Can the Treasury Exempt its Own Companies from Tax? The $45 Billion GM NOL Carryforward

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Abstract: To discourage firms from buying and selling tax deductions, Sec. 382 of the tax code limits the ability of one firm to use the "net operating losses" (NOL's) of another firm that it acquires. Under the Troubled Asset Relief Program (TARP), the Treasury lent a large amount of money to GM. In bankruptcy, it then transformed the debt into stock.

GM did not make many cars anyone wanted to buy, but it did have $45 billion in NOL's. Unfortunately for the Treasury, if it now sold the stock it acquired in bankruptcy it would trigger Sec. 382. Foreseeing this, the market would pay much less for its stock in GM.

Treasury solved this problem by issuing a series of "Notices" in which it announced that the law did not apply to itself. Sec. 382 says that the NOL limits apply when a firm's ownership changes. That rule would not apply to any firm bought with TARP funds, declared Treasury. Notwithstanding the straightforward and all-inclusive statutory language, GM could use its NOL's in full after Treasury sold out. The Treasury issued similar Notices about Citigroup and AIG.

Treasury had no legal or economic justification for any of these Notices, but the press did not notice. Precisely because they involved such arcane provisions of the corporate tax code, they largely escaped public attention. The losses were not minor -- they cost the country billions of dollars in tax revenue. That the effect could be so large and yet so hidden illustrates the risk involved in this kind of tax manipulation. The more difficult the tax rule, the more easily the government can use it to hide the cost of its policies and subsidize favored groups. We suggest that Congress give its members standing to challenge unlegislated tax law changes in court.

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"Dona clandestina sunt semper suspiciosa"[1]

I. Introduction

A. The Transaction:

Year after year, General Motors lost money -- enormous sums of money. It designed cars. It built cars. But no one wanted to buy the cars. Over time, it accumulated huge operating losses ("net operating losses," or NOL's). The tax code let GM carry forward these NOL's into the future. It let the firm save the losses for that day in the future when it would once again sell cars that people wanted.[2]

The day never came. Instead, in June 2009 GM (call it "Old GM") declared bankruptcy. It filed under Chapter 11 of the Bankruptcy Code and sold its assets to a new shell ("New GM") in a transaction governed by Sec. 363 of the Code. Old GM's shareholders lost their investment. They did not receive stock in New GM. Instead, Old GM's creditors become the New GM's stockholders: the U.S. Treasury (with 61%), the auto unions, and Canada swapped debt claims against Old GM for equity stakes in New GM. Other Old GM creditors acquired a 10 percent stake in New GM as well. In the fall of 2010, the Treasury re-sold a large amount of its New GM shares to the public, cutting its share to 26%.

New GM has the factories, offices, designs and some of the workers that Old GM had. It also acquired some 18 billion dollars worth of its NOL's.[3] It could not use them to

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[1] "Secret gifts are often suspicious." Sir Edward Coke, *Twyne's Case*, 3 Coke, 80 b. (Star Chamber, 1602), in Evans Holbrook & Ralph William Aigler, Cases on the Law of Bankruptcy: Including the Law of Fraudulent Conveyances 153-157 (1915), Google Books (books.google.com/). *Twyne's Case* was about a fraudulent conveyance by an insolvent debtor to a friendly creditor. Another passage from the case will be apt when we consider the relationship between statute and regulation:

"To one who marvelled what should be the reason that Acts and statutes are continually made at every Parliament without intermission, and without end; a wise man made a good and short answer, both of which are well composed in verse.

Quaeritur, ut crescitunt tot magna volumina legis?

In promptu causa est, orescit in orbe dolu

[In our inexpert translation: "It might be asked why such a large amount of laws grows? The basic reason is that the world's evil has grown."] And because fraud and deceit abound in these days more than in former times, it was resolved in this case by the whole Court, that all statutes made against fraud should be liberally and beneficially expounded to suppress the fraud."

[2] We simplify, of course. GM's problems were legion, not just bad design. See, for example,"Detroit's Downturn: It's the Productivity, Stupid: Union Work Rules Make It Almost Impossible for the Big Three To Keep Up with Foreign Competitors." *PajamasMedia*, December 16, 2008 (pajamasmedia.com/blog/detroits-downturn-its-the-productivity-stupid/).

