A Case for Congressional Facilitation of a Collaborative Model of Statutory Interpretation in the Tax Area: Lessons to be Learned from the Corn Products and Arkansas Best Cases and the Historical Development of the Statutory Definition of "Capital Asset(s)"

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A Case for Congressional Facilitation of a Collaborative Model of Statutory Interpretation in the Tax Area: Lessons to be Learned from the *Corn Products* and *Arkansas Best* Cases and the Historical Development of the Statutory Definition of “Capital Asset(s)”

BY MYRON C. GRAUER*

INTRODUCTION: SOME THOUGHTS ON THE RELATIONSHIP BETWEEN TAX CODE COMPLEXITY AND THE ROLE OF COURTS IN FORMULATING AND IMPLEMENTING TAX POLICY

Like Hamlet’s vision of death as a peaceful end to the traumas of life, tax simplification remains merely “a consummation devoutly to be
Even though the Reagan administration's tax reform initiative, which culminated in the Tax Reform Act of 1986, was promoted as an attempt at tax simplification, tax professionals are still distressed by the complexity in our tax laws. This concern over complexity was clearly evident at the historic Invitational Conference on Reduction of Income Tax Complexity in Washington, D.C. in January, 1990. This Conference, which was jointly sponsored by the American Bar Association ("ABA") and the American Institute of Certified Public Accountants ("AICPA"), brought together approximately 250 prominent tax practitioners, academics, and government officials.

Some participants charged that complexity arises, in part, from a desire by Congressional and Treasury staffers to draft elaborate rules to cover every contingency. This approach to the problem of complexity has been termed a "technical" one and has been subjected to both praise and criticism.


Id. at 382-83.
and criticism in an article by Professor Edward Zelinsky. Using the development of complex Code provisions dealing with qualified pension and profit sharing plans as an example, Professor Zelinsky demonstrates that cover-all-base complex provisions are not usually the result of pipe dreams by staffers. Rather, they often arise after taxpayers have won unintended benefits in court because the facts of their cases did not fall squarely within the conduct proscribed by the then-existing specific, albeit less complex, statutory provisions. Thus, hints Professor Zelinsky, it is not fair to condemn drafters for merely closing a statutory loophole. Some tax policies, he asserts, require complex statutory provisions. What we should do, he contends, is evaluate the complexities required to pursue a particular policy and consider those complexities in determining whether that policy should be pursued in the first place.

Professor Zelinsky's analysis is helpful in that it emphasizes that debates over complexity cannot be divorced from overall policy analysis. However, Professor Zelinsky's approach appears aimed more at reducing the quantity of the complexity in the tax laws rather than at reducing the quality or nature of that complexity. Despite Professor Zelinsky's appropriate defense of hard-working Congressional and Treasury tax specialists, the quality or nature of some complex tax provisions may in fact arise from excessively detailed provisions placed in the tax laws by drafters in an attempt to eliminate problems caused by uncertainty in the law and the litigation that those problems spawn. Such a detail-driven approach to drafting statutes in general, and tax statutes in particular, fails to give due deference to the role of the courts in the formation of tax policy. This, in turn, can lead to unfortunate results when the inevitable problems that the statute drafters sought to avoid ultimately are confronted by the court system. To reduce the nature, as well as the quantity, of the complexity found in tax code provisions, we should consider not simply the policy behind each proposed provision, but also the role of the courts and the role of Congress in formulating and implementing tax policy.

There is, of course, much literature in the field of statutory interpretation, and this Article will not attempt to re-examine it. That literature

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7 Edward A. Zelinsky, Another Look At Tax Law Simplicity, 47 TAX NOTES 1225 (1990).
8 Id. at 1226-27.
9 Id.
10 Id. at 1227.
11 Id. at 1228.
12 See, e.g., REED DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES
has already been re-examined in the context of interpreting tax statutes in a superb article by Professor Lawrence Zelenak. In an earlier article, the author of this Article drew from both Professor Zelenak’s article and the views of Dean (now Judge) Guido Calabresi on the role of courts in the age of statutes to analyze the historical development of the annual accounting concept in our income tax culture. Dean Calabresi’s position is that courts have the common law power to invalidate statutes that have become obsolete. Although some may consider this a radical position, Professor William Popkin apparently does not believe Dean Calabresi’s position to be radical enough.

In arguing for what he terms a “collaborative model of statutory interpretation,” Professor Popkin criticizes what he terms the “legislative will” model of statutory interpretation. According to Popkin, the legislative will model, which grants the judiciary the passive role of determining a legislature’s intent, unrealistically ignores that members of the judiciary cannot analyze legislative intent in a vacuum unaffected by their own substantive political values. Thus, a model of statutory interpretation is needed that does not confine deliberation about public values to the legislature, but “include[s] a creative role for courts as they

(1975); James W. Hurst, Dealing With Statutes (1982); Norman J. Singer, Sutherland Statutory Construction §§ 45.01 - 65.05 (5th ed. 1992); Karl N. Llewellyn, Remarks on the Theory of Appellate Decisions and the Rules or Canons About How Statutes Are To Be Construed, 3 Vand. L. Rev. 395 (1950); Max Radin, Statutory Interpretation, 43 Harv. L. Rev. 863 (1930).


Guido Calabresi, A Common Law for the Age of Statutes (1982).


Calabresi, supra note 14, at 164 ("[T]he common law function to be exercised by courts today . . . is the judgmental function . . . of deciding when a rule has come to be sufficiently out of phase with the whole legal framework so that, whatever its age, it can only stand if a current majoritarian or representative body reaffirms it.").


Id. at 578.

Id. at 579.
engage in statutory interpretation.\textsuperscript{21} To Popkin, Calabresi's approach is too limiting and too much tied to the legislative will model because "Calabresi still appears to believe that legislative intent is what courts seek when determining the meaning of statutes, with judicial choice relegated to the special task of dealing with obsolete statutes."\textsuperscript{22} Popkin, on the other hand, supports a more activist role for the judiciary with the following synopsis of his position:

The only strong claim made by the collaborative model is that law, not just legislation, is the product of public deliberation, which is an ongoing political process of identifying political values. Legislation is, therefore, tentative and questioning, not willful, and legislative equilibria are unstable, leaving open the possibility of revision. Rather than being an emanation from legislative will, a statute is better understood as a political event which enters into the law, to be interpreted by the courts. Because law, not just statutes, is the product of public deliberation about political values, courts must play a normative role when they interpret and apply the law.\textsuperscript{23}

This Article will not try to resolve the debate over the proper role for a court in dealing with a statutory provision or what model a court should use in determining what its role is. Rather, this Article will draw from that debate to suggest that if Congress were to recognize the value of granting courts a collaborative role in the implementation of tax policy, tax statutes could be drafted in a somewhat less detailed and thus less complex manner and court opinions interpreting them could be far more principled.

Approximately thirty-five years ago Professor Ernest Brown wrote:

I am sure that the draftsmanship of the 1954 Internal Revenue Code followed a pattern designed to minimize the chance of judicial interpolation, and to increase predictability. . . . I think its method is both unsound and self-defeating . . . because the very intricacy of the statute obscures both direction and limits designed to be imposed. I believe a statute, even a tax statute, can set forth the shape of its commands with relative clarity, and indicate the elements to be taken into account in applying them. I am confident that an attempt to

\textsuperscript{21} Id.
\textsuperscript{22} Id. at 580.
\textsuperscript{23} Id. at 590.
dispense with the need for responsible administration by the executive and judicial branches of the Government will be self-defeating.\textsuperscript{24}

Professor Brown reached this conclusion in part because “the multifariousness of the transactions to which tax statutes must relate\textsuperscript{25} makes it highly unlikely that drafters of tax statutes will be able to anticipate and draft for every transaction that a tax planner could devise.\textsuperscript{26}

Although Professor Brown would most likely eschew Professor Popkin’s radical view of the role of the judiciary,\textsuperscript{27} a similar theme runs through their thinking. Professor Popkin sees legislation as “tentative and questioning,”\textsuperscript{28} thus justifying a collaborative role for courts in the development of the law. He reasons that legislation is “tentative and questioning” because all law, regardless of its source, “is the product of public deliberation, which is an ongoing political process of identifying political values.”\textsuperscript{29} Because of this ongoing political process, a legislature cannot anticipate all future events which may come in contact with a particular statute. Thus, under the collaborative model, courts can keep the political process in motion by interpreting statutes in a manner consistent with the changing political topography. Similarly, Professor Brown recognizes that the drafters of tax statutes cannot anticipate every

\textsuperscript{25} Id. at 240.
\textsuperscript{26} Id.
\textsuperscript{27} Brown states:

There are, indeed, some who would . . . tell us that it is naive to think that Congress has collective will, that no statute has an intrinsic meaning and that ultimately the statute means what the judges say it means. They might admit that the shape of the statute emerging from the judicial process is different from its shape as it emerges from Congress, but they would say that this means only that the judges have taken an inert form and have given it shape by giving it life and effectiveness, and that this is the essence of the judicial function and process. Dissatisfaction with the shape which has emerged they would often diagnose only as unhappiness over the result of specific decisions.

Those who thus dismiss our problem have mistaken cynicism for sophistication, and judicial power for the judicial function. \textit{Whatever his role may be in the realm of constitutional dispute, the judge holding office for life must certainly approach the application of statutes by subordinating both his will and his views to the representative Congress, and must expend his energies in applying his understanding to that task.}

\textit{Id.} at 235-36 (emphasis added) (citations omitted).

\textsuperscript{28} See supra note 23 and accompanying text.

\textsuperscript{29} See supra note 23 and accompanying text.
transaction that a tax planner could create. However, unlike Professor Popkin, he does not espouse a broad collaborative role for courts in all events. Rather, he urges that tax statutes be drafted in a manner that would enable the judiciary to play a collaborative role in the development of tax law without resorting to a model of statutory interpretation that is as radical as Professor Popkin's. If such drafting were to occur, courts would neither be forced to engage in "slavish literalism . . . [n]or, what is more likely . . . , decisions which simply brush aside elaborate formulations in favor of what the individual judge, rightly or wrongly, senses to be the operative force of the statute" in cases not specifically covered by the statute. Professor Brown apparently would eschew Professor Zelinsky's surrender to the inevitability of complexity in some Code provisions.

Professor Brown's admonitions are as relevant today, as we seek to deal with the growing complexity in the Internal Revenue Code, as they were thirty-five years ago. Lest there be any doubt, an examination of the Supreme Court's treatment of one issue relative to a particular Code section should, unfortunately, prove Professor Brown to be correct. That section is § 1221, which defines "capital asset," and ironically it is not all that complex. It simply provides:

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include —

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the

30 See supra notes 25-26 and accompanying text.
31 Compare supra note 23 and accompanying text with supra note 27 and accompanying text.
32 See supra notes 24-27 and accompanying text.
33 Brown, supra note 24, at 251.
34 Compare Zelinsky's statement, "There is, however, no reason to view the complexity of sections 414(m), 414(n), and 414(o) and their regulations as a failure of technical skill or desire. Indeed, those who drafted these provisions have generally implemented the underlying policy as well as could be expected," Zelinsky, supra note 7, at 1227 with Brown's statement, "Let me be content here simply to cite developments under Sections 302, 306, 341 and 355 of the Internal Revenue Code of 1954 as indicating that intricate formulation will defeat its own ends. . . . I believe a statute, even a tax statute, can set forth the shape of its commands with relative clarity, and indicate the elements to be taken into account in applying them." Brown, supra note 24, at 251.
taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by —

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).\(^{35}\)

Nonetheless, two Supreme Court opinions, *Corn Products Refining Co. v. Commissioner*\(^ {37}\) and *Arkansas Best Corp. v. Commissioner*\(^ {38}\) demonstrate how this section, which on its face appears to cover all contingencies, led the Supreme Court to engage in what Professor Brown feared

\(^{36}\) Id.


most, both slavish literalism and a brushing aside of formulations to reach what the Court rightly sensed to be the correct result.\textsuperscript{39}

In the past much has been written about the \textit{Corn Products} case and the doctrine that it spawned.\textsuperscript{40} More recently, much has been written about the \textit{Arkansas Best} decision and its effects on the \textit{Corn Products} doctrine.\textsuperscript{41} A few of these articles\textsuperscript{42} have even noted in passing what Professor Stanley Surrey noted as far back as 1956, namely, that Congress' technical approach to defining "capital asset" has led to the problems evident in both of these opinions.\textsuperscript{43} No article, however, has

\textsuperscript{39} See supra note 33 and accompanying text.


\textsuperscript{42} See Boyles, supra note 41, at 734-35; Sprohge, supra note 41, at 96-98.

\textsuperscript{43} See Stanley S. Surrey, \textit{Definitional Problems in Capital Gains Taxation}, 69 HARV.
yet engaged in a detailed analysis of the Corn Products and Arkansas Best cases in the context of the morphogenesis of § 1221. This Article will attempt to do so in the hope of demonstrating the jurisprudential problems that can result from tax statutes that attempt to cover all contingencies.

This Article will not enter the current debate as to whether capital gains should receive preferential treatment. It will thus not advocate the formulation of a new definition of “capital asset.” The purpose of this Article is much more modest. It is simply to use § 1221 of the Code and the Corn Products and Arkansas Best opinions in a case study of what happens when Congress drafts too narrowly to indicate a collaborative role for the judiciary in the development of tax law. In the process,


44 Perhaps it is appropriate at this point to comment briefly on why this Article focuses on a collaborative role for the judiciary in the development of tax law and does not discuss the collaborative role of the Treasury. Professor Brown, of course, did allude to the need for a collaborative role for the executive branch (the Treasury) as well as for a collaborative role for the judiciary. See supra note 24 and accompanying text. Furthermore, Louis Eisenstein, some fifty years ago, explained why he preferred administrative construction of a tax statute by the Treasury to judicial construction of a tax statute. See Louis Eisenstein, Some Iconoclastic Reflections on Tax Administration, 58 Harv. L. Rev. 477, 536 (1945). Eisenstein believed that because the Treasury is constantly exposed to tax complexities, it is better qualified than the judiciary to administer the tax laws. Id. at 526. Indeed, Eisenstein believed that if the Treasury did its job properly, it could deal with technicalities, and Congress could “concentrate more upon fundamental policy considerations . . . [rather than spend] . . . valuable time with endless detail.” Id. at 539.

Although the recent promulgation of the partnership Anti-abuse rule, see Treas. Reg. § 1.701-2 (1994), may represent a sea change on the part of the Treasury, it appears that for the most part the Treasury has been a part of the problem of complexity, not part of the solution. Zelinsky notes that it is not just I.R.C. §§ 414(m), 414(n) and 414(o) that are complex; the regulations pursuant to them are also complex. See supra note 34. Additionally, participants at the January, 1990 ABA/AICPA Conference on Tax Complexity, blamed Treasury as well as Congressional staffers for drafting complex provisions. See supra note 6 and accompanying text. That the Treasury has been a part of the complexity problem should not be surprising. Treasury staffers are only human. They can no more anticipate the multifarious transactions that tax planners can devise than can Congressional staffers who specialize in the tax area. When they try to anticipate those transactions and draft for every contingency, they merely add complexity, albeit in a format other than a Congressional enactment. Because they cannot anticipate every transaction, there will always be interstices and a key role for the judiciary to play. Therefore, this Article focuses on the collaborative role of the judiciary. The less rigidly statutes (and to some extent regulations) are drawn, the better the judiciary can play its collaborative role without committing the two sins of slavish literalism and disregard of elaborate formulation to reach the operative force of the statute. See supra notes 30-33
this Article will indicate how § 1221 could have been better drafted to effectuate what historically appear to be Congress' evident purposes, but it will not make any judgment on the propriety of Congress' intentions or goals in drafting § 1221 in the first place. Although it deals on one level with the definition of "capital asset," the real purpose of this Article is to focus attention on a problem of tax code complexity that could perhaps be alleviated by statutory drafting that indicates a more collaborative role for the judiciary in the formulation and implementation of tax policy.\textsuperscript{45}

The Article shall proceed in the following manner. Part I will describe and analyze the \textit{Corn Products} case itself.\textsuperscript{46} Part II will discuss the \textit{Corn Products} doctrine.\textsuperscript{47} Part III will describe and analyze the \textit{Arkansas Best} case.\textsuperscript{48} Part IV will examine the history of § 1221 and relate it to what the Court did in the \textit{Corn Products} and \textit{Arkansas Best} cases.\textsuperscript{49} Finally, the Article will conclude with some thoughts on the tension between the desire for certainty in the tax code and the problems

\textsuperscript{45} At first blush it may appear ironic or even inappropriate that an article on Code complexity would focus on the definition of "capital asset" without addressing the merits or demerits of granting preferential treatment to capital gains. It is, of course, well-recognized that preferential treatment for capital gains causes great complexity in our tax laws. \textit{See}, e.g., \textit{William D. Andrews, A Consumption-Type or Cash Flow Personal Income Tax}, 87 \textit{Harv. L. Rev.} 1113, 1135 (1974); \textit{Daniel I. Halperin, Why Not the Best? Retain Equal Treatment of Capital and Ordinary Income}, (Letter), 48 \textit{Tax Notes} 368 (1990). But the complexity caused by preferential treatment for capital gains is transactional complexity. The type of complexity that we are dealing with in this Article is not transactional complexity, but rather complexity in the drafting of statutory provisions themselves. It is, therefore, not inappropriate to examine the problem of statutory complexity without addressing the problem of transactional complexity. It may, however, be ironic that this study of statutory complexity is well-served by examining a Code provision that has led to much transactional complexity.

