-

²⁶⁵ S. Rep. No. 83-1622, note 225, at 285.

²⁶⁶ See John G. Gemmill, *Loss Corporations*, 36 *Taxes* 105, 106 (1958).

²⁶⁷ See Samuel J. Lanahan, *Untitled Document*, in *Cohen Papers*, note 262, box 116, at 6-7 (contending that § 269 should supplement § 382 in such situations).

²⁶⁸ See Cuddihy, note 210, at 331.

²⁶⁹ See, e.g., *Maxwell Hardware Co. v. Commissioner*, 343 F.2d 713 (9th Cir. 1965). Congress attempted to end this strategy in 1986 by restricting the definition of "preferred stock" and granting Treasury the ability, through regulations, to treat certain stock interests as "not stock." See § 382(k)(6)(B)(ii); see also Peter L. Faber & Mark J. Silverman, *An Analysis of the New Ownership Regs Under Section 382: Part I*, 68 *J. Tax'n* 68 (1988) (arguing that Treasury's regulations did not apply to *Maxwell Hardware* fact patterns).

ceeded the statutory two-year time period to which § 382(a) applied. An initial purchase of less than 50% of the target's stock might yield working control, and a subsequent purchase outside the two-year window could bring the acquiring corporation's ownership above 80%. At this point, the target could be liquidated tax-free into the acquiring corporation, which succeeded to the target's NOL carryovers under § 381(a).²⁷⁰ Because the five-year NOL carryforward period exceeded § 382(a)'s two-year testing period, the acquiring corporation could use the target's pre-acquisition NOL carryovers at the cost of deferring some of their tax benefit. If the acquisitions were pursuant to a single plan, however, the transaction risked recharacterization under judicially created principles, including the step transaction doctrine.²⁷¹

Multi-step techniques also enabled taxpayers to avoid § 382(b)'s 20% continuity of ownership requirement. These techniques depended on the quirk that neither § 382(a) nor § 382(b) applied to tax-free stock-for-stock exchanges (B reorganizations) or tax-free contributions of property to a corporation (§ 351 transactions).²⁷² If a gain corporation acquired at least 80% of a loss corporation's stock in a B reorganization, the loss corporation could be liquidated into the gain corporation without triggering § 382(b).²⁷³ In order to avoid recharacterization as an acquisition of assets, tax practitioners recommended leaving a one- or two-year gap between the acquisition and the liquidation.²⁷⁴ Alternatively, the acquiring corporation could follow the B reorganization with a § 351 contribution of income-producing assets to the loss corporation. Again, each step in this structure fell outside of § 382(b)'s rule-bound language.²⁷⁵ Common to these complex transactional structures was a narrow reading of congres-

²⁷⁰ See Richard H. Levin, *Purchase and Sale of Corporate Businesses: Tax Opportunities and Pitfalls*, 35 *Taxes* 942, 944-45 (1957) (noting that "this procedure creates a drive toward under-the-table agreements"); Lanahan, *Untitled Document*, in *Cohen Papers*, note 262, box 116, at 6-7 (detailing a variation on the acquire/then liquidate structure).

²⁷¹ See also *Jackson Oldsmobile, Inc. v. United States*, 237 F. Supp. 779 (M.D. Ga. 1964) (staged buy-out upheld); *Glover Packing Co. v. United States*, 328 F.2d 342 (Ct. Cl. 1964) (staged buy-out involving a voting trust not upheld). Although the IRS (unsuccessfully) challenged these types of transactions under a *Libson Shops* rationale, it did not respond to these techniques in regulations or informal rulemaking, perhaps because the transactions hewed to the statute's literal language.

²⁷² See IRC § 382(a), (b)(1) (1954) (applying only to taxable purchases and transactions described in § 381(a)).

²⁷³ See IRC § 332 (governing tax-free liquidations).

