

Justice Blackmun's Federal Tax Jurisprudence

by ROBERT A. GREEN*

"If one's in the doghouse with the Chief, he gets the crud. He gets the tax cases, and some of the Indian cases, which I like but I've had a lot of them."¹

Justice Blackmun's independent-mindedness often landed him "in the doghouse with the Chief." As a result, he wrote many opinions in tax cases. Fortunately, he took delight in being "in the doghouse with the Chief,"² as well as in writing tax opinions.³ By my count, during his tenure on the Supreme Court, Justice Blackmun wrote majority opinions in 33 federal tax cases and concurring or dissenting opinions in an additional 26 federal tax cases.⁴ From time to

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1. Stuart Taylor, Jr., *Reading the Tea Leaves of a New Term*, N.Y. TIMES, Dec. 22, 1986, at B14 (quoting Justice Blackmun). Other Justices have made similar remarks. Shortly after his retirement from the Court, Justice Powell remarked that "[a] dog is a case that you wish the Chief Justice had assigned to some other Justice.' A deadly dull case, 'a tax case, for example.'" Stuart Taylor, Jr., *Powell on His Approach: Doing Justice Case by Case*, N.Y. TIMES, Jul. 12, 1987, at 1 (quoting Justice Powell). Similarly, when a reporter asked Justice Souter why he sings along with Chief Justice Rehnquist at the Court's annual Christmas carol party, Justice Souter replied, "I have to. Otherwise I get all the tax cases." Paul M. Barrett, *Independent Justice: David Souter Emerges as Reflective Moderate on the Supreme Court*, WALL ST. J., Feb. 2, 1993, at A1 (quoting Justice Souter).

2. Richard A. Meserve, *A Tribute to Justice Harry Blackmun*, 97 DICK. L. REV. 601, 602 (1993) ("Sometimes [during breakfast with his clerks] the Justice would announce with wry bemusement, even glee, that he was 'in the doghouse with the Chief' over a particular opinion").

3. See Donald Lay, *The Cases of Blackmun, J. on the United States Court of Appeals for the Eighth Circuit 1959-1970*, 8 HAMLINE L. REV. 2, 3 (1985) ("[i]t was no secret on the court, or among the bar, that Judge Blackmun enjoyed writing tax cases").

4. Classifying cases as "tax cases" is a line-drawing exercise that entails a certain amount of discretion. I have tried to err on the conservative side. I have not counted a number of cases that involved tax issues that are peripheral to the main issue in the case.

Justice Blackmun also wrote many of the landmark opinions in the area of state taxation. These opinions deal with challenges to state tax laws under the commerce clause and the due process clause of the Constitution. For discussions of these cases, see Karen Nelson Moore, *Justice Blackmun's Contributions on the Court: The Commercial Speech and State Taxation Examples*, 8 HAMLINE L. REV. 29, 49 (1985) (concluding that in the field of state taxation, "Justice Blackmun has led the efforts to clarify and rationalize the Court's

time, he urged the Court to hear even more tax cases. In one of his dissents from a denial of certiorari, he took the Court to task for its “natural reluctance to take on another complicated tax case that is devoid of glamour and emotion,” and argued that the Court should review tax cases when the issue has “importance in the administration of the income tax laws,” even in the absence of a conflict among the circuits.⁵

Many of Justice Blackmun’s tax opinions are legendary among tax lawyers and academics. It is no coincidence that law school casebooks in federal income taxation typically include more cases written by Justice Blackmun than by any other Supreme Court Justice.⁶

For Justice Blackmun, tax law was not something apart from the rest of the law. On the contrary, he viewed tax law as a microcosm of the legal system. The tax system includes the substantive provisions of the Internal Revenue Code (“the Code”), which prescribe the tax treatment of various transactions. Cases involving these provisions present the Justices with the full range of issues of statutory interpretation with particular salience. To what extent should a Justice be guided by purpose in interpreting a statute? In particular, in the tax context, to what extent should a Justice be guided by his or her understanding of the underlying structure or logic of the tax system? How, if at all, should a Justice’s approach to statutory interpretation be affected by the relative competence of the Supreme Court compared to other law-making institutions? I will return to these questions later in this article.

In addition to the substantive provisions of the Code, the tax system also includes the Internal Revenue Service and other administra-

decisions”); see also Dan T. Coenen, *Justice Blackmun, Federalism, and Separation of Powers*, 97 DICK. L. REV. 541, 548 (1993) (noting that Justice Blackmun wrote several of his most important contributions to the law of federalism in cases involving challenges to state taxation under the dormant commerce clause).

5. *Singleton v. Commissioner*, 439 U.S. 940 (1978) (Blackmun, J., dissenting from denial of certiorari). See also *Robertson v. United States*, 488 U.S. 899 (1988) (Blackmun, J., dissenting from denial of certiorari) (arguing that the Court should grant certiorari in a tax case for the reasons set forth in *Mellon Bank, N.A. v. United States*); *Mellon Bank, N.A. v. United States*, 475 U.S. 1032, 1034 (1986) (O’Connor, J., joined by Blackmun & Powell, JJ., dissenting from denial of certiorari) (arguing that the Court should grant certiorari in a tax case even in the absence of a conflict among the circuits “because the Court of Appeals’ construction of the Code will have a significant impact on the financial vitality of these [nonprofit] organizations and because I am unconvinced that this anomalous construction is justified by the language and history of the relevant provisions of the Code”).

6. See Stephen B. Cohen, *Thurgood Marshall: Tax Lawyer*, 80 GEO. L.J. 2011, 2011 (1992).

tive agencies, with both civil and criminal functions, that have a substantial effect on the lives of most Americans. The Supreme Court has a role in protecting individuals by confining the power and discretion of these agencies. Finally, the tax system includes a complicated system of litigation that involves not only the federal courts of general jurisdiction—the district courts, courts of appeals, and Supreme Court—but also a specialized Article I court (the Tax Court) and specialized Article III courts (the Court of Claims and the Federal Circuit). The Supreme Court has a role in elaborating the rules that govern the conduct of litigation in this judicial system. Thus, Justice Blackmun's tax jurisprudence involves not only statutory interpretation in substantive tax cases, but also constitutional law, criminal law, administrative procedure, and court procedure.

I. Justice Blackmun's Background in Taxation⁷

Justice Blackmun came to the Supreme Court with an expertise in taxation that is exceptional among Supreme Court Justices.⁸ He majored in mathematics at Harvard College, receiving his A.B. *summa cum laude* in 1929.⁹ He attended Harvard Law School from 1929-1932.¹⁰ At that time, Harvard Law School did not offer a single course devoted exclusively to the subject of federal taxation.¹¹ It was not until eight years after Justice Blackmun's graduation that the first law school casebook devoted to federal taxation, Erwin Griswold's *Cases on Federal Taxation*, was published.¹² Harvard Law School did offer a tax course dealing primarily with state and local taxation,¹³ but Justice Blackmun avoided taking it because he thought the subject would be unimportant and dull.

After law school, Justice Blackmun clerked for a year and a half for Judge John B. Sanborn on the United States Court of Appeals for

7. This section of the article is based in part on conversations with Justice Blackmun.

8. See William J. Brennan, Jr., *A Tribute to Justice Harry A. Blackmun*, 1990 ANN. SURV. AM. L. xi, xiii (noting that Justice Blackmun was the Court's authority on tax matters).

9. See THE SUPREME COURT JUSTICES: ILLUSTRATED BIOGRAPHIES, 1789-1993 486 (Clare Cushman ed., 1993) [hereinafter THE SUPREME COURT JUSTICES].

10. See *id.*

11. See *Interview with Erwin N. Griswold*, 11 ABA SEC. OF TAX'N NEWSL., Spring 1992, at 57.

12. See *id.* at 56.

13. See *id.* at 57. In addition to this general tax course, Harvard Law School offered a course in constitutional law that addressed the limitations on state and local taxation imposed by the Commerce Clause and the Due Process Clause. See *id.*

the Eighth Circuit.¹⁴ He then entered private practice with the Minneapolis firm of Dorsey, Colman, Barker, Scott, and Barber (now Dorsey & Whitney).¹⁵ At that time, federal taxation was just starting to blossom as an area of practice. The Dorsey firm's lead tax partner, Leland W. Scott, was a very able tax lawyer, but his health was poor, and he was often unavailable to advise clients. The firm decided that it would have to assign one of its associates to the tax department. The associates, including Justice Blackmun, regarded this prospect as a form of condemnation, and none volunteered. The firm chose Justice Blackmun. He would later regard this event as one of the best things that ever happened to him.

Justice Blackmun remained with the Dorsey firm for sixteen years, specializing in taxation and trusts and estates.¹⁶ Much of his work involved tax litigation, including litigation before the Supreme Court. While Justice Blackmun was still at the Dorsey firm, Judge Sanborn, who was a trustee of the St. Paul College of Law (now William Mitchell College of Law), suggested to Justice Blackmun that he teach at the school. Justice Blackmun did so from 1935 to 1941.¹⁷ He developed and taught the first tax course offered at the law school. Justice Blackmun also taught at the University of Minnesota Law School from 1945 to 1947.¹⁸

In 1950, Justice Blackmun left the Dorsey firm to become the first resident counsel of the Mayo Clinic in Rochester, Minnesota.¹⁹ At the Mayo Clinic, he not only developed his well-known expertise in the relationship between law and medicine, but he also continued to work on federal tax issues.²⁰ The Mayo Clinic is organized as a nonprofit charitable foundation, and a substantial portion of the law of nonprofit organizations is tax related.²¹ Justice Blackmun remained at the Mayo Clinic until 1959, when President Eisenhower nominated him to

14. See THE SUPREME COURT JUSTICES, *supra* note 9, at 487.

15. See *id.*

16. See *id.*

17. See *Biography*, 8 HAMLINE L. REV. 1, 1 (1985).

18. See *id.*

19. See THE SUPREME COURT JUSTICES, *supra* note 9, at 487.

20. See *Lay*, *supra* note 3, at 3 (noting that Justice Blackmun's background as a lawyer with the Mayo Clinic provided in-depth experience in the tax field).

21. Several of Justice Blackmun's majority tax opinions involved issues relating to tax-exempt organizations. In particular, *Portland Golf Club v. Commissioner*, 497 U.S. 154 (1990), dealt with the method of calculating a tax-exempt organization's unrelated business taxable income, and *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979), interpreted the term "business league," a form of tax-exempt organization defined in section 501(c)(6) of the Code.

the United States Court of Appeals for the Eighth Circuit.²² Justice Blackmun joined the Eighth Circuit on November 4, 1959, replacing his mentor, Judge Sanborn. Once again, he found himself immersed in tax issues.²³ His former colleague, Chief Judge Donald Lay, has estimated that more than 25 percent of Justice Blackmun's Eighth Circuit opinions were tax related.²⁴

II. Justice Blackmun's Jurisprudence in Constitutional Tax Cases

For many people, the words "tax case" conjure up the thought of a mind-numbingly dense statutory provision buried deep in the recesses of the Internal Revenue Code, which raises some hyper-technical issue that only an accountant could possibly understand or care about. There is, however, much more to tax law. Before turning to substantive tax issues, I will discuss Justice Blackmun's opinions in two tax cases that raise constitutional issues, *United States v. Carlton*²⁵ and *G.M. Leasing Corp. v. United States*.²⁶ In both of these cases, Justice Blackmun rejected the view that there is something unique about taxation, and that special constitutional rules should apply.²⁷ *Carlton* involves the constitutionality of retroactive tax legislation, an issue that has received considerable academic attention. Justice Blackmun's insights in this case led him to a conclusion that is consis-

22. See THE SUPREME COURT JUSTICES, *supra* note 9, at 487.

23. See *id.*

24. See Lay, *supra* note 3, at 3; see also THE SUPREME COURT JUSTICES, *supra* note 9, at 487 (noting that "[a] substantial percentage of Blackmun's opinions on the Eighth Circuit concerned taxation").

25. 512 U.S. 26 (1994).

