3-1-1986

Thinking about Nonliteral Interpretations of the Internal Revenue Code

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Recommended Citation

Lawrence Zelenak, Thinking about Nonliteral Interpretations of the Internal Revenue Code, 64 N.C. L. Rev. 623 (1986).
Available at: http://scholarship.law.unc.edu/nclr/vol64/iss3/4

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In interpreting the Internal Revenue Code, courts must frequently resolve conflicts between the Code's literal language and its underlying structure and policies. Professor Zelenak points out that the United States Supreme Court has failed to develop a coherent, consistent approach to resolving such conflicts, thus giving lower courts little guidance as to whether and when nonliteral interpretations of the Internal Revenue Code may be proper. Professor Zelenak argues that nonliteral interpretations of the Internal Revenue Code may be appropriate when the language of a Code provision, taken literally, conflicts with Code policy or structure. The complexity of the Code does not justify a blanket prohibition against nonliteral interpretation; indeed, in some instances, the Code's complexity may provide a basis for nonliteral interpretation by revealing underlying Code structure and policies with particular clarity. Moreover, Professor Zelenak contends that the progovernment bias some courts display in addressing questions of nonliteral interpretation is unwarranted and ultimately may prove detrimental to governmental inter-
ests. Professor Zelenak advocates an evenhanded approach to nonliteral interpretation of the Internal Revenue Code and urges the Supreme Court to develop and apply a coherent method for resolving questions of nonliteral interpretation consistent with the suggestions made in this Article.

I. INTRODUCTION

The Internal Revenue Code has a way of saying one thing while seeming to mean something else. Literal interpretations, based on the language of the Code, often conflict with interpretations based on the structure or policy of the Code. In the past four years, the United States Supreme Court has decided at least five cases involving conflicts between language-based interpretations of the Code and interpretations based on statutory structure or policy. The Court, however, has not consistently articulated any general principles for dealing with such conflicts. In two cases the Court adopted what it admitted were nonliteral interpretations, but neither opinion provided any substantial discussion of the general principles that courts should consider in dealing with proposed nonliteral interpretations of the Code. In a third case adopting a nonliteral interpretation, the Court provided a brief discussion of such general principles, noting that "[i]t is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute." In a fourth case, however, the Court rejected an interpretation it deemed incompatible with the statutory language, stating that it was not "free . . . to twist [the Code] beyond the contours of its plain and unambiguous language in order to comport with good policy." In the fifth case, the Court adopted a nonliteral interpretation without acknowledging that its interpretation could not be reconciled with the language of the statute. These five cases have created confusion as to whether and when nonliteral interpretations of the Code are permissible.

In Hillsboro National Bank v. Commissioner, the first of the five cases, the Supreme Court adopted a nonliteral interpretation of the Code without explaining how courts should analyze problems of nonliteral interpretation. One of the issues in Hillsboro National Bank was whether a corporation was required by the tax benefit rule to recognize income on a liquidating distribution of cattle feed, the cost of which the corporation had previously deducted as a business expense.

4. Id. at 586.
6. Id. at 764.
The literal language of section 336(a) of the Internal Revenue Code, providing that “no gain or loss shall be recognized to a corporation on the distribution of property in . . . complete liquidation,” seemed to shield the corporation from recognition of income on the distribution of the feed. Despite this clear and sweeping language, however, the Court deemed it necessary “to inquire whether this is the sort of gain that goes unrecognized under § 336.” The Court examined “the background of § 336 and its place within the framework of tax law” and concluded that “it does not prevent the application of the tax benefit rule.” Although the Court provided no general guidelines for the resolution of tensions between the language and the logic of the Code, it did offer some guidance by example. The Court explained at length why “the background of § 336 and its place within the framework of tax law” justified the application of the tax benefit rule “[i]n spite of the language of nonrecognition.”

The shortcoming of the Hillsboro National Bank opinion—an absence of guidance, other than by example, as to how arguments for nonliteral interpretations of the Code should be analyzed—is insignificant compared to the intellectual sloppiness of the Court’s opinion in Commissioner v. Tufts. One might conclude from Tufts that the Court prefers to deal with conflicts between Code language and Code logic by pretending that the conflicts do not exist. The Court held in Tufts that a taxpayer who disposes of property subject to a nonrecourse mortgage in excess of the fair market value of the property must include the full amount of the mortgage in the amount realized. As the Court explained, this conclusion is inescapable as a matter of tax logic.

The result in Tufts is irreconcilable, however, with the language of section 1001(b) of the Code, which defines “amount realized” as “the sum of any money received plus the fair market value of the property (other than money) received.” Although the Court acknowledged that section 1001(b) was the controlling statutory provision, it failed to explain how the statutory language could be construed to include in amount realized the full amount of a nonrecourse mortgage in excess of the fair market value of the property. The absence of an explanation is not surprising, because no explanation is possible. The language of section 1001(b) defines amount realized in terms of the economic benefit received by the person disposing of the property, and the transfer of property encumbered by a nonrecourse mortgage in excess of the value of the property does not confer an economic benefit on the transferor equal to the full amount of the mortgage. The Court might have admitted that its holding was contrary to the language of section 1001(b), but explained that the logic of the holding was
so compelling as to justify a nonliteral interpretation. It might even have taken the case as an opportunity to offer its thoughts on how courts should go about resolving conflicts between the language and the logic of the Code. Instead, the Court simply ignored the conflict, perhaps hoping no one would notice that the result in Tufts cannot be reconciled with the language of section 1001(b).

The Supreme Court's failure to acknowledge its departure from statutory language in Tufts contrasts sharply with its approach to Code interpretation less than a month later in Bob Jones University v. United States. The issue presented in Bob Jones was whether schools that practice racial discrimination can qualify as tax exempt educational organizations under section 501(c)(3). The Court's conclusion that they cannot was based on a nonliteral interpretation of the language of the Code. In the Court's view, section 501(c)(3) had implicitly adopted common-law standards of charity that would preclude an organization violating "established public policy" from qualifying for tax exempt status. Because the schools' discriminatory policies violated public policy, the schools were not "charitable" within the meaning of section 501(c)(3).

As the schools pointed out, the language of section 501(c)(3) provides that "[c]orporations organized and operated exclusively for religious, charitable . . . or educational purposes" are exempted from taxation. Because the statute uses the disjunctive "or," the schools argued that their status as educational organizations qualified them for tax exemption and that they were not also required to be charitable to qualify for tax exemption. The Court responded to this argument by citing the "well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute." Construing section 501(c)(3) "within the framework of the Internal Revenue Code and against the background of the Congressional purposes," the Court determined that, despite the seemingly unambiguous statutory language, an educational organization must be charitable in the common-law sense to qualify for tax exempt status.

The Court in Bob Jones may have conceded the issue of the "plain language" of section 501(c)(3) too easily; as Justice Powell observed in his concurrence, "[t]he statutory terms are not self-defining." Perhaps one could interpret the term "educational" in section 501(c)(3) to exclude all organizations violating fundamental public policy. This reading, although strained, is not outlandish; it is not as clearly nonliteral as the Supreme Court's holding that, de-

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20. I.R.C. § 501(c)(3) (1982) (Tax exempt organizations must be "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster . . . amateur sports competition . . . , or for the prevention of cruelty to children or animals.").
22. Id. at 598-99.
25. Id. at 586 (citing Brown v. Duchesne, 60 U.S. (19 How.) 183, 194 (1857)).
26. Id.
27. Id. at 607 (Powell, J., concurring).
spite the apparently contrary language of section 501(c)(3), a school must be charitable as well as educational to qualify for tax exemption.

In Badaracco v. Commissioner\textsuperscript{28} the Supreme Court refused to adopt a non-literal interpretation of section 6501, the Code's statute of limitations on the assessment of taxes. The taxpayers in Badaracco had originally filed fraudulent returns, but later filed nonfraudulent amended returns. Although taxes normally must be assessed "within three years after the return was filed,"\textsuperscript{29} section 6501(c)(1) permits assessment "in the case of a false or fraudulent return . . . at any time."\textsuperscript{30} The issue in Badaracco was whether the tax could be assessed only within three years from the filing of the nonfraudulent amended returns, or whether section 6501(c)(1) permitted assessment at any time despite the filing of the nonfraudulent amended returns.\textsuperscript{31}

The Court found the provisions of section 6501 "unambiguous on their face"\textsuperscript{32} so that "it would seem to follow that the present cases are squarely controlled by the clear language of § 6501(c)(1)."\textsuperscript{33} The taxpayers argued that "a nonliteral reading should be accorded the statute on grounds of equity to the repentant taxpayer and tax policy,"\textsuperscript{34} but the Court rejected that argument in words that seem to foreclose the possibility of any nonliteral statutory interpretation:

\begin{quote}
The cases before us . . . concern the construction of existing statutes. The relevant question is not whether, as an abstract matter, the rule advocated by petitioners accords with good policy. The question we must consider is whether the policy petitioners favor is that which Congress effectuated by its enactment of § 6501. Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement.\textsuperscript{35}
\end{quote}

This disavowal of the power to adopt a nonliteral interpretation of the Code is surprising in light of the Court's express declaration in Bob Jones that it did have the power to adopt a nonliteral interpretation and the Court's adoption of nonliteral interpretations in Hillsboro National Bank and Tufts. The disavowal may also have been unnecessary, because, as the Court explained: "[E]ven were we free to do so, there is no need to twist § 6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy, for substantial policy considerations support its literal language."\textsuperscript{36}

In Paulsen v. Commissioner,\textsuperscript{37} the most recent of the five cases dealing with nonliteral interpretation, the Supreme Court acknowledged that it was adopting

\begin{footnotes}
\footnote{28. 104 S. Ct. 756 (1984); see also infra text accompanying notes 149-60 (discussion of Badaracco).}
\footnote{29. I.R.C. § 6501(a) (1982).}
\footnote{30. \textit{Id.} § 6501(c)(1).}
\footnote{31. \textit{Badaracco}, 104 S. Ct. at 759.}
\footnote{32. \textit{Id.} at 761.}
\footnote{33. \textit{Id.}}
\footnote{34. \textit{Id.} at 764.}
\footnote{35. \textit{Id.}}
\footnote{36. \textit{Id.}}
\footnote{37. 105 S. Ct. 627 (1985).}
\end{footnotes}
a nonliteral interpretation of the Code. The taxpayers in Paulsen were stockholders in a state chartered stock savings and loan association (Commerce), which merged into a federally chartered mutual savings and loan association (Citizens). Pursuant to the merger, the taxpayers received passbook savings accounts and time certificates of deposit in Citizens in return for their Commerce stock. The issue in the case was whether the merger qualified as a reorganization under section 368(a)(1)(A) so that the taxpayers could defer recognition of any gain realized on the exchange pursuant to section 354(a)(1).

The Court in Paulsen stated that "under the literal terms of the Code the transaction would qualify as a tax-free 'reorganization' exchange," but added that "[s]atisfying the literal terms of the reorganization provisions . . . is not sufficient to qualify for nonrecognition of gain or loss." The Court noted that it had long interpreted the Code to "exclude [from nonrecognition treatment] sales structured to satisfy the literal terms of the reorganization provisions but not their purpose." Because the taxpayers had exchanged their Commerce stock for "essentially cash with an insubstantial equity interest," the transaction failed to satisfy the judicially created continuity-of-interest test, which requires "that the taxpayer's ownership interest in the prior organization . . . continue in a meaningful fashion in the reorganized enterprise." Because the "retained equity interest in the reorganized enterprise . . . [was] not a 'substantial' part of the value of the Commerce stock which was given up," the taxpayers were required to recognize the gain they had realized on the exchange.

Both in its language and in its holding, Paulsen appears to affirm the propriety of nonliteral interpretations of the Code. Paulsen, however, was a reorganization decision, and there is a long and special history of progovernment nonliteral interpretations of the Code's reorganization provisions. It is not clear from Paulsen that the Supreme Court would be as willing to adopt nonliteral interpretations outside the reorganization area. The Court in Paulsen remarked that "[s]atisfying the literal terms of the reorganization provisions . . . is not sufficient," but it did not discuss nonliteral interpretation of other parts of the Code.

Two things are apparent from a reading of these five opinions. First, conflicts between statutory language and tax policy or Code structure are common. Second, despite the frequency with which it considers such conflicts, the Supreme Court has not yet developed and applied any consistent method for

38. The passbook savings accounts and time certificates of deposit were Citizens' only ownership instruments. Id. at 631.
40. Id. § 354(a)(1).
41. Paulsen, 105 S. Ct. at 630.
42. Id.
43. Id.
44. Id. at 632.
45. Id. at 630.
46. Id. at 632.
47. See infra text accompanying notes 266-76.
resolving them. In *Hillsboro National Bank* the Court avoided making any general pronouncements on the subject. *Bob Jones* indicated that nonliteral interpretations may sometimes be appropriate, and *Paulsen* sanctioned nonliteral interpretations at least in the reorganization area. *Tufts* suggested that courts may adopt nonliteral interpretations so long as they do not acknowledge that they are doing so. In *Badaracco*, however, the Court seemed to condemn nearly all nonliteral interpretations. The effect of these cases has been to create unnecessary confusion concerning the propriety of nonliteral interpretations of the Code.49

The results reached in the five cases discussed above are not necessarily wrong; there is not even necessarily anything wrong with the way the Court weighed the statutory language against considerations of policy and logic in the individual cases. Nor would it be possible for the Court to formulate a mechanical set of rules for determining whether a literal or nonliteral interpretation would be more appropriate in a particular case. But it does not follow that the incoherence of the Supreme Court's present practice is inevitable. There is no excuse for the Court's approving nonliteral interpretation in one case, condoning it in a second, and practicing it surreptitiously in a third. There are a few general principles that can and should be applied in choosing between a literal and a nonliteral interpretation of the Code. Some of these principles are applicable to the interpretation of any statute; others are peculiar to the construction of the Internal Revenue Code. Although these principles cannot, by themselves, decree how any particular case should be decided, they can offer a consistent and sensible way of analyzing problems of nonliteral interpretation of tax statutes. If

49. In addition to the five cases discussed in the text, the Supreme Court recently decided three other cases with some relevance to the problem of nonliteral interpretation of the Code. United States v. National Bank of Commerce, 105 S. Ct. 2919 (1985), concerned the right of the Internal Revenue Service under I.R.C. § 6331(a) (1982) "to levy on [joint bank] accounts for delinquent federal income taxes owed by only one of the persons in whose name the joint accounts stand in order that the IRS may obtain provisional control over the amount in question." *National Bank of Commerce*, 105 S. Ct. at 2922. The Court held that the Code gave the Service the right to levy on such accounts. *Id.* at 2931. The majority did not believe that the case involved any question of nonliteral interpretation; it found the interpretations of the statutory language proposed by both parties to be "plausible." *Id.* at 2930 n.14. Justice Powell, however, accused the majority of "ignor[ing] the plain language" of the Code. *Id.* at 2937 (Powell, J., dissenting).

*Commissioner v. Engle*, 464 U.S. 206 (1984), presented the question whether I.R.C. §§ 611-613A (1982) "entitle taxpayers to an allowance for percentage depletion on lease bonus or advance royalty income received from lessees of their oil and gas mineral interests." *Engle*, 464 U.S. at 208. In a 5-4 decision the Court ruled in favor of the taxpayers and rejected an interpretive regulation as unreasonable. *Id.* at 226. The majority did not consider the case to involve any question of nonliteral interpretation; in its view the interpretations offered by both the government and the taxpayers could "be reconciled with the language of the statute itself." *Id.* at 217. Justice Blackmun, however, suggested that the majority's interpretation was difficult to reconcile with the statutory language. *Id.* at 228-31 (Blackmun, J., dissenting).

In *United States v. Rodgers*, 461 U.S. 677 (1983), the Court considered and rejected, with only a brief discussion, a proposed nonliteral interpretation of I.R.C. § 7403 (1982), which concerns judicial sales of property to satisfy delinquent taxpayers' tax liabilities. *Rodgers*, 461 U.S. at 700-02. The majority's opinion did not indicate when, if ever, a nonliteral interpretation of the Code would be appropriate. In a separate opinion Justice Blackmun argued in favor of a nonliteral interpretation based on principles governing the interpretation of statutes in derogation of the common law. *Id.* at 716 (Blackmun, J., concurring in part and dissenting in part). Obviously, those principles would seldom be relevant to an interpretation of the Internal Revenue Code.
the light they shed is dim, it is still considerably brighter than the recent emanations from the Supreme Court.

This Article argues that nonliteral interpretations of statutes, including the Internal Revenue Code, are sometimes proper. It then discusses the principles that courts should apply in deciding whether nonliteral interpretations of the Code should be adopted in particular situations.

II. IS A NONLITERAL INTERPRETATION EVER PROPER?

Interpreting statutes is not a task unique to the practice of tax law. The principles that apply to the interpretation of any statute apply to the interpretation of the Code as well. But the unique complexity of the Code makes it more than just another statute, and for that reason the question of when nonliteral interpretations of the Code are appropriate merits separate discussion from the appropriateness of nonliteral interpretations of statutes in general. On the more basic question, however, whether nonliteral interpretations are ever justified, there seems to be little reason for treating interpretation of the Code as a subject distinct from the interpretation of any other statute.

As the review of the five recent Supreme Court tax cases discussed in Part I has demonstrated, the Supreme Court has made contradictory statements on whether nonliteral statutory interpretations can ever be proper. The reasons for the Court's contradictory pronouncements on this subject can best be understood by remembering Justice Holmes' admonition that sometimes "a page of history is worth a volume of logic."