²⁷⁴ See Cuddihy, note 210, at 328; Arent, note 262, at 958-59; *Untitled Document* (Feb. 20, 1957), in *Cohen Papers*, box 116, note 262. These transactions predated formal administrative guidance that recharacterized a B reorganization followed by a tax-free liquidation as a tax-free acquisition of assets. See *Rev. Rul. 67-274*, 1967-2 C.B. 141.

²⁷⁵ Arent, note 262, at 959. The 1976 reforms to § 382 would have applied to § 351 transactions and B reorganizations. These reforms, although passed by Congress, did not

sional intent by tax practitioners, who meticulously assembled complex transactions to steer around the rule-bound hurdles created by § 382 while generally ignoring more general proscriptions about the buying and selling of NOL carryforwards.

Finally, some practitioners envisioned an affirmative use for § 382(b): to inoculate transactions against the uncertain scope of § 269, the standard-based disallowance rule for NOL carryovers, by forgoing a nominal portion of the loss corporation's NOL carryovers. Although § 269's predecessor gained little traction among taxpayers or courts before 1954, the provision acquired new life after the 1954 recodification.²⁷⁶ As a result, tax practitioners began to consider the interaction of § 269 and § 382. These practitioners noted the Senate Finance Committee's 1954 assertion that, "[i]f a limitation in this section [382] applies to a net operating loss carryover, section 269 . . . shall not also be applied to such net operating loss carryover."²⁷⁷ Practitioners hypothesized a structure in which a loss corporation's shareholders received 19% of the acquiring corporation's stock in a transaction to which § 382(b) applied. Although § 382(b) would disallow 5% of the loss corporation's NOL carryovers, the acquiring corporation would not face the uncertainties surrounding standard-based § 269.²⁷⁸ This structure traded full use of the loss corporation's NOL carryovers for a more definite outcome under § 269. Of course, the Senate introduced only § 382(a), making it somewhat implausible that the Senate's statement should apply to the House's half of the provision, § 382(b).²⁷⁹ Some taxpayers, however, implemented the strategy outlined above. When faced with such a structure on audit, Treasury settled with the taxpayer, noting that the case was "probably a bad case to litigate."²⁸⁰ Although this structure probably represented a minority view within the practitioner policy community, the affirmative use of § 382 shows how private planning techniques resulted in

take effect and were superseded by the Tax Reform Act of 1986. See Tax Reform Act of 1976, Pub. L. No. 94-455, §806, 90 Stat. 1520, 1599-1600.

²⁷⁶ See William M. Speiller, *Acquisitions by Loss Corporations of Profitable Businesses*, 40 *Taxes* 22, 33 (1962) (discussing case law under § 269); see also Schler, note 38, at 372-73 ("The Service historically has brought very few cases under § 269. . . . As a result, taxpayers and tax advisers tend to give very little weight to the possibility that the Service will attack a tax shelter based on § 269.").

²⁷⁷ See S. Rep. No. 83-1622, note 225, at 284 (adding that "the fact that a limitation under this section does not apply shall have no effect upon whether section 269 applies").

²⁷⁸ See Cuddihy, note 210, at 337.

²⁷⁹ In subsequent regulations, Treasury took the position that the application of § 382(b) did not preclude the application of § 269. See Reg. § 1.269-6 (Ex.1) (1962). In this way, practitioners' conversations about legal issues directly set the agenda for Treasury's subsequent rulemaking.

²⁸⁰ See *Surrey Papers*, note 248, box 137, folder 101-1 (memorandum discussing *Inter-oceanic Commodities Corporation*).

reconstructive interpretations that implicated new understandings of public policy different from those of the enacting legislature in 1954.²⁸¹ These reconstructive interpretations resulted in planning drift, both during the period they went uncorrected and through their effect on subsequent agency rulemaking.