26. 429 U.S. 338 (1977). Justice Blackmun also wrote the majority opinion in two other tax cases involving constitutional issues. *Freytag v. Commissioner*, 501 U.S. 868 (1991), involved the application of the Appointments Clause to the Tax Court judges. The Appointments Clause provides that "the Congress may by law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of law, or in the Heads or Departments." Section 7443A(b)(4) of the Code authorizes the Chief Judge of the Tax Court to assign any Tax Court proceeding, regardless of complexity or amount in controversy, to a special trial judge for hearing and preparation of proposed findings and a written opinion. Justice Blackmun concluded that a special trial judge is an "inferior Officer," and therefore must be appointed by the President, by a court of law, or by a head of a department. Justice Blackmun then upheld section 7443A(b)(4) on the ground that the Tax Court is a "Court[] of Law" within the meaning of the Appointments Clause. In *United States v. Janis*, 428 U.S. 433, 459-60 (1976), Justice Blackmun held that the "exclusionary rule should not be extended to forbid the use in the civil proceeding of one sovereign [the federal government] of evidence illegally seized by a criminal law enforcement agent of another sovereign [the state government]."

27. See *Carlton*, 512 U.S. at 30-31; *G.M. Leasing*, 420 U.S. at 358-59.

tent with the rather nonintuitive conclusions of the academic writers.²⁸ *G.M. Leasing* raises the issue whether there is a “tax enforcement” exception to the warrant requirement of the Fourth Amendment.²⁹ This case illustrates the important role of the Supreme Court in controlling the power and discretion of the Internal Revenue Service.

A. Retroactive Tax Legislation: *United States v. Carlton*

As originally enacted in the Tax Reform Act of 1986 (the “1986 Act”),³⁰ section 2057 of the Code allowed an estate to claim an estate tax deduction equal to one-half of the proceeds of any sale of employer securities by the executor of the estate to an employee stock ownership plan (“ESOP”).³¹ This deduction was available to any estate that filed a timely estate tax return after October 22, 1986, the date of enactment of the 1986 Act.³² To qualify for this deduction, an employer securities sale had to occur before the deadline for filing the estate tax return, including any extensions.³³

Jerry W. Carlton was the executor of the will of Willametta K. Day, who died on September 29, 1985.³⁴ To take advantage of the new ESOP deduction, Carlton used estate funds to purchase 1.5 million shares of MCI stock at a price of \$11,206,000 on December 19, 1986.³⁵ Two days later, Carlton sold the stock to the MCI ESOP for \$10,575,000. Therefore, the estate incurred a loss of \$631,000 on this transaction.³⁶ On December 29, 1986, Carlton filed a timely estate tax return, in which he claimed a deduction under section 2057 for one-half of the proceeds of the sale of the stock to the MCI ESOP, or

28. See, e.g., Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509 (1986); Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47 (1977).

29. See *G.M. Leasing*, 420 U.S. at 358-59.

30. See Tax Reform Act of 1986, Pub. L. No. 99-514, § 1172(a), 100 Stat. 2085 (adding new Code § 2057).

31. See I.R.C. § 2057(b). Section 2057 was one of a series of congressional efforts to promote ESOPs by providing tax incentives. See, e.g., I.R.C. §§ 133 (partial income tax exclusion for interest paid to banks on ESOP loans), 1042 (allowing certain taxpayers to defer capital gains taxes on sales of securities to ESOPs).

32. I.R.C. § 2057(c)(1).

33. See *id.*

34. See *United States v. Carlton*, 512 U.S. 26, 28 (1994).

35. See *id.*

36. See *id.* Not only had the market price of the stock fallen during the two-day period when the estate held the stock, but in addition, the estate sold the stock below the market price on the day of the sale. Congress expected that executors and ESOPs would negotiate such a below-market sales price, which would enable ESOPs to capture part of the benefit of the estate tax deduction.

\$5,287,000.³⁷ This deduction reduced the estate's tax liability by \$2,501,161.³⁸

There is little doubt that Congress never intended section 2057 to apply to such a transaction. Instead, it seems clear that Congress intended section 2057 to apply only when an executor sells stock that the decedent owned before death.³⁹ The language of section 2057, however, did not contain any such limitation. As a result, any estate could do what the Day estate did and claim a huge deduction by engaging in a transaction that almost completely lacks economic substance. Because of this, section 2057 would result in a revenue loss of as much as \$7 billion over a five-year period—over 20 times more than Congress had anticipated when it enacted the provision in 1986.⁴⁰

Congress acted quickly to close this loophole. On February 26, 1987, a bill was introduced to amend section 2057 to clarify that a sale of employer securities by an executor would not qualify for the deduction unless “the decedent directly owned the securities immediately before death.”⁴¹ This amendment was labeled a “Congressional Clarification of Estate Tax Deduction for Sales of Employer Securities,” and its legislative history stated:

As drafted, the estate tax deduction was significantly broader than what was originally contemplated by Congress in enacting the provision. The committee believes it is necessary to conform the statute to the original intent of Congress in order to prevent a significant revenue loss under the [1986 Act].⁴²

37. *See id.*

38. *See id.*

39. *See* STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., 2D SESS., TAX REFORM PROPOSALS: TAX TREATMENT OF EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs) 37 (Comm. Print 1985) (stating that Congress intended to create an “incentive for stockholders to sell their companies to their employees who helped them build the company rather than liquidate, sell to outsiders or have the corporation redeem their shares on behalf of existing stockholders”).

40. *See* 133 CONG. REC. H4145, H4293 (daily ed. Feb. 26, 1987) (statement of Mr. Bentsen).

41. *Id.* In introducing the amendment, Senator Bentsen observed: “Congress did not intend for estates to be able to claim the deduction by virtue of purchasing stock in the market and simply reselling the stock to an ESOP . . . and Congress certainly did not anticipate a \$7 billion revenue loss.” *Id.* at H4294. Without the amendment, Senator Bentsen stated, “taxpayers could qualify for the deductions by engaging in essentially sham transactions.” *Id.*

42. H. R. REP. NO. 100-391, pt. II, at 1045 (1987), *reprinted in* 1987 U.S.C.C.A.N., vol. 4, 2313-1, 2313-661.

This bill became law on December 22, 1987.⁴³ Congress made the new requirement retroactive to the date of the 1986 Act.⁴⁴ Therefore, the amendment applied to Carlton's sale of stock in December 1986.

When the Internal Revenue Service (the "IRS" or the "Service") audited the tax return for the Day estate, it disallowed the \$5,287,000 deduction under section 2057 on the ground that Day had not owned the MCI stock immediately before her death.⁴⁵ This disallowance resulted in a deficiency of \$2,501,161.⁴⁶ In the district court, Carlton conceded that the deficiency would be correct if the 1987 amendment were applicable.⁴⁷ He argued, however, that the retroactive application of the 1987 amendment to his 1986 transaction violated the Due Process Clause of the Fifth Amendment.⁴⁸ The district court ruled for the government.⁴⁹

A divided panel of the U.S. Court of Appeals for the Ninth Circuit reversed.⁵⁰ The panel majority concluded the retroactive application of the amendment was unconstitutionally harsh and oppressive because Carlton had detrimentally relied on the pre-amendment version of section 2057 when he engaged in the MCI stock transactions in December 1986, without any notice that Congress would amend section 2057.⁵¹

The Supreme Court reversed the Ninth Circuit. In a concurring opinion, Justice Scalia, joined by Justice Thomas, agreed with the Ninth Circuit that the "bait-and-switch" taxation in *Carlton* was harsh and oppressive.⁵² In their view, Congress in 1986 had invited Carlton to buy and sell the MCI stock in order to obtain the estate tax deduction.⁵³ In reliance on this invitation, Carlton did so at a cost to the estate of \$600,000.⁵⁴ Congress then retroactively disallowed the deduction and failed to compensate the estate for the cost it had incurred.⁵⁵ Justices Scalia and Thomas concluded that it was "harsh and

43. See Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10411, 101 Stat. 1330, 1330-432 (1987).

44. See *id.*

45. See *United States v. Carlton*, 512 U.S. 26, 29 (1994).

46. See *id.* at 25.

47. See *id.* at 26.

48. See *id.*

49. See *id.*

50. See *Carlton v. United States*, 972 F.2d 1051, 1062 (9th Cir. 1992), *rev'd*, 512 U.S. 26 (1994).

51. See *id.*

52. *Carlton*, 512 U.S. at 39 (Scalia, J., concurring in the judgment).

53. See *id.*

54. See *id.*

55. See *id.* at 40.

oppressive” when legislation “without notice, . . . gives a different and more oppressive legal effect to conduct undertaken before enactment of the statute.”⁵⁶

In his opinion for the Court, Justice Blackmun began by reviewing the standard for determining whether retroactive tax legislation violates the Due Process Clause.⁵⁷ In tax cases, the Court’s traditional standard has been whether “retroactive application is so harsh and oppressive as to transgress the constitutional limitation.”⁵⁸ In modern cases involving economic legislation arising outside of the tax context, however, the Court has asked whether the retroactive legislation is “arbitrary and irrational.”⁵⁹ The Court declared in 1984 that these two standards are identical.⁶⁰ In *Carlton*, Justice Blackmun reaffirmed the identity of these due process standards. Constitutionality only requires that the retroactive application of the statute be “supported by a legitimate legislative purpose furthered by rational means.”⁶¹

Applying this test, Justice Blackmun rejected the conclusion of the Ninth Circuit, Justice Scalia, and Justice Thomas that the retroactive application of a tax statute is harsh and oppressive when a taxpayer has detrimentally relied on prior law, without notice that Congress might change it.⁶² Justice Blackmun noted that “[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.”⁶³

Indeed, the reasoning of the Ninth Circuit and the concurring Justices is circular on the issue of reasonable reliance. They implicitly assumed that it is reasonable for a taxpayer to expect that the tax laws will not change in the absence of specific notice to the contrary, and they then concluded that the courts must protect this expectation. It is reasonable, however, for taxpayers to have such an expectation only if the courts *do* protect their expectation. If the Supreme Court were to

56. *Id.* at 39. (Scalia, J., concurring in the judgment) (quoting *United States v. Hemme*, 476 U.S. 558, 569 (1986)). In spite of finding the retroactive application of the 1987 amendment “harsh and oppressive,” Justice Scalia concluded that the retroactive application did not violate the Due Process Clause because the Due Process Clause guarantees *no* substantive rights, only process. *Id.* at 40.

57. *See id.* at 30-31.

58. *United States v. Hemme*, 476 U.S. 558, 568-69 (1986); *Welch v. Henry*, 305 U.S. 134, 147 (1938).

59. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976).

60. *See Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733 (1984).

61. *Carlton*, 512 U.S. at 30-31 (quoting *Pension Benefit Guaranty Corp.*, 467 U.S. at 733).

62. *See id.* at 39.

63. *Id.* at 33.

decree, as it did in *Carlton*, that the tax law is subject to change retroactively without notice, then reliance on the contrary expectation would cease to be reasonable. The question to be answered is whether the Court *should* decree this, or whether it should perpetuate taxpayer reliance on the expectation that the law will not change retroactively by declaring such change unconstitutional. The answer to this question requires an analysis of the consequences of making legal change retroactive.

Justice Blackmun had the key insight that the reliance argument proves too much, for even “[a]n entirely prospective change in the law may disturb the relied-upon expectations of individuals, but such a change would not be deemed therefore to be violative of due process.”⁶⁴ In common usage, a retroactive statute is one whose effective date provision specifically applies the new statutory rule to events occurring prior to the date of enactment. This type of retroactivity is more precisely called “nominal retroactivity.”⁶⁵ The 1987 amendment in *Carlton* was of this form. A prospective (or “nominally prospective”) statute, in contrast, is one whose effective date provision makes the new statutory rule applicable only to events occurring after the date of enactment.⁶⁶

To see how a prospective statute can disturb reliance interests, consider a taxpayer who is deciding whether to invest in an asset. The value of an investment asset is determined by the discounted present value of the future stream of after-tax income that the taxpayer expects the asset to generate. Suppose the taxpayer determines that under current tax law, this discounted present value exceeds the cost of acquiring the asset. The taxpayer should then rationally invest in the asset. Now, suppose that after the taxpayer makes this investment, the tax law is amended to increase the taxation of the income generated by that asset. Suppose further that this amendment is prospective, applying only to income generated after the date of enactment. In spite of this prospectivity, the amendment will immediately reduce the value of the asset because it will reduce the stream of after-tax income that the asset is expected to generate. As a result, the taxpayer who purchased the asset before the amendment was enacted, in reliance on then-current law, will experience a dramatic loss of wealth. If we are to protect this taxpayer’s reliance interest in the law that existed at the time he made the investment, then we must strike

64. *Id.* at 33-34.

65. See Graetz, *supra* note 28, at 49.

66. See *id.*

down even this purely prospective amendment. Striking down laws on this basis would enormously hinder Congress' efforts at meaningful tax reforms.