[3] The losses themselves were $45 billion; their book value as an asset is listed as $18 billion. We will use the figure $18 billion even though it is too high because standard accounting rules for tax assets are absurdly inaccurate. They are inaccurate for two reasons. First, GAAP requires companies to not discount for the time value of money. If a company expects to save $1 million in taxes in 16 years using deferred tax losses, it records that as a current tax asset worth $1 million, even though the present discounted value (at 5% interest)

reduce its tax liability immediately, since it was losing money. But in 2010 New GM did turn a profit, and presumably will use its NOL's to avoid corporate income tax on that profit.[4]

Ordinarily, when one company buys another's assets, it does not acquire its tax losses too. But the sale from Old GM to New GM qualified as a tax-free "reorganization" under Sec. 368 of the tax code: neither Old GM nor New GM incurred a tax liability, New GM entered Old GM's assets on its books with Old GM's "adjusted basis," and New GM acquired Old GM's NOL's.

The problem involved Treasury's plans to sell the shares it took in New GM. If the combined equity stake of any group of shareholders in a "loss corporation" like New GM climbs by more than 50 percentage points, Sec. 382 of the tax code limits the firm's ability to use those accumulated NOL's. Given Treasury's large stake in New GM, if it sold its entire stake to the public, those new owners would raise their combined interest by 50 points. New GM would then lose its ability to avoid taxes on future income.

To solve this "problem," the Treasury issued a series of "Notices." The Sec. 382 rules, it declared, would not apply to itself. When it sold its shares in New GM, the new owners might increase their ownership stake by 50 percentage points, but they would not trigger the Sec. 382 limits. The tax code offered no exception for government-owned shares, and the Treasury did not purport to find one. Instead, it just declared that the law did not apply.[5]

The Notices also apply to two other companies, AIG and Citigroup. Both of these companies had ownership changes over 50% as a result of TARP and would ordinarily, as in bankruptcy, lose their NOL's. If they retain them, that reduces the apparent (but not real) cost of the bailout because the government can resell its shares at a higher price.

Through these Notices, Treasury accomplished two highly political goals: (a) it disguised (by billions of dollars) the true cost of the bail-outs of GM and other firms, and (b) it routed funds (again, several billion dollars) to the Administration's supporters at the UAW. Ordinarily, if an Administration wildly misstates the cost of its policies or routes public funds to its friends, the press notices and complains. In this case, it did not. The press missed the manipulation precisely because it involved such a complex and highly arcane provision of the tax code. The more obscure the law, in other words, the greater the risk of political manipulation: precisely because its strategy involved such an obstruse corner of the law, the Administration was able to hide its politicized policies from the public.

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is only $458,000. Second, even if there is a good chance that the company will never make a profit again, it records the full amount if "it is more likely than not" that the company will someday make enough profit. Thus, if the company just mentioned estimated that its chances of failure before 16 years from now was a mere 49%, it would still record the $1 million as $1 million, not $510,000 or $233,580. For a critical view of this rule see "Deferred Income Taxes Should be Put to Rest." *SmartPros*, J. Edward Ketz (accounting.smartpros.com/x68912.xml) (March 2010).

[4] "Resurgent G.M. Posts 2010 Profit of $4.7 Billion," New York Times, February 4, 2011 (www.nytimes.com/2011/02/25/business/25auto.html).

[5] The last was: Internal Revenue Service Notice 2010-2, "Application of Section 382 to Corporations Whose Instruments are Acquired and Disposed of by the Treasury Department under Certain Programs Pursuant to the Emergency Economic Stabilization Act of 2008," 2010-2 I.R.B. 251 (www.irs.gov/irb/2010-02_IRB/ar09.html).

We do not address the wisdom of the bailouts themselves. Neither do we ask whether firms should be able to carry forward operating losses, whether they should be able to reorganize tax-free, or why the United States has a corporate income tax at all.[6] These are all interesting questions, but we have quite enough to do addressing the topic of selective tax relief through executive decree. Rather than explore these larger questions, we focus on the propriety of the Treasury's manufacturing a tax break to distribute and hide government largesse. More generally, we focus on the wisdom of giving a President the ability to invent a tax deduction for his political supporters without a need to answer to the courts or Congress.