More than thirty-five years ago Professor Karl Llewellyn posited twenty-eight pairs of mutually contradictory canons of statutory construction, all culled from judicial opinions. Several of the pairs of contradictory canons dealt with the permissibility or impermissibility of nonliteral interpretations. For example, the first contrasting pair was: "A statute cannot go beyond its text," and "To effect its purpose a statute may be implemented beyond its text." The twelfth pair was: "If language is plain and unambiguous, it must be given effect," and "[n]ot when literal interpretation would lead to absurd or mischievous conse-

51. See infra text accompanying notes 107-254.
52. See supra text accompanying notes 1-49; see also Commissioner v. Brown, 380 U.S. 563, 571 (1965) (citing several Supreme Court tax opinions for the proposition that nonliteral interpretations of the Code are sometimes appropriate). Compare Malat v. Riddell, 383 U.S. 569, 571-72 (1966) ("Departure from a literal reading of statutory language may, on occasion, be indicated by relevant internal evidence of the statute itself and necessary in order to effect the legislative purpose.") with Hanover Bank v. Commissioner, 369 U.S. 672, 687 (1962) (When statute's "plain and ordinary language" showed clear intent of Congress, Court was "not at liberty, notwithstanding the apparent tax-savings windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute.").
55. Id. at 401.
quences or thwart manifest purpose."56

Professor Llewellyn discussed why "in the field of statutory construction . . . there are 'correct,' unchallengeable rules of 'how to read' which lead in . . . variant directions."57 As he observed, "[w]hen it comes to presenting a proposed [statutory] construction in court, there is an accepted conventional vocabulary. . . . [T]he accepted convention still, unhappily requires discussion as if only one single correct meaning could exist. Hence there are two opposing canons on almost every point."58 Under the approach described by Professor Llewellyn, a court first decides, for reasons independent of the canons of construction, how a statute should be construed. The court then selects from among the contradictory pairs the canon or canons that will support the result the court has already reached by other means. This approach can lead to doctrinal chaos.

It is possible, however, to overstate the extent of the chaos. Although there certainly is language to the contrary in the decided cases,59 the weight of Supreme Court authority favors the possibility of nonliteral statutory interpretations. In fact, the Supreme Court has explicitly and repeatedly stated that it is sometimes appropriate to interpret statutes in a manner inconsistent with their literal language. Church of the Holy Trinity v. United States60 is often cited as the leading Supreme Court case adopting a nonliteral statutory interpretation. The Church of the Holy Trinity, located in New York, hired an alien residing in England as its pastor. This action violated the literal language of a statute that made it unlawful "in any way [to] assist or encourage the importation or migration of any alien . . . to perform labor or service of any kind in the United States . . . ."61 The Court "conceded that the act of the [church was] within the letter of [the statute],"62 but nevertheless concluded that the church had not violated the law. The Court found that "the title of the Act, the evil which was intended to be remedied, the circumstances surrounding the appeal to Congress, the reports of the committee of each house, all concur[red] in affirming that the intent of Congress was simply to stay the influx of . . . cheap unskilled labor."63 Because Congress had not intended to prohibit the hiring of alien ministers, the Supreme Court held that a nonliteral interpretation of the statute was appropriate:

[W]e cannot think Congress intended to denounce with penalties a transaction like that in the present case. It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its

56. Id. at 403.
57. Id. at 399.
58. Id. at 401.
60. 143 U.S. 457 (1892).
61. Id. at 458.
62. Id.
63. Id. at 465.
makers.\textsuperscript{64} The Court also observed that "[i]t is the duty of the courts . . . to say that however broad the language of the statute may be, the act, although within the letter, is not within the intention of the legislature, and therefore cannot be within the statute."\textsuperscript{65} In support of this position, the Court cited \textit{United States v. Kirby}\textsuperscript{66} in which a statute prohibiting the obstruction of the mail was held inapplicable to a mail carrier charged with murder. The \textit{Kirby} Court cited as precedent for its nonliteral interpretation "the judgment . . . that the Bolognian law which enacted 'that whoever drew blood in the streets should be punished with utmost severity,' did not extend to the surgeon who opened the vein of a person that fell down in the street in a fit,"\textsuperscript{67} and "the ruling . . . that the statute of 1st Edward II., which enacts that a prisoner who breaks prison shall be guilty of felony, does not extend to a prisoner who breaks out when the prison is on fire, 'for he is not to be hanged because he would not stay to be burnt.'"\textsuperscript{68} The Supreme Court noted in later cases that the rule of \textit{Holy Trinity} is not widely applicable. In \textit{Crooks v. Harrelson},\textsuperscript{69} an estate tax opinion, the Court stated:

[T]he principle is to be applied . . . only under rare and exceptional circumstances . . . [T]o justify a departure from the letter of the law . . . the absurdity must be so gross as to shock the general moral or common sense. . . . And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail.\textsuperscript{70}

Ten years after \textit{Harrelson}, however, the Court stated a more liberal rule governing the propriety of nonliteral interpretations. In \textit{United States v. American Trucking Associations}\textsuperscript{71} the Court adopted a nonliteral interpretation of the Motor Carrier Act,\textsuperscript{72} which gave the Interstate Commerce Commission the power to establish "qualifications and maximum hours of service of employees" of common carriers.\textsuperscript{73} Despite the breadth of this language, the Supreme Court held that the Commission's power did not extend to all employees of carriers, but only "to those employees whose activities affect the safety of operation."\textsuperscript{74} The Court explained:

There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases

\textsuperscript{64} Id. at 459.
\textsuperscript{65} Id. at 472.
\textsuperscript{66} 74 U.S. (7 Wall.) 482 (1868).
\textsuperscript{67} Id. at 487.
\textsuperscript{68} Id.
\textsuperscript{69} 282 U.S. 55 (1930).
\textsuperscript{70} Id. at 60.
\textsuperscript{71} 310 U.S. 534 (1940).
\textsuperscript{73} \textit{American Trucking}, 310 U.S. at 539.
\textsuperscript{74} Id. at 553.
we have followed their plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one "plainly at variance with the policy of the legislation as a whole" this Court has followed that purpose, rather than the literal words.75

The American Trucking Court's view, that a nonliteral interpretation may be proper if a literal interpretation would produce an unreasonable result, contrasts with the language in Crooks limiting the propriety of nonliteral interpretation to instances in which literal interpretation would produce a gross absurdity. The Supreme Court has not definitely resolved the tension between these two views.76 Under either view, however, nonliteral statutory interpretation will sometimes be proper.77

There is, then, considerable precedent for nonliteral statutory interpretation. Whether nonliteral interpretation should be permissible, however, is a question that must be resolved in the context of a theory of statutory interpretation. Unfortunately, as Professors Hart and Sacks have noted, "The hard truth of the matter is that American courts have no intelligible, generally accepted, and consistently applied theory of statutory interpretation."78 Similarly, another commentator recently observed that "modern judges...do not seriously believe themselves bound or even guided by general principles of interpretation beyond the vaguest adages about respect for legislative intent."79

In fact, despite those vague adages concerning respect for legislative intent, courts disagree even on whether statutory interpretation should be a search for

75. Id. at 543 (quoting Ozawa v. United States, 260 U.S. 178, 194 (1922)).

76. The Court cited Crooks v. Harrelson, 282 U.S. 55 (1930), with approval in Howe v. Smith, 452 U.S. 473, 483 (1981); Rubin v. United States, 449 U.S. 424, 430 (1981); and Tennessee Valley Auth. v. Hill, 437 U.S. 153, 187 n.33 (1978). In each case, however, the Court quoted the "rare and exceptional circumstances" language of Harrelson, 282 U.S. at 60, without mentioning the statement that "the absurdity must be so gross as to shock the general moral or common sense." Id.; cf. United States v. Rutherford, 442 U.S. 544, 552 (1979) ("Exceptions to clearly delineated statutes will be implied only where essential to prevent 'absurd results' or consequences obviously at variance with the policy of the enactment as a whole.") (citing Tennessee Valley Auth. v. Hill, 437 U.S. 153 (1978); United States v. American Trucking Ass'n, 310 U.S. 534 (1940)). For other recent Supreme Court opinions dealing with questions of nonliteral statutory interpretation, see Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 574 (1982) (rejecting the argument "that a literal construction of the statute...would produce an absurd and unjust result which Congress could not have intended"); and Watt v. Alaska, 451 U.S. 259, 266 (1981) ("The circumstances of the enactment of particular legislation may persuade a court that Congress did not intend words of common meaning to have their literal effect.").

77. This willingness to interpret statutes nonliterally is not unique to the Supreme Court. The elevation of the spirit of the law over its letter goes back at least as far as the medieval doctrine that statutes should be interpreted according to their "equity" or spirit. See 2A N. Singer, SUTHERLAND STATUTORY CONSTRUCTION §§ 54.01-08 (4th ed. 1984). The decisions of many American courts reflect a similar emphasis upon the spirit of the law. See id. §§ 45.12, 46.07, 54.03, 54.05, 58.06, and cases cited therein.


the intent of the legislature or for the meaning of the statute.\textsuperscript{80} An intent-based theory of statutory interpretation calls for author (legislature)-oriented interpretations, whereas a meaning-based theory mandates a reader-oriented interpretation. Under an intent theory, the standard of interpretation is the intent of the legislature that enacted the statute. Under a meaning theory, the standard of interpretation is how the statute would be understood by a hypothetical appropriate reader.

The weight of judicial authority favors an intent-based theory of interpretation.\textsuperscript{81} The Supreme Court relied on the "intention of the Legislature"\textsuperscript{82} in adopting a nonliteral interpretation in \textit{Holy Trinity}. In \textit{American Trucking} the Court remarked: "In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress."\textsuperscript{83} In \textit{Bob Jones} the Court justified its nonliteral interpretation by appealing to "the [congressional] intent that entitlement to tax exemption depends on meeting certain . . . standards . . . ."\textsuperscript{84} The appeal of an intent-based theory of interpretation is understandable. As Professor Hurst has written, "Because the statute's function is to make authoritative value determinations, fulfillment of the function is impossible without inquiry as to what values and what order of values the legislators had in mind."\textsuperscript{85}

There are logical difficulties, however, with a theory of interpretation based on legislative intent. In an influential 1930 \textit{Harvard Law Review} article,\textsuperscript{86} Professor Max Radin argued against an intent-based theory of statutory interpretation. Professor Reed Dickerson summarized the Radin attack on legislative intent:

Briefly, he says that it is unrealistic to talk about legislative intent, because the notion of "the lawmaker" is fictional; there is no such person. Nor is it realistic to talk about the intent of the heterogeneous collectivity known as "the legislature." In most cases, only one or two persons drafted the bill, many persons voted against it, and those who voted for it may have had differing ideas and beliefs. Even if the participating legislators had the same intent, we have no means of knowing it except "by the external utterances or behavior of these hundreds of men." Even if unanimous legislative intent were knowable, it would be powerless to bind the courts, because the legislators' function is not

\textsuperscript{80} Most judges are "[u]ndisturbed by the very sophisticated (and mainly academic) debate over the distinction between the meaning of enacted words and the intent of the enacting legislature." Weisberg, supra note 79, at 214.

\textsuperscript{81} 2A N. Singer, supra note 77, § 45.05.

\textsuperscript{82} Holy Trinity, 143 U.S. at 472.

\textsuperscript{83} American Trucking, 310 U.S. at 542.

\textsuperscript{84} Bob Jones, 461 U.S. at 586; see also Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982) ("[I]n rare cases the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters, and those intentions must be controlling.").

\textsuperscript{85} J. Hurst, Dealing with Statutes 40 (1982); see also R. Dickerson, The Interpretation and Applications of Statutes 36 (1975) ("[W]e are interested in the intended meaning of the author in the sense that the process of communication makes no sense unless some intention can be attributed to him. Intended meaning, therefore, remains the ultimate object of search even though no method has yet been devised by which this meaning can be directly known.").

\textsuperscript{86} Radin, Statutory Interpretation, 43 Harv. L. Rev. 863 (1930).
to impose their respective wills, but to "pass statutes." Even if legislative intent had binding force, it could hardly control the final interpretation in advance, because the legislature could not have intended to cover a particular factual situation that did not yet exist. Finally, legislative intent is irrelevant under any rule of interpretation that limits the interpreter to the text of the statute.  

In addition to the theoretical problems involved in ascertaining and implementing legislative intent, this approach to statutory interpretation also raises problems of notice. Requiring regulated persons to conform their conduct to legislative intentions not evidenced on the face of a statute is obviously less fair than permitting such persons to rely on a statute's apparent meaning.

Some courts and commentators have taken the position that statutes should be interpreted according to what they mean rather than according to what the legislature intended. What a statute means is determined by how the statute would be understood by a hypothetical intelligent and appropriately informed reader—the "typical member of the audience to which the communication is addressed." Justice Holmes said, "I don't care what [the legislature's] intention was. I only want to know what the words mean." In a similar vein, Justice Frankfurter remarked, "All these years I have avoided speaking of the


88. See Moore, supra note 87, at 258.

89. See 2A N. Singer, supra note 77, §§ 45.07-.08. Judicial support for a meaning-based standard of interpretation may be greater than a casual perusal of the cases would suggest. It is possible that some courts that have favored "intent" as the standard interpretation have meant what this Article has called "meaning." As Justice Holmes wrote:

Only a day or two ago—when counsel talked of the intention of a legislature, I was indiscreet enough to say I don't care what their intention was. I only want to know what the words mean. Of course the phrase often is used to express a conviction not exactly thought out—that you construe a particular clause or expression by considering the whole instrument and any dominant purposes that it may express. In fact intention is a residuary clause intended to gather up whatever other aids there may be to be interpreted beside the particular words and the dictionary.


90. As Professor Dickerson has observed:

Because we must generally assume that the author has not performed the futile act of trying to communicate by unfamiliar signs, the only reliable general key to meaning lies in the language habits of that audience. This notion of a predominating, observable pattern of usage it is convenient to personify in the "typical member of the audience to which the communication is addressed." Although like the "reasonable man" he is in a sense fictional, he is nonetheless useful. What the statute means to such a person is what the word "means" means in the question "What does the statute mean?" and that is the only thing it can mean.

R. Dickerson, supra note 85, at 36-37 (quoting Jones, The Plain Meaning Rule and Extrinsic Aids in the Interpretation of Federal Statutes, 25 Wash. U.L.Q. 2, 22 (1939)). Another commentator has framed the appropriate inquiry in the following way: "Instead of asking what a statute... 'means,' that is, as if we expected a one-sentence response, we can ask what it means in a different way: how would the ideal reader contemplated by this document, indeed constituted by it, understand its bearing in the present circumstances?" White, Law as Language: Reading Law and Reading Literature, 60 Tex. L. Rev. 415, 435 (1982).

91. Letter from Justice Holmes, reprinted in Frankfurter, supra note 89, at 538.
'legislative intent,' and I shall continue to be on my guard against using it." In Justice Frankfurter's view, courts engaged in statutory interpretation "are not concerned with anything subjective. [They] do not delve into the mind of legislators or their draftsmen, or committee members." Similarly, Professors Hart and Sacks proposed that "[t]he function of a court in interpreting a statute is to decide what meaning ought to be given the directions of the statute in the respects relevant to the case before it." They cautioned: "Before deciding that this statement is so nearly indeterminate as to be meaningless, notice what it does not say. It does not say that the court's function is to ascertain the intention of the legislature with respect to the matter in issue."

Intent and meaning are not necessarily mutually exclusive approaches to statutory interpretation. A reconciliation of sorts may be possible, as Professor Dickerson has suggested. He distinguished between "actual intent" (what this Article has called intent) and "manifest intent" (what this Article had called meaning). He argued that, although actual legislative intent is the theoretically correct standard for interpretation, "we must read statutes as if actual intent and manifest intent coincided, because in the long run we can approximate actual intent more reliably under that assumption than under any other." Under this view, what a statute would be understood to mean by the appropriate hypothetical reader is, in practice, the best guide to what the legislature intended.

This Article will not add to the debate as to whether statutory interpretation should be based on an intent standard, a meaning standard, or some reconciliation of the two. Its concern is limited to the question whether nonliteral interpretations are supportable under either or both of the standards.

It is not difficult to reconcile an intent-based theory of interpretation with occasional nonliteral statutory interpretations. Just as individuals misspeak themselves at times, so may legislatures. If a legislature has misspoken, an intent-based theory of interpretation requires that the statute be interpreted according to what the legislature intended, rather than what it said. It is also possible that a legislature will intentionally, rather than mistakenly, use language in a way incompatible with a literal interpretation, as Humpty Dumpty used a word to mean "just what I choose it to mean—neither more nor less." If the legislature's intent to use language in such a manner can somehow be discovered, an intent-based theory requires that the legislature's intent govern.

If a meaning-based theory of statutory interpretation is adopted, however, how can nonliteral interpretation be possible? How can a statute mean what its words do not say? Professors Hart and Sacks, who proposed a meaning stan-

92. Frankfurter, supra note 89, at 538.
93. Id. at 539.
94. 3 H. HART & A. SACKS, supra note 78, at 1410.
95. Id.
96. R. DICKERSON, supra note 85, at 69-70.
97. Id. at 36.
98. Id. at 80.
dard for interpretation, believed that a court could not properly give a statute a meaning that its words could not bear.\textsuperscript{100} In contrast, this Article contends that an entirely nonliteral interpretation can sometimes be proper, even under a meaning-based theory of interpretation. The explanation for this position lies in a contextual, or whole statute, approach to the discovery of statutory meaning.

It is generally accepted that particular words in a statute should not be read in isolation; rather, they must be understood in the context of the statute in which they appear. The relevant context is both internal (the entire statute in which the particular words to be interpreted appear) and external (the legislative history, the conditions to which the statute was a response, and the like). As Justice Holmes remarked, "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and time in which it is used."\textsuperscript{101} Judge Learned Hand used a different metaphor: "[T]he meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity [of statutory language] can ever obviate recourse to the setting in which all appear, and which all collectively create."\textsuperscript{102} More prosaically, Justice Cardozo wrote, "[T]he meaning of a statute is to be looked for, not in any single section, but in all the parts together and in their relation to the end in view."\textsuperscript{103} The English "Golden Rule" of statutory interpretation required courts "to take the whole statute together, and construe it all together."\textsuperscript{104}

Even under a meaning-based theory of statutory interpretation, the context in which the particular words to be interpreted appear may be so powerful as to indicate that the words must be given a meaning that, taken literally, they will not bear. There is no reason why words of a statute may not have, to their hypothetical appropriate reader, a meaning contrary to any literal interpretation, if the context persuasively indicates such a meaning. The statutory context may clearly indicate that the only sensible, logical interpretation is a nonliteral interpretation. If this is the case, the nonliteral interpretation should be regarded as the statute's meaning. Professors Hart and Sacks, who advocated a meaning-based theory of interpretation and who generally rejected nonliteral interpretation, did acknowledge the propriety of nonliteral interpretation in cases

\textsuperscript{100} 3 H. HART & A. SACKS, supra note 78, at 1225-26, 1411-12. The practical significance of this limitation depends, of course, on the range of meanings words can bear. Professors Hart and Sacks recognized that words can frequently bear a fairly wide range of meanings: "In deciding whether words will bear a particular meaning, a court needs to be linguistically wise and not naive. It needs to understand, especially, that meaning depends upon context." \textit{Id.} at 1412.