The Ninth Circuit and the concurring Justices asked the wrong question in *Carlton*. They took Carlton's decision to engage in the stock transaction as a given, and asked whether it was fair for the new law to apply retroactively to that prior decision. Thus, they used a backward-looking approach. A forward-looking approach would ask the following question: If the Court were to decree that the law is subject to retroactive change without notice, what consequences would this have on taxpayers' decisions in the future?

One obvious consequence is that investors would face greater risk in the future. Investors are often able to protect themselves, however, against the risk of change. For example, they can diversify their investments. A second, less obvious consequence is that such a decree would affect investors' incentives in the future. If investors expect that their investments will be protected from adverse changes in the law, they will have no incentive to try to predict changes in government policy, and they will undertake investments even when there is a significant likelihood that those investments will be judged undesirable in light of future reforms. On the other hand, if investors expect that their investments will be affected by adverse changes in the law, they will have an incentive to try to predict changes in government policy, and they will make investment decisions that are optimal in light of all available information about future policy.⁶⁷

This argument provides strong policy support for Justice Blackmun's conclusion that it should not be considered unconstitutional when legislation, to use Justice Scalia's words, "without notice, . . . gives a different and more oppressive legal effect to conduct undertaken before enactment of the statute."⁶⁸ The transaction in *Carlton* did not really amount to an investment because Carlton sold the MCI stock immediately after he purchased it. Nevertheless, a similar analysis applies. It should have been reasonably predictable in December 1986, even without specific notice, that Congress might change the

67. This analysis is not limited to the tax context. It is desirable for investors to try to predict legal change in general, and to take into account rational expectations about such change when they make investment decisions. Indeed, this analysis is not limited to the legal context. From the investor's perspective, the risk of legal change is not essentially different from other risks, such as the risk that technology, or consumer tastes, or even the weather will change. It is desirable for investors to take all such risks into account.

68. *Carlton*, 512 U.S. at 39 (Scalia, J., concurring in the judgment) (quoting *United States v. Hemme*, 476 U.S. 558, 569 (1986)).

1986 law. This predictability was enhanced by several factors that Justice Blackmun emphasized: (1) the retroactive amendment corrected an apparent mistake, (2) this mistake would have caused a significant and unanticipated revenue loss, (3) the taxpayer was able to take advantage of the mistake by engaging in a “purely tax-motivated” transaction (one with almost no economic substance), and (4) the legislative change in fact occurred within a short period of time after the transaction took place.⁶⁹

If taxpayers were protected from retroactive changes in these circumstances, they would have no incentive to predict such changes and to modify their conduct accordingly. This is particularly undesirable in the tax context, where taxpayers can move huge amounts of money very quickly to take advantage of temporarily available loopholes. The same logic applies even in situations where legal reform is less predictable. It is socially desirable for taxpayers to have an incentive to make decisions that are based on a rational assessment of the possibility of legal reform.

B. Confining the Power and Discretion of the Internal Revenue Service: *G.M. Leasing Corp. v. United States*

G.M. Leasing Corp. was managed and controlled by George I. Norman, Jr., who failed to file appropriate tax returns and subsequently became a fugitive.⁷⁰ Because of these circumstances, the Service made a jeopardy assessment against Norman.⁷¹ In turn, this gave the United States a lien upon all of Norman’s property.⁷² As a result, the Service was authorized to levy upon Norman’s property in order to collect the taxes he owed.⁷³ Because G.M. Leasing was found to be Norman’s alter ego, the Service was also authorized to levy upon G.M. Leasing’s assets in order to satisfy Norman’s income tax liability. Section 6331(b) of the Code defines “levy” to include “the power of distraint and seizure by any means.”⁷⁴

69. *Id.* at 32.

70. *G.M. Leasing v. United States*, 429 U.S. 338, 342 (1977).

71. *See id.* Section 6861(a) of the Code provides in pertinent part that “[i]f the Secretary believes that the assessment or collection of a deficiency . . . will be jeopardized by delay, he shall . . . immediately assess such deficiency . . . , and notice and demand shall be made by the Secretary for the payment thereof.” I.R.C. § 6861(a).

72. *See id.* at 350. Section 6321(a) of the Code provides in pertinent part that “[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.” I.R.C. § 6321(a).

73. *See G.M. Leasing*, 429 U.S. at 343.

74. I.R.C. § 6331(b).

Two days after the Service made this jeopardy assessment, revenue officers, "acting without a warrant," broke into a cottage owned by G.M. Leasing.⁷⁵ Once inside, they were unable to determine whether the cottage was a residence or an office.⁷⁶ They decided not to seize any property until they could clarify this situation.⁷⁷ That night, however, they observed that the lights were on in the cottage and that somebody was removing boxes.⁷⁸ Additionally, they received information that the cottage was an office and not a residence.⁷⁹ Therefore, sometime during the next two days, the agents again broke into the cottage without a warrant and seized its remaining contents, including furnishings, books, and records.⁸⁰ G.M. Leasing subsequently brought a suit against the government alleging that the levy violated the warrant requirement of the Fourth Amendment.⁸¹

In the Supreme Court, the government claimed the existence of "a broad exception to the Fourth Amendment that allows warrantless intrusions into privacy" in furtherance of tax law enforcement.⁸² In support of this contention, the government noted "that the First Congress, which proposed the adoption of the Bill of Rights, also provided that certain taxes could be 'levied by distress and sale of goods of the person or persons refusing or neglecting to pay.'"⁸³ The government also argued that the history of the common law in England and the laws in several states prior to the adoption of the Bill of Rights support a "tax enforcement" exception to the warrant requirement of the Fourth Amendment.⁸⁴

Justice Blackmun reviewed these historical materials and concluded that they did not include "anything approaching the clear evidence that would be required to create so great an exception to the Fourth Amendment's protection against warrantless intrusions into

75. *G.M. Leasing*, 429 U.S. at 344-45.

76. *See id.* at 345.

77. *See id.*

78. *See id.*

79. *See id.*

80. *See id.* at 345-46. In addition to levying on the premises and contents of G.M. Leasing's office, revenue officers also levied on automobiles registered in G.M. Leasing's name that were parked on public streets, parking lots, and other open places. *See id.* at 344. The Court held that the warrantless seizure of these automobiles did not violate the Fourth Amendment, because the seizure did not involve any invasion of personal privacy. *See id.* at 351-52.

81. *See id.* at 346.

82. *Id.* at 354.

83. *Id.* (quoting Act of Mar. 3, 1791, ch. 15, § 23, 1 Stat. 199, 204).

84. *See id.* at 355.

privacy.”⁸⁵ To the contrary, he found that the historical evidence pointed in the opposite direction: “[O]ne of the primary evils intended to be eliminated by the Fourth Amendment was the massive intrusion on privacy undertaken in the collection of taxes pursuant to general warrants and writs of assistance.”⁸⁶

The government also argued that the congressional enactment of section 6331(b), authorizing “distrain and seizure by any means,” justifies warrantless searches for tax enforcement purposes.⁸⁷ Justice Blackmun construed the statute, however, as being “silent on the subject of *intrusions into privacy*”; it merely “authorizes all forms of *seizure*.”⁸⁸ Not only did Justice Blackmun find this the most natural reading of the statute, but he also noted that a construction of the statute as authorizing intrusions into privacy by any means would raise serious constitutional questions.⁸⁹ As the facts of *G.M. Leasing* illustrate, searches in connection with tax levies involve considerable discretion on the part of the seizing officers as well as questions of disputed fact, such as whether the cottage was an office or a residence. Thus, judicial oversight is necessary.

Justice Blackmun also rejected the argument that a “tax enforcement” exception to the warrant requirement could be justified by special circumstances, such as the need for rapid action or the fact that the search involved a business that was pervasively regulated and subject to government licensing.⁹⁰ Unlike these established exceptions to the warrant requirement, a “tax enforcement” exception would be extremely broad, covering all defaults on all taxes. Justice Blackmun concluded that “the mere interest in the collection of taxes is insufficient to justify a statute declaring *per se* exempt from the warrant re-

85. *Id.*

86. *Id.*

87. *Id.* at 356.

88. *Id.* at 358.

89. *See id.*

90. *See id.* at 357-58. Justice Blackmun distinguished *United States v. Biswell*, 406 U.S. 311, 316-17 (1972), and *Colonnade Catering Corp. v. United States*, 397 U.S. 72, 76 (1970). *See G.M. Leasing*, 429 U.S. at 353-54. In *Biswell*, the Court upheld a warrantless search of a locked storeroom during business hours, pursuant to the inspection procedure authorized by the Gun Control Act of 1968, noting that when a gun dealer chooses to engage in the pervasively regulated business of selling guns and to accept a federal license, he does so with the knowledge that his business records, firearms, and ammunition will be subject to effective inspection. *See Biswell*, 406 U.S. at 316. Similarly, in *Colonnade Catering Corp.*, the Court concluded that Congress has broad authority to fashion standards of reasonableness for searches and seizures to regulate the liquor industry. *See Colonnade Catering Corp.*, 397 U.S. at 86-87.

quirement every intrusion into privacy made in furtherance of any tax seizure."⁹¹

As a result of the Supreme Court's decision in *G.M. Leasing*, the Service now prohibits agents from entering a taxpayer's premises to seize property for tax collection purposes unless they first obtain a court order.⁹² This procedure enables the district court to verify the existence of probable cause and to control the revenue officers' discretion by limiting the scope of the search.⁹³

III. Justice Blackmun's Jurisprudence in Cases Involving Substantive Tax Issues

The Supreme Court's role in the development of the substantive law of taxation involves statutory interpretation. Analyses of the contributions of Supreme Court Justices seldom devote much attention to their approaches to statutory interpretation. Constitutional law is much more glamorous.⁹⁴ But this selectivity results in a highly distorted picture of what the Justices actually do. Only a minority of the cases they decide involve constitutional issues; a far greater number involve statutory interpretation.⁹⁵

Justice Blackmun's opinions in substantive tax cases provide an excellent window into his approach to statutory interpretation. These opinions raise several over-arching issues with particular salience. One is how the relative competency of the Supreme Court compared

91. *Carlton*, 429 U.S. at 358.

92. See generally MICHAEL I. SALTZMAN, *IRS PRACTICE AND PROCEDURE* § 14.08[2][f], at 14-58 to 14-59 (2d ed. 1991).

93. See *id.* at 14-58 & n.31, 14-59 & nn.32-33.

94. See Mary Ann Glendon, *Comment, in A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW* 95, 98-99 (Amy Gutmann ed., 1997). Professor Glendon notes:

In the heyday of the Warren and Burger Courts, scholarship in statutory fields like tax, securities, and labor law gradually fell out of fashion as constitutional law became the glamour subject in the legal academy. The legislative process itself came in for disdain as dramatic civil rights decisions promoted the illusion that social change could be effected through litigation.

Id.

95. See Antonin Scalia, *Common-Law Courts in a Civil-Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws*, in *A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW*, 13-14 (Amy Gutmann 3 ed., 1997). Justice Scalia notes:

Even in the Supreme Court, I would estimate that well less than a fifth of the issues we confront are constitutional issues—and probably less than a twentieth if you exclude criminal-law cases. By far the greatest part of what I and all federal judges do is to interpret the meaning of federal statutes and federal agency regulations.

Id. (parenthesis omitted).

to other law-making institutions should affect the Justices' approach to statutory interpretation. Another is the extent to which the Justices should rely on their sense of the underlying structure or logic of a statutory scheme in deciding a case.

A threshold problem in examining Justice Blackmun's substantive tax opinions is their sheer number. Compounding this problem is the fact that the Justices seldom have an opportunity to engage in a sustained development of any one aspect of statutory law. They are limited by the cases that come before the Court and the cases that are assigned to them for an opinion.⁹⁶ I have chosen to focus on several cases that illuminate the over-arching issues referred to above. First, I consider a series of opinions that Justice Blackmun wrote that actually deal with a single aspect of tax law: the treatment of capital expenditures. Although this issue might seem to epitomize the hyper-technicality of the tax law, it actually goes to the heart of the nature of an income tax. Then, I conclude by discussing one of Justice Blackmun's most famous tax opinions, *Commissioner v. Tufts*,⁹⁷ which sharply raises the issue of how the Justices should deal with conflicts between "tax logic" and the language of the Code.