\textsuperscript{46} \textit{See infra} notes 51-81 and accompanying text.
\textsuperscript{47} \textit{See infra} notes 82-112 and accompanying text.
\textsuperscript{48} \textit{See infra} notes 113-63 and accompanying text.
\textsuperscript{49} \textit{See infra} notes 164-248 and accompanying text.
that can result from denying courts a more collaborative role in the development of tax law.\textsuperscript{50}

I. THE CORN PRODUCTS CASE

The Corn Products Refining Company manufactured various products from corn, such as starch, syrup, and sugar.\textsuperscript{51} It sold these products at prices established in contracts with its customers. However, Corn Products' corn storage facilities were so small that it could not keep on hand a sufficient supply of corn to fill all the orders it had outstanding for delivery of its products. As a result, it was forced to buy additional corn to fill its orders well after the contract prices for those orders had been agreed upon. If the price of corn rose after the contract price for the corn product had been agreed to, Corn Products' cost of production would rise and its profit on the transaction would drop commensurately. To protect itself against such an increase in corn prices, Corn Products began a policy of purchasing corn futures contracts so as to place a ceiling on the price that it would have to pay for the corn needed to fill its production contracts. If the price of corn on the spot market rose, Corn Products could either take delivery of the corn at the lower futures contract price or pay more for corn on the spot market and sell its futures contracts at a profit. Of course, if the spot market price for corn at the time for delivery was lower than that called for in the futures contract, Corn Products would buy the corn on the spot market and sell its futures contracts at a loss. Corn Products initially reported its gains and losses from its transactions in futures contracts as ordinary income and loss, but apparently later amended its returns for the years in question, claiming that the corn futures transactions should receive capital gain or loss treatment.\textsuperscript{52} By reporting the transactions as capital and by selling the

\textsuperscript{50} See infra notes 249-91 and accompanying text.

\textsuperscript{51} The Supreme Court decision in Corn Products represented the culmination and consolidation of several cases in the Tax Court involving the Corn Products Refining Company. The citations to the reported cases are: Corn Prod. Ref. Co. v. Commissioner, 16 T.C. 395 (1951), 11 T.C.M. (CCH) 721 (1952), supplemented by 20 T.C. 503 (1953), aff'd in part and review dismissed in part, 215 F.2d 513 (2d Cir. 1954), aff'd, 350 U.S. 46 (1955). Regarding the Second Circuit's partial affirmance and partial dismissal of review, the partial dismissal of review was with respect to an issue not relevant to the subject of this Article. Thus, for purposes of this Article, the Second Circuit can be viewed as affirming the holding of the Tax Court. The description in the text of this Article of the facts in Corn Products represents a distillation of the facts presented in all the reported opinions.

\textsuperscript{52} See Corn Products, 16 T.C. at 398; Corn Products, 215 F.2d at 515.
futures contracts at a profit when the price of corn rose, Corn Products could convert ordinary income into capital gain. Its increased costs of production caused by purchasing corn at the higher spot market price reduced its profits from the production and sale of corn products, but this reduction in profits was counterbalanced by the gain realized from the sale of the corn futures contracts.53

The Commissioner challenged Corn Products' assertions that its dealings in corn futures contracts were capital transactions and the Tax Court agreed with the Commissioner.54 In holding that the corn futures transactions were not capital, the Tax Court noted: "The corn futures contracts were not subject to depreciation and were not included in inventory."55 Thus, the Tax Court described the corn futures contracts in a manner that precluded them from falling outside the literal definition of "capital asset."56 The Tax Court, however, stated: "Petitioner's

Although it does not appear from these two opinions that the taxpayer's change of position initiated the tax dispute, it should be noted at this early stage of the Article that, in other cases, the absence of such a change in reporting position could well preclude the IRS from challenging a taxpayer's treatment of a similar gain as capital in nature. As futures contracts, like stocks and other securities, are ordinarily held for investment and are thus capital in nature, it would take an extremely sharp auditor to dispute the capital treatment of a gain from their sale. See infra note 81. In fact, the Court in Arkansas Best stated:

Because stock is most naturally viewed as a capital asset, the Internal Revenue Service would be hard pressed to challenge a taxpayer's claim that stock was acquired as an investment, and that a gain arising from the sale of such stock was therefore a capital gain. Indeed, we are unaware of a single decision that has applied the business-motive test so as to require a taxpayer to report a gain from the sale of stock as an ordinary gain.

485 U.S. at 222-23. As we shall see, this inability of the IRS to police taxpayer reporting in this area was a contributing factor to the decision in that case.

55 11 T.C.M. (CCH) at 723.
56 According to the Supreme Court opinion in Corn Products the statutory definition of "capital assets" in effect for the tax years in question read as follows:

(1) CAPITAL ASSETS. — The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for
purchases of corn futures did not constitute speculative transactions for profit, but were consummated in order to obtain business protection and to insure the profitable conduct of its business.”57 The Tax Court then added, "[I]t seems indisputable . . . that petitioner’s practice of purchasing corn futures was an integral part of its manufacturing business. It would hence be anomalous to view them as purely speculative transactions of a capital nature . . . ."58 With this language the Tax Court used a policy-oriented rationale to deny capital asset treatment to the corn futures contracts and more or less ignored the language in the statutory definition of “capital asset.”

The Tax Court need not, however, have taken this approach. The Second Circuit managed to affirm the Tax Court’s decision by finding the corn futures contracts to be within the statutorily provided inventory exception to the definition of “capital asset.” The appeals court stated:

In United States v. New York Coffee and Sugar Exchange, the Supreme Court set forth three general classifications of dealings in commodity futures: speculation, legitimate capital transactions, and hedging. These classifications have since been adopted as convenient nominal guides by the courts to determine the proper tax consequences of futures transactions. Where futures are dealt with for the purposes of speculation or what is called legitimate capital transactions, they obviously fall outside the possibly relevant exclusions of Section 117(a). In the hedge, however, the property is used in such a manner as to come within the exclusions, for it is a part of the inventory purchase system which is utilized solely for the purpose of stabilizing inventory cost. It is an integral part of the productive process in which the property is held not for investment but for the protection of profit with the intent of disposition when that purpose has been achieved. As such it cannot reasonably be separated from the inventory items and the cost (or profit) from such operations would necessarily be entered in the books of account of the business as part of cost of goods sold. The tax treatment of hedges, then, is not a “judge-made exception” to Section

57 11 T.C.M. (CCH) at 724.
58 Id. at 726 (citations omitted).
117(a); it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section.59

The Second Circuit then continued:

The futures transactions of this petitioner, it is true, did not constitute what is known as “true” hedging. The true hedge can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices. As the forward sales prices here were based mainly on the lower of order or market prices, the petitioner was protected only against increases in commodity prices and did not have the complete insurance of the true hedge. But this is a distinction presently of no significance. The property here was used for essentially the same purpose and in the same manner as in true hedging.

... Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.60

Although the Second Circuit’s view of “inventory” was somewhat expansive,61 its interpretation of the definitional statute reached a sound policy result without abandoning or ignoring the governing statutory language.62 Furthermore, the Second Circuit said no more than was needed to decide the case before it. Had the Supreme Court been in a frame of mind to decide only the case before it, it could simply have affirmed on the basis of the Second Circuit’s opinion.

60 Id.
61 Kauffman, supra note 40, at 606-07.
62 Several commentators have also noted that the Supreme Court could have reached the result that it did by similarly finding the corn futures contracts to fit within the statute’s inventory exception. See Bittker, supra note 40, ¶ 51.10.3, at 51-62 to 51-63; Marvin A. Chirelstein, Federal Income Taxation ¶ 17.02, at 286-87 (4th ed. 1985) [hereinafter Chirelstein, Federal Income Taxation]; Marvin A. Chirelstein, Capital Gain and the Sale of a Business Opportunity: The Income Tax Treatment of Contract Termination Payments, 49 Minn. L. Rev. 1, 41 (1964) [hereinafter Chirelstein, Contract Termination Payments]; Zelenak, supra note 13, at 644-45.
Apparently, however, as one commentator has noted: "[I]t was the Court's intention to use this case as a vehicle for a judicial pronouncement that would have far wider application than the facts here presented." The Court recognized, of course, that it could not legitimately ignore the fact that § 117 of the 1939 Code defined "capital asset" to be property with only certain enumerated exceptions. Thus the Court stated: "Nor can we find support for petitioner's contention that hedging is not within the exclusions of § 117(a)," and concluded its opinion with the statement, "We believe that the statute clearly refutes the contention of Corn Products." In fact, the government placed great emphasis upon these two sentences in its brief in the Arkansas Best case to support its contention that the Court in Corn Products merely affirmed the Second Circuit's holding that the corn futures in question fell within the statutorily provided inventory exception and did not create any new exception to the definition of "capital asset." However, immediately after stating, "Nor can we find support for petitioner's contention that hedging is not within the exclusions of § 117(a)," the Court continued:

*Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital-asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly*

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64 See *supra* note 56 (quoting the Corn Products' Court's presentation of the applicable statutory language).
65 *Corn Products*, 350 U.S. at 51.
66 *Id.* at 53.
applied and its exclusions interpreted broadly. This is necessary to
effectuate the basic congressional purpose. This Court has always
construed narrowly the term “capital assets” in § 117.68

As a result, the Supreme Court opinion cannot be read as merely
affirming the Second Circuit’s holding that the corn futures exception fell
within the statutorily provided inventory exception. The Court’s clear
statement that the corn futures did not come within the literal language
of the statutory exclusions and were not inventory refutes any such
contention.

How then can we explain the Court’s statements that hedging was
within the exclusions from the capital asset definition and that the statute
clearly refuted Corn Products’ contention?69 Apparently the Court
viewed the specific statutory exceptions from the definition of “capital
asset” as exemplifying an overarching Congressional purpose, namely, to
exclude from the capital asset concept transactions involving the everyday
operations of a business. Indeed, what could be more exemplary of
everyday business operations than gains and losses from sales of
inventory or stock in trade? To read the statute literally, however, and to
exclude from capital asset treatment only those assets falling within the
categories specifically listed in the statute might thwart the policies that
the statute was trying to promote. Thus, in saying that the statute clearly
refuted Corn Products’ contention that hedging was not within the
statutory exclusions, the Court merely meant that the statutory exclusions
evidenced such a strong policy against granting capital asset treatment to
everyday business operations that despite the literal language of the
statute, the everyday business transactions in the case before it must fall
within the statutory exception from capital asset treatment.70

The Supreme Court’s opinion in Corn Products has been criticized by
such highly respected tax law professors as Stanley Surrey,71 Ernest

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68 Corn Products, 350 U.S. at 51-52 (quoting Burnet v. Harmel, 287 U.S. 103, 106
(1932)) (emphasis added) (citations omitted).
69 See supra text accompanying notes 65 and 66.
70 Indeed, the Government, at the time of Corn Products, encouraged the Court to
read the statute in this manner. See Brief for the Respondent at 18, Corn Prod. Ref. Co.
preference to gains from, and of limiting the deductions of losses on, the sale or exchange
of capital assets must be gleaned from the exceptions enumerated in the statute, . . . .”).
71 See Surrey, supra note 43, at 993 (accusing the Court of “placing the congressional
definition of section 1221 gently to one side and then deciding the case on its own
concept of the capital gain — ordinary income division between investment and business”).
Brown, Marvin Chirelstein, and Boris Bittker. Although one additional commentator did criticize the opinion for attributing to Congress an overall intent that could not be divined from the legislative histories, the bulk of the criticism has been directed at the unnecessary nature of the Court’s approach. Even a commentator who advocates non-literal interpretations of the Internal Revenue Code has joined in this criticism. Corn Products, to him, involved the unnecessary use of non-literal interpretation. The same result could have been reached by a literal reading of the statute through an approach akin to that of the Second Circuit.

By emphasizing the policy behind the definition of “capital asset” rather than the narrow language in the statutory definition, the Court legitimated other efforts in other fact patterns to deny capital asset status to property transactions that were integrally related to the everyday operations of a taxpayer’s business. Because many of these transactions resulted in losses and because capital asset treatment is detrimental to the taxpayer in a loss situation, the Corn Products doctrine that assets

72 See Brown, supra note 24, at 249 (“[W]e have seen the Court, in an entirely unnecessary opinion, shake loose from the mooring of the statute in Corn Products Refining Co. v. Commissioner.”).
73 See CHIRELSTEIN, FEDERAL INCOME TAXATION, supra note 62, ¶ 17.02, at 283-87 (noting that perhaps the Corn Products Court could have reached the same result (and avoided the motive test that it spawned) on the narrower ground that these corn futures contracts fit within the inventory exception to the statutory definition of a capital asset).
74 See BITTKER, supra note 40, ¶ 51.10.3, at 51-62 to 51-63 (commenting that the Court could have achieved the same result by removing these futures contracts from capital asset treatment through the statutorily provided inventory exception to the scope of the definition of a capital asset).
76 See supra notes 71-74.
77 See Zelenak, supra note 13, at 644-47.
78 Id. at 644.
79 Id. at 645 (though not noting the Second Circuit’s opinion in Corn Products).
80 I.R.C. § 1211 reads as follows: SEC. 1211. LIMITATION ON CAPITAL LOSSES.

[Sec. 1211(a)]
(a) CORPORATIONS. — In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

[Sec. 1211 (b)]
(b) OTHER TAXPAYERS. — In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus
integrally related to a business' everyday operations were not capital in nature became a tool in the hands of the taxpayers and a revenue drain on the Treasury. The next section of this Article will briefly relate the development of the Corn Products doctrine.

II. THE CORN PRODUCTS DOCTRINE

At the outset it should be noted that Corn Products was not the first time that capital asset treatment was denied to assets that would ordinarily fall within the literal definition of "capital asset." In General Counsel Memorandum ("G.C.M.") 17322, the Internal Revenue Service held that hedging transactions in cotton futures by a cotton textile manufacturer were not dealings in capital assets. In reaching its decision in Corn Products, the Court noted the existence of this G.C.M. and its consistent

(if such losses exceed such gains) the lower of—
(1) $3,000 ($1,500 in the case of a married individual filing a separate return), or
(2) the excess of such losses over such gains.

I.R.C. § 1211 (West Supp. 1995). Although I.R.C. § 1212 provides for a carryforward of any disallowed or unused capital losses, the limitation in § 1211 on the immediate use of capital losses in excess of capital gains makes the characterization of a loss as capital detrimental to the taxpayer because the use of non-capital losses is not similarly limited.

The limitation on the recognition of net capital losses is a long-standing one. For a synopsis of its history, see Sanford M. Guerin, Capital Gain and Loss Tax Policy — Economic Substance or Legalistic Form?, 1985 Ariz. St. L.J. 905, 915-18.

Professor Chirelstein has probably best explained the use of the Corn Products doctrine to the benefit of taxpayers and the detriment of the Treasury in the following manner:

"[T]he Corn Products "rule" is available to taxpayers as well as the government; it is a "rule of law" which applies to gains and losses alike. Not surprisingly, therefore, . . . many of the litigated cases involving an application of the Corn Products doctrine are cases in which the security or other asset is disposed of at a loss. Asserting that the property was acquired for business rather than investment-related reasons, the taxpayer reports the loss as a deduction from ordinary income. When the very same property appreciates, on the other hand, the taxpayer is likely to find that investment motives were predominant and to report his profit as a capital gain. . . . [T]hen only a very sharp-eyed revenue agent would be likely to [think] of challenging it. Hence, ironically, the Corn Products doctrine has served chiefly as a justification for ordinary loss deductions; only occasionally has it produced ordinary treatment on the gain side.

Chirelstein, Federal Income Taxation, supra note 62, ¶ 17.02, at 285-86.

A graduate tax student at the University of Florida also noted this fact. See Battaglia, supra note 40, at 108-10.

application by courts and the Commissioner. Furthermore, the Court noted that Congress had apparently acquiesced in this tax treatment. Unlike the rationale of *Corn Products*, however, the rationale of the G.C.M. did not address whether the futures contracts fit the statutory definition of capital asset or whether the futures transactions were integrally related to the taxpayer’s everyday business operations. Rather, the Service viewed the losses incurred on the futures transactions as fully deductible ordinary and necessary business expenses for the cost of insurance against cotton market fluctuations.