Professor Dickerson, who also argued that statutes should be interpreted according to their meaning, \textit{see supra} text accompanying notes 96-98, did allow for nonliteral interpretations in some cases. \textit{See R. DICKERSON, supra} note 85, at 198-205, 213-16.

\textsuperscript{101} Towne v. Eisner, 245 U.S. 418, 425 (1918).

\textsuperscript{102} Helvering v. Gregory, 69 F.2d 809, 810-11 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935).

\textsuperscript{103} Panama Ref. Co. v. Ryan, 293 U.S. 388, 439 (1935) (Cardozo, J., dissenting).

\textsuperscript{104} See River Wear Comm'r's v. Adamson, 2 App. Cas. 743, 764 (H.L. 1877). For further discussion of contextual methods of interpretation, \textit{see} R. DICKERSON, supra note 85, at 213-15; J. HURST, \textit{supra} note 83, at 59-61; \textit{2A N. SINGER, supra} note 77, §§ 46.05, 47.02; De Sloovere, \textit{Contextual Interpretation of Statutes}, 5 FORDHAM L. REV. 219 (1936). The Supreme Court has acknowledged the need for a contextual approach to the interpretation of the Internal Revenue Code. \textit{See infra} text accompanying note 108.
of clear legislative mistake: "Courts on occasion can correct mistakes, as by inserting or striking out a negative, when it is completely clear from the context that a mistake has been made." This Article contends, however, that the situations in which nonliteral interpretations are appropriate under a meaning-based theory of interpretation extend beyond those that can fairly be labeled instances of mere legislative mistake. As discussed more fully below, there are instances in which nonliteral interpretations of the Code seem proper under either an intent-based or a meaning-based theory of interpretation. Those instances strongly suggest that a statute may have a meaning, as understood by a hypothetical intelligent and appropriately informed reader, that is incompatible with the literal language of the statute.

III. How To Think About Nonliteral Interpretations of the Internal Revenue Code

A. The Conflict Arises

The first step in applying the Internal Revenue Code, or any other statute, to a particular fact situation is simply to read the statute. The words of the statute will often clearly indicate how the statute is to be applied to the facts. There is a strong presumption that the words of a statute are used in their ordinary and customary senses. The Supreme Court has declared: "As we have often said, 'the words of statutes—including revenue acts—should be interpreted when possible in their ordinary, everyday senses.'" Normally, a legislature can communicate most clearly by using words in statutes in their "ordinary everyday senses," and so that is how legislatures normally use statutory language. It follows that most of the time statutes should be interpreted in accordance with the "ordinary, everyday senses" of the words used.

The Supreme Court has recognized, however, that the words of the Internal Revenue Code must be interpreted in context:

We have noted that "[t]he true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part." In some cases this contextual approach reveals a structure or indicates a policy which suggests that the particular words in question should not be interpreted in their ordinary senses. Although conflicts between statutory language and statutory context are not unique to the Internal Revenue Code, such conflicts occur in the Code with unusual frequency. The pervasiveness of such con-

105. 3 H. HART & A. SACKS, supra note 78, at 1413; see also id. at 1218 (note on "The Problem of Lapsus Linguae").
106. See infra text accompanying notes 176-210.
107. Malat v. Riddell, 383 U.S. 569, 571 (1966) (per curiam) (quoting Crane v. Commissioner, 331 U.S. 1, 6 (1947)).
Conflicts in the Code is related to the Code's complexity in two ways. First, the complexity and technicality of the Code's concepts often make it difficult for Congress to find words that, used in their "ordinary, everyday senses," clearly convey the intended meaning. Second, the very complexity of the Code may give the Code more in the way of underlying structures and permeating policies than most other statutes.109 These structures, policies, and principles can be discovered—sometimes easily, sometimes with great difficulty and uncertainty—through a thoughtful reading and study of the Code as a whole.

The Code presents an unusual number of situations in which the adequacy of language is challenged. It also provides an unusually helpful context for interpreting its many difficult passages.110 The combination of inadequate language and strong context results in a large number of situations in which context seems to be at odds with language.

A reading contrary to the ordinary sense of the words of a statute may be suggested not only by internal context (the statute taken as a whole), but also by external context (primarily, legislative history). As a practical matter, however, legislative history rarely provides the impetus for an interpretation contrary to the ordinary sense of a statute's language. This is because legislative history addresses only problems that Congress has specifically considered. Congress can usually draft statutory language that clearly covers specifically considered problems in the manner intended. Conflicts between statutory language and legislative history, therefore, are infrequent. In situations not specifically considered by Congress, however, statutory language is likely to be inadequate. In such cases the conflict will be between the particular language and the internal context supplied by the Code, rather than between the particular language and its legislative history.

The frequency with which collisions between language and context occur makes the Code a particularly difficult statute to interpret. One commentator has complained, perhaps only half jokingly, that "[e]veryday meanings are of only secondary importance when construing the words of a tax statute and are very seldom given any weight when a more abstruse and technical meaning is available."111 More seriously, Justice Frankfurter observed: "The imagination which can draw an income tax statute to cover the myriad transactions of a society like ours, capable of producing the necessary revenue without producing a flood of litigation, has not yet revealed itself."112

What, then, should a court do when the language of an Internal Revenue Code provision suggests an interpretation at odds with the interpretation suggested by the context of the entire Code? No doubt the Court should assign the burden of persuasion to the party arguing against the ordinary sense of the statu-

109. See infra text accompanying notes 230-47.
110. This is not to say it is always easy to discern the Code's structures, principles, and policies. See infra text accompanying notes 230-47.
112. Frankfurter, supra note 89, at 528.
tory language, but the question remains how that burden can be satisfied. That is the subject of the rest of this Article. The suggestions made in this Article are offered with the recognition that general discussions of problems of statutory construction are of limited usefulness. Justice Frankfurter "confess[ed] unashamedly" that he did "not get much nourishment from books on statutory construction."114 The problem is that, as Justice Holmes wrote, "every question of construction is unique, and an argument that would prevail in one case may be inadequate in another."115 Statutory interpretation is much more an art than a science;116 particular problems of interpretation cannot be solved by the mechanical application of rules of interpretation. Even so, a discussion of the art of interpreting the Internal Revenue Code may be of some usefulness if it recognizes and respects the uniqueness of each question of interpretation.

B. Interpretations Words Will and Will Not Bear

1. Interpretations Words Will Bear

There can be different degrees of tension between an interpretation suggested by language and an interpretation suggested by context. In some cases, the reading suggested by context, although not the most obvious interpretation of the statutory language considered in isolation, is an interpretation that the words will bear. In other cases, it may be difficult or impossible to reconcile the contextual interpretation with the statutory language. The more difficult it is to reconcile the contextual interpretation with the language to be construed, the more reluctant a court should be to adopt the contextual interpretation. This common sense rule of construction should apply under either an intent-based or a meaning-based theory of interpretation; the greater the difficulty in reconciling a suggested interpretation with the words of the statute, the harder it is to argue either that Congress intended the interpretation, or that the interpretation is what the statute would mean to the hypothetical appropriate reader. Nevertheless, in some cases the context may be so overwhelmingly persuasive that it requires giving the words of the statute an interpretation totally at odds with any possible literal interpretation of those words.

This approach differs from two common attitudes towards problems of nonliteral interpretation. One attitude fails to acknowledge the range of interpretations that may be compatible with the language of the statute; the result of this attitude is often an unjustified assumption of absolute incompatibility between a contextual and a literal interpretation. This failure to recognize the flexibility of words may have serious consequences in that courts may reject

113. J. Hurst, supra note 85, at 49.
114. Frankfurter, supra note 89, at 530.
115. United States v. Jin Fuey Moy, 241 U.S. 394, 402 (1916); see also J. Hurst, supra note 85, at 65 ("The twentieth-century emphasis [in statutory interpretation] thus is not on broad, standardized formulas, but on custom-built determinations, fashioned out of materials immediate and special to the legislation at issue.").
contextual interpretations under the mistaken assumption that they are irreconcilable with the statutory language, when really they are not. The second attitude is that a statute may never be given an interpretation incompatible with its language, that is, a nonliteral interpretation. Overly literal interpretations of the Code result from the convergence of these two attitudes. The interpreter adopting these attitudes may first mistakenly assume that the words of the statute are irreconcilable with the suggested contextual interpretation and may then conclude that the suggested contextual interpretation is therefore impermissible. The possible consequences of this conversion of attitudes are illustrated by a problem in the interpretation of section 312(c)(3) that arose when section 312(n)(4) was added to the Code in 1984.

Under the Internal Revenue Code, corporate distributions to shareholders are taxed as dividends—that is, as ordinary income—if the distributions are made out of corporate earnings and profits. Distributions are deemed to be "made out of earnings and profits to the extent thereof." Distributions in excess of earnings and profits are treated first as nontaxable recoveries of stock basis and then, after stock basis has been fully recovered, as capital gain. Section 312 of the Code describes the effects of various events on a corporation's earnings and profits account. The purpose of the account is to measure corporate earnings available for distributions to shareholders. When a corporation makes a distribution to a shareholder, the earnings and profits account should be reduced to reflect the fact that the earnings distributed are no longer available to the corporation for future distributions to shareholders. In the case of a distribution of property, section 312(a)(3) provides that the amount of the reduction is the corporation's adjusted basis in the property. Thus, in the case of a distribution of property with a fair market value in excess of its basis, section 312(a)(3), standing alone, provides for no reduction of earnings and profits as a result of the appreciation. This is because prior to the distribution of the appreciated property the unrealized appreciation has not been reflected by an increase in the corporation's earnings and profits. The only distribution that should reduce earnings and profits is a distribution of earnings and profits; a distribution of appreciation is not a distribution of earnings and profits if the appreciation has never been reflected in earnings and profits.

117. See, e.g., Badaracco v. Commissioner, 104 S. Ct. 756, 764 (1984); Hanover Bank v. Commissioner, 369 U.S. 672, 687 (1962); 3 H. HART & A. SACKS, supra note 78, at 1412 ("[A] court ought never to give the words of a statute a meaning they will not bear . . . .").
120. I.R.C. §§ 316(a), 301(c)(1) (1982).
121. Id. § 316(a).
122. Id. § 310(c)(2), (c)(3).
A distribution of appreciated property will often cause a corporation to recognize gain.\textsuperscript{127} Under section 312(f)(1)\textsuperscript{128} the recognition of that gain will cause an increase in earnings and profits by the amount of the gain recognized. Because recognition of the appreciation causes an increase in earnings and profits, distribution of the appreciation should cause a decrease. The Code permits a decrease in such cases. The mechanism for the decrease is section 312(c)(3),\textsuperscript{129} which provides that "proper adjustment" in the amount of reduction in earnings and profits under section 312(a)(3) "shall be made for . . . any gain recognized to the corporation on the distribution." The amount of the reduction in earnings and profits attributable to the distribution is increased by the gain recognized on the distribution;\textsuperscript{130} thus, the distribution of the appreciation does reduce earnings and profits to the extent of the gain recognized. This is a reasonable result, because the recognition of the gain caused an increase in earnings and profits under section 312(f)(1).

The difficulty in interpreting section 312(c)(3) arose with the addition of section 312(n)(4) to the Code. Section 312(n)(4) provides that a corporation which makes a distribution of appreciated property on which it does not have to recognize gain\textsuperscript{131} must nevertheless increase its earnings and profits by the amount of the unrecognized gain.\textsuperscript{132} This provision raises the question whether a corporation making a distribution covered by section 312(n)(4) is entitled to make a section 312(c)(3) adjustment so as to enjoy a larger section 312(a)(3) reduction in its earnings and profits. The answer suggested by the structure of the Code is clear: the corporation should be entitled to make the adjustment. Because the appreciation has caused an increase in earnings and profits, distribution of that appreciation should decrease earnings and profits. But the language of section 312(c)(3) may preclude this logical result because it permits adjustments only for "gain recognized to the corporation on the distribution," and the section 312(n)(4) increase in earnings and profits is attributable to a gain that the corporation did not recognize for purposes of determining its taxable income.

Nothing except a literal reading of section 312(c)(3) supports a disallowance of the adjustment to a corporation making a distribution covered by section 312(n)(4). The structure of the Code strongly supports allowance of the adjustment, and nothing in the legislative history of the Tax Reform Act of 1984 indi-

\textsuperscript{127} Recognition of gain would be by reason of some exception to the "general rule" of nonrecognition in I.R.C. § 311(a) (1982). See, e.g., id. § 311(b) (LIFO inventory); id. § 311(c) (liability in excess of basis); id. § 311(d) (West Supp. 1985) (before the Tax Reform Act of 1984, most distributions of appreciated property in redemption of stock (id. § 311(d) (1982)); after the 1984 Act, most nonliquidating distributions of appreciated property); id. § 453B (West. Supp. 1985) (disposition of installment obligations); id. § 1245 (West 1982 & Supp. 1985) (depreciation recapture for personal property); id. § 1250 (depreciation recapture for real property).

\textsuperscript{128} I.R.C. § 312(f)(1) (1982).

\textsuperscript{129} Id. § 312(c)(3).

\textsuperscript{130} See B. BITTKER & J. EUSTICE, supra note 126, ¶ 7.24, at 7-71.

\textsuperscript{131} Under I.R.C. § 311(d) (West Supp. 1985), a corporation will ordinarily recognize gain on a nonliquidating distribution of appreciated property. Nonrecognition of gain would be pursuant to § 311(d)(2), which provides for exceptions to the ordinary rule of § 311(d).

\textsuperscript{132} The effect of this increase is to ensure that the corporation will have sufficient earnings and profits so that the appreciation will be taxed as dividend income to the distributees. Thus, appreciation that escapes tax at the corporate level will result in a dividend tax at the shareholder level.
icates that a section 312(c)(3) adjustment should not be allowed in this situation. It may appear, then, that the literal language of the Code and the interpretation suggested by context are absolutely incompatible. If this were so, the conflict between statutory language and statutory context would present a difficult case. Perhaps the contextual interpretation would be the better choice because the context is so powerful and because there is no reason to believe that the inadequacy of the words of section 312(c)(3) to express the contextual interpretation is the result of anything other than congressional inadvertence.

After section 312(n)(4) was enacted, the Staff of the Joint Committee on Taxation noted and commented on the conflict the provision had created between the logic and the language of the Code. The Staff claimed that the logical result—permitting corporations to make section 312(c)(3) adjustments in cases to which section 312(n)(4) applies—was what "the Congress intended," and remarked that "[a] technical amendment may be appropriate to effectuate that intent." It is questionable, however, whether a technical amendment is needed to reconcile the statutory language with the logic of the Code. It is certainly true that the words "gain recognized," as used in the Internal Revenue Code, usually refer to gain recognized for the purpose of determining taxable income. Section 312, however, is devoted not to the measurement of taxable income, but to the measurement of earnings and profits. It does not do violence to the statutory language to read "gain recognized" in section 312(c)(3) as referring to gain.


134. The Staff of the Joint Committee on Taxation observed:

Under sections 312(a)(3) and 312(c)(3) of prior law, a distribution of appreciated property by a corporation reduced its earnings and profits by an amount equal to the adjusted basis of the property to the corporation increased by any gain recognized by the corporation on the distribution. In a case to which the new provision applies, the Congress intended that earnings and profits be reduced by an amount equal to the distributing corporation's adjusted basis in the property increased by any gain realized by the distributing corporation on the distribution. A technical amendment may be appropriate to effectuate that intent.

Id.

Such a technical amendment is contained in the Tax Reform Act of 1985, H.R. 3838, 99th Cong., 1st Sess. § 1504(f), 131 CONG. REC. H12698 (daily ed. Dec. 17, 1985). The Act, which has been passed by the House, would repeal I.R.C. §§ 312(n)(4), 312(c)(3) (1982), and amend I.R.C. § 312(b) (1982) to apply to any distribution by a corporation, with respect to its stock, of appreciated property. Section 312(b) currently applies only to distributions of inventory assets. A distribution of appreciated assets, to which § 312(b) applies, causes an increase in earnings and profits by the amount of the appreciation, § 312(b)(1)(A), and a decrease (but not below zero) by the amount of the fair market value of the assets distributed, § 312(b)(1)(B). The reduction in earnings and profits by the fair market value of the distributed asset has the same effect as permitting a § 312(c)(3) adjustment due to a § 312(n)(4) increase in earnings and profits. (After the § 312(c)(3) increase, the § 312(n)(3) decrease will be in the amount of the adjusted basis plus the increase in earnings and profits under § 312(n)(4) and that sum will equal the fair market value of the distributed property.) Thus, the proposed technical correction would achieve the logical result. As discussed infra text accompanying notes 135-36, the logical result can also be reached under the current statutory language.

135. Some commentary suggests that the current statutory language is incompatible with the interpretation indicated by context. B. BITTKER & J. JUSTICE, supra note 126, ¶ 7.24, at S7-24 to -25, (Cum. Supp. No. 2 1985); Letter to U.S. Treasury, Summarized in Focus on Treasury: Incoming Treasury Letters, 26 TAX NOTES 524 (1985) ("Hale and Dorr points to a 'glitch' in section 311").
recognized for purposes of determining earnings and profits, rather than to gain recognized for purposes of determining taxable income, if the context so requires. After all, section 312(n)(4) itself indicates that it is possible to think of gain recognition for earnings and profits purposes as a concept independent of gain recognition for gross income purposes.