E. Legislative and Regulatory Responses

In the late 1950's, public debate over the transfer of NOL carryovers revived, and both Congress and Treasury engaged in efforts to curtail trafficking in loss corporations. In 1956, Congressman Wilbur Mills, a powerful member of Ways and Means who ascended to chairman in 1958, convened a special advisory group tasked with drafting revisions to the 1954 recodification's corporate tax rules.²⁸²

The advisory group, whose members came from private practice, published its findings and recommendations in 1957 and 1958, and these findings were elaborated at subsequent hearings in 1958 and 1959.²⁸³ For § 382, the advisory group's relatively modest proposal would have harmonized § 382(a) and § 382(b) by limiting NOL carryovers after any 50% change in ownership, taxable or tax-free, without regard to any change in business.²⁸⁴ This proposal would have made § 382 entirely rule-bound, relegated standard-based analysis to § 269, and eliminated planning strategies involving business continuity and some multi-step planning techniques.²⁸⁵ Notwithstanding Mills' renowned ability to control tax legislation and shepherd his preferred proposals to enactment, Congress did not summon the will to correct private practitioners' interpretations of § 382.²⁸⁶ Although the hearings aired strong critiques of practitioners' efforts to circumvent the

²⁸¹ See Surrey Papers, note 248, box 137, folder 101-1 (memorandum discussing practitioner interpretations).

²⁸² See Edwin S. Cohen, *A Lawyer's Life: Deep in the Heart of Taxes* 269 (1994).

²⁸³ See 1958 Advisory Group Report, note 243; 1959 Hearings, note 216.

²⁸⁴ See 1958 Advisory Group Report, note 243, at 92; see also Letter from Norris Darrell to Samuel J. Lanahan (Nov. 14, 1957), in Cohen Papers, note 262, box 116 (advocating that § 382 treat acquisitions the same, regardless of method). The advisory group considered adopting the principle from *Libson Shops*, "that loss carryovers can be applied only against income from the business which generated the loss." This was rejected as being "too narrow a rule, not in harmony with the general carryover scheme of the statute, and that it would be difficult to draft and apply." 1958 Advisory Group Report, *supra*, at 90.

²⁸⁵ The advisory group would have strengthened § 269 to address acquisitions followed by a discontinuation of the target's historic business. See 1958 Advisory Group Report, note 243, at 92; see also Letter from Stanley S. Surrey to Edwin S. Cohen (Nov. 27, 1957), in Cohen Papers, note 262, box 116 ("This approach [of the advisory committee] will put a strain on Section 269, and I doubt whether it can stand the strain.").

²⁸⁶ At the hearings, Mills heavily critiqued tax planning that avoided § 382. These comments, of course, could have been grandstanding, although they are not inconsistent with Mills' more general approach to tax law. See Zelizer, note 44.

policy behind § 382 and § 269, these critiques failed to temper practitioners' enthusiasm for planning techniques that transferred NOL carryovers. In the absence of legislative correction, these planning techniques were authoritative to the extent they remained accepted within the tax policy community, and the result was planning drift.

In December 1960, Treasury proposed regulations under § 382 that broadened and clarified the provision's scope, and in 1962 these regulations were finalized in substantially similar form.²⁸⁷ The 1962 regulations addressed several planning techniques developed by practitioners in the 1950's. Specifically, the 1962 regulations elaborated the continuity of business exception under § 382(a) and provided several rules under § 382(b) to address multi-step acquisitions that, by their form, avoided any limitation on NOL carryovers. Constrained by the statute's structure and the need to respond to practitioners' planning, Treasury produced regulations that were reactive rather than conceptual, and private practitioners simply channeled their creative energy into alternative methods to circumvent § 382.