B. The Bad Man and the Law:

Recall Holmes's description of the law as being the prediction of the "Bad Man" about whether a judge would stop him:

> If you want to know the law and nothing else, you must look at it as a bad man [would look at it, a man] ... who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience. ... If we take the view of our friend the bad man we shall find that he does not care two straws for the axioms or deductions, but that he does want to know what the Massachusetts or English courts are likely to do in fact. I am much of this mind. The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law. [Holmes (1897)]

If a President is Holmes's Good Man, he will obey the Constitution because it is the Constitution. The Treasury gave General Motors an illegal tax break. As a Good Man, he will read our article, feel remorse, and fire everyone involved.

If a President is Holmes's Bad Man, on the other hand --- and public choice theory suggests that it is Bad Men who have the best chance of being elected --- he will obey the Constitution only when a court can make him obey it.[7] If he hears of our article, he will ignore it. As a lawyer, he knows that nobody has standing to challenge someone else's tax benefits in court. Thus, his "prophecy about

what a court will do" is easy: Nothing. The courts will reject any challenge for lack of standing, whatever the merits of a claim might be.

Only potential bad publicity would worry a Bad Man President. But publicity he can skirt by giving the funds through opaque provisions of the tax code. Publicity he can skirt by (take a deep breath) declaring an exemption from the application of Sec. 382 of the tax

[6] Two recent articles on the incidence and distortions due to the corporate income tax are Harberger(2006) and Kotlikoff & Miao(2010). Auerbach, Devereux & Simpson (2010) survey the pro's and con's of corporate income taxes and the various ways to structure them. Their unavoidable complexity, of which the present paper's subject is just one example, is one strong argument against corporate income taxes.

[7] A politician who upholds his personal principles and resists the will of the median voter or leave untouched the less honorable tools of political competition will, *ceteris paribus*, lose votes and lose elections. For more explanation, see Ramseyer (1995).

code to limits on carryforwards of NOL's following a sale under Sec. 363 of the Bankruptcy Code that uses preferred stock, credit bidding, and warrants by one company named GM to a different company also named GM. If the administration gave a billion dollars in cash to its supporters the press would notice. If it gives it through the obscure details of the corporate tax code, the press will fall asleep.

In the article that follows, we explain the intricacies of the tax break (Sec. II). We discuss the law involved (Sec. III). If you think all Presidents are Good Men, you may stop reading at that point. After all, following the Constitution is just a matter of understanding it. We explain it, you understand it, end of story. Lest some Presidents be Bad Men, however, we conclude by exploring procedural reforms Congress might adopt to prevent a recurrence of what happened with GM.

II. What Happened

A. The Detail:

General Motors was a public corporation with much unsecured debt, including $21 billion it owed to the UAW Trust on behalf of retired workers and $27 billion it owed to bondholders. None of these stakeholders was senior enough to see much return if the company liquidated in pieces. Probably, none would see much return even if the firm found a buyer for the whole company.

The senior creditors were a diverse lot. The U.S. Treasury had a secured interest in $19.4 billion from TARP loans, and $30.1 billion in other loans. The Canadian government held secured claims of $9.2 billion. Government senior debt thus totalled $58.7 billion. Private creditors held another $5.9 billion in secured loans.

GM filed for bankruptcy under Chapter 11 of the Bankruptcy Code. To restructure its finances, it then negotiated a sale under Sec. 363 of the Code. For this transaction, it formed a new shell, New GM. It (Old GM) then sold its assets to New GM. In exchange for its $21 billion unsecured debt to Old GM, the UAW Trust received 17.5 percent of the common stock of New GM, $6.5 billion in preferred stock, and $2.5 billion in debt. In exchange for their $27 billion unsecured debt, the other junior creditors received 10 percent of the common stock of New GM and warrants for another 15 percent. The private secured creditors (the $5.9 billion claim) were paid in full. The Canadian government received 12 percent of the New GM common stock, and the U.S. Treasury received interests detailed shortly below.

To consider the stakes involved, note that in December 2010 New GM had stock worth $54.4 billion and liabilities of $12.9 billion,[8] for a total asset value of $67.3 billion. In effect, the sale price in the 363 offer was: (a) $58.7 billion in senior credit claims, (b) $5.9 billion paid to private secured creditors, (c) $5.4 billion in stock (10 percent of $54.4 billion),

[8] CreditSuisse, General Motors Co, Christopher J. Ceraso, Robert Moffatt, and Shreyas Pati (Dec. 28, 2010).

and (d) a portfolio of harder-to-value warrants. This yields a total of $67 billion plus warrants.[9]

Apparently, the 363-sale buyers paid $67 billion plus the warrant value for assets worth $67.3 billion. That seems a remarkably high price, considering that no other bidder loomed on the horizon. The bankruptcy judge deserves praise for extracting so much value for Old GM's creditors.