Once it is understood that the interpretation so strongly suggested by context is an interpretation the words of the statute will bear, the proper interpretation of section 312(c)(3) is easily determined, even without the technical amendment suggested by the Joint Committee Staff. If, instead, it is incorrectly assumed that the words “gain recognized” cannot bear the interpretation “gain recognized for earnings and profits purposes,” the interpretive problem becomes more difficult than it need be and the risk of interpreting the statute incorrectly increases. An incorrect interpretation will necessarily follow if the belief that the words will not bear the suggested contextual interpretation is coupled with a belief that nonliteral interpretations are never permissible.

It is not uncommon for courts, including the Supreme Court, to assume too readily that a suggested contextual interpretation cannot be reconciled with the statutory language. If a court making this assumption nevertheless adopts a contextual interpretation, the court’s belief that the words will not bear the contextual interpretation has not changed the result; a court willing to adopt an interpretation it believes to be incompatible with the language of a statute would be all the more willing to adopt the interpretation if it believed that the interpretation was compatible with the statutory language. A court’s inability to recognize that the statutory language will bear a contextual interpretation can have unfortunate consequences, however, even if the court nevertheless adopts the contextual interpretation. The celebrated case of Corn Products Refining Co. v. Commissioner provides an example. In Corn Products the taxpayer, a manufacturer of products from grain corn, wanted to protect itself from sudden increases in the price of raw corn. The taxpayer might have increased its corn storage facilities so that it could store enough raw corn to protect itself against price increases, but this alternative would have required major capital expenditures. Instead, the taxpayer established a long position in the corn futures market by contracting to buy specific quantities of corn for specified prices at specified future dates. If the price of corn rose, the taxpayer would be protected because it could either accept delivery under the futures contracts at the favorable prices set by the contracts or sell the futures contracts and buy corn on the spot market. The gain on the sale of the futures contracts would offset the higher price paid for the spot market corn. The issue in Corn Products was

136. Reading “gain recognized” in I.R.C. § 312(c)(3) (1982) as “gain recognized for earnings and profits purposes” is also consistent with the making of a § 312(c)(3) adjustment in the case of a distribution that causes corporate recognition of gain for purposes of determining corporate taxable income because such a distribution also causes corporate recognition of gain for earnings and profits purposes. See id. § 312(f)(1).

whether gains from the sale of futures contracts were capital gains or ordinary income.

The Code defines capital assets as all assets except those specifically excluded. The taxpayer argued that because the corn futures contracts were not within any of the exceptions to the capital asset definition, they were capital assets. The Supreme Court accepted the taxpayer’s reading of the literal language of the statute, but nevertheless held that the corn futures were not capital assets. The Court reasoned that the taxpayer’s dealings in corn futures were part of its normal course of business, that Congress did not intend capital gains treatment to apply to profits made in the normal course of business, and that therefore the taxpayer’s gains were ordinary income, despite the incompatibility of that result with the literal language of the Code.

The Court did not discuss the possibility that the result in Corn Products could be reconciled with the language of the Code through an expansive reading of the statute. Under the Code, the term “capital asset” does not include “stock in trade,” “property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year,” or “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.” The term “inventory” in the statute can be read broadly to include inventory substitutes, such as the corn futures contracts. As Professor Chirelstein has observed:

[Section] 1221(1), after all, does not speak in terms of actual inventory, but of “property . . . which would” be included in inventory “if on hand” at the end of the year. Under this language, raw materials may be “inventory” whether they are actually “on hand” or are held in the form of a futures contract that matures during the taxable year.

Although this interpretation requires an expansive reading of the term “inventory,” it seems to be an interpretation the words of the statute will bear.

Although the result reached by an expansive interpretation of the term “inventory” would be the same as the result the Court actually did reach in Corn Products, the difference in analysis could have been significant in later cases. Corn Products is perhaps the Internal Revenue Service’s greatest Pyrrhic victory. In many cases, the facts that would require application of the Corn Products doctrine are accessible to taxpayers but difficult for the Service to discover. Suppose, for example, that a taxpayer owns an asset of a sort that is normally capital, such as corporate stock, but the purpose for holding the asset is somehow closely related to the taxpayer’s regular business. Under these circumstances, it is not clear whether the Corn Products doctrine would render any gain

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138. For the current version of the definition of capital assets, see I.R.C. § 1221 (1982).
139. Corn Products, 350 U.S. at 51 (“Admittedly, petitioner’s corn futures do not come within the literal language of the exclusions set out in [the predecessor to I.R.C. § 1221 (1982)].”).
140. Id. at 52-53.
143. M. CHIRELSTEIN, supra note 137, § 17.02, at 286.
or loss on the sale of the asset ordinary. The taxpayer in this situation will tend to give itself the benefit of the doubt, reporting a loss as ordinary and a gain as capital. If the taxpayer reports a gain as capital, it will be difficult for the Service to discover whether the *Corn Products* doctrine should apply because gain realized on the sale of corporate stock is ordinarily treated as capital gain.144 Thus, *Corn Products* and its aftermath exemplify what Professor Ginsburg calls the Law of Moses' Rod: "Every stick crafted to beat on the head of a taxpayer will, sooner or later, metamorphose into a large green snake and bite the Commissioner on the hind part."145 Because of the favorable treatment that the *Corn Products* doctrine may afford taxpayers, the Service has tried to limit the doctrine by arguing that it should not apply when the taxpayer had a substantial investment motive for holding an asset, even if a business motive for holding the asset predominated.146 The aftermath of *Corn Products* might have been different if the Supreme Court had decided the case on the narrow basis that the word "inventory" in section 1221(1) can and should be read broadly enough to include items, such as the corn futures contracts, that serve as inventory substitutes.147

As *Corn Products* demonstrates, a failure to appreciate that the words of the Code will bear a contextual interpretation can have undesirable consequences even when the court adopts the contextual interpretation. In addition to causing perhaps unfortunate developments in the law of capital gains, *Corn Products* may also have promoted an unduly narrow view of the range of interpretations typically compatible with statutory language. The narrowness of this view may have encouraged courts to conclude too readily that suggested contextual interpretations are incompatible with statutory language.148 This result is especially

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144. See id. at 285-86.
146. See W.W. Windle Co. v. Commissioner, 65 T.C. 694 (1976) (stock purchased with a substantial investment purpose is a capital asset even though there was a more substantial business motive for the purchase), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977); Rev. Rul. 78-94, 1978-1 C.B. 58.
147. See M. Chirelstein, supra note 137, at 287.
148. There are other instances, besides *Corn Products*, of courts reaching results suggested by context through perhaps unnecessary, nonliteral interpretations. See, e.g., Bob Jones Univ. v. United States, 461 U.S. 574 (1983) (discussed supra text accompanying notes 19-27); and Hantzis v. Commissioner, 638 F.2d 248 (1st Cir.), cert. denied, 452 U.S. 962 (1981). The taxpayer in *Hantzis* was a student at Harvard Law School who worked as a summer law clerk for a New York City firm. The issue in the case was whether the taxpayer could deduct her costs of traveling to and living in New York City under I.R.C. § 162(a)(2) (1982) as "traveling expenses . . . while away from home in the pursuit of a trade or business." The court ruled that, for purposes of § 162(a)(2), the taxpayer's home was New York City, not Boston. Thus, the taxpayer could not deduct her traveling and living expenses because she did not incur those expenses "while away from home." *Hantzis*, 638 F.2d at 254. The court's interpretation of home was contrary to ordinary usage. In a concurring opinion Judge Keeton suggested that the court could have reached the same result by focusing on the statutory requirement that travel expenses be incurred "in pursuit of a trade or business":

In the present case, although the taxpayer argues that her employment required her to reside in New York, that contention is insufficient to compel a determination that it was the nature of her trade or business that required her to incur the additional expense of maintaining a second residence, the burden that section 162(a)(2) was intended to mitigate. Her expenses associated with maintaining her New York residence arose from personal interests that led her to maintain two residences rather than a single residence close to her
unfortunate when it changes the outcome of a case—when a court rejects as inconsistent with the statutory language a contextual interpretation it might have accepted had it realized that the language and the contextual interpretation were compatible.

The Supreme Court's recent decision in Badaracco v. Commissioner 149 may be an example of such a situation. As noted earlier,150 Badaracco concerned whether a three year statute of limitations on the assessment of tax was applicable when taxpayers originally filed fraudulent returns but later filed nonfraudulent amended returns. Although section 6501(a) provides that the assessment ordinarily must be "within three years after the return was filed,"151 section 6501(c)(1) provides that "in the case of a false or fraudulent return . . . the tax may be assessed . . . at any time."152 In Badaracco the Court remarked "that the plain and unambiguous language of § 6501(c)(1) would permit the Commissioner to assess 'at any time' the tax for a year in which the taxpayer has filed 'a false or fraudulent return,' despite any subsequent disclosure the taxpayer might make."153 After indicating it was not "free . . . to twist § 6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy,"154 the Court concluded that the taxpayers' arguments in favor of a nonliteral reading of the statute must be rejected.

As Justice Stevens argued in dissent,155 the majority in Badaracco wrongly concluded that the interpretation suggested by the taxpayers was at odds with the "plain and unambiguous language" of the statute. Justice Stevens noted that section 6501(c)(1) applies "[i]n the case of a false or fraudulent return."156 In the cases at issue, the Commissioner had used the nonfraudulent amended returns, rather than the original fraudulent returns, as the bases for his assessments. In such a case, it does no violence to the statutory language to argue that section 6501(c)(1) does not apply because a case involving an assessment based

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150. See supra text accompanying notes 28-36.
152. Id. § 6501(c)(1).
153. Badaracco, 104 S. Ct. at 763.
154. Id. at 764.
155. Id. at 766-69 (Stevens, J., dissenting).
156. Id. at 766 (Stevens, J., dissenting). The majority considered this statutory language at some length, id. at 761-63, and concluded that under the statute's "plain and unambiguous language," id. at 763, a case involving a fraudulent original return would always remain a "case of a false or fraudulent return," despite the later filing of a nonfraudulent amended return. The majority did not advert to Justice Stevens' argument that the statutory language was compatible with a different interpretation. As explained in the text accompanying this note, the majority was wrong in thinking the statutory language was "plain and unambiguous" as applied to cases such as Badaracco.
on a nonfraudulent amended return is not a "case of a false or fraudulent return." It is also, however, consistent with the statutory language to argue that a case involving a fraudulent original return always remains a "case of a false or fraudulent return" so that section 6501(c)(1) would continue to apply despite the subsequent filing of a nonfraudulent amended return. Far from being "plain and unambiguous," the language of section 6501(c)(1) is highly ambiguous as applied to situations of the sort involved in Badaracco and is compatible with either the interpretation of the Service or that of the taxpayers.

The Court in Badaracco might have reached the same result, even if it had recognized this ambiguity in the statutory language. In fact, after stating that it was not "free . . . to twist [section] 6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy,"157 the Court explained at some length why "substantial policy considerations support[ed] [the statute's] literal language."158 Nevertheless, the Court's failure to discern the range of interpretations the words of the statute will bear is troubling. This narrow approach to statutory interpretation assigns too high a burden of persuasion to the party advocating the interpretation the Court claims is inconsistent with the statutory language. In some situations this approach will change the outcome of the case. It is especially likely to change the outcome if, as in Badaracco, it is paired with a judicial assertion that courts may never go beyond the "plain and unambiguous language" of the statute.

Although the interpretation of section 6501(c)(1) adopted by the Supreme Court in Badaracco may be the most reasonable interpretation, the way the Court addressed nonliteral interpretation is troubling for two reasons. Badaracco sets a bad example by not recognizing that words are often compatible with a wide range of possible interpretations,159 and it compounds the damage

157. Id. at 764.
158. Id.
159. The Court does not always make this mistake. For example, in United States v. Correll, 389 U.S. 299 (1967), the Supreme Court properly recognized that words can be compatible with a range of possible interpretations. I.R.C. § 162(a)(2) (1958) (current version at I.R.C. § 162(a)(2) (1982)) permitted the deduction of "traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business." The question presented in the case was the validity of the Commissioner's interpretation of § 162(a)(2) as allowing a deduction for meals only if the trip required the taxpayer "to stop for sleep or rest." Correll, 389 U.S. at 304 n.16. The Court noted, "The language of the statute---'meals and lodging . . . away from home'---is obviously not self-defining." Id. at 304.

In United States v. Foster Lumber, Inc., 429 U.S. 32 (1976), the Supreme Court evinced a similar understanding of the compatibility of statutory language with a range of interpretations. Foster Lumber involved interpretation of the provisions of I.R.C. § 172 (1964) (current version at I.R.C. § 172 (West 1978 & Supp. 1985)) concerning carryover of net operating losses. Although the Court described the interpretation advocated by the taxpayer as a "strained reading of the statute's terms," Foster Lumber, 429 U.S. at 41, it did not reject the taxpayer's interpretation on that basis alone. Rather, it considered at length the taxpayer's argument "that the legislative history and the broad policy behind the loss deduction section of the Code support its interpretation of . . . § 172(b)." Id. at 42. Only after carefully examining and rejecting this contention did the Court reject the taxpayer's interpretation. Id. at 42-48.
by espousing the view that nonliteral interpretations are never permissible.\textsuperscript{160}

2. Interpretations Words Will Not Bear

The examples discussed so far are cases in which the words of the statute can be reconciled with the proposed contextual interpretation; the contextual interpretation may require an unusual reading of the statutory language, but it is nevertheless compatible with the words of the statute. In other cases, it is extremely difficult, or even impossible, to reconcile the words of the statute with the contextual interpretation. Certainly, the more difficult it is to reconcile the words of the statute with a proposed interpretation, the clearer the evidence must be to support a proposed contextual interpretation. It is not appropriate, however, to reject a contextual interpretation automatically simply because it requires giving the words of the Code an interpretation they cannot literally bear. At times, strong contextual evidence for a nonliteral interpretation can and should override the literal language.

As a preliminary matter, it should be noted that it is not always clear whether a particular interpretation is one that the words of the statute will bear. Certainly there are many instances in which a proposed contextual interpretation is clearly compatible with the statutory language and many others in which the contextual interpretation and the words of the statute are clearly incompatible. There are still other instances, however, in which it is highly debatable whether the contextual interpretation is just within or just without the permissible range of interpretations for a particular set of words.\textsuperscript{161}

The difficulty of determining in some cases whether a contextual interpretation is one the words of a statute will bear is illustrated by the courts' interpretation of section 354(b)(1).\textsuperscript{162} In a long line of cases involving Service attempts to characterize liquidation-reincorporations as D reorganizations described in section 368(a)(1)(D),\textsuperscript{163} courts have held that the requirement of section 354(b)(1) that the transferee corporation acquire "substantially all of the assets of the

\textsuperscript{160} Parts of the Badaracco opinion suggest a more enlightened approach to questions of nonliteral interpretation. Although the majority claimed that the language of I.R.C. § 6501(c)(1) (1982) was "plain and unambiguous," Badaracco, 104 S. Ct. at 763, and did not explicitly address Justice Stevens' argument to the contrary, at least it explained at some length why it found the statutory language "plain and unambiguous." Id. at 761-63. This explanation relied not only on the language of § 6501(c), but also on the structure of the Code. In addition, the Court considered an argument made by the taxpayers, which had some similarity to Justice Stevens' argument. The taxpayers' contention was that the nonfraudulent amended return was "the return" referred to in § 6501(a). Badaracco, 104 S. Ct. at 763. Although the Court rejected this argument, it did not do so merely on the basis of the statutory language; rather, it also explained why "the structure of the Code," id. at 764, did not support the taxpayers' contention. Although the Court claimed it was powerless to adopt a nonliteral interpretation, it went to some lengths to refute the taxpayers' policy arguments in support of a nonliteral interpretation. Id. at 764-65.

\textsuperscript{161} See Frankfurter, supra note 89, at 535 ("Whether a judge does violence to language in its total context is not always free from doubt.").

\textsuperscript{162} I.R.C. § 354(b)(1) (1982).

\textsuperscript{163} I.R.C. § 368(a)(1)(D) (1982). Very generally, a liquidation-reincorporation is an attempt by the shareholders of a corporation to obtain the tax benefits of a liquidation while continuing to operate the business of the corporation in corporate form. The tax advantages include capital gains treatment of distributions to shareholders, step-up in basis of corporate assets without tax at the corporate level, and elimination of corporate earnings and profits. See B. BITTKER & J. EUSTICE,
transferor” corporation mandates only acquisition of substantially all of the operating assets of the transferor. As a result, courts have held that the acquisition of less than half of the transferor’s total assets satisfied section 354(b)(1) when substantially all of the operating assets were acquired. This interpretation finds considerable support in the underlying structure and policies of the reorganization provisions. Certainly, D reorganization analysis could not serve as an effective tool against liquidation-reincorporations if section 354(b)(1) were interpreted more strictly. It is a close question, however, whether the interpretation of “substantially all of the assets” as “substantially all of the operating assets” is an interpretation that the words of the statute will bear. But it is necessary to determine whether words will or will not bear a particular interpretation only if something turns on the determination. If it is never permissible to give a statute a contextual interpretation that its words cannot bear, then the determination must be made. But if contextual interpretations are sometimes proper even though irreconcilable with the statutory language, then it is not necessary to decide whether the words will bear the proposed contextual inter-

supra note 126, ¶ 11.05, at 11-18 to -21. If the Service succeeds in characterizing the transaction as a reorganization, the desired tax advantages will not be obtained.