In *Western Wine and Liquor Co. v. Commissioner*, the taxpayer, a wholesale liquor distributor, found itself, due to World War II, unable to obtain an adequate supply of liquor to meet its customers’ demands. It learned, however, that American Distilling Company planned, on a one-time basis, to grant dividends to its shareholders in the form of substantial quantities of liquor. In order to obtain the liquor, the taxpayer purchased substantial amounts of American Distilling stock. As soon as it received its liquor dividend, the taxpayer then sold the American Distilling stock at a loss. The IRS claimed the loss was capital, while the taxpayer, naturally, wanted to treat the loss as ordinary, alleging that it represented part of the cost of acquiring the whiskey which it held for sale to customers in the ordinary course of business. The Tax Court held for the taxpayer by looking to the substance rather than the form of the transaction. Although there was language in the opinion to the effect that the stock was not purchased for investment and its sale was “an incident of the business,” the Tax Court did try to bring the stock into a statutorily provided exception to the definition of capital asset. The Tax Court stated:

Since the stock was not acquired as an investment or for any purpose other than as a means of acquiring the whiskey, and it was sold as promptly as possible in the ordinary course of business after this purpose was accomplished, it was property held primarily for sale to customers in the ordinary course of business and was not a capital asset.

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84 *Corn Products*, 350 U.S. at 52-53.
85 *Id.* at 53.
86 15-2 C.B. at 152.
87 18 T.C. 1090 (1952), *appeal dismissed on Commissioner’s motion* 205 F.2d 420 (8th Cir. 1953).
88 *Id.* at 1099.
89 *Id.* at 1096-97.
90 *Id.*
Although the result in *Western Wine* was compelling from a policy perspective, the attempt to justify the result by reference to the statutory exception for property held primarily for sale to customers in the ordinary course of business does not withstand scrutiny. By the time of *Western Wine*, the Second Circuit had already affirmed a Tax Court decision that this statutory exception to capital asset treatment was applicable to securities only if sold by a taxpayer "regularly engaged in the purchase of securities at wholesale." The taxpayer in *Western Wine*, however, was *regularly engaged* in the purchase of liquor, not securities, at wholesale, and the securities in *Western Wine* were not purchased at wholesale. Thus, the attempt to bring *Western Wine*’s security transactions into a statutory exception from the definition of capital asset was weak indeed.

After *Western Wine*, and just prior to the Supreme Court decision in *Corn Products*, the Second Circuit decided *Commissioner v. Bagley & Sewall Co.* There the taxpayer, a manufacturing concern, was forced to post U.S. Government bonds as a performance bond for a contract. The taxpayer purchased the bonds, deposited them as security, and performed its contract. As soon as the contract was completed, the bonds were released to the taxpayer who immediately sold them at a loss. In holding for the taxpayer and treating the loss as ordinary, the Second Circuit made no attempt to fit the bonds within a statutorily provided exception to the definition of capital asset. Instead, it merely held that the loss on the bonds was fully deductible as an ordinary and necessary business expense because "the purchase and sale of these bonds was merely an incident in the carrying on by petitioner of its regular business."

These three examples, perhaps, explain why the Court in *Corn Products* framed its opinion more broadly than did the Second Circuit in *Corn Products*. *Corn Products* involved hedging through futures contracts, as did the G.C.M. promulgated almost twenty years earlier. As a result, it was quite appropriate for the Court to refer to that G.C.M. and to note that Congress had acquiesced in its interpretation. However, by the time of *Corn Products*, fact patterns, not involving hedging or futures

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91 Indeed, even the Government, in requesting the Court in *Arkansas Best* to reject the "Corn Products doctrine" and cases such as *Western Wine*, conceded the reasonableness of the result in *Western Wine*. Brief for the Respondent at 45-46 n.27, *Arkansas Best Corp. v. Commissioner*, 485 U.S. 212 (1988) (No. 86-751).
92 Van Suetendael v. Commissioner, 3 T.C.M. (CCH) 987, 993 (1944), aff’d, 152 F.2d 654 (2d Cir. 1945) (emphasis added).
93 221 F.2d 944 (2d Cir. 1955).
94 *Id.* at 946.
contracts, had developed in which capital asset treatment could be justifiably denied even though the assets involved could not possibly fit within any of the statutorily provided exceptions to the definition of "capital asset." If the Court in *Corn Products* had denied capital asset status to the hedging futures before it on the same narrow grounds as had the Second Circuit, the legitimacy of the approaches in *Western Wine* and *Bagley & Sewall* would have remained in limbo. With *Corn Products*, the Court had the opportunity to place its stamp of approval on the results in *Western Wine* and *Bagley & Sewall*. It, therefore, took the opportunity to do so. While its sweeping opinion may have been unnecessary to decide the case before it, the sweeping opinion indeed was necessary, in order for the Court to place its imprimatur on a developing area of the tax law in as efficient a manner as possible. Furthermore, it cannot be doubted that in so doing the Court recognized that taxpayers would be the prime beneficiaries of its opinion. In all of the preceding cases it was the taxpayer, in a loss situation, arguing for the approach that the Court affirmed.

As a result of the *Corn Products* opinion, courts could no longer determine the capital or ordinary nature of an asset merely by looking at the statutorily enumerated exceptions to the definition of capital asset. Rather, they were forced to consider whether the transaction involving the particular asset was integrally related to the taxpayer's everyday business operations and whether the taxpayer was motivated to acquire the asset for everyday business as opposed to investment purposes. As motive is somewhat difficult to determine, the results in the cases were not always consistent. Furthermore, because under certain circumstances, almost

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95 For an additional example of a pre-*Corn Products* case in which capital asset status was not bestowed upon assets that fit within the statutory definition of "capital asset," see *Tulane Hardwood Lumber Co. v. Commissioner*, 24 T.C. 1146 (1955) (loss on debentures purchased to ensure source of supply of plywood and not for investment purposes not treated as a capital loss).

96 Indeed, it should be noted that the Court was encouraged by the Government to take the sweeping approach that it did. The Government's brief did not attempt to defend the approach of the Second Circuit. Rather, the Government conceded that the futures contracts did not fall within the statutory exceptions to the definition of "capital asset." *Brief for the Respondent at 27*, *Corn Prod. Ref. Co. v. Commissioner*, 350 U.S. 46 (1955). Instead, the Government emphasized that the futures transactions were integrally related to the taxpayer's everyday business operation. *Id.* at 11-12, 27-28, 33. Furthermore, the Government made the Court aware of the scope of the issues emerging in the capital asset definitional area by directly referring to the *Western Wine* and *Bagley & Sewall* cases in its brief. *See id.* at 22.

97 *Chirelstein, Federal Income Taxation*, *supra* note 62, ¶ 17.02, at 283-84.

98 *See generally* Miller, *supra* note 40.
any type of asset or transaction can be deemed integrally related to one’s
everyday business operations, the doctrine was applied in a myriad of
circumstances. The story of the varied applications of the doctrine,
however, has been recounted many other times  and thus need not be
repeated here in any great detail.

The most striking feature of the doctrine’s application, however, was
that it could be used to preclude capital asset treatment in an ever-
expanding set of circumstances. One commentator, back in 1974,100
categorized the circumstances in which capital asset treatment would be
precluded (from narrowest to broadest) in the following manner:

1. Where the taxpayer’s motive is to accomplish a result normally
achieved by a deductible expense.101

2. Where the taxpayer’s purpose in acquiring the asset is to acquire
an underlying non-capital asset.102

3. Where the taxpayer’s motive is to protect his ordinary business
income.103

4. Where the taxpayer’s motive is to acquire a new business whose
operations are integrally related to or can be integrated into the
taxpayer’s pre-existing business operations.104

By the time the Arkansas Best case came to the Court, the doctrine’s
application had expanded so greatly that a Fifth Circuit decision permitted

99 See, e.g., Bittker, supra note 40, ¶ 51.10.3, at 51-61 to 51-69; Javaras, supra note 40; Kauffman, supra note 40; Korge, supra note 40; Battaglia, supra note 40; Davis, supra note 40; Marson, supra note 40; Miller, supra note 40; Womack, supra note 40.
100 Javaras, supra note 40.
101 This category would cover Western Wine’s stock purchase to obtain whiskey via a dividend. See supra text accompanying notes 87-92; see also Booth Newspapers, Inc. v. United States, 303 F.2d 916, 922 (Ct. Cl. 1962) (stock in a paper company purchased and held by a newspaper publisher only so long as was necessary to assure it of an adequate supply of newsprint during a paper shortage held not to be a capital asset).
102 This category would cover stock purchased solely to obtain non-capital assets held by the corporation whose stock was purchased. See John J. Grier Co. v. United States, 328 F.2d 163, 165 (7th Cir. 1964).
103 This category would cover stock purchased solely to protect one’s employment relationship with the corporation whose stock was purchased. See Steadman v. Commissioner, 424 F.2d 1, 5 (6th Cir. 1970).
104 This category would include the purchase of a subsidiary whose operations can benefit the existing operations of the parent. See Schlumberger Technology Corp. v. United States, 443 F.2d 1115, 1119 (5th Cir. 1971).
ordinary loss treatment even when a taxpayer admitted that it had initially agreed to purchase the corporate stock in question as an investment.\footnote{See Campbell-Taggart, Inc. v. United States, 744 F.2d 442 (5th Cir. 1984). In that case, by the time the agreement to purchase the stock in question was about to close, the taxpayer realized that the transaction was imprudent from a financial standpoint. The taxpayer did not believe that it was legally obligated to complete the stock purchase, but did so anyway to protect its goodwill and reputation as a business that kept its word. Because expenditures to protect goodwill are treated as ordinary deductions, the Fifth Circuit permitted ordinary loss treatment when the stock purchased under these circumstances was sold. Not even a clear holding by the Tax Court in W.W. Windle Co. v. Commissioner, 65 T.C. 694, 712 (1976), appeal dismissed on procedural grounds 550 F.2d 43 (1st Cir. 1977) "that stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase" could deter the Fifth Circuit. It simply concluded that by the time of the purchase, the motivation to go through with the deal was solely business in nature. 744 F.2d at 459 & n.54.}{j}

\footnote{I.R.C. § 1231 (West Supp. 1995).}{j}

\footnote{See Deltide Fishing & Rental Tools, Inc. v. United States, 279 F. Supp. 661, 665 (E.D. La. 1968) where the court rejected the government's attempt to apply \textit{Corn Products} to § 1231 property with the following language:}{j}

The government's reliance on \textit{Corn Products} is confusing from the beginning, for, unlike the property involved in the \textit{Corn Products} case, the tools in question here are excluded from the definition of "capital assets" by the express language of § 1221 itself. Here, there is simply no necessity for the application of the \textit{Corn Products} doctrine, since the express language of § 1221(2) excludes these tools from the capital-asset definition. The tools in question, by the express terms of § 1221, are not capital assets in the first place.

We must reject the government's contention that the \textit{Corn Products} case operates to exclude these tools, admittedly not capital assets under the express definition of that term in § 1221, from coverage under the provisions of § 1231. Section 1231 refers to the very class of property excluded from the definition of capital-asset by § 1221(2) and, with certain qualifications, allows gains from sales or involuntary conversions of such property to be \textit{treated}, or, to use the exact language of the statute, "\textit{considered} as gains . . . from sales or exchanges of capital assets." . . . [W]e would have great difficulty in applying the \textit{Corn Products} doctrine to exclude the tools in question here from the capital-asset treatment granted by § 1231 for the reason that, through § 1231, "Congress has said, in effect, that even though property used in the trade or business is not a capital asset, we are to treat it as a capital asset."}
ty of policing taxpayer compliance in *Corn Products* doctrine cases and considering that the doctrine gave the taxpayer the upper hand, not surprisingly, the government began to retreat from its position favoring broad application of the doctrine. By the late 1970s the government was successfully contending that *Corn Products* did not apply to the sale of partnership interests because § 741 specifically provided capital treatment for those transactions. By the mid-1980s, the government had reached the conclusion that the *Corn Products* doctrine was misbegotten and saw the *Arkansas Best* case as an opportunity to eliminate the doctrine from tax jurisprudence. It, therefore, did not oppose the taxpayer's petition for certiorari in *Arkansas Best* for a review of an Eighth Circuit decision that rejected the *Corn Products* doctrine. This Article will now examine the *Arkansas Best* case in some detail to determine the soundness of the Court's opinion and the motivation behind it.

III. THE *ARKANSAS BEST* CASE

Arkansas Best Corporation ("Arkansas Best") was a holding company which grew out of the diversification and expansion of a trucking company. Eventually the holding company owned 100% of the stock of five separate subsidiaries, two of which were in the insurance field, one of

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279 F. Supp. at 665 (quoting I.R.C. § 1231(a)) (emphasis in *Deltide*) (citation omitted). *But see* Hollywood Baseball Ass'n v. Commissioner, 423 F.2d 494 (9th Cir.), *cert. denied*, 400 U.S. 848 (1970) (applying *Corn Products* to § 1231 property—in that case, minor league baseball player contracts whose sale on demand to a major league team constituted an integral part of the minor league team's business operations).

108 *See supra* note 81.

109 *See* Pollack v. Commissioner, 69 T.C. 142, 145 (1977). Ironically, the position taken by the government in *Pollack* was very similar to the position taken by the district court in *Deltide Fishing & Rental Tools* in rejecting a government attempt to apply *Corn Products* to § 1231 property. *See supra* note 107. The positions of the taxpayer and the government had thus shifted 180 degrees with respect to how and when the *Corn Products* doctrine should be applied.


which was in the computer field, one of which was in the furniture business, one of which was in the tire business, and one of which was in its initial line of business, trucking. All five subsidiaries interacted with one another in a synergistic relationship. For example, the trucking company transported the furniture for the furniture company, obtained tires from the tire company, was insured by the insurance companies and had its billings handled through the computer company.\footnote{83 T.C. at 642-43.}

In 1968, Arkansas Best acquired approximately sixty-five percent of the outstanding stock of the National Bank of Commerce which was located in Dallas, Texas. The Bank did not interact with Arkansas Best’s other subsidiaries as those other subsidiaries did with each other and was acquired mainly for the positive effect it could have on financial statements that Arkansas Best was preparing in connection with a public offering of its stock.\footnote{Id. at 644-45.} Amendments to the Bank Holding Company Act in 1970, however, caused Arkansas Best to decide to divest itself of the Bank stock by 1981.\footnote{Id. at 645-46.} Then, beginning in 1972, the Bank began to experience serious financial problems.\footnote{Id. at 647.} To bolster the Bank’s finances and to obtain the resignation of the Bank’s president, Arkansas Best made further capital contributions to the Bank and purchased from the Bank president his personal holdings in the Bank’s stock.\footnote{Id. at 657.} Only after making these additional acquisitions of Bank stock did Arkansas Best begin to sell its Bank stock holdings. The sales resulted in a loss which Arkansas Best characterized as ordinary, pursuant to the \textit{Corn Products} doctrine.\footnote{\textit{Arkansas Best}, 485 U.S. at 214.}

With respect to the Bank stock purchased through 1972, the Tax Court held that the loss on the sale of that stock was capital.\footnote{Arkansas Best, 83 T.C. at 655.} In reaching this decision, the Tax Court was influenced by the fact that the Bank did not interact with the other Arkansas Best holdings in a synergistic manner similar to the way in which the other holdings interacted with each other. Thus, as the Bank did not operate as an

\footnotesize{\textsuperscript{114} 83 T.C. at 642-43.  
\textsuperscript{115} Id. at 644-45.  
\textsuperscript{116} Id. at 645-46.  
\textsuperscript{117} Id. at 647.  
\textsuperscript{118} Id. at 657. It might be noted that the Tax Court indicates that the Bank president’s stock was acquired after 1972, while the Eighth Circuit opinion indicates that it was acquired during 1972. \textit{See} 800 F.2d at 217. As the date is immaterial and as the Tax Court treated the sale of this block of stock in the same manner as it did the sale of all other post-1972 acquisitions, the Bank president’s stock shall be discussed in the text as if it were definitely acquired after 1972.  
\textsuperscript{119} \textit{Arkansas Best}, 485 U.S. at 214.  
\textsuperscript{120} \textit{Arkansas Best}, 83 T.C. at 655.}
integrated and necessary part of Arkansas Best's holdings' everyday business operations, the Bank stock purchased through 1972 must have been acquired for investment purposes.\(^{121}\)

With respect to the Bank stock purchased after 1972, however, the Tax Court held that the loss on the sale was ordinary.\(^{122}\) In reaching this conclusion the Tax Court stated:

> Owning a controlling interest in a bank - a highly regulated, peculiarly public institution - imposed a special responsibility on Arkansas Best. After 1972, Arkansas Best acquired additional shares of NBC stock to meet this obligation and protect its own business reputation.

> As a growing conglomerate, Arkansas Best depended upon its good reputation with creditors in order to assure a reliable source of financing for acquisitions. In addition, Arkansas Best's reputation as a conglomerate especially skilled in management determined its standing with other businessmen and in the stock market. (Arkansas Best was listed on the American Stock Exchange beginning in 1969 and on the New York Stock Exchange beginning in 1972.) Association with the failure of a bank would have severely blemished Arkansas Best's reputation in the financial and business communities in which it operated.

> Moreover, the demise of the bank would have exposed Arkansas Best (as the controlling shareholder) to potentially damaging and costly litigation by minority shareholders.