This $67.3 billion in asset value is not the net benefit to the 363-sale buyers or the senior creditors, however. That benefit depends on who owns the New GM equity and debt. Old GM's private secured creditors received $5.9 billion in cash for their $5.9 billion in debt. The Canadian government gave up its $9.2 billion in Old GM debt, but took a 12% stake in the common (stock worth .12(54.4)= $6.5 billion) plus $0.4 billion in preferred stock and $1.3 billion in debt in New GM -- for a total value of $8.2 billion.

The most glaring anomaly involved the UAW. The union's trust gave up <u>un</u>secured claims of $21 billion and received:

(i) 17.5% of the stock of New GM worth .175*54.4 = $9.5 billion,
(ii) $6.5 billion in preferred stock, and
(iii) $2.5 billion in debt,

for a total of $18.5 billion. Given that the UAW trust had been a junior creditor, this was a very good deal. By contrast, the other unsecured creditors gave up claims of $27 billion, and received only 10 percent of the common stock and warrants.

Recall that the U.S. Treasury held secured debt totalling $49.5 billion. In exchange for its claims, it took 61 percent of the stock in New GM (stock worth .61($54.4 billion) = $33.2 billion), $2.1 billion in preferred stock, and a $6.7 billion debt claim against New GM. All told, it received compensation of $42 billion.

Focus on the U.S. government. Through the Sec. 363 sale, it -- apparently -- lost ($49.5 billion - $42 billion =) $7.5 billion. Anyone who loses only ($7.5 billion/$49.5 billion) = 15 percent on a $49.5 billion loan to a failing firm does well indeed. Yet appearances deceive. The government also gave GM investors $45 billion in NOL's. If the 363 sale had not gone through, or the sale had been made to some outside buyer, these NOL's would have disappeared. The book value of these NOL's is $18 billion.

To be sure, Treasury was giving tax breaks partly to itself, and the book value of the NOLs exceeds their market value since it would take some years before GM could exhaust them. If the market value of the NOL's were, say, $12 billion (a little under the estimate of the stock analysts that we cite in Section B below), then that $12 billion was incorporated into the $54.4 billion equity value of the New GM, and we have overestimated the overall

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[9] Data in these paragraphs is from Warburton (2010), p. 536.

value of the deal for the Treasury. Of its $33.2 billion in stock, 7.32 (=.61(12)) was a tax gift to itself.

More simply, consider the $12 billion worth of NOL's an additional loss to the Treasury. In effect, the Treasury lent GM $49.5 billion, and lost ($7.5 billion + $12 billion)/$49.5 billion = 39 percent. If only Treasury could have inserted a further secret $20 billion of assets into New GM, New GM's stock price would have been so high that Treasury would have appeared to make a profit from the entire affair.

B. As GM Told it:

Here is how GM describes its tax situation:[10]

> … We recorded valuation allowances against certain of our deferred tax assets, which under ASC 852 also resulted in goodwill.[11]…
>
> In July 2009 with U.S. parent company liquidity concerns resolved in connection with the Chapter 11 Proceedings and the 363 Sale, to the extent there was no other significant negative evidence, we concluded that it is more likely than not that we would realize the deferred tax assets in jurisdictions not in three-year adjusted cumulative loss positions.
>
> Refer to Note 22 to our audited consolidated financial statements for additional information on the recording of valuation allowances.[12]

The following table summarizes the components of temporary differences and carryforwards that give rise to deferred tax assets and liabilities (dollars in millions):

	Successor		Predecessor	
	December 31, 2009 Deferred Tax		December 31, 2008 Deferred Tax	
	Assets	Liabilities	Assets	Liabilities
Postretirement benefits other than pensions	$ 4,194	$ —	$ 11,610	$ —
Pension and other employee benefit plans	8,876	406	16,171	8,648
Warranties, dealer and customer allowances, claims and discounts	3,940	75	6,682	90
Property, plants and equipment	7,709	278	7,429	3,197
Intangible assets	1,650	4,984	780	—
Tax carryforwards	18,880	—	18,080	—
Miscellaneous U.S.	5,844	1,269	8,122	288
Miscellaneous non-U.S.	3,306	1,944	3,485	773
Subtotal	54,399	8,956	72,359	12,996
Valuation allowances	(45,281)	—	(59,777)	—
Total deferred taxes	9,118	$8,956	12,582	$12,996
Net deferred tax assets (liabilities)	$ 162		$ (414)	

[10] Amendment No. 2 to Form S-1 Registration Statement under The Securities Act of 1933 General Motors Company, http://www.gm.com/vehicles/results.jsp?useFlash=N.