A. The Treatment of Capital Expenditures: *Lincoln Savings and Loan, INDOPCO, Idaho Power, and Newark Morning Ledger*

Section 162(a) of the Code allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."⁹⁸ "Ordinary" and "necessary" are commonplace words, but what do they mean in this context? In *Welch v. Helvering*,⁹⁹ Justice Cardozo interpreted the word "necessary" to impose only the minimal requirement that the expenses be "appropriate and helpful" for the development of the taxpayer's business.¹⁰⁰ His opinion suggests that the word "ordinary" is meant to distinguish between expenses that are currently deductible and those

96. See Moore, *supra* note 4, at 30-31 (discussing factors largely beyond the control of a Justice that affect his ability to influence the development of legal doctrine).

97. 461 U.S. 300 (1983).

98. I.R.C. § 162(a).

99. 290 U.S. 111 (1933). The issue in *Welch* was whether certain payments made by the taxpayer to enhance his business reputation were deductible from income as ordinary and necessary expenses, or instead were in the nature of capital expenditures. See *id.* at 112.

100. *Id.* at 113; see *Commissioner v. Tellier*, 383 U.S. 687, 689 (1966) (noting that the Court's decisions "have consistently construed the term 'necessary' as imposing only the minimal requirement that the expense be 'appropriate and helpful' for 'the development of the [taxpayer's] business'" (quoting *Welch*, 290 U.S. at 113)).

that are in the nature of capital expenditures.¹⁰¹ But Justice Cardozo was unable to provide any guidance for making this distinction, beyond the following unhelpful comment:

Here, indeed, as so often in other branches of the law, the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.¹⁰²

The distinction between ordinary expenses and capital expenditures is reiterated in section 263(a)(1) of the Code, which provides that no deduction shall be allowed for an "amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."¹⁰³ Justice Blackmun explained the significance of the distinction between ordinary expenses and capital expenditures in *INDOPCO, Inc. v. Commissioner*.¹⁰⁴

The primary effect of characterizing a payment as either a business expense or a capital expenditure concerns the timing of the taxpayer's cost recovery: While business expenses are currently deductible, a capital expenditure usually is amortized and depreciated over the life of the relevant asset, or, where no specific asset or useful life can be ascertained, is deducted upon dissolution of the enterprise.¹⁰⁵

The timing of a cost recovery might seem like a technicality, but it is fundamental to the nature of an income tax. The most widely accepted economic definition of income, generally referred to as the Haig-Simons definition, defines personal income as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."¹⁰⁶ More succinctly, personal income is the sum of consumption and saving, where saving refers to the increase in the taxpayer's net worth during the taxable period.

101. In *Tellier*, Justice Stewart cited *Welch* for the proposition that "[t]he principal function of the term 'ordinary' in § 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures which, if deductible at all, must be amortized over the useful life of the asset." *Tellier*, 383 U.S. at 689-90 (citing *Welch*, 290 U.S. at 113-16).

102. *Welch*, 290 U.S. at 114-15.

103. I.R.C. § 263(a)(1).

104. 503 U.S. 79 (1992).

105. *Id.* at 83-84.

106. HENRY C. SIMONS, *PERSONAL INCOME TAXATION* 50 (1938).

To illustrate this definition, suppose that a taxpayer purchases a productive asset, such as a piece of business equipment, for \$10,000. This purchase does not involve consumption (using up goods and services to obtain personal satisfaction), nor does it result in a change in the taxpayer's net worth. Before the purchase, the taxpayer owned \$10,000 in cash. After the purchase, he owns equipment worth \$10,000. The tax law does not treat the increase in the taxpayer's net worth from the acquisition of the equipment as income. Therefore, to obtain the correct result under the Haig-Simons definition, the taxpayer also should not be allowed to deduct the \$10,000 cost of the equipment in the year of purchase.

Now suppose that the equipment has a limited useful life, perhaps because of wear or obsolescence. Then its value presumably will decline each year, resulting in a decrease in the taxpayer's net worth each year. Of course, the taxpayer's *overall* net worth might not decrease: The decrease in the value of the equipment might be offset by revenues generated by the use of the equipment in the business. The tax law, however, treats such revenues as income. Therefore, to obtain the correct result under the Haig-Simons definition, the taxpayer must be allowed to deduct the decline in value of the equipment against these revenues (or against other income recognized by the tax law).

In other words, under the Haig-Simons definition of income, the taxpayer may not deduct the cost of the equipment as an ordinary and necessary business expense in the year of the purchase, but rather must capitalize the expenditure and deduct it over the useful life of the equipment in the form of depreciation deductions. A common way of explaining this, without explicitly referring to the Haig-Simons definition, is in terms of a matching principle: "the Code endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes."¹⁰⁷

Suppose Congress were to repeal the requirement of capitalization, thus allowing taxpayers to always deduct, or "expense," the cost of assets in the year of acquisition. The resulting tax would not be an income tax at all, but what is known as a "cash flow" tax.¹⁰⁸ The im-

107. *INDOPCO*, 503 U.S. at 84.

108. See Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax is Exempt Under a Cash Flow Tax?*, 52 TAX L. REV. 1, 1 (1996). Professor Warren states:

Like an income tax, a cash flow tax would include receipts from a variety of sources, including receipts from capital investment. The key distinction between the two taxes is that capital costs are currently deducted (or "expensed") under

mediate expensing of the full cost of acquisition would produce a large tax savings in the year of acquisition, compared to the savings that would be available under a Haig-Simons income tax. Recall that Haig-Simons depreciation allows the cost of acquisition to be deducted only gradually over the useful life of the asset as the asset value declines. The immediate tax savings from expensing can dramatically reduce the burden of the tax on capital income. Indeed, under certain plausible assumptions,¹⁰⁹ the tax savings from expensing *completely* eliminates the burden of the tax on capital income. In effect, capital income is exempt from the tax.¹¹⁰ Thus, repeal of the capitalization requirement would radically change the fundamental nature of the income tax.

In practice, it is not feasible to follow the Haig-Simons prescription for depreciation exactly, because doing so would require the taxpayer to determine the change in the fair market value of his assets each year. It is usually very difficult to determine fair market value without an actual sale. Therefore, the tax law assumes that assets depreciate in accordance with more-or-less arbitrary formulas. Indeed, in some cases, the tax law simply assumes that an asset will lose all of its value within the year of acquisition. Immediate expensing is then allowed, even if, in reality, the asset retains value beyond the year. In other cases, the tax law simply assumes that an asset will retain its value indefinitely. No depreciation is then allowed. Any discrepancy between these assumptions and actual changes in asset value are taken into account upon the eventual sale or other disposition of the asset, when gain or loss is calculated. These assumptions require line drawing, and the proper location of these lines is often very unclear.

Justice Blackmun wrote his first opinion dealing with the treatment of capital expenditures during his first Term on the Court. In *Commissioner v. Lincoln Savings and Loan Association*,¹¹¹ he held that an "additional premium" that a savings and loan association paid to the Federal Savings and Loan Insurance Corporation (FSLIC) was

the cash flow tax, whereas they are capitalized and later deducted (as depreciation or basis) under the income tax.

Id.

109. The key assumption is that the tax savings from expensing can be invested at the same rate of return as the original investment. *See id.* at 1-2.

110. *See id.* This proposition has been known by tax policy analysts for over fifty years. For an early statement, see E. Cary Brown, *Business-Income Taxation and Investment Incentives*, in *INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN* 300, 301 (1948).

111. 403 U.S. 345 (1971).

in the nature of a capital expenditure.¹¹² This additional premium increased the savings and loan association's interest in a "Secondary Reserve" maintained by the FSLIC. The savings and loan association reported its interest in the FSLIC's Secondary Reserve as an asset on its balance sheet. Justice Blackmun stated that "[w]hat is important and controlling is that the [additional premium] serves to create or enhance for Lincoln what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature and not an expense."¹¹³ This is consistent with the Haig-Simons definition of income, for if the payment creates or enhances an asset that retains value (i.e., produces benefits) beyond the taxable year, the taxpayer has not suffered a loss in net worth equal to the amount of the payment. Therefore, an immediate deduction of the amount of the payment is not appropriate.

However, this formulation led to confusion in the lower courts. Some courts interpreted Justice Blackmun's opinion to mean that *only* expenditures that create or enhance separate and distinct assets are required to be capitalized.¹¹⁴ Justice Blackmun had the opportunity to correct this misconception in *INDOPCO, Inc. v. Commissioner*.¹¹⁵ The taxpayer in *INDOPCO* incurred expenses for investment banking fees, legal fees, and other acquisition-related costs in the course of a friendly takeover, and it deducted these as ordinary and necessary business expenses.¹¹⁶ Justice Blackmun held that these expenditures had to be capitalized, even though they did not create or enhance a separate and distinct asset.¹¹⁷ Justice Blackmun rejected the argument that this holding is inconsistent with his opinion in *Lincoln Savings and Loan* stating, "We had no occasion in *Lincoln Savings and Loan* to consider the tax treatment of expenditures that, unlike the additional premiums at issue there, did not create or enhance a specific asset, and thus

112. *Id.* at 354.

113. *Id.*

114. *See e.g.*, *NCNB Corp. v. United States*, 684 F.2d 285, 293-94 (4th Cir. 1982) (bank expenditures for expansion-related planning reports, feasibility studies, and regulatory applications did not "create or enhance separate and identifiable assets," and therefore were ordinary and necessary expenses under § 162(a)); *Briarcliff Candy Corp. v. Commissioner*, 475 F.2d 775, 782 (2d Cir. 1973) (suggesting that *Lincoln Savings and Loan* "brought about a radical shift in emphasis," making capitalization dependent on whether the expenditure creates or enhances "a separate and distinct additional asset") (quoting *Lincoln Savings and Loan*, 403 U.S. at 354).

115. 503 U.S. 79 (1991).

116. *See id.* at 82.

117. *See id.* at 90.

the case cannot be read to preclude capitalization in other circumstances."¹¹⁸

What, then, is the test for distinguishing ordinary expenses from capital expenditures? Justice Blackmun adopted a facts and circumstances test. Quoting Justice Cardozo's opinion in *Welch v. Helvering*, he noted that "the 'decisive distinctions' between current expenses and capital expenditures 'are those of degree and not of kind,'" that "each case 'turns on its special facts,'" and that "the cases sometimes appear difficult to harmonize."¹¹⁹ Justice Blackmun emphasized, however, that one factor, while not absolutely controlling, is nevertheless of paramount importance: whether the expenditure produces benefits beyond the year in which it was incurred.¹²⁰ When this is the case, capitalization of the expenditure is the norm, and expensing is the exception.¹²¹ This expanded view of capital expenditures is also consistent with the Haig-Simons definition of income. There is nothing magical about the existence of a "separate and distinct asset." The key is that the expenditure creates value (an addition to the taxpayer's net worth) that lasts beyond the taxable year. It is always possible to invent a name for this value, such as "share in the FSLIC's Secondary Reserve," and then call it an "asset."

Justice Blackmun relied on an economic concept of income in deciding *INDOPCO*.¹²² He supported his conclusion with a number of other arguments as well. In particular, he relied on the language of section 263(a)(1), which refers to "permanent improvements or betterments."¹²³ He concluded that this language "envisions an inquiry into the duration and extent of the benefits realized by the taxpayer."¹²⁴ He also relied on the language and structure of the Code to support his general conclusion that "deductions are exceptions to the

118. *Id.* at 87.

119. *Id.* at 86 (quoting *Welch v. Helvering*, 290 U.S. 111, 114, 116 (1933), and *Deputy v. Du Pont*, 308 U.S. 488, 496 (1940)).

120. *See id.* at 87. Justice Blackmun noted that the "mere presence of an incidental future benefit—'some future aspect' may not warrant capitalization." *Id.* (emphasis in original) (quoting *Lincoln Savings and Loan*, 403 U.S. at 354). However, "a taxpayer's realization of benefits beyond the year in which the expenditure is incurred is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization." *Id.*

121. *See id.* at 84.

122. *See id.* Justice Blackmun explained the purpose of capitalization by stating that "the Code endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes." *Id.*

123. *Id.* at 88.