The 1962 regulations clarified Treasury's position with respect to planning techniques involving § 382(a)'s continuity of business exception by essentially adopting the Senate Finance Committee's stringent language about shifts in type, quantity, and location of business operations. The 1962 regulations denied continuity of business if a corporation's business was "substantially altered" because of "changes [in] the location of a major portion of its activities."²⁸⁸ Furthermore, the 1962 regulations defined a "facts and circumstances" test for business continuity by looking to whether a corporation's "loss carryovers are used to offset gains of a business unrelated to that which produced the losses."²⁸⁹ Finally, the 1962 regulations provided that any stock purchase in § 382(a)'s two-year testing period triggered the business continuity requirement, which restricted loss corporations' ability to divest themselves of business assets before a § 382(a) acquisition.²⁹⁰ Tax practitioners interpreted these "fairly stringent" regulations to limit standard-oriented planning techniques under § 382(a).²⁹¹

In the 1962 regulations, Treasury also addressed multi-step planning techniques under § 382(b). The regulations expressly recast tax-free stock acquisitions followed by tax-free liquidations as asset acquisitions.²⁹² In conjunction with a general anti-abuse rule that treated

²⁸⁷ See T.D. 6616, 1962-2 C.B. 98.

²⁸⁸ See Reg. § 1.382(a)-1(h)(9) (1962).

²⁸⁹ Reg. § 1.382(a)-1(h)(5). This provision reflected a limited version of the *Libson Shops* doctrine.

²⁹⁰ See *id.*

²⁹¹ See Wootton, note 204, at 875 n.8.

²⁹² Reg. § 1.382(b)-1(a)(6) (1962).

“two or more successive reorganizations” as occurring “simultaneously,” this recast either foreclosed or created uncertainty about the treatment of multi-step planning techniques.²⁹³ Other detailed rules attempted to ensure that target shareholders received a full 20% equity interest in the acquiring corporation.²⁹⁴ In this way, the 1962 regulations restricted tax practitioners’ flexibility in structuring acquisitions of loss corporations by essentially responding to existing interstitial and reconstructive interpretations of § 382.

In addition, Treasury’s agenda was set by eight years of tax planning that preceded its regulations under § 382. This long delay not only allowed private interpretations to define § 382’s implementation before 1962, but Treasury’s final regulations proved narrow and reactive. Counterfactual regulations, promulgated without any prior interpretations by practitioners, could have had different focus or content.

Following this flurry of regulatory activity, one practitioner ruminated that “[f]ew areas of tax law have undergone such rapid change as the rules governing utilization of operating losses.”²⁹⁵ This rapid change, however, had little practical consequence. Because of tax practitioners’ planning efforts, the actual practice of transferring NOL carryovers continued almost unhindered after Congress enacted § 382 in 1954—and, indeed, after Treasury finalized the 1962 regulations. Congress proved unable to enact legislation that would strengthen or clarify § 382, and Treasury was reduced to reacting to existing planning techniques. Private planning involving § 382 shifted the line between permissible and impermissible transfers of NOL carryovers in taxpayers’ favor, and this advantage persisted even after opportunities for legislative and administrative correction. In this way, planning drift affected policy development with respect to NOL carryovers, and the market in NOL carryovers continued until the Tax Reform Act of 1986 completely rewrote § 382 and the rules governing loss corporations. Although aspects of the 1986 reform²⁹⁶ reflected prior planning practices, the new § 382 substantially changed the planning landscape, as new techniques arose to avoid the new provision and the market in loss corporations cooled.²⁹⁷

²⁹³ Reg. § 1.382(b)-1(c).

²⁹⁴ See Reg. § 1.382(b)-1(a)(2).

²⁹⁵ Deshler D. Armstrong, *New Barriers to Utilization of Operating Losses*, 40 *Taxes* 867, 867 (1962).

²⁹⁶ Tax Reform Act of 1986, Pub. L. No. 99-514, § 621, 100 Stat. 2085, 2254-65.

²⁹⁷ See notes 204, 261. The Tax Reform Act of 1976, Pub. L. No. 94-455, § 806, 90 Stat. 1520, 1599-1600, included significant changes to § 382, but the effective date of these revisions was continually delayed until the reforms of 1986 mooted the issue.