[11] Amendment No. 2 to Form S-1 Registration Statement under The Securities Act of 1933 General Motors Company, http://www.gm.com/vehicles/results.jsp?useFlash=N. p. 82.

[12] Amendment No. 2 to Form S-1 Registration Statement under The Securities Act of 1933 General Motors Company, http://www.gm.com/vehicles/results.jsp?useFlash=N. p.138.

The table above from New GM's securities filings (page F-121 of its Form 8-K) shows that New GM claimed to inherit over $18 billion in tax carryforwards from Old GM.[13] Stock analysts wrote:

> We calculate an NPV of GM's deferred tax assets at $17.2bn of which $4bn is related to pension contributions and more than $13bn related to accumulated NOL's and tax credits including R&D credits.[14]

and

> Via a special regulation, GM's highly valuable US tax assets (worth $18.9B in the US at 09-end) were left intact…. Our Dec-2011 price target assumes a present value of $12.4B of (2011-ending) non-European global tax assets…. Present-valuing the $18.6B face value figure using a 12% discount rate (Ford is 8%; we use 12% for GM to reflect the lower mix of debt in its cap structure), we arrive at a PV for global economic tax assets ex. Europe of $12.4B at 2011-end.[15]

Thus, stock analysts were well aware of the existence and value of the NOL's, though they estimated their economic value at lower than their accounting value. This is an important element of the political economy of the situation. It was crucial both that the general public not realize that New GM's value was inflated by the taxes that the Treasury had agreed in advance to forgive, and that stock analysts did understand it. If the analysts missed the point, then when the government sold its GM stock, it would have received a much lower price. It would have given away government revenue, but without disguising the cost of its bail-out, approximately halving it from $24 billion to $12 billion.[16]

C. Other Firms:

Although we focus on GM, Treasury gave legally unauthorized NOL's to two other firms as well. As with GM, it did this by issuing TARP-specific "Notices" about the availability of NOL's. Citigroup, for example, claimed "tax assets" of $46.1 billion at the end of 2009.

In June 2009, Citigroup and the Treasury agreed to exchange the government's preferred stock for common stock. The government acquired a 33.6% ownership stake. In December 2009, Citigroup raised $20.3 billion by issuing about 24% new common stock so Citigroup had passed the threshold for a 50% ownership change. In 2010, Treasury sold all of its 7.7

[13] Not all these tax carryforwards were necessarily NOL's, strictly speaking. They may also include "built-in losses" on assets that declined in value and unused tax credits.

[14] General Motors Re-In-Car-Nation, Morgan Stanley, December 28, 2010.

[15] General Motors Overweight GM, GM US Reborn, High Octane SAAR and Product Play; Initiate with Overweight, J.P. Morgan, (Dec. 28, 2010).

[16] At the June 2011 market price of $29.97 per share, the government would lose $12 billion on the GM rescue if we exclude the Section 382 losses. See "GM Stock Sag Weighs on U.S. Exit." The Wall Street Journal, June 23, 2011, p. B2.

billion shares of common stock for $31.85 billion, a gain of $6.85 billion. According to Citigroup:

> The common stock issued pursuant to the exchange offers in July 2009, and the common stock and tangible equity units issued in December 2009 as part of Citigroup's TARP repayment, did not result in an ownership change under the Code.[17]

By "ownership change," it referred to the Sec. 382 rule detailed in Sec. III below. It based its claim that the section did not apply to it on the Treasury's "Notices."