> Expenditures to preserve business reputation are typically currently deductible business expenses. The purchase of stock may be a necessary tactic in the protection of business reputation, and, in certain narrow circumstances, may invoke the doctrine of Corn Products.

> Arkansas Best was not compelled to make purchases of NBC stock after 1972 nor could it have been motivated by the prospect of obtaining a profitable return on its purchases.\(^{123}\)

The IRS successfully appealed to the Eighth Circuit the decision of the Tax Court insofar as it allowed ordinary loss treatment on sales of Bank stock acquired after 1972.\(^{124}\)

One can certainly question whether the Tax Court should have applied Corn Products so as to allow ordinary loss treatment on the sale

\(^{121}\) *Id.*

\(^{122}\) *Id.* at 656-57.

\(^{123}\) *Id.* at 656 (citation omitted).

\(^{124}\) *Arkansas Best Corp. v. Commissioner*, 800 F.2d 215, 216 (8th Cir. 1986).
of the Bank stock acquired after 1972. As already noted, in so applying *Corn Products*, the Tax Court characterized the post-1972 acquisitions as expenditures to preserve Arkansas Best's business reputation. Thus, the Tax Court characterized these expenditures as falling within the narrowest category of the *Corn Products* cases — expenditures intended to accomplish a result normally achieved by a deductible expense. However, as the Tax Court had clearly noted that Arkansas Best did not operate the Bank as an integral part of its pre-existing business, these expenditures could just as easily have been characterized as falling beyond even one of the broadest fact patterns to which *Corn Products* applied — expenditures to acquire a new business whose operations are integrally related to the taxpayer's pre-existing businesses. Indeed, two factors indicate that it would have been more appropriate for the Tax Court to have treated the post-1972 acquisitions as part and parcel of an acquisition process that fell beyond what could properly be the broadest application of the *Corn Products* doctrine.

First, the Tax Court did note that as late as 1974, Arkansas Best hoped to sell its Bank stock at a gain and hoped for capital gain treatment on the sale. Thus, the post-1972 acquisitions must have been made with some expectation or hope of obtaining the gain that can result from accepting the risks of a capital investment. As a result, *Corn Products* should not have been applied to treat any of the stock sold as non-capital in nature.120

Second, although arguably the post-1972 acquisitions may have been made to preserve or maintain the business reputation of Arkansas Best, the need to maintain that reputation arose out of (and was merely incidental to) an investment that was not integrally related to the everyday operations of Arkansas Best's pre-existing businesses. Once the Tax Court found that the motivation behind the initial acquisition of any National Bank of Commerce stock fell outside the ambit of the *Corn Products* doctrine, the Tax Court could have held that the subsequent stock purchases to obtain the resignation of the Bank's president were made simply to preserve and further Arkansas Best's investment in the Bank.

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125 See supra text accompanying note 123.
126 See supra text accompanying notes 100 & 101.
127 See supra note 121 and accompanying text.
128 See supra text accompanying notes 100 & 104.
129 Arkansas Best, 83 T.C. at 647.
130 For an excellent article espousing the view that capital asset treatment should be applied to "gain[s] accruing due to risk" but not to "gain[s] accruing due to the mere passage of time," see William D. Popkin, *The Deep Structure of Capital Gains*, 33 CASE W. RES. L. REV. 153, 155 (1983).
By granting ordinary loss treatment under *Corn Products* to those subsequent purchases and sales of the Bank stock, the Tax Court went beyond even the questionable result in *Campbell-Taggart*.\(^{131}\) In that case, the Fifth Circuit permitted ordinary loss treatment on the sale of stock because by the time of the initial stock purchase, the taxpayer’s motive had purportedly changed from being of an investment nature to that of preserving its business reputation.\(^{132}\) In *Arkansas Best* the Tax Court extended the holding in *Campbell-Taggart* by examining each stock purchase separately so that the sale of one block of stock could obtain ordinary loss treatment even though there was still an investment motive when the initial block of stock was actually purchased.\(^{133}\) Based on these factors the Eighth Circuit could have reversed the Tax Court in *Arkansas Best* and limited ordinary loss treatment to those circumstances where there was no longer any investment motive present at the time of the initial stock acquisition.

\(^{131}\) See supra note 105 and accompanying text.

\(^{132}\) See supra note 105 and accompanying text.

\(^{133}\) One could argue that the Tax Court in *Arkansas Best* was not really extending the holding in *Campbell-Taggart* by examining each stock purchase separately because the stock in *Campbell-Taggart* was ostensibly also purchased in a two-step transaction, and the government urged that each step of the transaction be examined separately. See *Campbell-Taggart*, Inc. v. United States, 744 F.2d 442, 445 n.5 (5th Cir. 1984). However, the district court opinion in *Campbell-Taggart* strongly intimates that even by the time of the first step in the two-step transaction, Campbell-Taggart’s motivation for the purchase had changed from being of an investment nature to that of protecting its business reputation. See *Campbell-Taggart*, Inc. v. United States, 552 F. Supp. 355, 357 (N.D. Tex. 1982), aff’d, 744 F.2d 442 (5th Cir. 1984) (noting that at “[a]bout the same time as” the first step in the transaction occurred, it was apparent that the financial condition of the company whose stock Campbell-Taggart was acquiring had so significantly deteriorated that Campbell-Taggart might not have been legally obligated to carry out the purchase). Furthermore, because the first step in the purchase transaction occurred merely to satisfy some concerns that the Spanish government might have, and not because of any United States tax consequences, the district court in *Campbell-Taggart* effectively “ignored” the first step of the transaction, *Campbell-Taggart*, 552 F. Supp. at 357, and appears to have treated the stock purchase as transpiring for U.S. tax purposes only upon consummation of the second step of the transaction. *Id.* Perhaps for this reason, the government abandoned on appeal its argument that each step of the transaction be examined separately. *Campbell-Taggart*, 744 F.2d at 445 n.5. Because the government abandoned its argument in *Campbell-Taggart* that each step of the transaction be examined separately, the Fifth Circuit in *Campbell-Taggart* did not in fact examine separate stock purchases separately. Thus, the Tax Court in *Arkansas Best* was extending the holding in *Campbell-Taggart* by separately examining the sales of blocks of stock that were not purchased at the same time.
The foregoing analysis does not, of course, present a brightline test for the scope of the *Corn Products* doctrine that could be applied to any fact pattern that could arise. It merely tells how the Eighth Circuit could have reversed the Tax Court's application of the *Corn Products* doctrine without questioning the legitimacy of the doctrine itself, but to describe the Eighth Circuit's opinion as merely questioning the legitimacy of the *Corn Products* doctrine would be understating what occurred. It would be far more accurate to say that the Eighth Circuit attempted to gut the *Corn Products* doctrine of any viability, and the Supreme Court followed suit.

The Eighth Circuit's assault on the *Corn Products* doctrine began by looking to the literal language of § 1221 of the Code\(^{134}\) and concluding that capital stock clearly did not fall within any of the last four statutory exceptions from the broad definition of "capital asset."\(^{3}\) The court then considered whether the Bank stock could be treated as an ordinary asset under the first statutory exception which treats: stock in trade, property properly included in inventory if on hand at the end of the taxable year, and property held primarily for sale to customers in the ordinary course of business as non-capital assets. The Eighth Circuit found this exception inapplicable to Arkansas Best's ownership of the Bank stock because, "Generally, capital stock would meet this exception only if the taxpayer's business consisted of dealing in securities."\(^{6}\) Thus, the Eighth Circuit interpreted the inventory/stock in trade exception quite narrowly and concluded: "[T]he Bank stock was a capital asset because it does not fall into one of the statutory exceptions."\(^{3}\)

By implying, however, that capital stock could fall within the inventory/stock in trade exception only if the taxpayer was a securities dealer, the Eighth Circuit did more than just give a narrow literal reading to § 1221. It also strongly intimated that it would not have granted ordinary loss treatment to the taxpayers in *Western Wine* and *Booth Newspapers*\(^{138}\) even though those taxpayers' stock acquisitions were just as integrally related to their inventory requirements as the corn futures acquisitions in *Corn Products* were to Corn Products' inventory. Indeed, the Eighth Circuit then went on to reject the *Corn Products* doctrine when it stated:

\(^{134}\) See *supra* text accompanying note 36.

\(^{135}\) *Arkansas Best*, 800 F.2d at 218.

\(^{136}\) *Id.*

\(^{137}\) *Id.*

\(^{138}\) See *supra* note 101.
We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221. It seems to us that one of the last places where the legal system deliberately should foster subjectivity and uncertainty is in the tax code. *Corn Products and its progeny, which we respectfully view as misbegotten*, have done precisely that, leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. Congress could have written section 1221 to incorporate some sort of exception regarding capital stock, just as it recognized the unique position of securities dealers in 26 U.S.C. § 1236, but it did not do so.\(^{139}\)

The court claimed that the Eight Circuit had "declined all previous invitations to extend *Corn Products* beyond its facts"\(^{140}\) and further implied that Supreme Court precedent supported its view that the *Corn Products* doctrine was "misbegotten."\(^{141}\)

The Eighth Circuit looked to the 1972 Supreme Court decision in *United States v. Mississippi Chemical Corp.*\(^{142}\) and stated:

> In *Mississippi Chemical*, the Supreme Court based its characterization of capital stock as a capital asset solely on the language of section 1221, and ignored its previous decision in *Corn Products* entirely. . . . The Supreme Court held that since the stock was "of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code, and its cost is non-deductible."\(^{143}\)

Although the Court in *Mississippi Chemical* did state, "Since the security is of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code . . .",\(^{144}\) the Court did not base that determination on the language of § 1221 as the Eighth Circuit asserted. Rather, the Court looked to the policies behind the establishment of the "Banks for Cooperatives" pursuant to the Farm Credit Act of 1933 to determine whether the cost of acquiring certain stock in one of those Banks was a currently deductible expenditure.\(^{145}\)

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\(^{139}\) *Arkansas Best*, 800 F.2d at 221 (emphasis added).

\(^{140}\) *Id.* at 219.

\(^{141}\) *Id.* at 221.

\(^{142}\) 405 U.S. 298 (1972).

\(^{143}\) *Arkansas Best*, 800 F.2d at 219-20.

\(^{144}\) *Mississippi Chem. Corp.*, 405 U.S. at 310.

\(^{145}\) *Id.* at 302-11.
Indeed, because the issue in *Mississippi Chemical* was how to treat the acquisition costs of certain stock, not how to treat the gain or loss realized on the disposition of that stock, it is unfortunate that the Court in *Mississippi Chemical* ever indicated that the issue might involve whether the stock in question was a capital asset under § 1221. The true issue was whether the expenditure in that case was for any type of asset, the cost of which would have to be capitalized, not whether the asset, if there were any, was capital or non-capital. As a result, the *Corn Products* doctrine was totally irrelevant to the disposition of the issues in *Mississippi Chemical*. It is for that reason and that reason alone that the Court in *Mississippi Chemical* ignored the *Corn Products* doctrine. Thus, the Eighth Circuit’s attempt to justify its rejection of the *Corn Products* doctrine through Supreme Court case law that developed after the *Corn Products* case does not withstand close scrutiny.

Not surprisingly, the brief for Arkansas Best in the Supreme Court duly noted this weakness in the Eighth Circuit’s analysis. Perhaps for that reason the Supreme Court used a somewhat different rationale than the Eighth Circuit to reach effectively the same result. However, even the Supreme Court’s rationale was not devoid of flaws.

The Court began its opinion by asserting that the wording of § 1221 explicitly precluded the motivational inquiry necessitated by the *Corn Products* doctrine. The Court stated: “Section 1221 of the Internal Revenue Code defines ‘capital asset’ broadly, as ‘property held by the taxpayer (whether or not connected with his trade or business),’ and then excludes five specific classes of property from capital-asset status.” The Court emphasized the parenthetical language in the statute, “(whether or not connected with his trade or business),” and stated that because of it, inquiries as to whether property was acquired for a business purpose were irrelevant. However, the Court’s implication that characterizations pursuant to the *Corn Products* doctrine must revolve around whether property was acquired for a business purpose was inaccurate. The *Corn Products* doctrine examined whether a transaction was *integally related to everyday business operations* on the one hand or was entered into for investment purposes on the other, not merely, as the Court implied, whether a transaction was simply connected to the taxpayer’s business.

Even if it was determined that a transaction was connected to a

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147 *Arkansas Best*, 485 U.S. at 215-16.
148 Id. at 217.
149 See CHIELSTEIN, FEDERAL INCOME TAXATION, supra note 62, ¶ 17.02, at 284.
taxpayer's trade or business, the *Corn Products* doctrine still required a determination as to whether the transaction was integrally related to the business' everyday operations or in the nature of an investment. Both types of transactions could arise in connection with the taxpayer's trade or business. Thus, contrary to the Court's assertion, the parenthetical language did not preclude the type of inquiry called for by the *Corn Products* doctrine.

Additionally, at the same time that the Court was misusing the parenthetical language that it quoted from § 1221, it also misstated the exceptions to § 1221. In describing the statutory exceptions from capital asset treatment found in § 1221, it described § 1221(3) simply as denying capital asset treatment to "'a copyright, a literary, musical, or artistic composition,' or similar property." In reality § 1221(3) denies capital asset status only to copyrights and literary, musical or artistic compositions or similar property "held by — (A) a taxpayer whose personal efforts created such property," or a taxpayer whose basis in the property is determined by reference to its creator's basis. Thus, capital asset status is granted to an artistic, literary, and musical work in the hands of a taxpayer who did not create it or receive it from its creator as a gift.

This distinction, which the Court's description of § 1221(3) overlooked, is extremely important for our purposes. It further demonstrates that the statutory exceptions to capital asset treatment indicate that capital asset treatment should not be given to assets that are integrally related to the taxpayer's everyday business operations. Just as inventory is integrally related to a typical business' everyday operations, so, too, are finished works of art integrally related to an artist's everyday business operations. Thus, both types of assets are denied capital asset status. But as art in the hands of a collector is not integrally related to his everyday business operations, it is generally granted capital asset status. The Court, by conveniently ignoring the statutory evidence of this important distinction, was able to present the exceptions found in § 1221 as narrow exceptions, unconnected by any underlying policy or theme.

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150 *Arkansas Best*, 485 U.S. at 216.
152 Id. § 1221(3)(C).

153 This Article says "generally granted capital asset status" because pursuant to § 1221(3)(C) a collector who obtains a work of art as a gift from the artist will not obtain capital asset treatment on the sale of that art work. The rationale for § 1221(3)(C) is, however, readily explainable. It precludes an artist from obtaining the benefits of capital gain treatment by giving his art work to a family member or close friend who might sell the art, pay tax at capital gains rates, and turn the net after tax proceeds over to the artist.
Once the statutory exceptions were presented in this manner, it was a small step for the Court to read § 1221 literally. The Court did admit some reluctance to ignore the fact that over twenty-five years of Congressional silence indicated no displeasure with the *Corn Products* doctrine.\(^\text{154}\) Still, the Court continued, "[w]e cannot ignore the unambiguous language of § 1221, however, no matter how reticent Congress has been. If a broad exclusion from capital-asset status is to be created for assets acquired for business purposes, it must come from congressional action, not silence."\(^\text{155}\)

The Court did not, however, overrule the *Corn Products* case itself. Rather, the Court limited *Corn Products* to its specific facts and "conclud[ed] that *Corn Products* is properly interpreted as standing for the narrow proposition that hedging transactions that are an integral part of a business' inventory-purchase system fall within the inventory exclusion of § 1221."\(^\text{156}\) In reaching this conclusion the Court relied in part upon the following statement in *Corn Products* that was emphasized in the Government's brief:\(^\text{157}\) "'Nor can we find support for petitioner's contention that hedging is not within the exclusions of [§ 1221].'"\(^\text{158}\) But as this Article has already noted, this statement did not necessarily indicate that the *Corn Products* Court believed that the futures contracts in question fell within the inventory exception.\(^\text{159}\) Furthermore, despite the *Arkansas Best* Court's contention to the contrary,\(^\text{160}\) this Article has already demonstrated that the Court's approach in *Corn Products*, when compared to the Second Circuit's approach in that same case, indicates that the Court did not want its holding to be so limited in application.\(^\text{161}\) Thus, the Court's interpretation of *Corn Products* is not very convincing.

One short passage in the Court's opinion does, however, make the Court's rejection of the *Corn Products* doctrine appear to be well-founded. The Court, in justifying its literal reading of § 1221 stated:

\(^{154}\) *Arkansas Best*, 485 U.S. at 222 n.7.

\(^{155}\) Id.

\(^{156}\) Id. at 222.

\(^{157}\) See supra notes 65-67 and accompanying text.


\(^{159}\) See supra text accompanying notes 69 and 70.

\(^{160}\) See *Arkansas Best*, 485 U.S. at 221 ("This Court indicated its acceptance of the Second Circuit's reasoning when it began the central paragraph of its opinion: 'Nor can we find support for petitioner's contention that hedging is not within the exclusions of [§ 1221].'").