166. There are numerous other close questions scattered throughout the Code. The question of the validity of Treas. Reg. § 1.351-1(a)(ii) (1955) as an interpretation of I.R.C. § 351 (1982) provides an interesting example. (The regulation was held valid in Estate of Kamborian v. Commissioner, 469 F.2d 219 (1st Cir. 1972), aff'd 56 T.C. 847 (1971)). Section 351(a) provides: “No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.” I.R.C. § 351(a) (1982). Thus, nonrecognition is available if, and only if, the transferors of property to the corporation are, as a group, in control of the corporation after the exchange. Suppose that A plans to transfer appreciated property to a corporation in exchange for its stock, and that A will not be in control of the corporation immediately after the exchange. If A is the only transferor of property to the corporation, he must recognize gain because the control requirement of § 351(a) will not be satisfied. But suppose A persuades B, who owns all the outstanding stock of the corporation, to transfer a trivial amount of property to the corporation in exchange for a trivial amount of additional stock at the same time that A makes his exchange. A hopes that A and B will both be considered transferors of property; if they are, A will not have to recognize gain on his exchange. The language of § 351(a) suggests that this plan should work, but the regulation says it will not:

Stock or securities issued for property which is of relatively small value in comparison to the value of the stock and securities already owned (or to be received for services) by the person who transferred such property, shall not be treated as having been issued in return for property if the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property.


It is debatable whether the interpretation expressed in the regulation can be reconciled with the language of the statute. Ultimately, however, it should not matter, because the regulation’s interpretation—that “token exchanges” should be ignored in determining whether the control requirement of § 351 has been satisfied—is so clearly required by structure and policy as to be proper regardless of whether it is compatible with the statutory language. See also supra text accompanying note 27 (discussion of whether the statutory term “educational” at issue in Bob Jones can bear the proposed contextual interpretation); Zelenak, Should Courts Require the Internal Revenue Service To Be Consistent?, 40 TAX L. REV. 411, 433-47 (1985) (discussion of I.R.C. § 6110(j)(3) (1982)).
pretation. In such cases, it is enough to recognize that because of the considera-
ble tension between the language of the statute and the proposed contextual
interpretation, the contextual interpretation will prevail only if the evidence to
support it is very persuasive.

Cases in which the proposed contextual interpretation is plainly incompati-
ble with the language of the statute, however, require an answer to the question
whether a nonliteral interpretation is ever proper. Unfortunately, recent
Supreme Court tax cases suggest conflicting answers to this question. In Bob
Jones University v. United States the Court indicated by both word and deed
that nonliteral interpretations are permissible. In Paulsen v. Commissioner the
Court again sanctioned nonliteral interpretations, at least of the reorganiza-
tion provisions. In Hillsboro National Bank v. Commissioner, too, the
Court admitted it was adopting a nonliteral interpretation, but provided no gen-
eral discussion of the standards to be applied in determining the propriety of
nonliteral interpretations in specific cases. In Badaracco, however, the Court
indicated that it was not "free... to twist [section] 6501(c)(1) beyond the con-
tours of its plain and unambiguous language in order to comport with good
policy." The Commissioner v. Tufts opinion contains within itself the con-
tradiction that exists among the other cases. Although the Court in Tufts
adopted a nonliteral interpretation, its failure to acknowledge that it was doing
so suggests either that nonliteral interpretations are improper or that they may
be adopted by courts only clandestinely.

The conflict apparent in these cases should be resolved in favor of the per-
missibility of nonliteral interpretations. In some cases, powerful contextual evi-
dence justifies an interpretation incompatible with the literal statutory language.
The Tufts case provides a good example. The issue in Tufts was whether a tax-
payer who disposes of property subject to a nonrecourse mortgage in excess of
the fair market value of the property must include in amount realized the entire
amount of the mortgage. The United States Court of Appeals for the Fifth Cir-
cuit had required the taxpayer to include relief from the nonrecourse mortgage
in amount realized only to the extent that the mortgage did not exceed the value
of the property. The Supreme Court reversed, holding that the entire amount
of the mortgage must be included in amount realized. Tax logic strongly sug-
gests that the full amount of the nonrecourse mortgage should be included in
amount realized. If it is not, the taxpayer will have received an undeserved tax

168. "It is a well-established canon of statutory construction that a court should go beyond the
literal language of a statute if reliance on that language would defeat the plain purpose of the stat-
ute." Bob Jones, 461 U.S. at 586-87; see supra text accompanying notes 19-27.
170. Paulsen, 105 S. Ct. at 630; see supra text accompanying notes 37-48.
173. Badaracco, 104 S. Ct. at 764; see supra text accompanying notes 28-36.
175. See supra text accompanying notes 14-18.
benefit. It has been the Service's "longstanding position,"\textsuperscript{177} therefore, that the taxpayer must include in amount realized the entire amount of the mortgage.\textsuperscript{178}

Despite the logic of the Service's position, it appears incompatible with the language of the Code. The relevant statutory language defines amount realized as "the sum of any money received plus the fair market value of the property (other than money) received."\textsuperscript{179} This language defines amount realized in terms of economic benefit received. Because, by definition, a taxpayer's liability on a nonrecourse mortgage is limited to the mortgaged property, a taxpayer's economic benefit in being "relieved" of a nonrecourse mortgage cannot exceed the value of the mortgaged property.\textsuperscript{180} Imagine a taxpayer holding property with a fair market value of $1.4 million subject to a nonrecourse mortgage of $1.8 million.\textsuperscript{181} The property has no effect on the taxpayer's net worth. It has no positive effect because it is subject to a liability greater than its value. It has no negative effect because the liability is nonrecourse—the taxpayer's other assets are not subject to the liability. If the entire $1.8 million mortgage should suddenly disappear (if, for example, Santa Claus were to pay off the mortgage as the taxpayer's Christmas present), the taxpayer would own, free and clear, property worth $1.4 million. Thus, relief from the liability would increase the taxpayer's worth only by the $1.4 million value of the property, not by the full $1.8 million amount of the mortgage. The economic benefit to the taxpayer of relief from the nonrecourse mortgage would be limited to the value of the property securing the mortgage. By the same logic, a taxpayer who disposes of property subject to a nonrecourse mortgage in excess of the value of the property can realize an economic benefit from "relief" from the mortgage no greater than the value of the property. To the extent that the mortgage exceeds the value of the property, the taxpayer receives no economic benefit.\textsuperscript{182}

\textsuperscript{177} Tufts, 461 U.S. at 319 (O'Connor, J., concurring).
\textsuperscript{179} I.R.C. § 1001(b) (1982).
\textsuperscript{180} See Crane v. Commissioner, 331 U.S. 1, 14 n.37 (1947) ("Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage.").
\textsuperscript{181} The dollar amounts are loosely based on the facts in Tufts. See Tufts, 461 U.S. at 302-03.
\textsuperscript{182} It can be argued that there is never any economic benefit in being "relieved" of a nonrecourse mortgage by disposing of the mortgaged property, regardless of whether the amount of the mortgage exceeds the value of the property. As Professor Bittker has written, Relief from a nonrecourse debt is not an economic benefit if it can be obtained only by giving up the mortgaged property. It is analogous to the relief one obtains from local real property taxes by disposing of the property: Like nonrecourse debt, the taxes must be paid to retain the property; but no one would suggest that the disposition of unprofitable property produces an economic benefit equal to the present value of the taxes that will not be paid in the future.

Professor Bittker would argue that the $1.4 million economic benefit from relief from a nonrecourse mortgage, in the example in the text, results only because the taxpayer retains the property after the mortgage has been removed. Professor Bittker would claim the example does not demonstrate that there is any economic benefit in being "relieved" of a nonrecourse debt by disposing of the mortgaged property. If he is correct, then perhaps even the holding of Crane v. Commissioner, 331 U.S. 1 (1947)—that "relief" from a nonrecourse mortgage whose amount is less than the value of the mortgaged property must be included in amount realized upon the disposition of the mortgaged property—requires a nonliteral interpretation of § 1001(b). The Crane Court, however, did not con-
Including in amount realized mortgage "relief" that confers no economic benefit on the taxpayer is incompatible with the language of section 1001(b). To the extent that the taxpayer receives no economic benefit, "relief" from a nonrecourse mortgage cannot constitute either "money received" or "property (other than money) received." Yet, tax logic indicates that the full amount of the nonrecourse mortgage should be included in the amount realized. When the taxpayers in Tufts incurred the nonrecourse obligation in connection with the acquisition of the property, the amount of the loan was not included in income and was included in their basis in the property on the assumption that they would pay off the loan.183 When the taxpayers disposed of the property, it became clear that the assumption had been mistaken: in fact, the taxpayers would never pay off the loan. Accordingly, the taxpayers were required to include the amount of the loan in amount realized on disposition of the property to correct the mistaken assumption that had initially caused the amount of the loan to be excluded from income and included in basis. The Supreme Court explained:

[T]he Commissioner may ignore the nonrecourse nature of the obligation in determining the amount realized upon the disposition of the encumbered property. He thus may include in the amount realized the amount of the nonrecourse mortgage assumed by the purchaser. The rationale for this treatment is that the original inclusion of the amount of the mortgage in basis rested on the assumption that the mortgagor incurred an obligation to repay. Moreover, this treatment balances the fact that the mortgagor originally received the proceeds of the nonrecourse loan tax-free on the same assumption. Unless the outstanding amount of the mortgage is deemed to be realized, the mortgagor effectively will have received untaxed income at the time the loan was extended and will have received an unwarranted increase in the basis of his property.184

To understand how compelling the tax logic is, consider the following example, loosely based on the facts of Tufts. A taxpayer purchases an apartment building for $1.8 million by giving the seller a nonrecourse note for the entire purchase price. Over the next several years, during which the taxpayer makes no principal payments on the note, the taxpayer claims depreciation deductions on the building totaling $400,000, thus reducing her basis in the building to $1.4 million. Over the same period of time, the building actually declines in value to $1.4 million. At this point, faced with the prospect of making payments of $1.8 million to protect property worth only $1.4 million, the taxpayer decides to de-


183. Tufts, 461 U.S. at 307-08.
184. Id. at 309-10.
fault on the note and let the seller repossess the property. The taxpayer has experienced no economic loss or gain on the property. The taxpayer paid nothing but the mortgage for the property and received nothing but relief from the mortgage upon default. Yet, despite the fact that the taxpayer has suffered no economic loss, she has been allowed a $400,000 tax loss in the form of depreciation deductions. If, in keeping with the language of section 1001(b), the taxpayer’s amount realized is limited to $1.4 million (the value of the property), she will have no gain or loss on the disposition.\(^\text{185}\) As a result, the taxpayer will retain the tax benefit of the $400,000 depreciation deductions, even though there was no economic loss. Nothing in the Code, except the language of section 1001(b), supports this result. If, however, the full $1.8 million is included in the amount realized, the taxpayer will have a $400,000 gain.\(^\text{186}\) This gain will offset the taxpayer’s $400,000 depreciation deductions, so that the net tax result will coincide with the net economic result of no gain or loss. Logic supports this result, but the language of section 1001(b) does not.

The tax logic that supports inclusion of the full amount of the nonrecourse mortgage in amount realized is not limited to cases of depreciable property.\(^\text{187}\) Assume the same facts as in the preceding example, except the property is non-depreciable land. When the property declines in value from $1.8 million to $1.4 million, the taxpayer decides to abandon it to the seller. Because the taxpayer has taken no depreciation deductions, her basis remains $1.8 million, the full amount of the nonrecourse mortgage. As in the previous example, the taxpayer has suffered no economic gain or loss. The burden of the $400,000 decline in value falls on the seller, not the taxpayer. Logic indicates, then, that the taxpayer should realize neither gain nor loss on the disposition. This result can be obtained by including the full $1.8 million in the taxpayer’s amount realized.\(^\text{188}\) If, however, in accordance with the language of section 1001(b), relief from the mortgage is included in amount realized only to the extent of the $1.4 million value of the property, the taxpayer will have a $400,000 tax loss,\(^\text{189}\) despite the absence of any economic loss.

The interpretation of section 1001(b) suggested by the logic and structure of the Code, and adopted by the Court in *Tufts*, is incompatible with the literal language of section 1001(b). However, when the logic supporting a nonliteral interpretation is compelling, and when the inadequacy of the statutory language is the result of congressional inadvertence rather than design, it is proper to give a statute an interpretation incompatible with its words. This proposition is equally true under either an intent-based or a meaning-based theory of interpretation.\(^\text{190}\) Under an intent-based theory, it can be argued that Congress either

\(^{185}\) An amount realized of $1.4 million minus an adjusted basis of $1.4 million yields no gain or loss.

\(^{186}\) An amount realized of $1.8 million minus an adjusted basis of $1.4 million yields $400,000 gain.

\(^{187}\) See *Tufts*, 461 U.S. at 310 n.8.

\(^{188}\) An amount realized of $1.8 million minus a basis of $1.8 million yields no gain or loss.

\(^{189}\) An amount realized of $1.4 million minus a basis of $1.8 million yields $400,000 loss.

\(^{190}\) For a description of the intent-based and meaning-based theories of interpretation, see *supra* text accompanying notes 80-98.
intended the nonliteral interpretation or would have intended it if it had considered the question.\(^{191}\) Under a meaning-based theory, the argument would be that the nonliteral interpretation is what the words of the statute would be taken to mean by an informed, intelligent reader considering those words in the context of the Code as a whole. Thus, the result in \textit{Tufts} is entirely reasonable; the Court erred only in failing to acknowledge that its interpretation cannot be squared with the words of section 1001(b).\(^{192}\)

If the choices in \textit{Tufts} were limited to giving taxpayers an undeserved tax benefit by following the literal language of section 1001(b) or adopting the nonliteral but logical interpretation adopted by the Supreme Court, the Court's choice was clearly correct. There was, however, a third alternative, suggested by Professor Wayne Barnett in an amicus brief\(^{193}\) the possibility of bifurcating the transaction into a liability transaction and a property transaction.\(^{194}\) Under Professor Barnett's analysis, in the property transaction the property is disposed of for its fair market value,\(^{195}\) and in the liability transaction the nonrecourse debt is cancelled for a payment equal to the fair market value of the property.\(^{196}\) The taxpayer may recognize gain or loss on the property transaction under section 1001\(^{197}\) and may have cancellation of indebtedness income on the liability transaction under section 61(a)(12).\(^{198}\) Like the nonliteral approach adopted by the \textit{Tufts} Court, this analysis avoids conferring undeserved windfalls on taxpayers. It may have very different practical consequences, however, because the Code treats cancellation of indebtedness income differently from gain on the sale or other disposition of property.\(^{199}\) Because the bifurcation approach limits the amount realized on the disposition of the property to the fair market value of the property, it avoids the nonliteral interpretation of section 1001(b) inherent in the

\(^{191}\) See Cawley v. United States, 272 F.2d 443, 445 (2d Cir. 1959) ("We are to put ourselves so far as we can in the position of the legislature that uttered [the words of the statute], and decide whether or not it would declare that the situation that has arisen is within what it wished to cover.").

\(^{192}\) The Court did admit that including the full amount of the nonrecourse loan in amount realized would be inconsistent with a "theory of economic benefit." \textit{Tufts}, 461 U.S. at 307. The Court, however, did not acknowledge that the language of § 1001(b) defines amount realized in terms of economic benefit; nor did it acknowledge that its interpretation appears incompatible with the language of § 1001(b).

\(^{193}\) See Amicus Brief for Respondents, \textit{Tufts}.

\(^{194}\) See \textit{Tufts}, 461 U.S. at 310-12 n.11, 317-20 (O'Connor, J., concurring) (discussing Professor Barnett's analysis in Amicus Brief for Respondents).

\(^{195}\) Justice O'Connor wrote, "The benefit received by the taxpayer in return for the property is the cancellation of a mortgage that is worth no more than the fair market value of the property, for that is all the mortgagor can expect to collect on the mortgage." \textit{Id.} at 318 (O'Connor, J., concurring).

\(^{196}\) \textit{Id.} at 318-19 (O'Connor, J., concurring).


\(^{198}\) I.R.C. § 61(a)(12) (1982); see \textit{Tufts}, 461 U.S. at 318-19 (O'Connor, J., concurring). The taxpayer, however, may be able to use I.R.C. § 108 (West 1984 & Supp. 1985) to avoid being taxed currently on the cancellation of indebtedness income. Section 108 provides that cancellations of indebtedness may be excluded from gross income under certain circumstances.

\(^{199}\) See \textit{Tufts}, 461 U.S. at 319 (O'Connor, J., concurring). Cancellations of indebtedness may sometimes be excluded from income under I.R.C. § 108 (West 1984 & Supp. 1985). If they are not excluded, they are taxable as ordinary income. Gains on sales of property are generally includable in income but may be eligible for favorable tax treatment under \textit{id.} § 1202(a) (60% deduction for net capital gains of noncorporate taxpayers) or \textit{id.} § 1201(a)(1), (a)(2) (28% alternative tax rate for net capital gains of corporations).
At the same time, however, by applying a cancellation of indebtedness analysis to the liability transaction, the bifurcated approach avoids the tax windfall that limiting amount realized to the value of the property would otherwise entail.

The bifurcation analysis seems quite compelling because it reaches a logical result without requiring a nonliteral interpretation of section 1001(b). Yet the Court in Tufts rejected this analysis with little difficulty. In a footnote, the Court said, "Although [bifurcation] indeed could be a justifiable mode of analysis, it has not been adopted by the Commissioner. Nor is there anything to indicate that the Code requires the Commissioner to adopt it." Elsewhere in the opinion, the Court alluded to the principle that administrative interpretations of the Code should be respected if they "implement the statutory mandate in a reasonable manner." In a concurring opinion, Justice O'Connor observed that the bifurcation approach would be preferable "were we writing on a [clean] slate." She remarked, however, that, "[i]n the light of the numerous cases in the lower courts including the amount of the unrepaid proceeds of the mortgage in the proceeds on sale or disposition, ... it is difficult to conclude that the Commissioner's interpretation of the statute exceeds the bounds of his discretion." She concluded: "As long as [the Commissioner's] view is a reasonable reading of § 1001(b), we should defer to the regulations promulgated by the agency charged with interpretation of the statute."