For Citigroup, the NOL's had additional importance because of its status as a bank. Banks must worry about regulatory capital requirements. As Davidson (2011) explains:

> Banks hold NOL's as deferred tax assets (DTA's). DTA's, in turn, constitute a portion of a bank's tier 1 capital. Were Citigroup to have lost its ability to use its NOL's, it might have had to write down its tier 1 capital. [with footnote saying "12 C.F.R. sec. 225 at appendix A.II.A.1. NOL's may constitute up to 10 percent of tier 1 capital, to the extent that the institution `is expected to realize [a tax deduction by their use] within one year… based on its projections of future taxable revenue for that year….' 12 C.F.R. sec. 225 at appendix A.II.B.4.a.i.]

After many travails, in January 2011 AIG completed a reorganization that gave Treasury 92.1% of its common stock. AIG claimed "Deferred tax assets: Losses and tax credit carryforwards" of $26.2 billion at the end of 2009. It claimed other valuable tax attributes as well,[18] including "Unrealized loss on investments" of $8.7 billion. These, too, hinged on Notices exempting the firm from the coverage of Sec. 382. AIG acted on the assumption that it had not yet had an "ownership change" for tax purposes. It was worried enough about a private-market 50% ownership change that would trigger Section 382, however, that it installed a poison pill to prevent large share purchases.

III. The Law

A. Introduction:

In fact, the law -- arcane in the extreme -- does not grant New GM the NOL's it claims if the government sells its shares. Neither does it grant Citigroup and AIG any right to the tax assets they claimed. To be sure, the law lets the GM NOL's survive the Sec. 363 sale in bankruptcy, as we will show. To that extent, New GM did inherit the NOL's. It can continue to use them, however, only so long as the Treasury holds its stock. Once Treasury sells its shares to the public, New GM should by statute lose its access to most if not all of the loss carryforwards.

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[17] "Citi's deferred tax – an asset of dubious worth." Tax Research UK: Richard Murphy on Tax and Economics, (www.taxresearch.org.uk/Blog/2010/09/07/citis-deferred-tax-an-asset-of-dubious-worth/) (Sept. 7, 2010).

[18] American International Group, Inc., 2009 Annual Report, at 334. (www.aigcorporate.com/investors/annualreports_proxy.html). "The application of U.S. GAAP requires AIG to evaluate the recoverability of deferred tax assets and establish a valuation allowance, if necessary, to reduce the deferred tax asset to an amount that is more likely than not to be realized (a likelihood of more than 50 percent)."

New GM did claim the NOL's, and the Treasury concurred. For 2010, New GM has access to the losses because the government has not yet sold enough of its stock. But once it sells, New GM will be able to claim the losses only because the Treasury told it it could. Through a series of "Notices," it declared that the statutory limitations on the use of NOL's after a defined "ownership change" did not apply if the Treasury owned the stock. The statute itself did not differentiate between government and non-government owners. Nonetheless, as we will explain in detail later, Treasury wrote that New GM could continue to claim the NOL's after it sold its stock, and New GM happily deferred.

First, however, we must go into how New GM could possibly acquire the NOL's in the first place. The law is massively opaque -- but that is the point. Precisely because the corporate tax rules are as complex as they are, the Administration could successfully deflect attention from what it did.

B. <u>Cancellation of Indebteness and Net Operating Losses</u>:

1. <u>The law as stated.</u> -- (a) <u>Cancellation of debt</u>. Consider first the tax treatment of cancelled debt, relevant here because of the cancellation of Old GM's debt to the Treasury. Suppose a firm has debt outstanding. It negotiates with its creditors, and they agree to trade their debt claims for stock. The firm will have cancellation of indebtedness(COD)income equal to the difference between the face amount of the cancelled debt and the market value of the stock distributed (I.R.C. Secs. 61, 108(e)(8); <u>U.S. v. Kirby Lumber Co.</u>, 284 U.S. 1 (1931)).

Now suppose the firm is insolvent. If its creditors swap their claims for stock, under general tax principles it will have COD income. In fact, however, the Internal Revenue Code provides that what would otherwise be COD income will not constitute taxable income. Instead, under Sec. 108 of the code the firm will need to reduce the amount of its other "tax attributes" by the amount of the COD income excluded. Most relevant here, it will need to reduce the amount of its net operating losses (NOL's) by the amount of the excluded income. Given that $1 of NOL would reduce net taxable income by $1, this obviously leaves the firm (in many cases) in much the same position as if it had included the COD income all along (I.R.C. Sec. 108(a)(1)(B), (b)(2)(A)).