124. *Id.*

norm of capitalization.”¹²⁵ In addition, he discussed lower-court precedents and scholarly commentary dealing with the issue, and concluded that “[c]ourts long have recognized that expenses such as these, ‘incurred for the purpose of changing the corporate structure for the benefit of future operations are not ordinary and necessary business expenses.’”¹²⁶

In addition, Justice Blackmun considered the practical implications of rejecting a “separate and distinct asset” requirement for capitalization.¹²⁷ The taxpayer in *INDOPCO* argued that this requirement provided a “principled basis” upon which to differentiate ordinary expenses from capital expenditures, and that abandoning it would create indeterminacy and uncertainty.¹²⁸ Justice Blackmun responded by stating that little would be lost by abandoning the “separate and distinct asset” test: “grounding tax status on the existence of an asset would be unlikely to produce the bright-line rule that petitioner desires, given that the notion of an ‘asset’ is itself flexible and amorphous.”¹²⁹

Justice Blackmun’s opinion in *INDOPCO*, like his opinions in other cases, exemplifies a practical reasoning approach to statutory interpretation. The philosophical basis for this approach can be traced back to Aristotle’s theory of practical reasoning, which proposes that one can determine what is right in specific cases, even without a universal theory of what is right.¹³⁰ This approach does not rely exclusively on any single touchstone for interpretation. Rather, it relies on multiple arguments that draw on a broad range of evidence and considerations: the statutory text, legislative history, legislative purpose, post-enactment developments (including judicial and administrative precedents), and the practical consequences of alternative interpretations. A useful metaphor for this approach is that of the contrast between the chain and the cable:

A chain is no stronger than its weakest link, because if any of the singly connected links should break, so too will the chain. In contrast, a cable’s strength relies not on that of individual threads, but upon their cumulative strength as they are woven

125. *Id.* at 84.

126. *Id.* at 89 (quoting *General Bancshares Corp. v. Commissioner*, 326 F.2d 712, 715 (8th Cir. 1964), *cert. denied*, 379 U.S. 382 (1964)).

127. *Id.* at 87 n.6.

128. *Id.*

129. *Id.*

130. See ARISTOTLE, *NICOMACHEAN ETHICS* bk. VI, chs. 5-11 (H. Rackham trans., Harvard Univ. Press rev. ed. 1962); see generally William Eskridge & Philip Frickey, *Statutory Interpretation as Practical Reasoning*, 42 *STAN. L. REV.* 321, 323-24 (1990).

together. Legal arguments are often constructed as chains, but they tend to be more successful when they are cable-like.¹³¹

The practical reasoning approach tends to focus on the concrete, to avoid broad opinions, to acknowledge indeterminacy, and to address explicitly any conflicting evidence and policies.¹³²

This approach continues to be apparent in Justice Blackmun's next case involving the treatment of capital expenditures, *Commissioner v. Idaho Power Co.*¹³³ Idaho Power Co. owned transportation equipment used in constructing its own power facilities.¹³⁴ The company reported the allowable depreciation for its transportation equipment as an ordinary and necessary business expense.¹³⁵ Justice Blackmun's opinion in *Idaho Power* held that a portion of this equipment depreciation must be allocated to the taxpayer's construction of its power facilities, and that this portion must be treated as a capital expenditure.¹³⁶

Once again, Justice Blackmun's conclusion is consistent with the Haig-Simons definition of income. Depreciation deductions normally would be allowable with respect to the transportation equipment, because one would presume that the equipment declines in value as it is used, and that this decline in value is not matched by untaxed appreciation in value of other assets. In *Idaho Power*, however, the taxpayer used the transportation equipment to construct other capital assets.¹³⁷ The decline in value of the transportation equipment in the course of this usage presumably was matched by an increase in the value of the power facilities. The tax law does not treat this increase in value of the power facilities as income. Therefore, if the tax law allowed Idaho Power to deduct the depreciation on the transportation equipment currently, the taxpayer would be reporting a net loss when none had occurred. One can achieve the correct net result by denying the taxpayer a current deduction for the amount of depreciation on the transportation equipment to the extent that it is allocable to the construction, and by requiring the taxpayer to capitalize this amount.

As in *INDOPCO*, Justice Blackmun relied on an economic concept of income in deciding *Idaho Power*.¹³⁸ He also relied on a policy

131. Eskridge & Frickey, *supra* note 130, at 351.

132. *See id.* at 371.

133. 418 U.S. 1 (1974).

134. *See id.* at 4.

135. *See id.* at 5.

136. *See id.* at 19.

137. *See id.* at 5.

138. *See id.* at 10-11, 14, 16.

argument based on “tax parity”: capitalization of construction-related depreciation is necessary if taxpayers who do their own construction work are to be treated comparably to taxpayers who hire independent contractors to do their construction work.¹³⁹ Justice Blackmun also reasoned by analogy, noting that “[c]onstruction-related depreciation is not unlike expenditures for wages for construction workers,” and that “when wages are paid in connection with the construction or acquisition of a capital asset, they must be capitalized and are then entitled to be amortized over the life of the capital asset.”¹⁴⁰

Finally, Justice Blackmun supported his decision by noting that two regulatory agencies required Idaho Power to use accounting procedures that capitalized construction-related depreciation.¹⁴¹ Justice Blackmun considered this evidence relevant, although not controlling.¹⁴²

As in *INDOPCO*, Justice Blackmun also focused on the text of the statute, and responded explicitly to the taxpayer’s arguments.¹⁴³ Section 263(a)(1) states that no deduction shall be allowed for “any amount *paid out* for permanent improvements or betterments made to increase the value of any property or estate.”¹⁴⁴ The taxpayer argued that depreciation of construction equipment represents merely a decrease in value and is not an amount “paid out” within the meaning of this language.¹⁴⁵ Justice Blackmun concluded, however, that this language could be construed to apply to depreciation as well as to a direct payment of cash because “[i]n acquiring the transportation equipment, taxpayer ‘paid out’ the equipment’s purchase price; depreciation is simply the means of allocating that payment over the various accounting periods affected.”¹⁴⁶ Thus, each depreciation deduction reflects a portion of the amount “paid out” to acquire the transportation equipment.

Justice Blackmun’s last case involving the capitalization requirement, *Newark Morning Ledger Co. v. United States*,¹⁴⁷ involved the

139. *Id.* at 14.

140. *Id.* at 13.

141. *See id.* at 14-15

142. *See id.* Justice Blackmun subsequently wrote *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), the leading case dealing with the relationship between financial or regulatory accounting and tax accounting.

143. *See id.* at 16.

144. I.R.C. § 263(a)(1) (emphasis added).

145. *See Idaho Power*, 418 U.S. at 16.

146. *Id.* at 17.

147. 507 U.S. 546 (1993).

tax treatment of acquired intangible assets.¹⁴⁸ The taxpayer, Newark Morning Ledger, was the successor to The Herald Company.¹⁴⁹ In 1976, Herald acquired Booth Newspapers, Inc., which published eight Michigan newspapers with about 460,000 subscribers.¹⁵⁰ After the acquisition, Herald continued to publish the eight newspapers under their prior names.¹⁵¹ For federal income tax purposes, Herald allocated the acquisition price of \$328 million among the various assets of Booth Newspapers.¹⁵² Specifically, Herald allocated \$234 million to various financial and tangible assets and \$68 million to an intangible asset called "paid subscribers."¹⁵³ This latter asset consisted of the 460,000 identified subscribers to the eight Booth newspapers.¹⁵⁴ Although these subscribers could terminate their subscriptions at any time, Herald expected most of them to continue to subscribe after the change in ownership.¹⁵⁵ The "paid subscribers" asset reflected the value of this future income expectancy.¹⁵⁶ Herald allocated the remaining \$26 million to going-concern value and goodwill.¹⁵⁷

The Treasury regulations in effect at the time allowed a taxpayer to depreciate an intangible asset as long as the taxpayer could demonstrate that the asset had a limited useful life and could estimate the length of that useful life with reasonable accuracy.¹⁵⁸ These regulations also provided, however, that "[n]o deduction for depreciation is allowable with respect to goodwill."¹⁵⁹ Neither the Code nor the regulations defined "goodwill."¹⁶⁰

On its tax returns for 1977 to 1980, Herald claimed depreciation deductions based on the \$68 million of the acquisition price allocated to "paid subscribers."¹⁶¹ The Service disallowed these deductions. In litigation, the government did not try to establish a rational foundation for determining whether a capital asset is depreciable.¹⁶² It merely declared, without any analysis, that goodwill is nondepreciable

148. *See id.* at 548.

149. *See id.* at 549.

150. *See id.* at 549 & n.2, 550.

151. *See id.* at 549.

152. *See id.*

153. *See id.* at 549-50.

154. *See id.* at 550.

155. *See id.*

156. *See id.*

157. *See id.*

158. Treas. Reg. § 1.167(a)-3.

159. *Id.*

160. *See Newark Morning Ledger*, 507 U.S. at 555.

161. *See id.* at 550.

162. *See id.* at 551.

because the regulations say so, and that any asset resembling conventional goodwill is therefore nondepreciable.¹⁶³

Justice Blackmun surveyed the case law and concluded that a useful definition of “goodwill” is “the expectancy of continued patronage.”¹⁶⁴ The value of the “paid subscribers” asset was clearly based on the expectancy that these subscribers would continue to give their patronage to Herald. Thus, this asset seemed to fit under the conventional definition of “goodwill.”¹⁶⁵ Justice Blackmun noted, however, that whether an asset is depreciable should not be settled by definition.¹⁶⁶ Instead, Justice Blackmun looked at the purpose of accurately calculating net income.¹⁶⁷ Depreciation is necessary to calculate net income accurately when an asset declines in value over its useful life.¹⁶⁸ “Goodwill” is treated as a nondepreciable asset only because it does not decline in value over a limited useful life.¹⁶⁹ Thus, for depreciation purposes, “goodwill” ought to be defined in terms of this key characteristic, rather than by reference to some general definition unrelated to taxation. Therefore, Justice Blackmun held that “a taxpayer able to prove that a particular asset can be valued and that it has a limited useful life may depreciate its value over its useful life regardless of how much the asset appears to reflect the expectancy of continued patronage.”¹⁷⁰

In his dissent, Justice Souter, joined by Chief Justice Rehnquist and Justices White and Scalia, took Justice Blackmun to task for relying on the “purposes of the Code” in reaching his decision.¹⁷¹ The dissenters stated that “[s]uch policy initiatives are properly left to Congress, which can modify the *per se* ban on depreciating goodwill at any time.”¹⁷² Indeed, Congress did substantially modify the law governing the depreciation of goodwill in 1993, the same year that *New-*

163. *See id.* at 551-52.

164. *Id.* at 555 (quoting *Boe v. Commissioner*, 307 F.2d 339, 343 (9th Cir. 1962)).

165. *See id.* at 556.

166. *See id.* at 565 n.13.

167. *See id.* at 565. Justice Blackmun noted that “[i]t is more faithful to the purposes of the Code to allow the depreciation deduction under these circumstances, for ‘the Code endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes.’” *Id.* (quoting *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992)).

168. *See id.* at 553.

169. *See id.* at 564-65.

170. *Id.* at 566.

171. *Id.* at 582 n.10 (Souter, J., dissenting).

172. *Id.*

ark Morning Ledger was decided, by enacting section 197 of the Code.¹⁷³

Section 197 allows taxpayers to amortize most purchased intangible assets on a straight-line basis over a 15-year period.¹⁷⁴ Such section 197 intangibles include goodwill, patents, copyrights, know-how, customer-based or supplier-based intangibles, government licenses, covenants not to compete, franchises, trademarks, and tradenames.¹⁷⁵ This law brings about a major simplification. It obviates the need for taxpayers to distinguish goodwill from other section 197 intangibles because they are all amortizable in the same way. It also obviates the need for taxpayers to estimate the useful life of section 197 intangibles because all such intangibles are amortizable over a 15-year period, regardless of their actual useful lives. The Court, of course, would be institutionally incapable of accomplishing such a sweeping reform.

These capital expenditure cases raise several over-arching issues that transcend the specific issues in the cases. The first is whether a Justice should rely on his or her understanding of "tax logic," derived from an economic concept of income, in interpreting specific provisions of the Code. I will defer discussion of this issue until Part III.B, below, when I consider the *Tufts* case. A second over-arching issue is how a Justice's view of the comparative institutional competence of the Court should affect his or her approach to tax cases.

Congress and the Treasury Department have several obvious advantages over the Court when it comes to developing substantive tax law. First, Congress and the Treasury have much greater technical expertise than the Court. Their staffs include experts in tax law as well as tax economists, who are able to estimate the likely effects of changes in the tax law on taxpayer behavior and on government revenues. Second, the legislative and regulatory processes allow an opportunity for thorough public debate of the issues. In litigation in the Court, in contrast, debate is largely confined to the parties, although non-parties may file *amicus* briefs. Finally, Congress and the Treasury have considerable control over their agendas and enormous flexibility to fashion new legal rules that balance conflicting interests and policy concerns. The Court, in contrast, must confine itself to interpreting the language of the specific Code provisions at issue in the cases that come before it.