\(^{161}\) See supra text accompanying notes 62-70, 79-81, and 94-96.
The legislative history of the capital-asset definition supports this interpretation, see H.R. Rep. No. 704, 73d Cong., 2d Sess., 31 (1934) ("[T]he definition includes all property, except as specifically excluded") . . . .

Immediately thereafter, the Court quoted the Treasury regulation interpreting that section: "The term "capital assets" includes all classes of property not specifically excluded by section 1221."162

In the next section, this Article will take a closer look at the legislative history behind the capital asset definition. Then it can be determined if the Court's brief reference to it and to one sentence in the regulations justified the rejection of the Corn Products doctrine for a literal interpretation of § 1221.

IV. THE ORIGINS OF § 1221 AND WHAT THEY TELL US ABOUT THE ARKANSAS BEST AND CORN PRODUCTS OPINIONS

The preceding Part of this Article demonstrated that the Arkansas Best Court materially misstated the exceptions to capital asset status found in § 1221 in a manner that made its literal interpretation of § 1221 appear entirely justifiable.163 Unfortunately, that Court also materially misstated the origins of § 1221 in a manner that enabled it to ignore the policy considerations that led to the creation of special treatment for capital assets in the first place.

In its presentation of the history of § 1221, the Arkansas Best Court stated, "The inventory exception was part of the original enactment of the capital-asset provision in 1924. See Revenue Act of 1924, ch. 234, § 208(a)(8), 43 Stat. 263."164 However, the original enactment of the capital asset provision occurred not in 1924, but rather in 1921.165 Furthermore, the inventory exception also appeared in that original 1921 enactment.166 In 1924, the 1921 enactment was merely amended. But that amendment and the legislative history behind it provide the key to understanding the thinking of Congress as it formulated a definition for the term "capital asset." By beginning its historical account with the Revenue Act of 1924, rather than with the Revenue Act of 1921, the

162 Arkansas Best, 485 U.S. at 218.
163 Id. (quoting Treas. Reg. § 1.1221-1(a) (as amended in 1975)).
164 See supra notes 150-54 and accompanying text.
165 Arkansas Best, 485 U.S. at 218 n.6 (emphasis added).
167 See id.
Arkansas Best Court omitted key evidence of an investment versus everyday business operations dichotomy in Congressional thinking that is supportive of the Corn Products doctrine. The original definition of the term "capital assets" appeared in § 206(a)(6) of the Revenue Act of 1921 and read as follows:

(6) The term "capital assets" as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

Several aspects of this definition indicate that Congress intended to draw a line between investment transactions on the one hand and transactions integrally related to everyday business operations on the other. First, reference was actually made to investment property in defining what constituted a capital asset. However, this reference was superfluous and confusing. Second, the only initial exclusion from capital asset status of property clearly held for profit or investment was property which, if on hand at the end of the taxable year, would be properly included in inventory. No property could be more exemplitive of everyday business operations property. Third, and most important, however, is that property qualified as a capital asset only if it was held by the taxpayer for more than two years. Although a cogent argument has been made that capital

168 Unfortunately, this omission by the Court cannot be dismissed as merely an oversight by a clerk who, in researching the history of the statutory provision, failed to take his or her research back far enough. The government, in its brief, quoted the 1921 Act provision, thus noting the earlier enactment and its inclusion of the inventory exception. See Brief for the Respondent at 20 n.10, Arkansas Best Corp. v. Commissioner, 485 U.S. at 212 (1988) (No. 86-751). In its brief the government, by citing only the statutory language and the amendments to it from 1921 to 1924, was able to argue that, at least beginning in 1924, investment motivation was irrelevant in determining capital asset status. See id. However, this Article, by examining not just the statutory language, but also the legislative history behind the language and the changes to it, will demonstrate that the 1924 amendment was not actually intended to remove investment motivation from consideration in determining capital asset status. One can only wonder why the Arkansas Best Court, with its attention directed to the 1921 Act, delivered an opinion that not only ignored the legislative history behind that Act and the amendment to it, but also ignored the Act itself.


170 See infra notes 185-98 and accompanying text.
asset status should not simply revolve around the length of time that a piece of property has been held,\textsuperscript{171} the fact remains that by holding property over an extended period of time a taxpayer indicates that he is holding the property for investment gains. Thus, by denying capital asset status to property not held for more than two years, Congress precluded capital asset status not simply from inventory items but also from all other pieces of property whose purchase and sale had been in such close proximity to each other that the holding of that property might appear to be part of a business' everyday operations.

The legislative history behind the initial imposition of a special regime for capital assets lends further support to the theory that Congress was primarily, if not exclusively, concerned with the effect of the tax laws on long-term investments. The House Ways and Means Committee Report which accompanied the Revenue Act of 1921 explained the imposition of a preferential rate for capital gains in the following manner:

The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum (and the amount of surtax greatly enhanced thereby) in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of the tax revenue, have been blocked by this feature of the present law. In order to permit such transactions to go forward without fear of a prohibitive tax, the proposed bill ... adds a new section ... [which limits the rate of taxation] ... upon capital net gain ... \textsuperscript{172}

The House's concern over the bunching into one year of those gains that had accrued over a number of years was explained to the Senate Finance Committee by Dr. T. S. Adams, who represented the Treasury before Congress.\textsuperscript{173} He gave as an example a situation in which gains accrued over an eight year period!\textsuperscript{174} Dr. Adams explained that by

\textsuperscript{171} See supra note 130.
\textsuperscript{173} Richard S. Doyle, Taxation of Income Derived from Installment Sales, 4 Nat'l Income Tax Mag. (Taxes) 53, 56 (1926).
\textsuperscript{174} Internal Revenue: Hearings on H.R. 8245 Before the Senate Comm. on Finance [Confidential Print for Use of Members of the Senate] 67th Cong., 1st Sess., 36-37 (1921)
taxing in one year the gains that had accrued over eight years the tax
laws were imposing a higher nominal rate of tax than would have been
imposed if the gain had been taxed as it accrued. The purpose of the
capital gain provision, explained Dr. Adams, was to remove this high rate
of taxation caused by this bunching of gains so that "the sale of capital
assets . . . [would cease] . . . being held up or blocked by the heavy rates
of taxation."175

Thereafter, the Senate Finance Committee issued a Report that, like
the House Report, explained the imposition of a preferential tax rate on
capital gains as an effort to alleviate the lock-in effect caused by the
bunching of long-term gains into one tax year.176 Indeed, the only
explanation found in the entire legislative history of the 1921 Act for
singling out capital assets for special treatment is the alleviation of the
lock-in effect caused by this bunching of gains. As Congress' sole
concern in instituting a special regime for capital assets was to deal with
gains that had accrued over a number of years, Congress must not have
intended that regime to apply to the converse of such gains; namely,
gains that were integrally related to the everyday operations of a business.

In 1924, the definition of "capital assets" was amended to read as
follows:

The term "capital assets" means property held by the taxpayer for more
than two years (whether or not connected with his trade or business),
but does not include stock in trade of the taxpayer or other property of
a kind which would properly be included in the inventory of the
taxpayer if on hand at the close of the taxable year, or property held by
the taxpayer primarily for sale in the course of his trade or busi-
ness.177

Added to the exceptions from capital asset status was "property held by
the taxpayer primarily for sale in the course of his trade or business."
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This new exception was added "to remove any doubt as to whether

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175 Id. at 37.
176 Id. at 36.
177 See SENATE COMM. ON FINANCE, INTERNAL REVENUE BILL OF 1921, S. REP. NO.
275, 67th Cong., 1st Sess. 12 (1921), reprinted in 95A REVENUE ACTS 1909-1950, supra
note 172.
179 Id.
property which is held primarily for resale constitutes a capital asset whether or not it is the type of property which under good accounting practice would be included in inventory." 180 Thus, Congress more clearly indicated that capital asset status was not intended for profits and losses arising out of everyday business transactions.

Another definitional change brought in 1924, however, might at first blush appear to remove completely all consideration of investment intent in determining capital asset status. That change was the deletion of the requirement found in the 1921 Act that a capital asset be held "for profit or investment." 181 However, this deletion must be read in conjunction with another 1924 deletion from the definitional language found in the 1921 Act. The 1921 Act provided that "[t]he term 'capital assets' . . . does not include property held for the personal use or consumption of the taxpayer or his family. . . ." 182 This exclusion from capital asset status of "property held for the personal use or consumption of the taxpayer or his family . . ." was also deleted by the 1924 Act amendment. 183

In explaining these changes to the definition of "capital assets" the Senate Finance Committee Report simply stated:

In the existing law, property held for the personal use or consumption of the taxpayer or his family is excluded in the definition of capital assets. In the proposed bill, this restriction has been removed, with the purpose of permitting a taxpayer selling residential property at a profit to elect to be taxed under the capital gain section if he so desires. 184

One could argue that this portion of the Committee Report addresses only the deletion of the exclusion of personal use or consumption property and does not address the deletion of the requirement that a capital asset be


181 Compare supra note 169 and accompanying text (defining "capital assets" under the Revenue Act of 1921) with supra note 178 and accompanying text (defining "capital assets" under the Revenue Act of 1924).

182 See supra note 169 and accompanying text.

183 Compare supra note 169 and accompanying text (defining "capital assets" under the Revenue Act of 1921) with supra note 178 and accompanying text (defining "capital assets" under the Revenue Act of 1924).

held "for profit or investment." However, explanatory notes prepared for
the Senate Finance Committee to accompany the statutory language state:

On page 39, lines 9 and 10, the words "for profit or investment" and in
lines 12 and 13 the words "property held for the personal use or
consumption of the taxpayer or his family," which words appear in the
existing law, were not proposed to be stricken out by the Treasury draft.
The effect of striking out the words is to treat as capital assets dwelling
houses and other property held for personal use. ¹⁸⁵

Thus, the drafters of the 1924 Act apparently deleted the words "for
profit or investment" simply to clarify that personal use property could
now qualify for capital asset status.

Any confusion generated by the deletion of the words "for profit or
investment" should, nevertheless, be blamed on their unfortunate
inclusion in the definition of capital asset in the first place. Congress, in
1921, could have just as effectively excluded personal use or consumption
property from the definition of capital asset by stating (as it did) that such
property was excluded, without adding the requirement that a capital asset
be held "for profit or investment." The inclusion of the "for profit or
investment" requirement in 1921 most likely resulted from a misguided
excess of caution on the part of the statutory drafters.

This excess of caution may well have resulted from the fact that the
income tax laws have always drawn a line between expenditures incurred
for profit or investment on the one hand and expenditures incurred for
personal consumption reasons on the other. In fact, I.R.C. § 162 which
allows a deduction for "all the ordinary and necessary expenses paid or
incurred during the taxable year in carrying on any trade or busi-
ness,"¹⁸⁶ and I.R.C. § 262, which generally denies a deduction "for
personal, living, or family expenses,"¹⁸⁷ both find their origins in the
Income Tax Law of 1913,¹⁸⁸ the first income tax statute promulgated

¹⁸⁵ STAFF OF SENATE COMM. ON FINANCE, 68TH CONG., 1ST SESS., COMPARATIVE
PRINT OF THE REVENUE ACT OF 1924 Supp. I, n.2 (Comm. Print No. 2 1924), reprinted
in 67 REVENUE ACTS 1909-1950, supra note 172.
¹⁸⁷ Id. § 262(a).
¹⁸⁸ In fact, current §§ 162 and 262 were originally found together in a single section
which provided in pertinent part, "in computing net income for the purpose of the normal
tax there shall be allowed as deductions: First, the necessary expenses actually paid in
carrying on any business, not including personal, living, or family expenses . . . ." Income
pursuant to the Sixteenth Amendment.\textsuperscript{189} Developments in the tax statutes to this day continue to draw the same line. Thus, § 212 extends the deductibility granted by § 162 to expenditures “incurred . . . for the production . . . of income”\textsuperscript{190} even if those expenditures do not arise out of a taxpayer’s trade or business.\textsuperscript{191} The tax laws now even attempt to draw the line when a taxpayer may have incurred an expense for both personal and business reasons. Thus, § 183 not only limits the deductibility of expenses incurred in activities not engaged in for profit (such as hobbies), but also raises a presumption as to when an activity is engaged in for profit so that all the expenditures incurred in it may be deductible.\textsuperscript{192} Furthermore, § 280A draws brightline distinctions with technical rules to determine when the costs of maintaining an office in one’s home are deductible.\textsuperscript{193} Nevertheless, this longstanding distinction in the tax laws between expenditures for profit or investment on the one hand and expenditures incurred for personal consumption reasons on the other, should have been immaterial to the drafters of the 1921 Act.

The longstanding distinction is necessary so that the tax is imposed only upon actual accretions to one’s wealth.\textsuperscript{194} If deductions were not

\textsuperscript{189} The Sixteenth Amendment, ratified in 1913, provides, “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” U.S. CONST. amend. XVI.

\textsuperscript{190} I.R.C. § 212(1) (West Supp. 1995).

\textsuperscript{191} Current I.R.C. § 212(1) originated as § 23(a)(2) of the Internal Revenue Code of 1939. That subsection was added to the Code by § 121 of the Revenue Act of 1942. Revenue Act of 1942, ch. 619, § 121, 56 Stat. 798, 819 (1942). In reporting this new provision out, the Senate Finance Committee stated, “The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production . . . of income . . . whether or not such expenses are paid or incurred in carrying on a trade or business . . . .” SENATE COMM. ON FINANCE, THE REVENUE BILL OF 1942, S. REP. NO. 1631, 77th Cong., 2d Sess. 87 (1942), reprinted in 108 REVENUE ACTS 1909-1950, supra note 172.

\textsuperscript{192} I.R.C. § 183 (West Supp. 1995).

\textsuperscript{193} Id. § 280A.

\textsuperscript{194} The notion that a theoretically pure income tax is a tax on one’s accretions to wealth comes from what is commonly known as the Haig-Simons definition of income. Henry Simons formulated a classic definition of income as follows: “the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and the end of the period in question.” HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938). In so doing, he drew from the work of R.M. Haig and quoted Haig as defining income as “the money value of the net accretion to one’s economic power between two points in time.” Id. at 61 (quoting Robert M. Haig, The Concept of Income, in THE FEDERAL INCOME TAX 7 (Robert M. Haig ed., 1921)). As Simons so succinctly noted, there are, therefore, two
allowed for expenses incurred in the generation of income, the tax would be imposed on more than one’s accretion to wealth and would thus be a tax on gross receipts rather than a tax on income. If deductions were allowed for personal consumption expenditures, the tax would be imposed on less than one’s income because the “market value of rights exercised in consumption” would be improperly removed from the tax base. A line must therefore be drawn between for profit or investment expenditures on the one hand and personal consumption expenditures on the other in determining what is deductible so that the tax is imposed on no more and no less than one’s true income.

The drafters of the 1921 Revenue Act, however, in defining the term “capital asset” were not trying to determine what is properly deductible in an effort to impose the tax on the theoretically correct tax base. In fact, they were doing just the opposite. They were deviating from the income tax ideal by imposing a different rate upon a different type of income as determined by its source. By including the “for profit or investment” requirement in the initial capital asset definition, the drafters added a superfluous and irrelevant phrase whose necessary deletion only three years later could be cause for confusion.

It is not mutually inconsistent to hold the same property for personal use and for profit or investment. Many persons view their residences, the property referred to in the 1924 Act’s Committee Report and explanatory note, as investments. So too, fine art may be held both for personal use and for profit or investment. As we have seen, drawing basic components to the concept of income. One is the market value of amounts consumed. This takes into account that portion of one’s income that is currently used and transformed into goods and services. The other is the portion of income that is not currently consumed but is saved for future use. Both portions, however, represent accretions to wealth. To the extent that consumption comes from previous savings rather than from current income, the Simons formula takes this into account by offsetting that “dissavings” against consumption in the second part of the formula. Thus for a tax to be on one’s income under the Haig-Simons approach, it must be on no more and no less than one’s accretion to wealth, and to determine accretions to wealth one must take into account amounts consumed during the period in question.

195 See supra note 194.
196 See supra note 194.
197 Under the Haig-Simons definition no mention is made as to how income from differing sources should be treated. This failure to distinguish types of income by their sources, however, is entirely proper because under a purely theoretical wealth accretion approach to income, the source of that income is irrelevant. To rephrase Gertrude Stein, an accretion is an accretion is an accretion!
198 See supra note 184 and accompanying text.
199 See supra note 185 and accompanying text.
1NTERPRETATION OF “CAPITAL ASSETS”

a line between personal use or consumption expenditures on the one hand and profit or investment motivated expenditures on the other is essential in the deduction area to arrive at a proper tax base. However, once we decide to deviate from the proper tax base by taxing a certain type of income, as determined by its source, at a preferential rate, the need to draw the line between personal use or consumption expenditures on the one hand and for profit or investment expenditures on the other disappears into thin air. Congress, therefore, did not need to include the “for profit or investment” requirement in its 1921 Act capital asset definition because that definition already excluded personal use or consumption property. Its removal in 1924 should be deemed the removal of unnecessary surplusage. On the other hand, by retaining in the 1924 Act the requirement that property be held for more than two years to qualify for capital asset status, Congress was still indicating that only property held long enough to generate investment gains should be accorded capital asset treatment. As a result, the deletion of the words “for profit or investment” in 1924 should not be interpreted as making irrelevant to capital asset determinations the taxpayer’s investment motivation (or lack thereof) in acquiring and holding an item of property.