Finally, suppose the firm is solvent, but files for reorganization under bankruptcy. If as part of its bankruptcy reorganization the creditors swap their claims for stock, the result (for purposes here) is the same as if the firm were insolvent. Under Sec. 108, it can exclude the COD from income, but must offset the excluded amount against its NOL's (I.R.C. Sec. 108(a)(1)(A), (b)(2)(A).

(b) <u>Tax reorganizations</u>. Many reorganizations under the bankruptcy code also constitute "reorganizations" under the tax code. If but only if a transaction qualifies as a "reorganization" under the tax code, a firm that takes the assets of another firm may also take its NOL's. Note that although both the bankruptcy and the tax codes use the term "reorganization," the word refers to different concepts in each. Those concepts are not interchangeable.

In general, reorganizations in bankruptcy are "G reorganizations" under the tax code -- meaning that they fall under Sec. 368(a)(1)(G) of the Internal Revenue Code:

> [A] transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case; but only if ... stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

Note two points relevant here. First, "Section 363 sales" occur in a "title 11 or similar case." "Title 11" (not "Chapter 11") refers to the Bankruptcy Code, and "section 363" refers not to Sec. 363 of the tax code but to Sec. 363 of the Bankruptcy Code. As a result, if a "debtor in possession" (a bankruptcy concept) sells its assets under Sec. 363 it sells its assets in a Title 11 case. The court of <u>In re Motors Liquidation Co.,</u> 430 B.R. 65 (S.D.N.Y. 2010) explicitly indicated that a Sec. 363 sale (indeed, exactly the GM sale at issue here) could constitute a qualifying G reorganization. This is the position the Treasury has long taken as well (e.g., in Ltr 8503064 (Oct. 24, 1984); Ltr 8521083 (Feb. 27, 1985)).

Second, Sec. 354 of the tax code requires merely that <u>some</u> security holders (not <u>only</u> security holders) of the old firm receive "stock or securities" of the new firm. I.R.C. Sec. 354(a) provides:

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization ... are ... exchanged solely for stock or securities in ... another corporation a party to the reorganization.

Suppose the creditors to the old firm include both long-term bond holders and trade creditors. Suppose both receive stock in the new firm. The former held "securities" in the old firm, but the latter did not (bonds are securities, trade credit is not). For at least three decades, the Treasury has taken the position that the transaction qualifies under Sec. 354 even though some of the stock goes to creditors who did not hold securities. Instead, it has argued that a transaction qualifies under Sec. 354 if at least one of the old firm creditors who received stock in the transaction held a security of the old firm.[19]

(c) <u>Net operating losses.</u> Only in a qualifying tax reorganization will a firm that acquires the assets of another also acquire its NOL's. Suppose again that a firm induces its creditors to swap their claims for stock. Suppose further that some NOL's remain after the Sec. 108 adjustments detailed earlier.

Generally, if a debt-for-stock swap occurs as part of a transaction in which a firm sells its assets to another firm, the acquiring firm will not obtain its NOL's too. After all, the losses are specific to the selling firm. The acquiring firm buys the seller's assets, but it does not -- indeed, legally could not -- buy its "tax losses." Conceptually, these tax attributes describe the financial characteristics of a firm; they are not "things" that firms can buy and sell.

[19] E.g., <u>Com. Rep. to the Bankruptcy Tax Act of 1980</u>; Ltr 8503064 (Oct. 24, 1984); Ltr 8521083 (Feb. 27, 1985); see generally Pickerill (2009)

Under Sec. 381 of the tax code, however, if one firm buys the assets of another firm in a qualifying tax "reorganization," it also acquires its NOL's. More specifically, Sec. 381(a) provides:

> In the case of the acquisition of assets of a corporation by another corporation ... in a transfer to which section 361 ... applies, but only if the transfer is in connection with a reorganization described in subparagraph ... (G) of Section 368(a)(1), the acquiring corporation shall succeed to ... the items described in subsection (c) of the ... transferor corporation ...

Note two observations. First, if a firm exchanges its assets for stock as part of a G reorganization, Sec. 361 will apply to the exchange. In turn, that section specifies that the two firms recognize no gain or loss on the transaction. Second, Sec. 381(c)(1) lists "net operating losses." Provided the debt-for-stock swap occurs in a G reorganization, an acquirer takes the seller's NOL's along with its assets.