173. See Omnibus Budget Reconciliation Act of 1993 § 13261(a), Pub. L. No. 103-66 (codified at I.R.C. § 197).

174. See I.R.C. § 197(a).

175. See I.R.C. § 197(d).

These considerations led Justice Douglas to adopt the view that the Court in general should avoid hearing substantive tax cases, leaving ambiguities in the Code and loopholes to be fixed by Congress or the Treasury Department. Justice Douglas was the sole dissenter from Justice Blackmun's opinion for the Court in *Commissioner v. Idaho Power Co.*,¹⁷⁶ where he stated:

This Court has, to many, seemed particularly ill-equipped to resolve income tax disputes between the Commissioner and the taxpayers. The reasons are (1) that the field has become increasingly technical and complicated due to the expansions of the Code and the proliferation of decisions, and (2) that we seldom see enough of them to develop any expertise in the area. Indeed, we are called upon mostly to resolve conflicts between the circuits which more providently should go to the standing committee of the Congress for resolution.¹⁷⁷

Justice Douglas expressed similar views in his lone dissent from Justice Blackmun's opinion for the Court in *United States v. Genesee*.¹⁷⁸

I protest now what I have repeatedly protested, and that is the use of this Court to iron out ambiguities in the Regulations or in the Act, when the responsible remedy is either a recasting of the Regulations by Treasury or presentation of the problem to the Joint Committee on Internal Revenue Taxation, which is a standing committee of the Congress that regularly rewrites the Act and is much abler than we to forecast the revenue needs and spot loopholes where abuses thrive.¹⁷⁹

In a provocative article, Professor Frederick Schauer has argued that the Justices' lack of expertise and interest in most statutory cases explains why they increasingly rely on a "plain meaning" approach to statutory interpretation.¹⁸⁰ According to Professor Schauer, this approach enables them to conserve judicial resources for more glamorous cases¹⁸¹ and facilitates coordination on a single interpretation.¹⁸² Professor Schauer suggests that the "blunt, frequently crude, and cer-

176. 418 U.S. 1 (1974).

177. *Id.* at 19 (Douglas, J., dissenting). Justice Douglas went on to refer to *Idaho Power* as a "picayune case" and to the Court's tax jurisprudence as a "leaden-footed pursuit of law and justice." *Id.*

178. 405 U.S. 93 (1972).

179. *Id.* at 114-15 (Douglas, J., dissenting) (footnote omitted).

180. See Frederick Schauer, *Statutory Construction and the Coordinating Function of Plain Meaning*, 1990 SUP. CT. REV. 231, 253-56.

181. See *id.* at 255 (noting that a plain meaning approach enables the Court to "marshal[] its human resources in such a way that it is undesirable for the Justices and their clerks to become truly internally expert in every subject that comes to their attention").

tainly narrowing device”¹⁸³ of plain meaning actually might produce better results in technical statutory interpretation cases than reliance on theoretically richer and more sensitive tools of interpretation.¹⁸⁴ Turning specifically to the tax area, he states that “[m]y instinct is that these Justices with these clerks with this amount of time will make less of a hash of tax law in the long run by trying to rely on plain meaning than by trying to divine and apply the deepest purposes and equities of the Internal Revenue Code.”¹⁸⁵

I find these arguments unpersuasive. I believe Justice Blackmun is correct that tax law is not something separate and apart from the rest of the law. Any argument that the Justices should avoid deciding tax cases or that they should decide these cases using suboptimal methods of statutory interpretation would apply equally to many other areas of statutory law. These statutory cases are often very important to the public welfare¹⁸⁶—far too important for the Justices to ignore them or to decide them haphazardly in the hope that Congress will bail them out when they make mistakes.

Obviously, none of the Justices—not even one with Justice Blackmun’s impressive background in taxation—can match the expertise of someone who devotes his or her full time to tax issues. But this lack of expertise is not peculiar to the tax area. As with all cases involving technical issues, the parties have a responsibility to educate the Justices. Indeed, this is often regarded as an advantage of courts of general jurisdiction. Requiring specialists to explain technical issues to a generalist judge can clarify those issues. Moreover, a generalist judge is more likely than a specialist to rethink issues from first principles and to see basic arguments that the specialists might have missed because of their narrower focus.¹⁸⁷

182. *See id.* Professor Schauer argues that the Justices might seek agreement on results and on methods of inquiry in some significant number of cases for reasons of institutional stability. *See id.*

183. *Id.* at 252.

184. *See id.* at 254 n.85.

185. *Id.*

186. Professor Schauer himself notes that many dull statutory interpretation cases are more socially important than cases involving, say, flag desecration. *See id.* at 247.

187. As Justice Scalia has noted, “even in a matter as specialized as tax, the disadvantage of inexperience is often more than made up for by the advantage of a fresh outlook and broad viewpoint.” Remarks by Justice Antonin Scalia Before the Fellows of the American Bar Foundation and the National Conference of Bar Presidents 9-10 (Feb. 15, 1987), *quoted in* Richard L. Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 U. PA. L. REV. 1111, 1120 (1990).

In tax cases, because of the amount of money at stake, the private party is often represented by very able counsel. The Government, of course, is represented by the Solicitor General's office. This office usually includes a tax expert. Moreover, it has the support of the Tax Division staff of the Justice Department. Therefore, the quality of the briefing and oral argument will tend to be extremely high in tax cases—much more so than in many other areas of Supreme Court practice. Moreover, the great majority of the tax cases that the Supreme Court hears come to the Court because of a split in the Courts of Appeals. This means that the issues likely will have been analyzed in several trial court and Court of Appeals decisions, giving the Justices an excellent starting point for their own analyses.

It is true that a thorough and sensitive analysis of tax cases will require an expenditure of judicial resources that might be spent on other cases. The solution, however, is for the Court to exercise care in selecting cases for argument in the first place. Once the Justices agree to grant *certiorari* in a case, there is little justification for taking a second-best approach to deciding the case. Moreover, although the Court could conserve its own resources by treating tax cases superficially and relying on Congress for correction, this approach would necessarily waste legislative resources.¹⁸⁸

It is also true that there is a reasonable likelihood of legislative correction if the Court decides a tax case incorrectly, since legislative activity occurs frequently in the tax area.¹⁸⁹ *Newark Morning Ledger* suggests that even when the Court is correct in its holding, Congress is sometimes quick to step in and enact even more comprehensive reforms. On the other hand, the Court's decisions can have a significant effect on the *likelihood* of legislative reform. The Court's decisions always affect the legislative process simply by altering the status quo. The side that wins in Court has the relatively easy task of blocking legislative action in order to preserve the status quo. The side that loses has the much more difficult task of overcoming legislative inertia to obtain affirmative relief.¹⁹⁰

In the tax context, the Court's decisions further affect the likelihood of legislative reform in a more specific way. If the Supreme Court decides a case in favor of the Government, it will be difficult for

188. See James J. Brudney, *Congressional Commentary on Judicial Interpretations of Statutes: Idle Chatter or Telling Response?*, 93 MICH. L. REV. 1, 20-32, 38 (1994).

189. See Edward A. Zelinsky, *Text, Purpose, Capacity, and Albertson's: A Response to Professor Geier*, 2 FLA. TAX REV. 717, 728 (1996) (arguing that the Code is very amenable to legislative correction).

190. See *id.*

the interest group that loses to obtain legislative relief, because such relief will result in a revenue loss. Under the current budgetary process, this revenue loss must be offset with a revenue-raising provision. The inclusion of such a provision in the legislative package will generate opposition from the interest groups whose taxes will increase as a result of the revenue-raising provision. In consequence, the losing interest group will likely find it very difficult to prevail in Congress.¹⁹¹ For example, in *Newark Morning Ledger*, if the Court had decided that case in favor of the Government, the bill that enacted section 197 probably would have become a revenue loser. The need to include a revenue raising provision would then have made passage of the bill much less likely, possibly resulting in a loss of the opportunity to make this very significant tax reform.

Finally, even if Congress can be expected to respond by correcting mistakes, it is still simplistic to argue that the Court need not be concerned with fixing loopholes or with deciding tax cases correctly. There inevitably will be delays before Congress enacts corrective legislation, and aggressive taxpayers will be able to exploit loopholes or erroneous Supreme Court interpretations of the law in the interim. Because taxpayers can often move huge sums of money very rapidly to exploit such opportunities, these interim consequences can be very substantial. Moreover, the congressional correction almost invariably will increase the already staggering complexity of the Code.¹⁹² Finally, even after Congress enacts corrective legislation, there is a good chance that taxpayers and their legal advisors will succeed in designing even more sophisticated transactions to get around the new legislation as well. It is unrealistic to expect Congress to draft unambiguous and loophole-free statutes, or even corrections to statutes. The limits of the English language ensure ambiguity, and the limits of human foresight ensure unintended loopholes. The courts can serve a critical role as a back-stop against abusive transactions that exploit these ambiguities and loopholes. To do so, however, they must interpret the Code in light of its basic underlying purposes – in

191. See Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492, 511 n.62 (1995) (noting that the response that Congress can always fix a wrong tax decision is far too facile today because under budget laws enacted in the 1980s, statutory proposals that would lose revenue must be matched by proposals that would raise revenue).

192. One can argue, however, about whether overlaying the Code with a judicial gloss might result in an even more complicated system than would result from legislative correction.

particular, the purpose of accurately measuring economic income.¹⁹³ Not only will this approach remove the unwarranted benefits of abusive transactions after the fact, but it will also deter taxpayers from engaging in such transactions in the first place.

B. The Role of Tax Logic in Statutory Interpretation: *Commissioner v. Tufts*

*Commissioner v. Tufts*¹⁹⁴ deals with the effect of a nonrecourse loan on the amount realized when property is sold.¹⁹⁵ Nonrecourse debt is debt for which the borrower is not personally liable.¹⁹⁶ The lender's only remedy in the case of default is to foreclose on the property that secures the debt. If the fair market value of that property falls below the amount of the outstanding debt, the debtor can simply abandon the property to the lender, who will bear the loss.

When Justice Blackmun decided *Tufts*, he was writing against the background of *Crane v. Commissioner*.¹⁹⁷ In 1932, Beulah B. Crane inherited an apartment building and lot from her deceased husband.¹⁹⁸ At the time of her husband's death, the property had an appraised fair market value of \$255,000.¹⁹⁹ It was also subject to a nonrecourse mortgage in the same amount.²⁰⁰ Between 1932 and 1938, Crane managed the apartment building and claimed depreciation deductions totaling \$25,000.²⁰¹ She based these deductions on the

193. I have focused above on the possibility that Congress will correct its own mistakes or erroneous Court decisions. Another possibility, raised by Justice Douglas in the quotations above, is that the Treasury Department might make these corrections through regulations. Of course, there are limits to the Treasury's authority to do so. Another problem with relying on regulatory agencies for correction is that they are often prone to capture by the interest groups they are supposed to regulate. Therefore, they cannot be relied on to act as faithful agents of Congress. Some tax scholars have argued that the Treasury Department is less prone to capture than most administrative agencies. See Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1192-94 (1993); Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 114-15 (1990). Even if this assertion is true, there is still the risk that the Treasury will overreach because of its mission of protecting the Government's revenues.

194. 461 U.S. 300 (1983).

195. See *id.* at 302.

196. See *id.*

197. 331 U.S. 1 (1947). In order to make the underlying logic of *Crane* more transparent, the discussion in the text is based on a slightly simplified version of the facts, including alterations of the dollar amounts involved.

198. See *id.* at 3.

199. See *id.*

200. See *id.*

201. See *id.* at 3 & n.2.

premise that her basis in the property at the time of inheritance was \$255,000.²⁰² In 1938, Crane sold the property, still subject to the \$255,000 mortgage, to a third party for \$2,500 in cash.²⁰³

The applicable provisions of the tax law at the time of the events in *Crane* were essentially the same as the corresponding provisions of current law. (To facilitate the discussion of both *Crane* and *Tufts*, I will refer consistently to the current provisions.) Section 1001(a) of the Code provides that “[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis” Section 1001(b) defines the “amount realized” as “the sum of any money received plus the fair market value of the property (other than money) received.” The Code further provides that the initial basis of property acquired from a decedent shall be the fair market value of the property at the date of the decedent’s death,²⁰⁴ and that this basis shall be adjusted (i.e., reduced) over time by the amount of any allowable depreciation deductions.²⁰⁵

The issue in *Crane* was how much gain Crane realized on her sale of property in 1938.²⁰⁶ On her tax return, Crane reported a gain of \$2,500 on the transaction.²⁰⁷ According to her analysis, the “property” in question was her *equity* in the apartment building and lot.²⁰⁸ When she acquired the property by inheritance in 1938, the value of this property was zero because the fair market value of the apartment building and lot was exactly offset by the amount of the mortgage.²⁰⁹ Her initial basis in the property was zero.²¹⁰ Given a zero basis, she was not entitled to claim depreciation deductions.²¹¹ Therefore, her adjusted basis in the property in 1938 was still zero.²¹² When she sold the property in 1938, her amount realized was equal to the \$2,500 in cash that she received.²¹³ Thus, her gain from the sale was equal to \$2,500 (her amount realized) minus zero (her adjusted basis in the property), or \$2,500.²¹⁴

202. *See id.* at 3.