One striking aspect of Tufts was the Court's willingness to follow the Commissioner's "longstanding position" of interpreting section 1001(b) nonliterally (although, of course, the Court never acknowledged that the interpretation was nonliteral), even though a bifurcation analysis could have produced a reasonable result without necessitating the nonliteral interpretation required by the Commissioner's position. In view of the confusion that a bifurcation analysis

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200. See Amicus Brief at 17-19, Tufts. The bifurcation approach, as described by Justice O'Connor, limits the inclusion of "relief" from a nonrecourse mortgage in the amount realized to the fair market value of the mortgaged property. Tufts, 461 U.S. at 318 (O'Connor, J., concurring). Up to the value of the mortgaged property, however, this approach does include "relief" from the mortgage in amount realized. If one accepts the position that "[r]elief from a nonrecourse mortgage is not an economic benefit if it can be obtained only by giving up the mortgaged property," Bittker, supra note 182, at 282, then Professor Barnett's position may itself involve a nonliteral interpretation of § 1001(b). See supra note 182. Professor Barnett, however, contended that his interpretation did not require a nonliteral interpretation. Amicus Brief at 17-19, Tufts. In contrast, whether the Supreme Court's position in Tufts requires a nonliteral interpretation of § 1001(b) is not debatable: it clearly does. Thus, Professor's Barnett's approach has the virtue of avoiding the unquestionably nonliteral interpretation inherent in the Supreme Court's analysis.

201. Tufts, 461 U.S. at 311 n.11.


204. Id. at 319-20 (O'Connor, J., concurring).

205. Id. at 320 (O'Connor, J., concurring).

206. Id. at 319 (O'Connor, J., concurring).

207. On the general question of judicial deference to reasonable regulatory interpretations of statutes, see infra text accompanying notes 298-302. An oddity of Tufts was that although the Commissioner's interpretation may have been longstanding, it had not been long expressed in a
would have introduced into a fairly settled area of the law, the Court was right to prefer the Commissioner's longstanding nonliteral interpretation to an interpretation that produced a logical result and avoided the Commissioner's nonliteral interpretation. There are, then, two lessons about nonliteral interpretation arising out of Tufts. One is that a nonliteral interpretation, firmly based in the structure and policies of the Code, may properly prevail over a literal but unreasonable interpretation. The second lesson is, perhaps, even more radical: a nonliteral interpretation, firmly based in Code structure and policy, may sometimes be preferable to a reasonable interpretation compatible with the statutory language, if the nonliteral interpretation is a longstanding position of the Commissioner.

There are numerous examples of cases in which a strong argument can be made for a contextual interpretation incompatible with the statutory language. In *Hillsboro National Bank*, for instance, the Supreme Court held that contextual considerations required a corporation to recognize income on the distribution to its shareholders, in complete liquidation, of previously expensed assets. The Court so held despite the unequivocal statement in section 336(a) that "no gain or loss shall be recognized to a corporation on the distribution of property in . . . complete liquidation." A greater conflict between judicial interpretation and statutory language could scarcely be imagined.

There are cases, however, in which a nonliteral interpretation should not be accepted, even though the result of applying the words of the Code literally is offensive to tax logic. How, then, does one determine when to reject the literal language of the Code because it conflicts with Code structure and logic and when to accept it even though it makes little sense? Interpretation is more art than science, and there is no easy answer to this question. Much depends on a well-trained instinct. Roughly speaking, the degree of deference that should be

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regulation. In fact, the regulation embodying the interpretation was promulgated while *Tufts* was pending before the United States Court of Appeals for the Fifth Circuit. *Tufts*, 461 U.S. at 310 n.9. 208. 460 U.S. 370 (1983). 209. I.R.C. § 336(a) (Supp. V 1981) (current version at I.R.C. § 336(a) (1982)). 210. The Supreme Court was also persuaded by arguments in favor of nonliteral Code interpretations in *Paulsen*, 105 S. Ct. at 627, and *Bob Jones*, 461 U.S. at 574. For a discussion of these cases, see supra text accompanying notes 19-27 & 37-48. See also J.C. Penney Co. v. Commissioner, 312 F.2d 65, 66 (2d Cir. 1962) (analysis of "the rare case in which it is as clear as anything ever can be that Congress did not mean what in strict letter it said"); Focht v. Commissioner, 68 T.C. 223 (1977) (adopting nonliteral interpretation holding that the accounts payable of a cash basis taxpayer were not "liabilities" for purposes of I.R.C. § 356(c) (1976)), acq. 1980-2 C.B. 1. See infra note 295 for a discussion of the issue considered in *Focht*.

For discussion of another case in which context may justify a nonliteral interpretation of the Code, see Gunn, *Some Observations on the Interpretation of the Internal Revenue Code*, 63 TAXES 28 (1985). Prior to its 1984 amendment, § 722 stated that the basis of a contributing partner's interest in a partnership shall be "increased by the amount (if any) of gain recognized to the contributing partner" upon the making of a contribution of property to the partnership. I.R.C. § 722 (1982) (current version at I.R.C. § 722 (West Supp. 1985)). Despite this clear language, Professor Gunn argued that the structure and logic of the Code compelled the conclusion that basis should not be increased when gain was recognized because of a constructive distribution resulting from a contribution of mortgaged property to a partnership. Gunn, *supra*, at 30-31. Professor Gunn used § 722 as an example to support his general observation that the Code should sometimes be interpreted nonliterally. This problem in the interpretation of § 722 has been resolved by a clarifying amendment, added by the Tax Reform Act of 1984, Pub. L. No. 98-369, § 722(f), 98 Stat. 494, 974.
afforded to an illogical but literal interpretation depends on the precision with which the statute addresses the particular question to be decided. If the factual pattern to which the statute must be applied is one that Congress did not specifically consider or address in enacting the statute, and if the inadequacy of the statutory language to support the logical result is due to congressional inadvertence rather than design, then a nonliteral interpretation may be appropriate under either an intent-based or a meaning-based theory of interpretation. If, however, the incompatibility of the statute's words with the logical result is due to congressional design, that design, however misguided, must be respected. When the statutory application is one that Congress considered and specifically addressed in enacting the statute, then the literal interpretation is both what Congress intended and what the statute means. Such clearly expressed decisions of the legislature must be respected by the courts even when they are illogical.\textsuperscript{211}

Thus, for example, the result in *Tufts* is reasonable even though it conflicts with the language of section 1001(b), because Congress did not consider the issue in *Tufts* in enacting the statute.\textsuperscript{212} The result would necessarily be different if section 1001(b) contained this additional sentence: "Amount realized shall not include relief from a nonrecourse mortgage, to the extent the amount of the mortgage exceeds the fair market value of the property secured by the mortgage." In either case, following the literal language of the statute would produce an illogical result, but in the first case the literal language need not be followed and in the second case it must.

A more realistic example is provided by section 356(a)(2),\textsuperscript{213} which provides that boot received in a corporate division or reorganization, which "has the effect of the distribution of a dividend," shall be treated as a dividend only to the extent of gain recognized. This dividend within gain limitation makes no sense in terms of the structure of the Code. Normally, a dividend distribution is not connected with a sale or exchange; consequently, the dividend is taxable in full, the concept of recognition of gain being irrelevant. If, then, a distribution in connection with a corporate division or reorganization has the effect of a dividend, it should be taxed as a dividend in full, even if the amount of the dividend exceeds the gain recognized.\textsuperscript{214} Yet, as irrational as the

\textsuperscript{211} Decisions of the legislature must be respected unless they are so irrational as to be unconstitutional. Constitutional challenges to provisions of the Internal Revenue Code, on irrationality and similar grounds, generally have not fared well. See, e.g., Pledger v. Commissioner, 641 F.2d 287 (5th Cir.), cert. denied, 454 U.S. 964 (1981); Sakol v. Commissioner, 574 F.2d 694 (2d Cir.), cert. denied, 439 U.S. 859 (1978). Both cases rejected constitutional challenges to the application of I.R.C. § 83 (West 1984 & Supp. 1985).

\textsuperscript{212} What is now the first sentence of I.R.C. § 1001(b) was first enacted as § 202(c) of the Revenue Act of 1924, Pub. L. No. 176, 43 Stat. 253, 256. For the provision's legislative history, see H.R. REP. No. 179, 68th Cong., 1st Sess. 13 (1924), and S. REP. No. 398, 68th Cong., 1st Sess. 13 (1924). This material is collected in J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 686-87 (1938).

\textsuperscript{213} I.R.C. § 356(a)(2) (1982).

\textsuperscript{214} I.R.C. §§ 302(d), 356(b), 356(e) (1982) each deal with situations somewhat analogous to the situation addressed in § 356(a)(2) but do not contain dividend within gain limitations. Both the American Law Institute and the Staff of the Senate Finance Committee have proposed repealing the dividend within gain limitation of § 356(a)(2). See STAFF OF SENATE FIN. COMM., 99TH CONG., 1ST SESS., THE SUBCHAPTER C REVISION ACT OF 1985, 45, 95-96, 217 (Comm. Print 1985); AMER-
dividend within gain limitation is, it is so clearly and explicitly required by the statute that a court should not reject it in favor of a more logical nonliteral interpretation.

In sum, different contextual interpretations produce different degrees of tension with the words of the Code. Some contextual interpretations are compatible with the statutory language even if they do not comport with the usual or most obvious sense of the words. Other contextual interpretations are clearly incompatible with the statutory language, and still others are difficult to classify as either compatible or incompatible with the words of the statute. The more difficult it is to reconcile an interpretation with the literal language, the stronger the evidence for a contextual interpretation must be for that interpretation to prevail. There are, however, instances in which the evidence supporting a contextual interpretation is so strong that such an interpretation should be accepted even though it cannot be reconciled with statutory language. Such a nonliteral interpretation should prevail, however, only when the unsatisfactory result that would be obtained by following the literal language of the statute is the product of legislative inadvertence, rather than legislative design.

C. The Effect of Statutory Complexity

1. Complexity Compelling Literal Interpretation

The Code's complexity may have an impact on a court's willingness to adopt a nonliteral interpretation. A common analysis is that the more complex the statute, the less willing a court should be to ignore its literal language. As Judge Raum of the Tax Court recently wrote:

[W]here a statute is clear on its face, we would require unequivocal evidence of legislative purpose before construing the statute so as to override the plain meaning of the words used therein. And this is particularly so . . . where we have a complex set of statutory provisions marked by a high degree of specificity.215

Similarly, Judge Hall of the Tax Court argued against a nonliteral interpretation of the Code because it would require the court to "tinker with too complex a statutory framework."216

Despite the superficial appeal of this analysis, it is fundamentally misguided. Nonliteral interpretations are justified primarily, if not exclusively, when a statute must be applied to fact patterns that Congress did not consider when it enacted the statute.217 It may be true, as a general rule, that the more complex a statute, the more likely it is that a particular fact pattern to which the

217. See supra text accompanying notes 211-14; cf. Tilford v. Commissioner, 75 T.C. 134, 154 (1980) (Simpson, J., dissenting) ("Usually, when we have a vexing problem of statutory interpretation, we are faced with a problem not anticipated during the development of the legislation . . . ."), rev'd, 705 F.2d 828 (6th Cir.), cert. denied, 464 U.S. 992 (1983).
statute must be applied was within the contemplation of the enacting Congress. It is possible, then, that complex statutes require nonliteral interpretations less often than simple statutes. But if this is so, it is not due to statutory complexity as such; rather, it is due to an inverse correlation between complexity and the number of fact patterns to which the statute must be applied that were not considered by the enacting Congress. Thus, the nonliteral interpretation of section 1001(b) in *Tufts* is reasonable not because section 1001(b) is a simple provision (although it is, by Internal Revenue Code standards), but because the problem in *Tufts* was not specifically considered by Congress in enacting the statute. Conversely, the illogical dividend with gain limitation of section 356(a)(2) probably should be interpreted literally, not because section 356(a)(2) is part of the complex corporate reorganization tax provisions, but because the limitation of dividend treatment to recognized gain was so clearly contemplated by Congress.

Judges who rely on statutory complexity as a reason for strictly adhering to the literal terms of a statute may be confusing statutory complexity with the question whether Congress considered and addressed a particular fact pattern in enacting the statute. If Congress did consider and specifically address the problem in the statute, that is a compelling reason to reject any nonliteral interpretation. Statutory complexity, in and of itself, however, is not a sufficient reason.

Judge Learned Hand adopted this view in *Helvering v. Gregory*. The issue in *Gregory* was whether a transaction that met the literal statutory requirements for a tax free corporate reorganization, but had no purpose except to bail out earnings and profits at capital gains rates, should be treated as a tax free reorganization. The Board of Tax Appeals had ruled in the taxpayer's favor. Judge Hand summarized the Board's reasoning: "All these transactions being real, their purpose was irrelevant, and section 112(j)(1)(B) was applicable, especially since it was part of a statute of such small mesh as the Revenue Act of 1928; the finer the reticulation, the less room for inference." In an opinion written by Judge Hand, the United States Court of Appeals for the Second Circuit reversed the Board, holding that the transaction was not a tax free reorganization, "even though the facts answer[ed] the dictionary definitions of each term used in the statutory definition." Judge Hand explained that this result followed from "the underlying presupposition . . . that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the shareholders' taxes [was] not one of the transactions contemplated as corporate 'reorganiza-

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218. See supra text accompanying notes 176-207.
219. See supra text accompanying notes 213-14.
220. Nonliteral interpretations of statutes as complex as § 356(a)(2) may be appropriate when the fact pattern presented in a particular case is not one that Congress considered. The nonliteral reading of I.R.C. § 722 (1982) (current version at I.R.C. § 722 (West Supp. 1985)) advocated by Professor Gunn is an example. See supra note 210.
221. 69 F.2d 809 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935).
222. Id. at 810.
223. Id.
Thus, Judge Hand implicitly rejected the Board's view that statutory complexity renders nonliteral interpretations impermissible. Instead, he first determined that the fact pattern in the case was not one contemplated by Congress in enacting the reorganization provisions. He then examined the statutory context for any light it might shed on the "purpose of the section," on the statute's "underlying presupposition," and ultimately on "what the statute meant" by a 'reorganization.' In the light of the statutory context, Judge Hand concluded that a nonliteral interpretation was required despite the complexity of the statute.

2. Complexity Supplying Statutory Context

Far from being incompatible with nonliteral interpretations, statutory complexity sometimes provides the justification for nonliteral interpretations. Nonliteral interpretations are most often suggested by the statutory context. The pattern of the statute in which the language to be interpreted appears may indicate a statutory structure and an underlying legislative policy at odds with a literal interpretation of the language. Often, the very complexity of the Code will reveal a coherent and logical statutory structure that forms a surer contextual basis for a nonliteral interpretation than a simpler statute could provide. Complexity often accompanies carefully devised statutory structures and policies that may provide a basis for overriding statutory language inconsistent with the statutory context. But it is not statutory complexity as such that supports nonliteral interpretation; rather, it is the detailed and coherent statutory structure that complex statutes often express that supports nonliteral interpretation. It is possible, of course, for a complex statute to lack a coherent structure or policy; such a statute, despite its complexity, does not provide the contextual support required to justify a nonliteral interpretation. For the most part, the complex areas of the Code reveal rational and coherent structures and policies, but there certainly are exceptions. Whether Code complexity provides a framework of structure and policy on which a nonliteral interpretation can be based is a question that can be answered only on a case-by-case basis.

It is often difficult to discern the extent to which underlying policies and

224. Id. at 811.
225. Id. at 810 ("[I]t does not follow that Congress meant to cover such a transaction . . . ").
226. Id. at 811 ("the setting in which all [the words of the statute] appear, and which all collectively create").
227. Id.
228. Id.
229. Id.
230. Professor Bittker has commented:

For myself, I can only say that after devoting five years to this project [writing his treatise], I am more convinced than when I started that the proportion of senseless detail to pervasive structural principles is relatively low, and that the Code, while not the most majestic attainment of human thought, is far less rickety than is commonly believed.

1 B. Bittker, supra note 50, at vii. Perhaps Justice Holmes' observation that "taxation . . . in most communities is a long way off from a logical and coherent theory" can be dismissed as irrelevant because it predates the Internal Revenue Code. Paddock v. City of New York, 211 U.S. 446, 450 (1908).
structures may permit or require nonliteral interpretation of complex Code provisions. There are two dangers. One is that a court may fail to discern through the Code's surface complexity the policies and structures that compel a nonliteral interpretation. Such a court will wrongly reject a nonliteral interpretation. The other danger is that a court may incorrectly conclude that the literal language of a provision is inconsistent with the Code's policies and structures. Such a court may wrongly adopt a nonliteral interpretation. Consider, for example, the opinion of the United States District Court for the District of Delaware in Pierson v. United States,231 one of the decisions arising out of the acquisition by International Telephone and Telegraph Corporation (ITT) of stock of the Hartford Fire Insurance Company (Hartford).232 The issue in Pierson was whether any boot—that is, any consideration other than voting stock of ITT—was permissible in a type B stock-for-stock reorganization.233 Although the language of section 368(a)(1)(B)234 is not absolutely clear on this point, it appears to prohibit the use of any boot whatsoever; it provides that stock of the target corporation must be obtained "in exchange solely for all or part of [the] voting stock"235 of the acquiring corporation. The district court, however, rejected the most obvious reading of the words of section 368(a)(1)(B) and held that up to twenty percent boot was permissible in a B reorganization.236 The court based this conclusion on its understanding of the underlying structures and policies of the reorganization provisions as indicated in part by the statutory context. The court noted that section 368(a)(2)(B)237 permits up to twenty percent boot in a type C stock-for-assets reorganization and concluded that the statute should be interpreted to permit the same leeway in a B reorganization.238

The district court's decision was reversed by the United States Court of Appeals for the Third Circuit in Heverly v. Commissioner.240 The court of ap-

233. A type B stock-for-stock reorganization is defined in I.R.C. § 368(a)(1)(B) (1982) as: "[T]he acquisition by one corporation, in exchange solely for all or part of its voting stock . . . , of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition)."
234. Id.
235. Id.
238. A type C stock-for-assets reorganization is defined in I.R.C. § 368(a)(1)(C) (1982) as: [T]he acquisition by one corporation, in exchange solely for all or part of its voting stock . . . , of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded. As noted in the text, the limitation on permissible consideration in a type C reorganization is eased somewhat by I.R.C. § 368(a)(2)(B) (1982).
239. Pierson, 472 F. Supp. at 973.
peals rejected the district court's view that boot should be allowed in a B reorganization because it is permitted in a C reorganization. The court explained:

Contrary to what taxpayers argue, this provision, [section] 368(a)(2)(B), does not allow substantially more flexibility in clause C transactions than in clause B transactions. If cash or other property is given, the liabilities assumed by the acquiring corporation must be included in the total twenty percent allowable nonstock consideration, whereas the assumption of liabilities need not be counted against the solely for voting stock requirement if no nonstock consideration is exchanged. Thus, since provision must be made for creditors, and since rarely will the transferor corporation have less than twenty percent of its asset value encumbered by liabilities, the apparent permissibility of cash or other property under clause C is almost inevitably illusory. We believe Congress was fully aware of, and probably intended, this limitation on nonstock consideration under clause C.241

This analysis demonstrates that the permissibility of boot in a C reorganization is largely illusory. Once this fact is understood, the C reorganization boot provisions afford little justification for interpreting section 368(a)(1)(B) to permit the use of up to twenty percent boot in a B reorganization.