Before terminating its discussion of the Revenue Act of 1924 this Article must note one additional provision that came into the tax law at that time. With the Revenue Act of 1924, Congress, for the first time, placed a limit on the deductibility of capital losses. Until this limitation was placed in the tax law, a taxpayer could limit the taxability of net capital gains under the Revenue Act of 1921, but nothing in the law

\[200\text{ See supra notes 185-86 and accompanying text.}\]

\[201\text{ New § 208(c) of the Revenue Act of 1924 limited the deductibility of capital losses as follows:}\]

\[\text{In the case of any taxpayer (other than a corporation) who for any taxable year sustains a capital net loss, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:}\]

\[\text{A partial tax shall be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount minus 12\% per centum of the capital net loss; but in no case shall the tax under this subdivision be less than the taxes imposed by sections 210 and 211 computed without regard to the provisions of this section.}\]


\[202\text{ Section 206(b) of the Revenue Act of 1921 granted preferential tax treatment to capital gains as follows:}\]

\[\text{In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211}\]
limited his ability to utilize net capital losses to their full extent to offset ordinary income. Congress believed the opportunity for tax avoidance was too great and the injustice to the government so clear under the

of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provision of law, including penalties, as other taxes under this title.

Revenue Act of 1921, ch. 136, § 206(b), 42 Stat. 227, 233 (1921). Preferential treatment of capital gains continued in the Revenue Act of 1924 as follows:

In the case of any taxpayer (other than corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain.


The problem faced by the government was clearly explained in a committee report to a proposed bill that would have amended the Revenue Act of 1921. Although that particular bill never became law, the substance of it became the limitation on the deductibility of capital losses contained in the Revenue Act of 1924. The committee report accompanying this proposed bill stated:

Congress, in the revenue act of 1921 . . . provide[d] that the tax on capital gains in the case of property acquired and held by the taxpayer for profit or investment for more than two years should be limited to 12½ per cent. But Congress failed to place a similar limitation on capital losses, so that today the taxpayer pays a maximum tax of 12½ per cent on gains derived from the sale of capital assets, but is allowed to deduct in full from his taxable income his net losses resulting from the sale of capital assets during the taxable year. The injustice to the Government is too obvious to require much comment. The taxpayer may refrain from taking his profits, or, if he does take them, pays but a 12½ per cent tax, whereas he is at liberty any time to take advantage of any losses that may have been incurred and avail himself of a full deduction from his income. When we consider that the rate on the larger incomes runs as high as 58 per cent, it can readily be realized how great the advantage is. The Government can collect but 12½ per cent of a gain, but it is compelled to lighten the burden of the taxpayer to the extent of 58 percent of his losses.
circumstances that logic required a limitation on the deductibility of net capital losses. The technical details of the form this loss limitation took from time to time are not as important for purposes of the present discussion as is the fact that a limitation on the deductibility of capital losses entered the law. As we shall see, the presence of this limitation precipitated additional Congressional tinkering with the definition of the term "capital asset." The tinkering that resulted from the existence of a limitation on the deductibility of capital losses should not, however, be interpreted as evidencing a policy shift away from the purpose of the original capital asset definition. That purpose, of avoiding the lock-in effect on assets held for investment gains, remained throughout the subsequent changes that were made in the definition of capital asset. The balance of this Part of this Article will analyze a few of the major definitional changes that subsequently transpired to demonstrate the continued viability of the initial policy behind the capital asset definition.

From 1924 until 1934 the definition of capital asset remained basically unchanged. Then, in the Revenue Act of 1934, Congress substantively restructured the definition of the term "capital asset." Because the Arkansas Best Court cited the legislative history surrounding the changes contained in this Act to support its literal reading of current § 1221, the 1934 Act changes must be scrutinized to determine if the Arkansas Best Court was correct in using the legislative history as it did.

In 1934 Congress recognized that the requirement of a two-year holding period in the definition of "capital asset" was leading to unwanted manipulations by taxpayers. On the one hand, taxpayers holding assets that had dropped in value would sell them just before the two-year time period expired. Such a sale would preclude the assets from being deemed capital assets, thus not subjecting the loss on the sale to the limitation on the deductibility of capital losses. On the other hand, taxpayers holding appreciated assets would forestall sales of those assets until the two-year holding period had elapsed. After the holding period had elapsed, those assets were deemed capital assets and the full tax

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205 See supra note 176-77 and accompanying text.
206 See supra notes 176-77 and accompanying text.
207 See supra note 162 and accompanying text.
preference was available regardless of how much or how little longer the assets were held.\textsuperscript{209}

The solution was to remove the holding period completely from the definition of capital asset\textsuperscript{210} and instead to place it in a separate provision dealing with the taxability of capital gains and losses.\textsuperscript{211} By removing the holding period from the definition of capital asset, Congress was able to stop the revenue drain caused by the dumping of loss assets just before the two-year holding period expired. Net losses from sales or exchanges of similar types of assets were subject to limitations on their


\textsuperscript{210} Section 117(b) of the Revenue Act of 1934 thus defined “capital assets” as follows:

\begin{quote}
(b) Definition of Capital Assets. — For the purposes of this title, “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.
\end{quote}


The only other substantive change contained in this definition was the insertion of the requirement that property held primarily for sale in the ordinary course of business be held primarily for sale “to customers” in order to be excluded from capital asset treatment. This insertion was placed in the definition to preclude stock speculators, who were trading on their accounts, from denying their stock was a capital asset in order to avoid the capital loss limitation provisions. See H.R. Conf. Rep. No. 1385, 73d Cong., 2d Sess. 22 (1934), reprinted in 100 Revenue Acts 1909-1950, supra note 172.

\textsuperscript{211} See § 117(a) of the Revenue Act of 1934, which provided:

\begin{quote}
General Rule. — In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

- 100 per centum if the capital asset has been held for not more than 1 year;
- 80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;
- 60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;
- 40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;
- 30 per centum if the capital asset has been held for more than 10 years.
\end{quote}

deductibility regardless of how short a period of time any of those assets had been held.212

It is in the context of this loophole-closing change that the legislative history cited by the Arkansas Best Court should be read. The Court, to support its literal reading of current §1221 and its rejection of the Corn Products doctrine, stated:

The legislative history of the capital-asset definition supports this interpretation, see H.R. Rep. No. 704, 73d Cong., 2d Sess. 31 (1934) ("[T]he definition includes all property, except as specifically excluded") . . . as does the applicable Treasury regulation, see 26 CFR §1.1221-1(a) (1987) ("The term 'capital assets' includes all classes of property not specifically excluded by section 1221").213

The above-quoted statement from the 1934 Committee Report, however, appears in a portion of that Report that is noting the technical details that result from the new structural treatment of capital gains and losses in the Revenue Act of 1934.214 As the major structural change involved the removal of the holding period from the actual definition of "capital asset,"215 the quoted language could easily be interpreted as simply highlighting the fact that the definition now turned only on the type of property involved and not on the length of time that it was held. If this is all that was intended by the Committee Report, then this cryptic line should not be interpreted as demanding a rigid and literal reading of the statutory definition without regard to the underlying policy concerns.

Ironically, the Treasury Regulation also quoted by the Arkansas Best Court supports just this limited interpretation. The full text of the Treasury Regulation quoted by the Arkansas Best Court did not simply state, "The term 'capital assets' includes all classes of property not specifically excluded by section 1221," as it appears in the Court's

212 See §117(d) of the Revenue Act of 1934, which provided in pertinent part, "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges." Revenue Act of 1934, ch. 277, §117(d), 48 Stat. 680, 715 (1934).


214 See House Comm. on Ways and Means, Internal Revenue Bill of 1934, H. Rep. No. 704, 73d Cong., 2d Sess. 20, 30-32 (1934), reprinted in 100 Revenue Acts 1909-1950, supra note 172. The technical details in this part of the Report, however, must be read in conjunction with the Report's earlier explanation of the reasons for the change in the definition of "capital assets." See id. at 9-10.

215 See supra notes 210-12 and accompanying text.
Rather, the full text provided: "The term 'capital assets' includes all classes of property not specifically excluded by section 1221. In determining whether property is a 'capital asset', the period for which held is immaterial." 217 Moreover, this regulatory provision had its origins in Article 117-1 of Regulations 86 Relating to the Income Tax Under the Revenue Act of 1934. That original regulation, in its entirety, provided:

ART. 117-1. Meaning capital of assets. — The term "capital assets" includes all classes of property not specifically excluded by section 117(b). The term is not limited to stocks and bonds nor to property held for more than two years. In determining whether property is a "capital asset," the period for which held is immaterial. 218

This contemporaneous interpretation of the 1934 Act’s new definition of “capital assets,” which in part tracks the quoted language from the quoted Committee Report, is strong evidence that that quoted language was merely intended to highlight the removal of the holding period from the definition of capital asset. If, as it appears, that is all that was intended, the legislative history offered by the Arkansas Best Court is not very persuasive in arguing for a literal interpretation of current § 1221 in disregard of the underlying policy considerations that the Corn Products Court found controlling.

In evaluating whether the Corn Products Court reached the proper conclusions as to the policy underlying the capital asset definition, the origins of current §§ 1221(2) and 1231 are quite enlightening. Section 1221(2) excludes from the definition of "capital asset" depreciable property used in a taxpayer’s trade or business and real property used in his trade or business. 219 Section 1231, however, provides special treatment for such property. Generally speaking, § 1231 provides capital treatment for such property if all sales, exchanges and involuntary conversions (including condemnation by eminent domain) in a taxable year net out to a gain, but provides ordinary treatment if they net out to a loss. 220 The result is preferential capital treatment if there are net

216 See supra note 213 and accompanying text.
217 Treas. Reg. § 1.1221-1(a) (as amended in 1975) (emphasis added).
220 Id. § 1231.
Section 1221(2) first appeared in the tax laws in § 117(a)(1) of the Revenue Act of 1938 which excluded from the definition of "capital assets" "property, used in the trade or business, of a character which is subject to the allowance for depreciation." The Revenue Act of 1942 added to this exclusion "real property used in the trade or business of the taxpayer" so that depreciable buildings and the land on which they sat would receive similar tax treatment. When the 1938 provision was being considered, the House Ways and Means Committee stated that this new provision was based upon a recognition that all business gains and losses directly affect profits and thus should be taxed similarly. Taken by itself, this statement would undercut the validity of the *Corn Products* doctrine which was based upon the premise that Congress intended to draw a line between those transactions that were integrally related to everyday business operations and those that were not. However, read in context, it does not.

The *Corn Products* doctrine arose out of a case in which the Court was considering the policy underlying the granting of preferential treatment to certain types of gains. Yet the example which follows the above-noted statement in the Committee Report indicates that in 1938 Congress was thinking primarily about how this change in the capital asset definition would affect the deductibility of losses. That Congress was primarily concerned with the effect of the capital loss deduction limitations is further demonstrated by an earlier statement in that same Committee Report that the change in "[t]he definition of capital assets . . . in the great majority of cases, should be of benefit to the taxpayer, since it will allow him to take losses against his ordinary income from the sale of such property." Indeed, only four years later, when the predecessor to current § 1231 was being enacted, the Ways and Means Committee indicated that the predecessor to § 1221(2) had been enacted.

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225 Id. at 34-35.
226 Id. at 7.
in 1938 solely to deal with the harshness of the limitation on the deductible nature of capital losses.227

It stands to reason that in 1938 Congress was more concerned with the tax consequences of losses than it was with the tax consequences of gains. Late in 1937 a major recession began that pushed the economy even further into the depths of the Great Depression.228 Concerns about the tax treatment of gains were irrelevant at that time. Thus, the enactment of the predecessor to § 1221(2) should be viewed simply as an attempt to alleviate the hardship caused by the limitation of the deductibility of capital losses and not as a pullback from the policy of granting preferential treatment on the gains side of the ledger to only those assets held for investment gains. The 1942 enactment of the predecessor to § 1231 merely confirms this theory.

The predecessor to § 1231 has been described as “addressed to a problem of limited scope,”229 namely the hardship incurred by persons whose property was seized by the government through condemnation or sold to the government under threat of condemnation for use in World War II. As wartime shortages often caused the value of property to rise above its adjusted basis, the forced realization of this property at temporarily inflated wartime prices would generate a large tax liability absent an ameliorative provision.230 The relief granted was providing capital asset treatment to most depreciable and real property used in the taxpayer’s trade or business if the gains and losses from sales or exchanges in such property netted out to a gain.231 Section 1231 has therefore been described as “a statute . . . that persisted long after the rationale had disappeared.”232

The foregoing analysis of the genesis of § 1231 finds support in the House Ways and Means Committee Report which noted the tax problem confronting a taxpayer who sold trawlers used in his business to the Government at a gain.233 However, the description of § 1231 as a

230 Id. at 578-79.
231 Revenue Act of 1942, ch. 619, § 151(b), 56 Stat. 798, 846 (1942), adding § 117(j) to the Internal Revenue Code of 1939.
232 BITTKER & STONE, supra note 229, at 579.
233 HOUSE COMM. ON WAYS AND MEANS, INTERNAL REVENUE BILL OF 1942, H.R.
provision "that has persisted long after the rationale had disappeared" implies that there is something anomalous about granting preferential capital gain treatment to real and depreciable property used in one's trade or business. That implication is even more specifically presented in a successor edition to the book that described § 1231 as persisting after its rationale had disappeared. That successor edition describes § 1231 as a provision:

which seems more a response to economic or political forces than to tax logic. The rule embodied in § 1221(2) seems logically correct since it is hard to see any good reason for distinguishing, for tax purposes, between gains or losses arising from normal business operations and gains or losses from disposing of assets used in the business.\(^{235}\)

Unless the foregoing statement is meant as a condemnation for having a capital asset distinction in the first place (which, read in context, it does not appear to be), this statement is open to criticism on more than one count.

First, it ignores the longstanding policy evident in the definition of a capital asset of distinguishing between gains arising from everyday business operations and gains from assets held for investment. Second, and relatedly, by not giving the history surrounding the enactment of § 1221(2), that statement makes § 1221(2) appear as a norm that undercuts any claim that Congress intended in its definition of capital assets to draw any line between gains from everyday business operations and gains from assets held for investment. Yet, as we have seen, § 1221(2) came into the tax laws only to eliminate hardship in the case of loss and, in reality, not to treat all gains in any way connected to one's trade or business in an identical manner.\(^{236}\) Indeed, because the predecessor to § 1221(2) came into the tax laws only four years before the predecessor to § 1231, § 1231 can be viewed as merely undoing the change wrought upon the capital asset definition by § 1221(2)'s predecessor in gain situations while retaining in loss situations the amelioration from hardship that that section provided.

When one purchases real or depreciable property for use in one's trade or business that person can be deemed to be investing for the long

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234 See supra note 232 and accompanying text.
236 See supra notes 221-29 and accompanying text.
term in that trade or business. The lock-in effect that gave rise to the original capital gain preference in 1921 could thwart the otherwise economically sensible sale of these business assets just as it could thwart the sale of any other assets. As a result, § 1231 should be viewed not as a World War II anomaly but rather as an equitable effort to bring the capital asset definition back in consonance with its original 1921 policy roots while simultaneously accounting for the ramifications of the later-enacted capital loss deduction limitations.237

237 Although he does not engage in a similar analysis of the development of the definition of "capital asset," and more particularly §§ 1221(2) and 1231, Professor Chirelstein also sees a somewhat similar justification for the asymmetrical treatment provided by § 1231. He states:

[An argument can be made that the present nonsymmetrical treatment is actually correct as a matter of tax policy (depending, of course, on a willingness to accept capital-ordinary distinctions to begin with). Thus, on the gain side, it can be argued that sales of fixed assets, as opposed to stock-in-trade, are really extraordinary transactions which involve the disposition of a part of the business itself. They do not occur in the regular course of operations, and the profits which they generate often represent appreciation that has accrued over an extended period of time. "Mobility of capital" considerations are also relevant: as with conventional investment property, if we impose a tax at full rates merely because there has been a realization, the owners of such assets may be deterred from transferring their funds to better and more desirable economic uses, including the purchase of new equipment.

As respects losses, although symmetry would be expected normally, in the present context we find ourselves dealing with depreciable property, rather than corporate stock or the like. If the property were retained by the taxpayer for the remainder of its useful life, an ordinary loss would be allowed, in effect, through annual deductions for depreciation. The same would be true if the property were simply abandoned or scrapped without being sold at all. Since investment in depreciable property, thus, is recoverable through an offset against ordinary income, the result, arguably, should be no different when allowable depreciation is anticipated by the sale of the property at a loss. To be sure, this justification does not serve very well where land is concerned, because land is non-depreciable. However, the alleged difficulty of allocating the purchase price of real estate between land and buildings when both are sold together has evidently convinced Congress that it would be too burdensome to insist on separate capital loss treatment for the land component.