203. *See id.*

204. *See* I.R.C. §§ 1011(a), 1014(a)(1).

205. *See* I.R.C. § 1016(a).

206. *See Crane*, 331 U.S. at 2-3.

207. *See id.* at 3.

208. *See id.*

209. *See id.*

210. *See id.*

211. *See id.* Of course, this is contrary to what she actually did in prior years, when she claimed depreciation deductions totaling \$25,000. *See id.* at 3 & n.2.

212. *See id.* at 3.

213. *See id.* at 3-4.

214. *See id.* at 4.

The Commissioner disagreed with this analysis and determined that Crane realized a gain of \$27,500 on the transaction.²¹⁵ He theorized that the “property” she acquired and sold was not her equity in the apartment building and lot, but rather the physical property itself; that is, her rights to possess, use, and dispose of the property, undiminished by the mortgage.²¹⁶ Her initial basis in this property was equal to its fair market value at the date of the decedent’s death, or \$255,000.²¹⁷ Her adjusted basis in the property at the time of sale was equal to her initial basis minus the \$25,000 of allowable depreciation, or \$230,000.²¹⁸ Her amount realized on the sale included not only the \$2,500 in cash, but also the \$255,000 of debt to which the property was subject, for a total amount realized of \$257,500.²¹⁹ Thus, her gain from the sale was equal to \$257,500 (amount realized) minus \$230,000 (adjusted basis in the property), or \$27,500.

The Court in *Crane* agreed with the Commissioner that the term “property” meant the building and lot, undiminished by the mortgage.²²⁰ Thus, Crane’s original basis was \$255,000.²²¹ In addition, the Court agreed that the \$255,000 of debt to which the property was subject was properly included in the “amount realized” on the sale.²²² The Court began by noting that if Crane had been personally liable on the mortgage, relief from the mortgage would have produced an economic benefit to Crane equal to \$255,000.²²³ The benefit would have been the same as if Crane had been paid \$255,000 in cash and had used the cash to repay the mortgage.²²⁴ Therefore, relief from a personal debt should be treated as if it were “money received” for purposes of the definition of “amount realized.”²²⁵

The Court then argued that even though Crane was not personally liable on the debt, relief from the mortgage still produced an economic benefit to her valued at \$255,000.²²⁶ The Court reasoned that if the lender had called the loan in 1938, Crane would have wanted to repay the full amount of the mortgage rather than surrender the prop-

215. *See id.*

216. *See id.*

217. *See id.*

218. *See id.*

219. *See id.*

220. *See id.* at 5.

221. *See id.* at 4-5.

222. *See id.* at 14.

223. *See id.* at 13.

224. *See id.*

225. *See id.* at 14.

226. *See id.*

erty, because the property was worth \$2,500 more than the mortgage.²²⁷ In other words, she would have treated the loan exactly as if it were a loan for which she were personally liable. Thus, according to the Court, when Crane sold the property subject to the mortgage, "the benefit to [her was] as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another."²²⁸ In footnote 37, however, the Court added the following qualification:

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. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. That is not this case.²²⁹

Although Crane lost the case, her analysis was economically sound. Before she inherited the apartment building and lot, her net worth was zero. After she inherited the property, her net worth was still zero, because the value of the property was exactly offset by the amount of the mortgage. After she sold the property, her net worth was \$2,500, because she owned \$2,500 in cash and had no other assets or liabilities. Therefore, under the Haig-Simons definition of income, she realized income of \$2,500 during the period involved in the case. This is exactly the amount of income that results from Crane's analysis.²³⁰

The Commissioner's analysis, however, also produces the correct result, if one ignores differences in timing and any difference between capital gains and ordinary income.²³¹ Under the Commissioner's analysis, Crane had an initial basis of \$255,000 in the property, and there-

227. *See id.* at 12.

228. *See id.* at 14 (footnote omitted). Professor Boris Bittker has argued that this final step in the Court's reasoning is incorrect. In Professor Bittker's view, a taxpayer receives an economic benefit when she is relieved of a nonrecourse mortgage and *retains* the property without the mortgage, but not when she is relieved of a nonrecourse mortgage because she *disposes* of the mortgaged property. *See* Boris Bittker, *Tax Shelters, Nonrecourse Debt, and the Crane Case*, 33 TAX L. REV. 277, 282 (1978).

229. *Crane*, 331 U.S. at 14 n.37.

230. Of course, under Crane's analysis, she was *not* entitled to the depreciation deductions that she claimed from 1932 to 1938. If she were allowed to claim those deductions and still to report only \$2,500 of gain—which is what she actually did on her tax returns—then the result would be incorrect. The Service was in a bind in the *Crane* case, because the statute of limitations undoubtedly had run on most of Crane's claimed depreciation deductions. Thus, to achieve the economically correct result in her case, the Service had no choice but to challenge the amount realized on the sale.

231. Of course, differences in timing and differences between capital gains and ordinary income should not be ignored. They are very important.

fore was entitled to claim \$25,000 of depreciation deductions while she held the property.²³² When she sold the property, she realized gain of \$27,500.²³³ When the \$25,000 of depreciation deductions are netted against this gain, the result is \$2,500 of income—exactly the amount prescribed by the Haig-Simons definition.

It was against this backdrop that Justice Blackmun decided the *Commissioner v. Tufts*²³⁴ case. *Tufts* raised precisely the question left open in footnote 37 in *Crane*. In 1970, a partnership constructed an apartment complex using \$1.9 million in funds that it had borrowed on a nonrecourse basis.²³⁵ Over the next two years, the partnership claimed depreciation deductions on the property totaling \$400,000.²³⁶ Therefore, at the end of this period, the partnership had an adjusted basis in the property equal to \$1.5 million.²³⁷ The property, however, had declined in fair market value to \$1.4 million.²³⁸ Then, the partnership sold the property, subject to the nonrecourse debt, for a de minimis amount of cash.²³⁹

The partnership reported a loss of \$100,000 from the sale.²⁴⁰ The partnership claimed that the amount realized on the sale was equal to the fair market value of the property, or \$1.4 million.²⁴¹ The gain was then equal to this amount minus the partnership's \$1.5 million adjusted basis in the property, a loss of \$100,000.²⁴² On audit, the Commissioner determined that the sale resulted in a gain of \$400,000.²⁴³ The Commissioner's theory was that the amount realized on the sale was equal to the full amount of the nonrecourse obligation, or \$1.9 million.²⁴⁴ The gain was then equal to this amount minus the partnership's \$1.5 million adjusted basis in the property, or \$400,000.²⁴⁵

232. See *Crane*, 331 U.S. at 4.

233. See *id.* at 4-5.

234. 461 U.S. 300 (1982).

235. See *id.* at 302. In order to make the underlying logic of *Tufts* more transparent, the discussion in the text is based on a slightly simplified version of the facts. For example, the partnership actually invested \$44,212 of its own capital in the apartment complex as well as the approximately \$1.9 of borrowed funds.

236. See *id.*

237. See *id.*

238. See *id.* at 303.

239. See *id.*

240. See *id.*

241. See *id.*

242. See *id.*

243. See *id.*

244. See *id.*

245. See *id.*

The taxpayer's theory in *Tufts* is inconsistent with the Haig-Simons definition of income. Before the events in *Tufts*, the partnership had no assets and no liabilities, and therefore had a net worth of zero.²⁴⁶ It then borrowed money on a nonrecourse basis, built the apartment complex, and later sold the complex subject to the debt for a *de minimis* amount of cash, ending up with no assets and no liabilities, a net worth of zero.²⁴⁷ Therefore, under the Haig-Simons definition of income, it realized no gain or loss during this period. For tax purposes, however, it reported a total tax loss of \$500,000, consisting of the \$400,000 of depreciation deductions and an additional loss of \$100,000 on the sale.²⁴⁸ Under the Commissioner's theory, in contrast, the partnership would have a total tax loss of zero—the \$400,000 of depreciation deductions would be exactly offset by the gain of \$400,000 realized on the sale.²⁴⁹

One can also understand the correctness of the Commissioner's approach by considering how the partnership in *Tufts* treated the \$1.9 million nonrecourse mortgage in 1970. The \$1.9 million was not included in income, but was included in the partnership's basis in the property, on the assumption that the partnership would repay the \$1.9 million.²⁵⁰ When the partnership sold the property subject to the mortgage in 1972, however, it became clear that the partnership would never repay the \$1.9 million.²⁵¹ In order to correct the mistaken initial assumption, the partnership should be required to include the \$1.9 million amount of the loan in the amount realized on the sale of the property. This was exactly Justice Blackmun's analysis in *Tufts*.²⁵²

The problem is that it is impossible to reconcile this result with the language of the Code.²⁵³ Section 1001(b) defines "amount realized" as "the sum of any money received plus the fair market value of the property (other than money) received." This language can be construed broadly to include the value of any economic benefit received

246. *See id.* at 302.

247. *See id.* at 302-03.

248. *See id.* at 302.

249. As noted above, the result under the Commission's theory is not exactly the same as the result under the Haig-Simons definition because of differences in timing and differences between capital gains and ordinary income. *See supra* note 231 and accompanying text.

250. *See Tufts*, 461 U.S. at 302.

251. *See id.* at 303.

252. *See id.* at 307-08.

253. *See* Michael Livingston, *Practical Reason, "Purposivism," and the Interpretation of Tax Statutes*, 51 TAX L. REV. 675, 693-94 (1966); Lawrence Zelenak, *Thinking About Non-literal Interpretations of the Internal Revenue Code*, 64 N.C. L. REV. 623, 653 (1986).

by the seller. Certainly, as the Court noted in *Crane*, when a purchaser assumes a *personal* liability of the seller, it is the same as if the purchaser paid the seller additional money, which the seller used to repay the liability. Thus, relief from a personal liability is like “money received,” a component of the definition of “amount realized.”

When a purchaser takes property subject to a nonrecourse mortgage in excess of the value of the property, this clearly does not confer an economic benefit on the seller equal to the full amount of the mortgage. The seller’s liability on the nonrecourse mortgage is limited to the value of the property securing the mortgage. Therefore, the seller’s economic benefit from being relieved of a nonrecourse mortgage cannot exceed the value of the property. Relief from a nonrecourse mortgage can be considered to constitute either “money received” or “property (other than money) received” only to the extent of this economic benefit.²⁵⁴

Justice Blackmun’s opinion for the Court in *Tufts* upheld the Commissioner’s position.²⁵⁵ Justice Blackmun based his decision in part on tax logic, noting that “[t]o permit the taxpayer to limit his realization to the fair market value of the property would be to recognize a tax loss for which he has suffered no corresponding economic loss.”²⁵⁶ But Justice Blackmun also relied on post-enactment judicial precedents and administrative practice, particularly the Court’s previous decision in *Crane*. Justice Blackmun acknowledged that the economic benefit theory underlying the decision in *Crane* does not support his result, but he interpreted *Crane* also to stand for the proposition that a nonrecourse loan should always be treated as a personal loan for purposes of section 1001(b).²⁵⁷ The decision in *Tufts* follows from this proposition.

Justice Blackmun’s opinion in *Tufts*, together with his opinions in the capital expenditure cases discussed in Part III.A, raise the issue of how much, if at all, a Justice should rely on statutory purpose—in particular, on his or her understanding of “tax logic” based on an economic concept of income—in interpreting specific provisions of the Code. In each of the substantive tax opinions discussed above, Justice Blackmun reached a result that is consistent with the Haig-Simons definition of income. Moreover, Justice Blackmun explicitly relied on notions of tax logic in deciding these cases. His decision in *Tufts*, how-

254. See I.R.C. § 1001(b).

255. See *Tufts*, 461 U.S. at 313.

256. *Id.* (footnote omitted).