The moral of Pierson is that a little learning is a dangerous thing. A court should be sure it understands the structure and policy inherent in the statutory context before it adopts a strained or nonliteral interpretation based on that context. (By the same token, a court should also be sure it understands the structure and policy inherent in the statutory context before it rejects a strained or nonliteral interpretation.) With the exception of the judges of the Tax Court, the judges deciding federal tax cases generally do not have extensive familiarity with the intricacies of the Code's structure. This lack of expertise in tax law makes it imperative that counsel for both taxpayers and the government explain fully and clearly the arguments for and against nonliteral contextual interpretations. Only in this way can most courts make thoughtful and informed decisions as to whether the statutory context is so persuasive as to require nonliteral interpretations in particular cases.

The opinion of the United States Court of Appeals for the Fifth Circuit in Abdalla v. Commissioner242 is an outstanding example of how courts should analyze whether underlying Code structures and policies are sufficiently clear to support a nonliteral interpretation. The issue in Abdalla was a complex one involving "the interrelationship of a 1374 net operating loss deduction and the deductions allowed for worthless stock (165(g)) and worthless nonbusiness debt (166(d)) in a situation where the taxpayer and his Subchapter S corporation have different taxable years."243 The taxpayer and the government argued for different nonliteral interpretations. The court agreed with the parties that "[t]he result reached by a literal reading of the Code does indeed appear contrary to

241. Id. at 1245.
242. 647 F.2d 487 (5th Cir. 1981).
243. Id. at 488.
Congress' general intention." After a careful review of the cases, the court concluded that nonliteral interpretations of the Code are sometimes permissible: "[A] long-standing line of precedent establishes the principle that a statute may be interpreted and enforced in a manner contrary to its literal and unambiguous wording when the intent of the legislative scheme clearly indicates a result contrary to that dictated by the statute." Based on this analysis, one might have expected the Abdalla court to adopt a nonliteral interpretation. The court, however, declined to do so. Instead, it considered the ramifications of each of the proposed nonliteral interpretations and concluded that, "[w]hile Congress does not seem to have intended the outcome unambiguously dictated by the Code in this case, neither does Congress seem to have intended either of the schemes proposed by the parties to this suit." Given the unsatisfactory nature of all the possible interpretations, both literal and nonliteral, the court decided the best course was simply to apply the statute as written.

Regardless of the merits of the result in Abdalla, the court's method of analyzing a question of nonliteral Code interpretation should serve as a model for other courts facing similar problems. The court in Abdalla was open to the possibility of a nonliteral interpretation when a literal interpretation seemed to conflict with the statutory context. But the court was willing to adopt a nonliteral interpretation only if it could find a nonliteral interpretation that was itself consistent with the statutory context. The approach employed in Abdalla can be difficult and time-consuming; it requires a court to delve deeply into the complexities of the Code. This approach, however, is the only method of analysis that fully respects both the language of the Code and its underlying policies and structures.

3. Complexity and the Question of Audience

The more complex a statute, the more likely it is to be addressed to specialists in the statutory subject matter, rather than to the general public. The nature of the statutory audience should affect the interpretation of the statute. Justice Frankfurter made the point succinctly:

We must, no doubt, accord the words the sense in which Congress used them. . . . It will help to determine for whom they were meant. . . . If a statute is written for ordinary folk, it would be arbitrary not to assume that Congress intended its words to be read with the minds of ordinary men. If they are addressed to specialists, they must be read by judges with the minds of specialists.

A court should be somewhat more willing to adopt a contextual interpretation that is difficult or impossible to reconcile with the literal language of a statute when the statute is addressed to an audience of specialists, rather than to the

244. Id. at 495.
245. Id. at 496.
246. Id. at 503.
247. Id.
248. Frankfurter, supra note 89, at 536.
public at large. This is true whether the standard of interpretation is based on intent or meaning.

Consider first an intent-based theory of interpretation. Congress presumably intends that the words of a statute be interpreted according to the sense in which the words normally would be understood by the audience to which the statute is directed.\textsuperscript{249} It is unlikely that Congress would intend for words directed to the general public to be given a nonliteral or unusual interpretation; Congress would probably intend the public to take those words in their usual sense. If the statute has an audience of specialists, however, it may be more reasonable to suppose that Congress intended the statutory words to be understood in ways other than their usual sense. Specialists would be more likely than a general audience to understand the statutory context as a possible basis for nonliteral or unusual interpretations of the statutory language. Moreover, once such an interpretation has been judicially or administratively propounded, specialists are more likely than members of the general public to know of the interpretation.\textsuperscript{250} Thus, Congress may sometimes intend for the words of a statute addressed to specialists to be understood differently from the usual sense of those words.\textsuperscript{251}

The analysis under a meaning-based theory of interpretation is similar. The objective meaning of a statute depends on how the statute would be understood by a hypothetical intelligent and appropriately informed reader, the "typical member of the audience to which the communication is addressed."\textsuperscript{252} A hypothetical reader who is a member of the general public will have less sensitivity to statutory context and the possibility of unusual or nonliteral interpretations suggested by that context than a hypothetical reader who is a specialist. It follows that the words of a statute addressed to specialists are more likely to have an unusual or nonliteral meaning than the words of a statute addressed to a general audience.

Although it may be true, as a general rule, that the more complex a statute the more likely it is directed towards specialists rather than the general public, the key to greater judicial receptivity to contextual interpretation should be not the complexity of the statute,\textsuperscript{253} but the sophistication of the statute’s audience. In applying this principle, courts should not treat the Code as a monolithic entity. Many parts of the Code are consulted only by specialists. Contextual inter-

\textsuperscript{249} See supra text accompanying note 107.

\textsuperscript{250} See Hantzis v. Commissioner, 638 F.2d 248, 257 (1st Cir. 1981) (Keeton, J., concurring) ("A word used in a statute can mean, among the cognoscenti, whatever authoritative sources define it to mean."); cert. denied, 452 U.S. 962 (1981).

\textsuperscript{251} Under an intent-based theory of interpretation, a nonliteral interpretation may be proper either because the legislature intentionally used words nonliterally or because the legislature mistakenly failed to use the proper words to express its intent. See supra text accompanying note 99. The claim here is only that it is more likely that Congress intentionally used words nonliterally in statutes addressed to specialists than in statutes addressed to the general public, not that drafting mistakes are necessarily more common in statutes addressed to specialists.

\textsuperscript{252} R. DICKERSON, supra note 85, at 36; see supra notes 89-93 and accompanying text.

\textsuperscript{253} Cf supra text accompanying notes 218-20 (issue not complexity, but whether Congress considered problem); supra text following note 230 (issue not complexity, but whether complexity provides a framework of structure and policy).
pretations of these provisions may frequently be appropriate, even though
difficult or impossible to reconcile with the statutory language. Courts, how-
ever, should be wary of unusual or nonliteral interpretations of the words of
Code provisions that are consulted regularly by members of the general public to
determine the tax consequences of their own transactions and to prepare their
own returns.\(^\text{254}\)

D. *The Question of Whose Ox Is Gored*

1. The Progovernment Bias

The five recent Supreme Court cases discussed above\(^\text{255}\) suggest that courts
are more likely to adopt a nonliteral interpretation at the government’s behest
than at a taxpayer’s. In four of the five cases\(^\text{256}\) the Court adopted nonliteral
interpretations opposed by the taxpayers, and in the fifth case\(^\text{257}\) the Court re-
jected a nonliteral interpretation advocated by the taxpayer.\(^\text{258}\) Just as striking
as the difference in result is the difference in the Court’s stated attitude toward
nonliteral interpretation, depending on which party wants a nonliteral inter-
pretation.\(^\text{259}\) The only case in which the Court used language hostile to nonliteral
interpretations was the case in which the taxpayer advocated the nonliteral
interpretation.\(^\text{260}\)

The lower courts, too, seem more willing to consider nonliteral interpreta-
tions proposed by the government than those proposed by taxpayers. This
progovernment bias exists despite a paucity of express authority to support it.
In fact, one authority declares “it is a settled rule that tax laws are to be strictly

\(^{254}\) I.R.C. § 162(a)(2) (1982), governing the deductibility of business travel expenses, is a provi-
sion often consulted by members of the general public. In view of the provision’s general audience,
Judge Keeton was right to reject a strained definition of the statutory term “home” in Hantzis v.
Commissioner, 635 F.2d 248, 256-57 (1st Cir.) (Keeton, J., concurring), cert. denied, 452 U.S. 962
(1981). Judge Keeton aptly observed that “it is a distinct disadvantage of a body of law that it can be
understood only by those who are expert in its terminology.” Id. at 257. This observation is particu-
larly true of provisions such as § 162(a)(2) that are frequently consulted by the general public. It is
much less true of statutory provisions consulted primarily or exclusively by specialists.

\(^{255}\) See *supra* text accompanying notes 1-49.

\(^{256}\) Paulsen v. Commissioner, 105 S. Ct. 627 (1985); Bob Jones Univ. v. United States, 461 U.S.
574 (1983); Commissioner v. Tufts, 461 U.S. 300 (1983); Hillsboro Nat’l Bank v. Commissioner, 460


U.S. 672 (1962). In both cases the taxpayers urged the Court to adhere to the literal language of the
Code, and in both cases the taxpayers won.

\(^{259}\) In Badaracco v. Commissioner, 104 S. Ct. 756 (1984), the Court responded to the tax-
payer’s argument for a nonliteral interpretation by stating that it was not “free . . . to twist
§ 6501(c)(1) beyond the contours of its plain and unambiguous language.” *Badaracco*, 104 S. Ct. at
764. In Paulsen v. Commissioner, 105 S. Ct. 627 (1985), however, in which the government advo-
cated a nonliteral interpretation, the Court declared that “[s]atisfying the literal terms of the reor-
organization provisions . . . is not sufficient to qualify for nonrecognition of gain or loss.” *Paulsen*,
105 S. Ct. at 630. Moreover, in Bob Jones Univ. v. United States, 461 U.S. 574 (1983), the Court
adopted a nonliteral interpretation over the taxpayer’s objection, citing the “well-established canon
of statutory construction that a court should go beyond the literal language of a statute if reliance on
that language would defeat the plain purpose of the statute.” *Bob Jones*, 461 U.S. at 586.

construed against the state and in favor of the taxpayer.”261 That “settled rule” may be outdated; probably the prevalent attitude today—at least in terms of the amount of lip service it receives—is that tax laws should be construed even-handedly, favoring neither the government nor the taxpayer.262 The Service itself claims to subscribe to this approach.263 On the question of nonliteral interpretations of the Code, one Tax Court judge has assumed that an evenhanded approach should be applied: “This approach of assuming the responsibility of attempting to carry out the purpose of the legislation is, of course, applied without regard to whether the result benefits the government or the taxpayer.”264

Why, then, if most of the express pronouncements advocate either strict construction in favor of the taxpayer or an evenhanded approach favoring neither party, do courts in practice seem to be more willing to adopt nonliteral interpretations at the government’s request than at taxpayers’ request? The answer seems to be that over the decades, the courts have come to view themselves as having a special duty to act as guardians of the fisc by closing loopholes that Congress inadvertently left open.265 Although there is a long history of judicial willingness to protect the fisc from Congress’ sloppy drafting, there is no corresponding history of judicial willingness to protect taxpayers from Congress’ mistakes. The result is that the government is more likely than a taxpayer to succeed in persuading a court to adopt a nonliteral interpretation.

Gregory v. Helvering266 was perhaps the most influential case in the development of the progovernment interpretive bias. In Gregory the Supreme Court held that a transaction did not qualify as a tax free reorganization, despite the fact that it satisfied the requirements of the literal language of the statute. Find-

261. 3 C. SANDS, SUTHERLAND ON STATUTORY CONSTRUCTION § 66.01, at 179 (1974). Professor Sands notes, however, that there is some authority favoring an evenhanded approach and even some authority favoring construction of tax statutes in favor of the government. Id. § 66.02, at 184-85.

262. See 1 B. BITTKER, supra note 50, § 4.3.1, at 4-25 to -27.

263. The Service’s Statement of Principles of Internal Revenue Tax Administration declares:

[It] is the duty of the Service . . . to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

. . . It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is “protecting the revenue.”

1984-1 C.B. ii. The Service has, in fact, interpreted the Code nonliterally to a taxpayer’s benefit. In Rev. Rul. 79-23, 1979-1 C.B. 3, the Service stated that “when a literal reading of a section of the Code will result in an absurd or unreasonable result when that section is read in light of other sections, the legislative intent must be followed instead.” Id. at 4. The Ruling applied that principle in favor of a taxpayer to a question involving the zero bracket amount of a United States citizen or resident alien married to and living with a nonresident alien.


265. See Arrowsmith v. Commissioner, 344 U.S. 6, 11 (1952) (Jackson, J., dissenting) (criticizing majority for deciding a tax case (although not one involving a question of nonliteral interpretation) on the basis of “solicitude for the revenues”).

266. 293 U.S. 465 (1935), aff’d sub nom. 59 F.2d 809 (2d Cir. 1934). The decision of the United States Court of Appeals for the Second Circuit in Gregory is discussed supra text accompanying notes 221-29.
ing that the transaction had "no business or corporate purpose" other than to bail out corporate earnings and profits at capital gains rates, the Court concluded that the transaction did not qualify as a tax free reorganization because it was not "the thing which the statute intended." The decision in Gregory gave rise to the business purpose doctrine—the rule that a transaction will not qualify as a tax free corporate reorganization if it was not undertaken for some legitimate business purpose.

The spirit of Gregory has infused the entire law of the tax treatment of corporate reorganizations, with the result that "[b]oth the terms of the specifications [of the code's reorganization provisions] and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule [that realized gain must be recognized]."

In addition to the business purpose doctrine, both courts and the Department of the Treasury have adopted the nonstatutory requirements of continuity of business enterprise and continuity of proprietary interest. In imposing continuity of proprietary interest as a requirement for qualification as a tax free reorganization, the Supreme Court has acknowledged that the governing Code provisions are "not to be read literally." The Court reiterated this nonliteral approach in its recent application of the continuity of proprietary interest doctrine in Paulsen: "Satisfying the literal terms of the reorganization provisions . . . is not sufficient to qualify for nonrecognition of gain or loss."

The Supreme Court has been willing, even eager, to interpret the Code's corporate reorganization provisions nonliterally to prevent taxpayers from using

267. Gregory, 293 U.S. at 469.
268. Id.
270. The regulations discussing the continuity of business enterprise requirement are at Treas. Reg. § 1.368-1(d), T.D. 7745, 1981-1 C.B. 134, 140-41. According to the regulations, "Continuity of business enterprise requires that the acquiring corporation (P) either (i) continue the acquired corporation's (T's) historic business or (ii) use a significant portion of T's historic business assets in a business."
271. Pinellas Ice Co. v. Commissioner, 287 U.S. 462 (1933), the first Supreme Court decision involving the continuity of proprietary interest requirement, antedated Gregory by two years. The regulations discussing the continuity of proprietary interest requirement are at Treas. Reg. §§ 1.368-1(b), 1.368-2(a) (1955). The Supreme Court recently characterized the continuity of proprietary interest doctrine as "requir[ing] that the taxpayer's ownership interest in the prior organization must continue in a meaningful fashion in the reorganized enterprise." Paulsen, 105 S. Ct. at 630; see also supra text accompanying notes 37-48 (discussion of Paulsen).
273. Paulsen, 105 S. Ct. at 630. Other Supreme Court opinions contain similar statements. See, e.g., Bazley v. Commissioner, 331 U.S. 737, 741 (1947) ("In a series of cases this Court has withheld the benefits of the reorganization provision in situations which might have satisfied provisions of the section treated as inert language, because they were not reorganizations of the kind with which [the statute], in its purpose and particulars, concerns itself."); Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 182 (1942) ("[A] transaction may not qualify as a 'reorganization' under the various revenue acts though the literal language of the statute is satisfied.").
those provisions to obtain tax benefits inconsistent with the "underlying assumptions and purposes" of the Code. The Court has required compliance not only with the literal terms of the reorganization provisions, but with their underlying assumptions and purposes as well. Although particular aspects of the non-literal interpretation of the reorganization provisions are questionable, the general approach taken by the courts and the Service seems correct. That approach has been to ask whether the structures and policies indicated by the statutory context require an interpretation that goes beyond or is inconsistent with the "underlying assumptions and purposes" of the Code. The courts and the Service have viewed the "underlying assumptions and purposes" of the reorganization provisions as generally requiring nonliteral interpretations in the government's favor to prevent taxpayers from gaining unintended tax benefits from the application of these provisions. This understanding of the structures and policies underlying the reorganization provisions may be correct. Problems have arisen, however, because nonliteral interpretations of the reorganization provisions have come to be seen as the prototypical cases of the nonliteral interpretation of the Code. Because judicial opinions in reorganization cases generally apply progovernment nonliteral interpretations, the assumption seems to have developed—largely unconsciously perhaps—that progovernment nonliteral interpretations are somehow more legitimate than protaxpayer nonliteral interpretations.