Chirelstein, Federal Income Taxation, supra note 62, ¶ 18.02(a), at 320. Professor Chirelstein’s analysis of the loss side in a manner that justifies ordinary loss treatment for depreciable property but not for corporate stock, an asset often given ordinary loss treatment under the Corn Products doctrine, see supra notes 101-04 and accompanying text, most likely results from the fact that he was examining the language of § 1231 without examining the legislative history of §§ 1221(2) and 1231 and from the fact that he was not tying the history behind those sections in to the Corn Products doctrine, which we are doing here. See infra text accompanying notes 238-41.
This analysis of the history of §§ 1221(2) and 1231 gives rise to an interesting conclusion with respect to the *Corn Products* doctrine. From a Congressional policy standpoint, *Corn Products* was absolutely correct on the gain side — preferential treatment should be granted only to gains on transactions in assets not integrally related to everyday profits and losses. That conclusion is not very surprising. However, the ramifications of *Corn Products* in loss transactions are also consistent with Congressional policy. This conclusion may, however, at first appear to be surprising.

The taxpayer’s ability to use *Corn Products* to his advantage in loss situations gave rise to taxpayer abuse and difficulties in administration by the Internal Revenue Service, as was noted by the *Arkansas Best* Court and Professor Chirelstein. Nonetheless, read together, the legislative histories of the 1938 and 1942 Revenue Acts strongly indicate that Congress did not want the “integrally related to everyday business operations” distinction to operate on the loss side. It wanted all business losses to be fully deductible. Thus, in applying the *Corn Products*

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238 The *Arkansas Best* Court stated:

It is also important to note that the business-motive test advocated by petitioner is subject to the same kind of abuse that the Court condemned in *Corn Products*. The Court explained in *Corn Products* that unless hedging transactions were subject to ordinary gain and loss treatment, taxpayers engaged in such transactions could “transmute ordinary income into capital gain at will.” The hedger could garner capital-asset treatment by selling the future and purchasing the commodity on the spot market, or ordinary-asset treatment by taking delivery under the future contract. In a similar vein, if capital stock purchased and held for a business purpose is an ordinary asset, whereas the same stock purchased and held with an investment motive is a capital asset, a taxpayer such as Arkansas Best could have significant influence over whether the asset would receive capital or ordinary treatment. Because stock is most naturally viewed as a capital asset, the Internal Revenue Service would be hard pressed to challenge a taxpayer’s claim that stock was acquired as an investment, and that a gain arising from the sale of such stock was therefore a capital gain. Indeed, we are unaware of a single decision that has applied the business-motive test so as to require a taxpayer to report a gain from the sale of stock as an ordinary gain. If the same stock is sold at a loss, however, the taxpayer may be able to garner ordinary-loss treatment by emphasizing the business purpose behind the stock’s acquisition. The potential for such abuse was evidenced in this case by the fact that as late as 1974, when Arkansas Best still hoped to sell the Bank stock at a profit, Arkansas Best apparently expected to report the gain as a capital gain.

485 U.S. at 222-23 (citations omitted).

239 See supra note 81.

240 See supra note 224 and accompanying text.
doctrine to losses, taxpayers were trying to effectuate what Congress wanted all along — the full deductibility of all business losses.

By taking into account the effect of the limitations on the deductibility of capital losses along with the history behind the enactments to the predecessors of §§ 1221(2) and 1231, we see that the Corn Products doctrine fits quite nicely into the policy evident behind the definition of "capital assets." The opportunity for taxpayers to abuse the doctrine could have been easily eliminated by a simple statutory provision, had Congress so desired.241

One final change brought about by the Revenue Act of 1942 deserves mention. This Article has previously noted that the length of the holding period required for obtaining preferential capital treatment for gains strongly indicated the importance of investment intent.242 The 1942 Act reduced that holding period to only six months.243 One could argue that with such a short holding period in place investment intent was no longer of much importance. However, in proposing the new and shorter six-month holding period, the Senate Finance Committee stated:

Your committee has reduced the holding period to 6 months. . . . The realization of a capital gain is entirely a matter within the discretion of the taxpayer. If the rates are too high, the Government will lose not

241 In fact, in 1976 Congress had before it H.R. 10902, reprinted in H.R. Rep. No. 94-1360, 94th Cong., 2d Sess. 6-7 (1976). That bill would have eliminated the opportunity for taxpayer abuse of the Corn Products doctrine with respect to the purchase and sale of corporate securities. It would have required taxpayers to file a notice with the Internal Revenue Service within thirty-one days of purchasing a security stating that the security was purchased for business and not investment purposes or be forever barred from arguing for ordinary loss treatment. The accompanying committee report described the workings of the provision as follows:

The giving of notice does not guarantee ordinary loss treatment for a taxpayer; he still must establish that he did not acquire and hold the stock as a capital asset. The bill simply adds a threshold condition for ordinary loss treatment that, in any event, the taxpayer must have filed the required notice within the required period.

If a taxpayer filed the necessary notice and realizes a gain when he sells the security, the bill provides that his gain is to be ordinary income and not capital gain. In such a situation, ordinary income treatment is automatic; the bill does not permit the taxpayer to show that on the particular facts he held the stock as a capital asset.


242 See supra text accompanying note 171.

only income taxes but also stamp taxes upon the transfer of property. The net receipts from capital gains and losses have been steadily declining . . . .

Your committee believes that the lowering of the holding period will have the effect of encouraging the realization of capital gains and thereby result in added revenue to the Treasury. It is believed that a holding period of 6 months will be a sufficient deterrent to the speculator as contrasted with the legitimate investor.\[244\]

It should be clear, therefore, that investment intent was still deemed highly relevant. This Part of the Article has traced the development of and policy behind §§ 1221(1), 1221(2), and 1231, the key provisions for purposes of the Corn Products doctrine. Earlier this Article noted how § 1221(3) is consistent with the Corn Products doctrine’s drawing of a line between those transactions integrally related to everyday business operations and those that are not, and it criticized the Arkansas Best opinion for describing § 1221(3) in a manner that obfuscated that point.\[245\] Current § 1221(4) excludes from capital asset status “accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in [§ 1221(1)].”\[246\] Clearly, this exclusion relates to assets integrally related to everyday business operations. The last subsection of § 1221 in effect at the time of the Arkansas Best decision and with which the Court concerned itself was current § 1221(5).\[247\] That section, excluding from capital asset status certain government publications received from the government for less than their public sale price, came into the Code because of the strange effect that capital asset status has on the charitable contribution deduction.\[248\] There is not much of a secondary market for these documents so the enactment of this exclusion has nothing to do with the taxation of gains or losses from the sale of these assets. As a result, § 1221(5) is


\[245\] See supra text accompanying notes 150-53.


\[247\] Id. § 1221(5); see also Arkansas Best Corp. v. Commissioner, 485 U.S. 212, 216 n.2 (1988).

irrelevant to any analysis of the validity of the *Corn Products* doctrine. Where all of this history leads us will be the subject of some concluding thoughts.

**SOME CONCLUDING THOUGHTS**

The foregoing historical analysis can lead to only one conclusion. The rationale of the Court in *Corn Products*, and to a large extent the doctrine that it spawned, are consonant with the policy inherent in the development of the definition of the term “capital asset.” On the other hand, the opinion of the Court in *Arkansas Best* can be viewed as a distressing example of Supreme Court jurisprudence.

From a policy analysis perspective not only does the *Arkansas Best* Court appear not to appreciate the policy behind the statute it is interpreting, but moreover, the Court presents that statute in an edited manner that improperly makes that statute appear not to be guided by any coherent policy theme at all. Furthermore, the Court’s use of legislative history to support its rejection of the *Corn Products* doctrine can most charitably be described as “sloppy.” First, the Court misstates the revenue act that was the genesis of the definition of “capital asset” even though the government’s brief correctly stated the act which first defined “capital assets” and as a result of this misstatement overlooks key evidence of the policy behind Congress’ determination of what that term encompassed. Then the Court quotes legislative history which, when read in context, can reasonably be interpreted to stand for something far different from the proposition for which the *Arkansas Best* Court was using it.

The above criticism of the Supreme Court’s opinion in *Arkansas Best* should not be interpreted as a ringing endorsement of the Supreme Court’s opinion in *Corn Products*. In that opinion the Court eschewed a literal reading of the statutory definition of “capital assets” in favor of a policy-oriented approach, when the same result in the case before it could have been reached by paying far more homage to the exact wording of governing statutory language. While the Court may have had valid reasons for taking a non-literal approach to the definition of “capital assets,” by unnecessarily doing so in deciding the case before it, the

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249 See supra text accompanying notes 150-54.
250 See supra notes 165-68 and accompanying text.
251 See supra notes 165-201 and accompanying text.
252 See supra text accompanying notes 207-19.
253 See supra notes 58-79 and accompanying text.
254 See supra notes 82-96 and accompanying text.
Court appeared to be placing its imprimatur upon one of Professor Brown’s great concerns, the brushing aside by courts of statutory formulations to do simply what they thought was right. With this imprimatur in place, it became quite easy for other courts to develop a judicially created exception to the statutory definition of “capital assets” separate and apart from (and totally unbounded by) the exceptions to the definition provided for by the statute itself.

While there may have been good policy justification for this judicially encrafted exception known as the “Corn Products doctrine,” its freedom from any statutory bounds led to the preclusion of capital asset status in an ever-expanding set of circumstances with no end in sight as to the type of transactions that might fall within the exception. The result was an administrative nightmare for the IRS in which a taxpayer could wait until a transaction ended to label it capital or ordinary depending upon whether it resulted in a gain or loss. If a transaction ended in a gain, the IRS would be lucky if it knew enough facts to challenge the taxpayer’s capital characterization at audit. If the transition ended in a loss, the taxpayer had the ever-expanding scope of the doctrine in his arsenal to defend his ordinary characterization from IRS attack. The result was a, “Heads I win, tails you lose,” proposition for the taxpayer, regardless of the merits of his case.

The taxpayer’s ability to whipsaw the government with the _Corn Products_ doctrine would have ended had Congress passed the 1976 proposal that would have required taxpayers, upon purchasing a particular asset, to file a notice with the IRS stating that an asset was being purchased for everyday business, rather than investment purposes, or be forever barred from claiming ordinary loss treatment on the disposition of the asset. Under this proposal a taxpayer who filed the notice would have been precluded from claiming capital treatment were the asset eventually disposed of at a gain, but the IRS would not have been precluded from challenging the ordinary characterization of a loss despite the filing of such a notice. The requirement of this notice, if properly administered by computer or otherwise, could have eliminated the...

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255 See _supra_ notes 33, 39 and accompanying text.
256 See _supra_ notes 100-05 and accompanying text.
257 See _supra_ notes 81, 238 and accompanying text. See also _supra_ note 52 and accompanying text (raising the question of whether Corn Products itself would have had its capital characterization of a gain transaction challenged had it not been red-flagged on an amended return).
258 See _supra_ note 241.
259 See _supra_ note 241.
whipsaw problem by making it impossible for taxpayers to wait to see
whether a transaction produced a gain or a loss, confident that gains
reported as capital would rarely, if ever, be challenged, let alone be
detected as inappropriate, in the audit process.

Perhaps Congress' failure to adopt a provision akin to that before it
in 1976 justifies the Court's taking matters into its own hands in Arkansas
Best when it became clear that the Corn Products doctrine was becoming
unworkable. Indeed, one could argue that inasmuch as the Court in Corn
Products made possible the administrative problem in the first place, it
was the Court's duty in Arkansas Best to undo, as best it could, the
damage it had done in Corn Products. In its effort to accomplish this
result, however, the Court gave us an opinion that does not withstand
scrutiny and indeed might not even resolve the administrative problem
Corn Products created.260

However, regardless of the flaws in both the Corn Products and
Arkansas Best opinions, they may simply represent the best we can
expect when a court must apply a narrowly-drafted statute to a fact
pattern that the policy evidenced by the statute indicates was unanticipat-
ed when the statute was drafted. Recognition of this problem thus leads

260 Inasmuch as the Court in Arkansas Best clearly noted the administrative problems
inherent in permitting corporate stock to be treated as anything other than a capital asset, see supra note 238 (quoting Arkansas Best, 485 U.S. at 222-23), and inasmuch as the Court prefaced this notation with the statement, "Arkansas Best, which is not a dealer in securities, has never suggested that the Bank stock falls within the inventory exclusion," Arkansas Best, 485 U.S. at 222, one could surmise that the Arkansas Best Court intended that corporate stock could only be treated as a non-capital asset under the inventory exception of I.R.C. § 1221(1) when it was held by a securities dealer. This inference is reinforced by the Arkansas Best Court's apparent rejection of Booth Newspapers, Inc. v. United States, 303 F.2d 916 (Ct. Cl. 1962). See Arkansas Best, 485 U.S. at 216 n.4, 222 n.7. Booth Newspapers, in firmly establishing the "source of supply" principle that first appeared in Western Wine and Liquor Co. v. Commissioner, see supra notes 87-93 and accompanying text, held that corporate stock in a paper company, purchased and held by a newspaper publisher only so long as was necessary to assure it of an adequate supply of newsprint during a paper shortage, was not a capital asset. Nonetheless, in 1991, more than three years after Arkansas Best was decided, the Claims Court in Circle K Corp. v. United States, 23 Cl. Ct. 665 (1991) determined that the "source of supply" principle survived Arkansas Best, cited Booth Newspapers with approval, and held that corporate stock in an oil company which was purchased by a convenience store chain that sold gasoline, to assure it of a gasoline supply during a gasoline shortage, qualified as a non-capital asset under the inventory exception of I.R.C. § 1221(1). Circle K Corp., 23 Cl. Ct. at 671-72. Regardless of whether one agrees with the Claims Court's interpretation of Arkansas Best in Circle K, it is clear from the Circle K case that the Arkansas Best Court did not fully succeed in its effort to resolve the administrative problem created by the Corn Products opinion.
to the question of how the statutory definition of a “capital asset” might better have been drafted to preclude the problem evident in the Corn Products and Arkansas Best opinions.

The statute could have been structured in the following manner. First, it could have provided a general rule stating: “The term ‘capital asset’ means investment property held by the taxpayer (whether or not connected with his trade or business).” This language is taken almost verbatim from current Code § 1221 with the limiting adjective “investment” being added. Second, the statute could have defined “investment property” as:

Property, transactions in which (regardless of whether ownership of that property by the taxpayer is partially or even wholly motivated by the desire for personal use or consumption by the taxpayer) are not integrally related to the everyday operations of the taxpayer’s trade or business and the profits and losses which those everyday operational transactions generate.

Third, the definition could have also contained a further refinement of the definition of “investment property” by providing:

Under no circumstances shall the term “investment property” include property held by the taxpayer for less than at least two years; or include stock in trade of the taxpayer or other property of a kind which would be properly included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business or property held in lieu of or as a substitute for any such property.

This refinement would have combined the original definition’s holding period with an expanded version of the exclusion now found in I.R.C. § 1221(1). As shall be noted shortly, the scope of this bright-line refinement of or exclusion from the definition of “investment property” could be expanded to correct egregious and longstanding errors by courts. In such a statute, the focus would have been on the policy behind the definition of “capital asset” with the brightline exclusions or

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262 See supra note 169 and accompanying text.
refinements providing guidance to courts when facing questions as to what other property holdings qualified as "investment property."

Finally, to preclude taxpayers from being able to whipsaw the government, as was the case under the *Corn Products* doctrine, the statutory definition could also have required the taxpayer to designate an asset as non-capital within thirty days of its purchase in order to avail himself of ordinary treatment should the asset be sold at a loss. This would, in effect, be an incorporation into the statute of the designation requirement that was proposed in 1976. Under this provision the IRS would not be precluded from contesting the non-capital characterization should a loss occur, but having once designated an asset as non-capital, the taxpayer would be forever barred from designating it as capital should a gain ensue on its disposition.

At first blush the foregoing suggestion might appear to lead to a more complex statute than the current definition of "capital asset." The brightline refinements of or exclusion from the definition of "investment property" could be deemed an invitation for Congress to expand the exclusions as time goes on. Ultimately, Congress might do just what this Article advocates against: make the list endless in an attempt to cover all conceivable transactions or property holdings. The suggestion for a brightline exclusion, however, is not such an invitation at all. It is merely a recognition that courts need legislative guidance, and even with it, do not always reach correct decisions. Furthermore, in a collaborative model of lawmaking that views law as "the product of public deliberation about political values," Congress must also have an opportunity to respond to errant court decisions.