257. See *Crane v. Commissioner*, 331 U.S. 1, 14 (1947).

ever, is difficult, if not impossible, to reconcile with the text of the specific statutory provision at issue.

Yet Justice Blackmun's decision in *Tufts* seems clearly correct. If section 1001(b) were truly read literally, not even relief from a personal debt would qualify as an "amount realized," since such relief is not literally "money" or "property (other than money)." If one expands the meaning of "amount realized" to include any economic benefit received by the taxpayer, this solves the problem of relief from personal debt, but still produces a result at odds with the economic concept of income when applied to relief from a nonrecourse mortgage where the amount of the mortgage exceeds the value of the property. It seems clear, however, that Congress did not contemplate this specific situation when it drafted section 1001(b); indeed, Congress seems not to have contemplated relief from indebtedness at all. Under these circumstances, it seem reasonable to allow tax logic to trump statutory language.

But perhaps the distinction between tax logic and statutory text is actually illusory. In particular, perhaps one can deduce the principles of tax logic from the text of the Code, read in its entirety. If so, even a textualist might find an interpretation based on tax logic acceptable—the interpretation would be what an informed, intelligent reader would understand the words of the Code provision at issue to mean when the provision is read in the context of the Code as a whole.

Unfortunately, I do not believe that tax logic can be deduced from the Code in this manner. Tax scholars often use the Haig-Simons definition of income as the touchstone for tax logic, as I have done in my discussion of Justice Blackmun's substantive tax opinions. But Henry Simons did not come up with his definition by reading the Internal Revenue Code and inferring what Congress meant to tax. Quite the contrary. The source of his definition is economics, and tax scholars use his definition as an *external* yardstick against which the provisions of the Code can be evaluated and criticized.²⁵⁸

Quite simply, it flies in the face of reality to suppose that one can deduce the Haig-Simons definition of income from the language of the Code, or to assume that Congress intended for all Code provisions to conform to this definition.²⁵⁹ On the contrary, Congress often has

258. See MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 107 (3d ed. 1995). Professors Graetz and Schenk note that the Haig-Simons definition of income "is used by many economists and lawyers as a basis for testing the equity of the income tax." *Id.*

259. See *id.* Professors Graetz and Schenk state that:

departed from the Haig-Simons concept of income, and it has done so for a host of reasons.

First, as discussed in connection with Justice Blackmun's capital expenditure cases, a rigorous implementation of the Haig-Simons definition would be impracticable. In particular, it is not practical to require taxpayers to calculate the change in their net worth during the taxable period, as the Haig-Simons definition would require, because this would require them to determine the fair market value of all of their assets at the end of each year.²⁶⁰ If it were simple and costless to do this, then all expenditures that produce benefits beyond the taxable year would be treated as capital expenditures, and all capital assets would be treated as depreciable, with the allowable depreciation being equal to the change in the value of the assets each year. It is precisely because it is impractical to determine fair market value that the tax law requires taxpayers, the Service, and the courts to draw lines between ordinary expenses and capital expenditures, and between depreciable and non-depreciable capital assets.

Viewed in this light, each of the capital expenditure cases discussed above involved finding a compromise between the conflicting goals of accurately reflecting economic income and achieving a practical and administrable tax system. I think Justice Blackmun approached these cases correctly. On the one hand, he followed a Haig-Simons approach in laying down general principles, in particular, the concept that "capital expenditure" should be construed broadly and that capital assets should generally be treated as depreciable if they have a limited useful life that can be estimated with reasonable accuracy. On the other hand, however, he declined to establish bright-line rules for drawing these lines and insisted instead that each case must be decided on the basis of its specific facts.

A second problem in relying on the Haig-Simons definition is that it is ambiguous. In particular, the concept of "consumption" is not well defined. As a result, translating the Haig-Simons definition into specific tax rules often requires one to make further, contestable

Simons himself . . . noted that the definition would not serve for all purposes and, without modification, would not describe a satisfactory tax base. It is also not clear that a generally accepted economic definition of income necessarily should be accepted by Congress, the Service and the Courts for tax purposes.

Id.

260. It is also impracticable to have taxpayers rigorously calculate the market value of their consumption during the year. This would require, for example, that they determine and pay tax on the fair market rental value of the homes they own and occupy, on the fair market rental value of the consumer durables they own and use, and on the fair market value of the services they provide for themselves.

policy choices. A classic example is the issue whether deductions for charitable contributions and medical expenses are consistent with the Haig-Simons definition of income. This, in turn, hinges on whether one regards making a charitable contribution or using medical services as a form of personal consumption. Leading tax scholars have reached opposite conclusions on this basic issue.²⁶¹ Clearly, a Justice cannot decide such issues through an abstract inquiry into the economic meaning of income.

Third, the Code is full of "tax incentive" or "tax expenditure" provisions. These are provisions in which Congress has intentionally departed from an economic concept of income in order to advance a legislative purpose other than the accurate measurement of economic income.²⁶² For example, the Code's treatment of saving departs radically from the Haig-Simons definition with respect to two of the most important forms of personal saving, owner-occupied housing and retirement saving. These departures are intentional. Congress wanted to give taxpayers a greater incentive to own their own homes and to save for their retirement than they would have under a pure Haig-Simons income tax.

Finally, members of Congress sometimes depart from an economic concept of income, not because they are trying to advance some public policy, but because they wish to do favors for interest groups in exchange for campaign contributions, votes, or other benefits. As a result of all these factors, there are substantial and pervasive differences between the meaning of "income" in the Code and the Haig-Simons definition of income. These differences are so great that many tax scholars have concluded that our so-called income tax is not really an income tax at all.²⁶³

261. Compare William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972) (deductions for charitable contributions and medical expenses are consistent with the Haig-Simons definition), with Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 834 (1979) (deductions for charitable contributions and medical expenses are not consistent with the Haig-Simons definition).

262. Of course, as discussed in the preceding paragraph, because the Haig-Simons definition is ambiguous, it is often impossible to distinguish between "tax expenditure" provisions and provisions that accurately measure income.

263. See generally UNEASY COMPROMISE: PROBLEMS OF A HYBRID INCOME-CONSUMPTION TAX (Henry J. Aaron et al. eds., 1988). In the introduction to this book, the editors note:

Analysts have recognized that despite their names, neither the "personal income tax" nor the "corporation income tax" is a true income tax. For a variety of reasons, practical and political, Congress has repeatedly shied away from any attempt to tax such major elements of income as accrued but unrealized capital

Thus, there are serious problems with relying on legislative purpose in interpreting Code provisions, and in particular with relying on the presumed purpose of accurately reflecting economic income. The alternative of ignoring purpose and considering only text is attractive on a number of grounds.²⁶⁴ Arguably, textualism best reflects the constitutional roles of Congress and the Court. According to this argument, the constitutional role of Congress is to enact texts; the law consists of these texts, not the unexpressed intent or purpose of Congress.²⁶⁵ The constitutional role of the Court, in this view, is to follow the enacted text, not to produce what the Justices consider to be the most desirable result.²⁶⁶ Textualism also promotes formal, rule-of-law values; in particular, it enables citizens to rely on clear statutory language to determine their rights and duties.²⁶⁷ Finally, according to this argument, textualism confines judicial discretion.²⁶⁸

One problem with this argument is that a textual approach to statutory interpretation is not nearly as neutral and deterministic as proponents of textualism would like. Text-based sources of interpretation are themselves manipulable. The dictionary will often give a range of meanings for the words of a statute, from which a Justice may choose. In some cases, the dictionary is not helpful at all. For example, in the capital expenditures cases discussed above, the Code uses the term “ordinary”—not in its everyday meaning, but as a term of art

gains. . . . And certain elements of the personal income tax—notably the treatment of qualified pensions, individual retirement accounts, Keogh plans, and other tax-sheltered saving—resemble the rules that would apply under a consumption tax. In addition, Congress on its own initiative and with the consent of successive administrations has enacted a host of special-purpose credits, deductions, and allowances for reasons that had no basis in the principles of either income or consumption taxation.

Id. at 1.

264. Justice Blackmun did decide one federal tax case using what appears to be a plain meaning approach. In *Badaracco v. Commissioner*, 464 U.S. 386 (1984), he interpreted a statute of limitations provision on the basis of its “plain and unambiguous language.” *Id.* at 396. He went further and appeared explicitly to reject reliance on policy considerations: “The relevant question is not whether, as an abstract matter, the rule advocated by petitioners accords with good policy. . . . Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement.” *Id.* at 398. In spite of this statement, Justice Blackmun did go on to discuss the policies supporting his interpretation, *see id.* at 398-400, and he concluded that “substantial policy considerations support [the provision’s] literal language.” *Id.* at 398. For a criticism of this opinion, see Douglas A. Kahn, *The Supreme Court’s Misconstruction of a Procedural Statute – A Critique of the Court’s Decision in Badaracco*, 82 MICH. L. REV. 461 (1983).

265. *See* Scalia, *supra* 95, at 17-18.

266. *See id.* at 22.

267. *See id.* at 25.

268. *See id.* at 17-18.

to state the distinction between deductible expenses and capital expenditures. The dictionary definition of “ordinary” sheds no light on the nature of this distinction.

The textual approach becomes even less deterministic when one considers context. The meaning of a text is strongly influenced by context, and this includes the interpreter's own context. It is a commonplace observation that individuals with differing viewpoints will often understand the same words differently.²⁶⁹

Textualism also ignores values that are promoted by considering purpose, particularly the value of allowing statutes to develop over time to meet new circumstances. This value is especially important in the tax area. As discussed above, it is unrealistic to expect Congress to anticipate all of the clever transactions that taxpayers and their advisors will devise to exploit ambiguities and loopholes in the Code. If the Court is to serve as a back-stop to protect against abusive transactions, the Justices must engage in purposive interpretation.

Of course, this is no easy task. The Justices must distinguish true loopholes from intentional departures from an economic concept of income. And they must be able to analyze complex transactions to determine their economic substance.²⁷⁰ Finally, they must balance the benefits of purposive interpretation against the costs, including increased uncertainty and the possible “chilling” of legitimate transactions.

Justice Blackmun's practical reasoning approach would seem to be the best course in light of these considerations. Although Justice Blackmun did consider purpose—in particular, the purpose of reflecting economic income—in deciding substantive tax cases, he did not rely on this consideration exclusively. He also considered the statutory text; other policies, such as treating similarly situated taxpayers alike; the practical implications of alternative holdings; and post-en-

269. More generally, individuals tend to display a “confirmatory bias” when they evaluate evidence. That is, they tend to ignore evidence that contradicts their existing viewpoint or even to misinterpret such evidence as additional support for their viewpoint. For a discussion of the literature on this psychological phenomenon, see Matthew Rabin, *Psychology and Economics*, 36 J. ECON. LIT. 11, 26-29 (1998).

270. Arguably, even Justice Blackmun was not always successful at this. For example, in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), Justice Blackmun concluded that the economic substance of a complicated three-party sale and leaseback transaction was consistent with its form, and that the Government was unlikely to lose significant revenue if this form were respected. See *id.* at 583-84. For a criticism of this analysis, see Bernard Wolfman, *The Supreme Court in the Lyon's Den: A Failure of Judicial Process*, 66 CORNELL L. REV. 1075 (1981).

actment developments, including judicial precedents and administrative practice.

The practical reasoning approach is difficult to apply well. It requires a Justice to evaluate and balance a wide range of often conflicting factors. This requires judgment. But judgment is the quintessential quality that we expect of judges. In the hands of a capable judge, the practical reasoning approach seems almost certain to produce better decisions than one that singles out one factor, to the exclusion of all others, as the touchstone for interpretation.

IV. Conclusion

Justice Blackmun's opinions in federal tax cases reflect many of his strengths as a Justice. In particular, they reflect his practical reasoning approach to deciding cases, an approach that is particularly suited to tax cases. They also reflect his tremendous sense of duty to the Court, to the parties who appear before it, and to the public it serves. I have, in this article, focused on a small number of the Justice's tax opinions that I find particularly important and interesting. To Justice Blackmun, however, every case was important, interesting, and worthy of meticulous attention to detail and careful deliberation. I have discussed whether the Justices might, or should, be influenced in their approach to substantive tax cases by a view that the Court lacks institutional competence in the tax area and that Congress can always correct the Court's mistakes. For Justice Blackmun, however, these considerations would simply be irrelevant. He saw his duty clearly. It was to do the best he could to do justice in every case that came before him.