A progovernment bias may be appropriate in the reorganization area, in view of the particular assumptions and purposes of the reorganization provisions of the Code. It does not follow, however, that a progovernment bias should pervade every question of nonliteral interpretation of every portion of the Code. Whenever a court adopts a nonliteral interpretation of the Code, it is in a sense adopting a rule of construction favoring the party benefitted by that nonliteral interpretation. It is, after all, deciding the issue in that party's favor despite statutory language to the contrary. But the rule of construction favoring that party is, or should be, a specialized one, adopted in response to the particular assumptions and purposes underlying the portion of the Code involved in the case. In some cases, the assumptions and purposes underlying particular Code provisions will favor the government, but in other cases they will favor the taxpayer.

There is no justification for a general rule of construction favoring nonliteral interpretations proposed by the government over those proposed by taxpay-

275. See infra note 277.
276. For another example of this same phenomenon, see supra text accompanying notes 163-66 (discussion of the use of type D reorganization as a tool against liquidation-reincorporations).
277. Some commentators, however, have criticized the various nonstatutory reorganization requirements. See, e.g., STAFF OF SENATE FINANCE COMM., supra note 209, at 40, 50; AMERICAN LAW INSTITUTE, supra note 214, at 164-68; Faber, Continuity of Interest and Business Enterprise: Is It Time to Bury Some Sacred Cows?, 34 TAX LAW. 239 (1981); Isenbergh, Musings on Form and Substance in Taxation (Book Review), 49 U. CHI. L. REV. 859 (1982).
278. Badaracco v. Commissioner, 104 S. Ct. 756 (1984), may be an example. In Badaracco the Court noted: "'Statutes of limitation sought to be applied to bar rights of the Government, must receive a strict construction in favor of the Government.'" Id. at 761 (quoting E.I. Dupont de Nemours & Co. v. Davis, 264 U.S. 456, 462 (1924)).
Perhaps most courts would agree if they considered the question directly. By relying on the reorganization cases for guidance, however, courts may have unreflectively assumed that a progovernment bias is always appropriate in nonliteral interpretation cases. Contrary to this assumption, "it is far from clear why the Internal Revenue Code should be construed strictly against either the taxpayer or the government." The general principle of construction applicable to questions of nonliteral interpretation of the Code should be one of evenhandedness, with no bias in favor of either party. In any given case, however, the assumptions and purposes underlying the portion of the Code being interpreted may require a specialized rule of construction favoring one party or the other, in the sense that those assumptions and purposes justify a nonliteral interpretation in favor of one of the parties. The mistake in applying the reorganization cases to the rest of tax law has been the failure to see that, at most, the reorganization cases justify a progovernment rule of construction only in the reorganization area, and not throughout the entire Code.

The preference for evenhandedness of interpretation is based largely on notions of fairness and accuracy. It is fundamentally unfair to apply a double standard that benefits the government and penalizes taxpayers. It is likely that most courts share this notion, and would refuse to apply a double standard if they realized what they were doing. Certainly, there is scant explicit judicial support for a double standard. In addition to promoting fairness, an evenhanded approach is more likely than a biased approach to result in accurate interpretations. This is equally true whether the standard of interpretation is the meaning of the statute or the intent of Congress.

2. The Law of Moses' Rod

From the government's point of view, there is a practical reason why, in the long run, it actually may fare as well or even better under an evenhanded approach than under a progovernment interpretive bias. The reason is expressed in the Law of Moses' Rod: "Every stick crafted to beat on the head of a taxpayer will, sooner or later, metamorphose into a large green snake and bite the Commissioner on the hind part." Justice Jackson used a different metaphor to express the same idea in his dissent in Arrowsmith v. Commissioner. After observing that "[a] victory may have implications which in future cases will cost the Treasury more than a defeat," he referred to federal tax law as "a field

279. But see infra text accompanying notes 298-302 (discussion of judicial deference to regulations).
280. 1 B. Bittker, supra note 50, § 4.3.1, at 4-27.
281. Ginsburg, supra note 145, at 100. Moses and Aaron both had rods that turned into serpents. The story of Moses' rod is told in Exodus 4:1-5, and the story of Aaron's rod in Exodus 7:8-13. In neither case did the serpent bite any person, on the hind part or elsewhere. For this reason, a more appropriate Old Testament story to illustrate Professor Ginsburg's point might be the story of Balaam's curse, in which Balaam's every attempt to curse the Israelites became a blessing. The story is told in Numbers 22-24. The author is indebted to Paul Sherer for this information.
283. Id. at 11 (Jackson, J., dissenting).
beset with invisible boomerangs."  

The same interpretation that favors the government in one case may favor the taxpayer in another. Consider the question whether an asset is a capital asset. A determination that the asset is capital benefits the taxpayer when the asset is disposed of for a gain, but benefits the government when the asset is disposed of at a loss. Thus, the Supreme Court’s progovernment ruling in *Corn Products Refining Co. v. Commissioner*, that the corn futures contracts were not capital assets, came back to haunt the Service when similar assets were sold at a loss by other taxpayers.

The rise and fall of the F reorganization provides another example of the Law of Moses' Rod. Prior to 1982, an F reorganization was defined by section 368(a)(1)(F) as “a mere change in identity, form, or place of organization, however effected.” The provision was virtually unused for many years, applying to little more than changes in the state of incorporation. In *Davant v. Commissioner*, however, the Service persuaded the United States Court of Appeals for the Fifth Circuit that a reorganization involving two commonly owned operating entities could qualify as an F reorganization. The Service wanted F reorganization treatment in *Davant* so that it could treat a purported sale of stock as a reorganization and thus tax cash received by the shareholders as a dividend, rather than as a capital gain. The Service’s position that a reorganization involving two operating entities could constitute “a mere change in identity, form, or place of organization” was novel, and at least arguably inconsistent with the literal language of the Code. Nevertheless, the Service convinced the court in *Davant* that an expansive reading of section 368(a)(1)(F) was appropriate.

It did not take long for the stick to turn into a snake and bite the Commissioner. In *Estate of Stauffer v. Commissioner* the United States Court of Appeals for the Ninth Circuit held that the merger of three commonly owned corporations into a single, newly created corporate entity qualified as an F reorganization. The taxpayer desired characterization as an F reorganization to take advantage of the favorable loss carryback rules applicable to F reorganizations.

In response to the Moses’ Rod problem revealed by *Estate of Stauffer*, the Service sought and received congressional relief from its victory in *Davant*. Sec-

284. *Id.* at 12 (Jackson, J., dissenting).
289. 366 F.2d 874 (5th Cir. 1966), cert. denied, 386 U.S. 1022 (1967).
290. Shortly after *Davant*, the United States Court of Appeals for the Fifth Circuit again interpreted § 368(a)(1)(F) expansively, at the Service’s request, in Reef Corp. v. Commissioner, 368 F.2d 125 (5th Cir. 1965), cert. denied, 386 U.S. 1018 (1967). The court held that a liquidation-reincorporation constituted an F reorganization, even though the owners of 48% of the stock of the old corporation owned no stock in the new corporation. The Service desired characterization as an F reorganization to solve a statute of limitations problem that characterization as a D reorganization would not have solved.
291. 403 F.2d 611 (9th Cir. 1968).
tion 225 of the Tax Equity and Fiscal Responsibility Act of 1982 amended section 368(a)(1)(F) to apply only to "a mere change in identity, form, or place of organization of one corporation, however effected."294

Corn Products, Davant, and their aftermaths show the Law of Moses' Rod at work in the context of nonliteral interpretations of the Internal Revenue Code.295 The cases demonstrate that a dubious interpretation, adopted only because of a progovernment bias, may have dire consequences to the government when taxpayers discover how to turn the interpretation to their advantage. In the long run, the fisc may fare better if such dubious interpretations are not accepted; a progovernment bias may actually cost the government money. Corn Products and Davant also demonstrate the impracticality of applying different rules of interpretation, depending on whether the government or the taxpayer seeks a nonliteral interpretation. The same evenhanded approach to interpretation should be used regardless of which party wants a nonliteral interpretation because in a different fact situation the requested interpretation might favor the other party. Thus, it really makes little sense to view interpretations as progovernment or protaxpayer. And if interpretations are not viewed as progovernment or protaxpayer, no approach other than an evenhanded one is reasonable.

There is, perhaps, one way the Moses' Rod phenomenon could be reconciled with a progovernment interpretive bias: by interpreting the same provision of the Code differently depending on whether the government or the taxpayer would be favored by a nonliteral interpretation in the case at hand. As unfair and unworkable as that may sound, the United States Court of Appeals for the Ninth Circuit accused the Service of advocating such an approach in Estate of Stauffer: "But the Commissioner does not take issue with the 'F' reorganization finding in the Davant factual context. In effect, he says that an 'F' reorganization is one thing when the issue is treatment of gain and another when the issue is loss carryback."296 The court rightly gave short shrift to this argument:

We do not see how the definitive principles of an "F" reorganization can change from one case to another, from one context to another,

295. There are many other examples of the Law of Moses' Rod. For example, Ginsburg, supra note 145, at 100-01, discusses the problems the Service caused itself by insisting that I.R.C. § 357(c) (1976) (current version at I.R.C. § 357(c) (1982)) required a cash basis taxpayer to recognize gain on an I.R.C. § 351 (1982) transfer of assets to a controlled corporation in exchange for stock of the corporation, to the extent the taxpayer's accounts payable assumed by the corporation exceeded the taxpayer's basis in the assets transferred to the corporation. The Service's interpretation of § 357(c) was as literal as it was illogical. Incidentally, the Service's initial success in persuading the Tax Court to adopt its interpretation of § 357(c) is a good example of progovernment bias at work. See Raich v. Commissioner, 46 T.C. 604 (1966). In light of Gregory and its progeny, it is difficult to imagine that the Tax Court would have accepted a literal interpretation that produced such unfortunate results if the taxpayer, instead of the government, had sought the literal interpretation. The Tax Court rejected the holding in Raich in Focht v. Commissioner, 68 T.C. 223 (1977), acq. 1980-2 C.B. 1. The Revenue Act of 1978, Pub. L. No. 95-600, § 365, 92 Stat. 2763, 2854-55, confirmed the result in Focht by adding I.R.C. §§ 357(c)(3), 358(d)(2) (1982).
296. 403 F.2d at 619.
dependent upon which position the Commissioner of Internal Revenue prefers. While the factual situation which gives rise to a determination in a given case will invariably differ, the standards by which the determination is to be made cannot. An "F" reorganization is just that, and tax consequences flow from that determination, not vice versa.297

Seldom, if ever, in the tax field can an interpretation be classified as always progovernment or always protaxpayer. The same interpretation may be progovernment in one factual situation and protaxpayer in another. If one rejects the possibility of interpreting the same provision differently in different cases, depending on what will help the government in a particular case, then all that remains is an evenhanded approach to interpretation.

3. Deference to Regulations

Although an evenhanded approach generally should be applied to problems of nonliteral interpretation, there is one limited sense in which a progovernment bias is appropriate. Courts will defer to Treasury regulations interpreting the Code if the statutory language is "‘so general . . . as to render an interpretive regulation appropriate,’”298 and if the regulations are "‘found to ‘implement the congressional mandate in some reasonable manner.’”299 The Supreme Court explained the reasons for this deference in National Muffler Dealers Association v. United States:300

"Congress has delegated to the [Secretary of the Treasury and his delegate, the] Commissioner [of Internal Revenue], not to the courts, the task of prescribing ‘all needful rules and regulations for the enforcement’ of the Internal Revenue Code. 26 U.S.C. § 7805(a).” That delegation helps ensure that in "this area of limitless factual variations," like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," who will be responsible for putting the rules into effect.301

It follows from this principle of deference to Treasury regulations that the existence of an interpretive regulation should be decisive in a case in which an interpretive regulation is appropriate and in which reasonable arguments can be made both for a literal interpretation and for a nonliteral contextual interpretation. If the regulation reasonably adopts a nonliteral interpretation, a court should defer to the regulation, even if the court otherwise would have preferred a literal interpretation. If, instead, the regulation reasonably adopts a literal interpretation, the court likewise should defer, even if the court otherwise would

297. Id.
301. Id. at 477 (quoting United States v. Correll, 389 U.S. 299, 307 (1967), and United States v. Moore, 95 U.S. 760, 763 (1878)).
have favored a nonliteral interpretation. The existence of a regulation enables
the government to prevail so long as its regulatory interpretation is reasonable,
and a regulatory interpretation may be reasonable even though it is not one the
court would have reached in the absence of the regulation. As the Supreme
Court has said, "The choice among reasonable interpretations is for the Com-
mmissioner, not the courts."\textsuperscript{302} In this limited sense, a progovernment bias in
interpretation is justified. However, the same reasonable regulatory interpreta-
tion that favors the government in one case may work to the taxpayer's advan-
tage in another. A court should be equally deferential to a regulation regardless
of which party benefits from the regulation's interpretation of the Code in the
particular case. In that sense, deference to reasonable interpretive regulations
does not result in a progovernment bias.

IV. CONCLUSION

The Internal Revenue Code constantly generates problems of nonliteral in-
terpretation, yet the courts have failed to develop a consistent approach to such
problems. Much of the blame lies with the Supreme Court, whose recent opin-
ions in this area have demonstrated a serious lack of consistency. In one case
the Court declared: "It is a well-established canon of statutory construction
that a court should go beyond the literal language of a statute if reliance on that
language would defeat the plain purpose of the statute."\textsuperscript{303} In another case it
claimed that it was not "free . . . to twist [the Code] beyond the contours of its
plain and unambiguous language in order to comport with good policy."\textsuperscript{304} In a
third case the Court adopted a nonliteral interpretation without acknowledging
that it was doing so.\textsuperscript{305} The signals from the Supreme Court are hopelessly
confused.

It is time for the courts to develop a consistent approach to problems of
nonliteral Code interpretation along the lines suggested in this Article. Although
the chaos in the Supreme Court's recent opinions may be understand-
able as a page of history,\textsuperscript{306} it is inexcusable as a matter of logic. It is time for
the Court to eliminate the confusion resulting from the contradictions among its
recent opinions by adopting a consistent and coherent approach to problems of
nonliteral interpretation of the Internal Revenue Code.

This Article has discussed the most important elements of a sound ap-
proach to the problem of nonliteral interpretations of the Code. The basic prob-
lem is that often the literal language of the Code suggests one interpretation,
whereas the broader statutory context reveals underlying structures and policies
that suggest a different interpretation. In some cases the interpretation indicated

\textsuperscript{302} National Muffler, 440 U.S. at 488; see also Fulman v. United States, 434 U.S. 528, 536
(1978) ("[T]he issue before us is not how we might resolve the statutory ambiguity in the first in-
stance, but whether there is any reasonable basis for the resolution embodied in the Commissioner's
Regulation.").

\textsuperscript{303} Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983).


\textsuperscript{305} Tufts v. Commissioner, 461 U.S. 300 (1983).

\textsuperscript{306} See supra text accompanying notes 52-58.
by context can be reconciled with the literal language of the statute, although only by giving the words of the statute a somewhat unusual interpretation.307 In other cases, the interpretation suggested by the statutory context is absolutely inconsistent with any possible literal interpretation of the statutory language.308 "[E]very question of [statutory] construction is unique";309 there is no formula that will reveal whether, in a particular case, a court should adopt a literal or a contextual interpretation of the statute. As a general rule, the greater the conflict between a proposed contextual interpretation and the literal language of the statute, the stronger the evidence for the contextual interpretation must be. There should be no absolute rule, however, prohibiting interpretations incompatible with literal statutory language. Sufficiently strong evidence can justify a contextual interpretation, even when that interpretation is irreconcilable with the statutory language.

What makes the Code special, as an object of interpretation, is its complexity. The complexity and detail of the Code are sometimes cited as reasons why the Code should not be interpreted nonliterally.310 Statutory language clearly designed to address a particular fact pattern should be applied literally to such a fact pattern, even if the result seems inconsistent with the Code's underlying structures and policies.311 Despite the Code's detail and complexity, however, there are a great many fact patterns that Congress did not specifically address or consider in enacting the Code. In cases involving such patterns, the complexity of the Code alone does not justify an absolute prohibition on nonliteral interpretations.312 In fact, the Code's complexity can sometimes provide a basis for nonliteral interpretations because the detail of the Code may reveal its underlying structures and policies with a clarity that could not be achieved in a simpler statute.313

In practice many courts, including the Supreme Court, seem more willing to adopt nonliteral interpretations proposed by the government, than those advocated by taxpayers.314 A better approach to problems of nonliteral Code interpretation would be an evenhanded one, with neither a progovernment nor a protaxpayer bias.315 In the long run, the government may actually prefer an evenhanded approach because an interpretation favorable to the government in one case may favor the taxpayer in the next case.316 The deference of the courts to reasonable interpretations of the Code expressed in Treasury regulations constitutes a legitimate limited exception to the principle of evenhandedness in interpretation.317

307. See supra text accompanying notes 117-60.
308. See supra text accompanying notes 161-214.
310. See supra text accompanying notes 215-16.
311. See supra text accompanying notes 211-14, 217-20.
312. See supra text accompanying notes 215-29.
313. See supra text accompanying notes 230-47.
314. See supra text accompanying notes 255-76.
315. See supra text accompanying note 279.
316. See supra text accompanying notes 281-97.
317. See supra text accompanying notes 298-302.
If a consistent judicial approach to problems of nonliteral interpretation is to develop, the courts will have to be detailed and explicit in their analyses of particular cases. If the Supreme Court were to address the issues raised by suggested nonliteral interpretations carefully and explicitly, it would cease to invoke the wildly inconsistent principles found in cases such as *Bob Jones* and *Badaracco*. The adoption of nonliteral interpretations sub silentio, as in *Tufts*, would become a thing of the past. Moreover, the current progovernment bias on issues of nonliteral interpretation would not survive careful analysis.

The current haphazard approach to nonliteral interpretations of the Code is inadequate, even though it may produce appropriate results in some cases. A consistent and principled approach is needed. The courts can develop such an approach only by being explicit in their analyses of proposed nonliteral interpretations. The Supreme Court should lead the way in developing a consistent and principled approach to problems of nonliteral interpretation of the Internal Revenue Code. If the number of recent Supreme Court cases involving such problems is any indication, the Court will have ample opportunity to do so.