The only brightline exclusion or refinement that would be appropriate in an initially promulgated statute is the one quoted above which combines the original holding period with an expanded version of current § 1221(1). Additional brightline exclusions or refinements such as those found in current § 1221(3) and (4) should be added by Congress only if needed to correct egregious errors by courts. Even if a court, or even the Supreme Court, initially reaches an incorrect conclusion with respect to an issue, Congress should not necessarily move quickly to correct the error. Rather, whenever appropriate, the issue should be permitted to percolate for some time in the court system. This percolation gives courts

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264 See supra notes 258-59 and accompanying text.
265 See supra notes 258-59 and accompanying text.
266 See supra note 23 and accompanying text.
time to take into account various ways in which the issue in question can arise and how best to deal with an earlier errant court decision. Percolation such as this enabled the Supreme Court in *Tufts* to correct an earlier errant footnote it had dropped in the *Crane* case regarding amount realized when the principal amount of an assumed mortgage exceeds the fair market value of the mortgaged property at the time of mortgage assumption and transfer of the property. Congressional intervention on the issue in *Tufts* might well have added a complex Code provision that did not resolve the *Tufts* issue any better than did the *Tufts* Court.

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259 Crane v. Commissioner, 331 U.S. 1, 14 n.37 (1947).
270 In *Crane*, the taxpayer sold certain property which was encumbered by a non-recourse mortgage of approximately $255,000. The buyer accepted the property subject to the mortgage and transferred $2500 cash to the taxpayer/seller net of selling costs. *Id.* at 3-4. Thus, the buyer and seller must have agreed that the property was worth more than the amount of the mortgage encumbering it. Otherwise, no cash would have been paid to the seller when the property was accepted subject to the mortgage. The *Crane* Court held that the amount realized by the taxpayer on the sale included the $255,000 mortgage amount to which the property was subject as well as the $2500 in cash netted on the sale. *Id.* at 13-14. The *Crane* Court then added in its infamous footnote:

> 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.

*Id.* at 14 n.37. In *Tufts*, the Court corrected the erroneous impression it left in *Crane* that the *Crane* rule might not apply when the amount of the mortgage outstanding exceeds the fair market value of the property on the date of the sale. The *Tufts* Court clearly held that when property is sold or otherwise transferred subject to an outstanding mortgage, the full amount of the mortgage outstanding is included in the amount realized, regardless of whether the fair market value of the property exceeds, is equal to, or is less than the amount outstanding on the mortgage. *Tufts*, 461 U.S. at 317.

271 The author is indebted to Professor Bernard Wolfman, Fessenden Professor at the Harvard Law School, for remarks suggesting that *Tufts* correction of the implications left by the *Crane* footnote and Commissioner v. Glenshaw Glass Co.'s, 348 U.S. 426 (1955), correction of the impression left by Biner v. Macomber, 252 U.S. 189 (1920), regarding the definition of income, see infra notes 274-81 and accompanying text, are examples of how percolation through the court system can correct earlier judicial missteps better than can a detailed legislative response. For Professor Wolfman's remarks, see Tape of Session on Formation of Tax Policy, held by the Taxation Section of the American Bar Association (May 15, 1992) (Cassette #1, Side 2, on file with author). For a very recent article that is apparently sympathetic to the views espoused in this Article and by Professor Wolfman, see James W. Colliton, *Standards, Rules and the Decline of the Courts in the Law of Taxation*, 99 DICK. L. REV. 265, 312-14 (1995) (lamenting tax statutes that deny courts the flexibility necessary to reach the best result in each case by
Even with this cautionary note, Congress might choose to add brightline exclusions to the definition of "investment property" until the list exceeds those now found in I.R.C. § 1221. However, as long as the exclusions remain faithful to and consonant with the underlying policy focus of the definition of "investment property," the length of the list of exclusions should not constitute, in and of itself, cause for concern. The mere length of a list of exclusions (or inclusions) does not by itself make a statutory provision complex. I.R.C. § 61(a) in defining "gross income" contains fifteen brightline inclusions; yet it is doubtful that it has ever been described as a complex provision. It is simply one that has provided a collaborative role for the courts to play in defining the term "gross income," while simultaneously containing helpful brightlines to guide the courts in their collaborative mission.

Indeed, the development of the definition of "gross income" through Supreme Court litigation provides a perfect example of how percolation of an issue through the court system can result in the correction of earlier judicial missteps by the Court through well-reasoned opinions when the statute itself leaves room for a collaborative role for the judiciary to play. In 1920, the Court in *Eisner v. Macomber*, in interpreting a predece-
sor to current § 61(a) that was similarly structured to § 61(a)\textsuperscript{275} defined income as "'the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets."\textsuperscript{276} Such a limited definition would exclude from income clear accretions to wealth such as windfalls and punitive damage awards. Some thirty-five years later the Court recognized that the \textit{Eisner v. Macomber} definition of income was too limited in scope and in \textit{Commissioner v. Glenshaw Glass Co.}\textsuperscript{277} effectively redefined "income" to mean "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."\textsuperscript{278}

With this redefinition, the Court corrected its earlier mistake in \textit{Eisner v. Macomber} and brought the definition of "income" in line with the theoretically pure Haig-Simons definition of "income."\textsuperscript{279} To accomplish this definitional change, the Court noted that it had already taxed "the fortuitous gain accruing to a lessor by reason of the forfeiture of a lessee's improvements on the rented property . . . ."\textsuperscript{280} Then it added that the \textit{Eisner v. Macomber} definition of income served a useful purpose in that particular case so as to distinguish gain from capital, "[b]ut it was not meant to provide a touchstone to all future gross income questions."\textsuperscript{281} Thus, the Court was able to correct its earlier misstep without the distortion of precedent, statutory language, and legislative history that resulted when the \textit{Arkansas Best} Court tried to correct the excesses that grew out of the \textit{Corn Products} doctrine. Were more statutory provisions drafted in a collaborative vein as this Article suggests for the statutory

\textsuperscript{275} The predecessor to current I.R.C. § 61(a) which was interpreted in \textit{Eisner v. Macomber} was § 2(a) of the Revenue Act of 1916, ch. 463, 39 Stat. 756, 757 (1916). See \textit{Eisner v. Macomber}, 252 U.S. at 200 n.1 (1920). That section provided, in pertinent part: That, subject only to such exemptions and deductions as are hereinafter allowed, \textit{the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid}, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or \textit{gains or profits and income derived from any source whatever . . . .}


\textsuperscript{276} 252 U.S. at 207.

\textsuperscript{277} 348 U.S. 426 (1955).

\textsuperscript{278} \textit{Id.} at 431.

\textsuperscript{279} \textit{See supra} note 194.

\textsuperscript{280} 348 U.S. at 430 (citing Helvering v. Bruun, 309 U.S. 461 (1940)).

\textsuperscript{281} \textit{Id.} at 431.
definition of "capital asset," perhaps we could have more well-crafted and principled opinions like *Glenshaw Glass* and fewer distressing opinions like *Arkansas Best* and *Corn Products*.

This collaborative approach to statutory drafting might not, however, sit well with the practicing bar and their tax clients. Clients often wish to know the tax consequences of a transaction before deciding to go through with it. As a result, they often pressure their tax counsel to advise them of the tax consequences of a contemplated transaction. Naturally, tax counsel, when placed under such pressure from a client, feel far more comfortable when they can answer each client's question by pointing to statutory language that directly covers that client's anticipated transaction.

Nonetheless, even in today's world, where tax statutes are not drafted in the collaborative manner advocated by this Article and attempts are made in legislation to cover a wide array of specific transactions, tax counsel still cannot answer all clients' questions with certainty. Often, the only way a client can be made sufficiently comfortable is to obtain a ruling from the IRS before the contemplated transaction is entered into. Were the collaborative approach to statutory drafting advocated by this Article adopted, concededly there would be even less certainty as to the tax consequences of anticipated transactions. Yet the diminishment of certainty in result is a cost worth paying to obtain the flexibility in administration and public deliberation of values among governmental branches that would flow from a collaborative system of statutory drafting. To argue otherwise requires arguing that our legal system should provide greater certainty of result to citizens facing tax issues than it grants to citizens facing other legal issues.

On two occasions this author has taken refuge from the complexities of the Internal Revenue Code to write in the area of antitrust. Anti-trust is certainly an area of the law that has a significant impact upon the planning and effectuation of commercial transactions. Not only can a

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228 See supra note 23 and accompanying text.

229 See Myron C. Grauer, Recognition of the National Football League as a Single Entity Under Section 1 of the Sherman Act: Implications of the Consumer Welfare Model, 82 Mich. L. Rev. 1 (1983) (contending that NFL teams should be deemed legally incapable of conspiring with one another in violation of § 1 of the Sherman Act because they should not be deemed separate entities for Sherman Act purposes); Myron C. Grauer, The Use and Misuse of the Term "Consumer Welfare": Once More to the Mat on the Issue of Single Entity Status for Sports Leagues Under Section 1 of the Sherman Act, 64 Tul. L. Rev. 71 (1989) [hereinafter Grauer, The Use and Misuse] (elaborating upon why single entity status should be granted to sports leagues because they produce a product that each league team could not produce on its own).
violation of the antitrust laws result in criminal liability,284 but victims of antitrust violations may also recover from the perpetrators three times the damages they incur.285 Indeed, this treble damage provision can induce private litigants to convert mere contract claims into antitrust actions even in situations where such conversions are not warranted by

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284 The basic criminal provisions of the antitrust laws are found in §§ 1-3 of the Sherman Act, which provide as follows:

§ 1. Trusts, etc., in restraint of trade illegal; penalty
Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000 or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 2. Monopolizing trade a felony; penalty
Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000 or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 3. Trusts in Territories or District of Columbia illegal; combination a felony
Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.


285 Section 4 of the Clayton Act provides in pertinent part:

[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

Id. § 15 (1988).
sound antitrust policy.286 As a result, the fear of defending against both criminal sanctions and treble damages under the antitrust laws could very well inhibit the consummation of perfectly legal business transactions even more than could uncertainty as to the tax consequences of any such transactions.

Although it is naive to think that the IRS can ignore revenue implications in evaluating the tax ramifications of any business or other transaction, the IRS must temper its desire for revenue in evaluating transactions with the recognition that if it is not perceived as fair and even-handed, its legitimacy will be undermined and our voluntary compliance system could suffer. Similar constraints, however, do not exist to inhibit a private plaintiff from fashioning a novel claim for treble damages under the antitrust laws.

Given this state of affairs, one might expect statutory specificity in the antitrust laws to exceed that found in the tax code so that the in terrorem effect of the threat of both criminal sanctions and treble damages would be counterbalanced by a high degree of certainty under the law. The opposite, however, is in fact the case. Section 1 of the Sherman Act simply outlaws "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . ."287 Section 2 of the Sherman Act in similarly broad language provides, in pertinent part, that "[e]very person who shall monopolize, or attempt to monopolize, . . . any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ."288 Perhaps even broader language is found in § 5 of the Federal Trade Commission Act which outlaws "unfair methods of competition."289 Determination of the parameters of each of these broadly worded sections has been left to the courts, and attorneys for business persons must advise their clients about the legality of proposed transactions based upon their review of judge-made law, much of which has been highly criticized.290 Although mechanisms do exist for obtaining advance rulings from the Justice Department and the Federal Trade Commission as to the legality of proposed transactions, so comparatively

286 See, e.g., Grauer, The Use and Misuse, supra note 283, at 87-88.
287 See supra note 284.
288 See supra note 284.
289 See supra note 284.
290 See supra note 284.
287 See supra note 284.
few rulings are ever issued that these mechanisms cannot be at all equated with the ruling mechanism available from the IRS and the comfort level that the tax ruling mechanism can thus provide. 291

291 The Justice Department is not authorized to give advisory opinions to private parties. Nonetheless, under certain circumstances the Department of Justice will issue what is known as a “Business Review Letter” indicating its present position with respect to enforcement regarding a proposed business transaction. See generally 28 C.F.R. § 50.6 (1995). Although the Justice Department remains free to change its enforcement position at a later date with respect to a transaction to which it has already issued a Business Review Letter, it has never done so when the party requesting the letter fully and truly disclosed all material and relevant facts in requesting the letter. See id. § 50.6(9). In 1987, thirty-two Business Review Letters were issued; in 1988, eighteen; in 1989, fifteen; in 1990, nine; in 1991, seven; and in 1992, ten were issued. ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, TEN-YEAR WORKLOAD STATISTICS 1 (1993).

The Federal Trade Commission in very limited circumstances will issue an advisory opinion with regard to a proposed business activity. See generally FTC Procedures and Rules of Practice, 16 C.F.R. §§ 1.1-1.4 (1995) [hereinafter FTC Rules]. For a formal advisory opinion to be given by the Commission, the matter must either involve “a substantial or novel question of fact or law and there . . . [must be] . . . no clear Commission or court precedent” or the matter must be “of significant public interest.” Id. § 1.1. According to Benjamin I. Berman, approximately one such formal opinion letter is issued in the antitrust area in a six-year period. Telephone interview with Benjamin I. Berman, Attorney Advisor to the Secretary of the Federal Trade Commission (Aug. 24, 1992). Additionally, the staff of the FTC may informally render advice where a formal advisory opinion would not be appropriate. See FTC Rules, supra, § 1.1(b). According to Mr. Berman, these staff advisory letters are not formally compiled, but FTC records indicate that in the antitrust area: in 1987, seven staff advisory letters were issued; in 1988, five were issued; in 1989, three were issued; in 1990, three were issued; in 1991, zero were issued; and through August 23, 1992, two were issued. Telephone interview with Benjamin I. Berman, Attorney Advisor to the Secretary of the Federal Trade Commission (Aug. 24, 1992). The comfort level provided by these staff advisory letters is not very great. FTC Rules, supra, § 1.3(c), provide: “Advice rendered by the staff is without prejudice to the right of the Commission later to rescind the advice and, where appropriate, to commence an enforcement proceeding.” On the other hand, in those very rare cases where a formal advisory opinion is given by the Commission, “[T]he Commission will not proceed against the requesting party with respect to any action taken in good faith reliance upon the Commission’s advice, . . . where all the relevant facts were fully, completely, and accurately presented to the Commission and where such action was promptly discontinued upon notification of rescission [sic] or revocation of the Commission’s approval.” Id. § 1.3(b).

With respect to tax issues, § 7805 of the Internal Revenue Code, I.R.C. § 7805 (West Supp. 1995), grants broad authority to the Treasury Department and thus the IRS to issue rules, regulations, and rulings. Generally speaking, the National Office of the IRS will issue an advance letter ruling to a taxpayer in any one of a number of circumstances, so long as the issue in question is not currently being examined by the IRS for an earlier year with respect to that taxpayer and so long as the return for the year in question has not yet been filed. See generally Rev. Proc. 95-1, §§ 3, 5, 1995-1 I.R.B. 9, 15-21. A
Nonetheless, despite the far lower degree of certainty and predictability of results available in the antitrust field than is available in the tax field and the draconian consequences that can flow from an adverse antitrust judgment, the structure of our antitrust statutes and the collaborative role that they provide for the courts in the development of the law has not had a crippling effect on the American economy.

The point of this comparison of the structure of our tax statutes to the structure of our antitrust statutes is not, however, to justify going to a system of tax statutes as broadly worded as the antitrust statutes are. Rather, this comparison has a more modest goal. It is simply to demonstrate the questionable nature of any claim for granting citizens facing tax issues the degree of certainty of result that tax statutes drafted in an attempt to cover all anticipated situations seek to attain. If our economic system can survive very broadly drafted antitrust statutes with the collaborative role that they provide for the courts in the development of the law, any predictions of dire consequences that would result from less tightly drafted tax statutes must be taken with quite a few grains of salt.

The exact degree of complexity or detail that should be contained in a tax statute, of course, cannot be subject to any hard and fast rule. As the approach to defining "capital asset" suggested in this Article indicates, the detail and complexity appropriate for tax statutes can be and should be greater than that currently found in the antitrust laws. What is

"ruling" is defined as, "a written statement issued to a taxpayer or his authorized representative by the National Office which interprets and applies the tax laws to a specific set of facts." 26 C.F.R. § 601.201(a)(2) (1995). See also Rev. Proc. 95-1, § 1.01, 1995-1 I.R.B. 9, 13 for a similar definition of "letter ruling." Although a letter ruling may be revoked or modified unless it is accompanied by a "closing agreement," id., any "revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued," 26 C.F.R. § 601.201(b)(6) (1995), so long as: "(1) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was issued with respect to a prospective or proposed transaction, and (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment." Id. In 1987, the IRS issued 4161 Letter Rulings; in 1988, 3977 Letter Rulings were issued; in 1989, 4121 were issued; in 1990, 3372; in 1991, 2643; and in 1992, 2408 Letter Rulings were issued. Search of LEXIS, Fedtax Library, PLR file (Aug. 23, 1993). One certainly can argue that far more transactions involve tax implications than involve antitrust implications. Nonetheless, given the great disparity in the number of advance rulings given in each area and the disparity in the circumstances under which advance rulings can and will be given, persons facing legal questions in the antitrust area usually must act without the assurances that persons facing tax questions can obtain.
important is not that all detail be eliminated from the Internal Revenue Code but rather that such detail be present only as needed to assist the judiciary in fulfilling its collaborative function in the development of our tax law. When the detail goes beyond that and attempts to cover all contingencies, the judiciary cannot perform its collaborative function in a principled manner, and unfortunate sagas such as the Corn Products/Arkansas Best story will inevitably become part of our tax culture.