2. <u>The law applied to GM.</u> Now turn to the reorganization of GM. Insolvent, GM filed for reorganization in bankruptcy court in the Southern District of New York. It sold its assets to a newly formed corporation (New GM) in a Sec. 363 sale. In exchange, it received stock in the new firm which it distributed to its bond holders and other creditors.

Absent Sec. 108, GM would have had COD income equal to the difference between the amount of its debt and the value of the stock it distributed. We will see next, however, that in bankruptcy the rule may be different.

C. <u>Change in Control</u>:

1. <u>The law as stated.</u> A firm that buys another firm's assets in a G reorganization cannot necessarily use the transferor's NOL's immediately. To limit "trafficking" in tax losses, Sec. 382 of the tax code limits a firm's ability to use the NOL's of a "loss corporation" that it buys (defined at Sec. 382(k)). The limits apply whenever the stock owned by shareholders holding 5 percent or more in the loss corporation increase by 50 percentage points within a three-year period.[20] And these limits then restrict the amount of the NOL's that the firm can use to a "section 382 limitation" amount:

> The section 382 limitation for any post-change year is an amount equal to --
> (A) the value of the old loss corporation, multiplied by
> (B) the long-term tax-exempt rate.

Consider how this 382 scheme works. Suppose first that a <u>solvent</u> firm <u>not</u> in bankruptcy convinces its creditors to swap their debt claims for stock. It will recognize COD income. It will apply its NOL's against that income. And if any NOL's remain, then -- if the stock held by 5 percent shareholders increases by at least 50 percentage points -- the firm will be able to use only the product of its earlier value and the long-term tax-exempt rate (I.R.C. Sec. 382(b)(1)).

[20] I.R.C. Sec. 382(g)(1), (i). A shareholder is a 5 percent shareholder if he holds more than 5 percent either before or after the ownership change. Id., at Sec. 382(g)(2)(B).

Suppose second that a firm convinces its creditors to swap their claims for stock in a bankruptcy proceeding. As noted earlier, under Sec. 108 it will not recognize its COD as income but will reduce the amount of its NOL's by the amount of that excluded COD. Importantly, under some circumstances Sec. 382 will not thereafter limit its ability to use its NOL's even if there has been a Sec. 382 change in control. Instead, Sec. 382(l)(5) states that the limits do not apply if (a) the transaction occurs in a title 11 case and (b) "the shareholders and creditors of the old loss corporation ... own ... stock of the new loss corporation" equal to at least 50 percent (I.R.C. Sec. 382(l)(5)). Potentially, NOL's could (only "could" -- even under (l)(5) the NOL's do not necessarily live) survive bankruptcy proceedings in full.

Suppose third that an insolvent firm does not file for bankruptcy, but still induces its creditors to swap their debt claims for stock. Absent more, according to Sec. 382 its NOL's will disappear. They will disappear because the firm can thereafter only use a portion of its earlier value ("the value of the old loss corporation") -- and Sec. 382 defines that earlier value as "the value of the stock" of the insolvent corporation (I.R.C. Sec. 382(e)(1)). Because the firm was insolvent, its stock was worth nothing (or nearly nothing). The product of the "value of the old loss corporation" and the "long-term tax-exempt rate" will fall to zero, and the NOL's will disappear.

Finally, suppose an insolvent firm does not meet Sec. 382(l)(5)'s 50-percent test. Provided it negotiates its debt-for-stock swap within a bankruptcy filing, under Sec. 382(l)(6) it may add to the value of the firm used to calculate the amount of annual useable NOL's the value created by cancelling the creditors' claims. It can use each year, in other words, a proportional share not just (i) of the value of the pre-reorganization firm but (ii) of that value plus any value attributable to the debt cancellation (I.R.C. Sec. 382(l)(6)).

2. The law applied to GM. -- After its Sec. 363 sale, the creditors of Old GM owned 100 percent of the stock of New GM. Under Sec. 382(l)(5), all of its NOL's may have survived. If the old creditors obtained less than 50 percent of the stock of New GM, then under Sec. 382(l)(6) New GM would have been able to use only an amount of NOL's calculated by adding the value of the cancelled debt to the value of Old GM.

D. Later Control Shifts:

1. The Sec. 382 dilemma. -- Even for New GM, however, Sec. 382 created a risk. First, suppose that New GM tried to avoid the limits on its NOL's through Sec. 382(1)(5). If within two years of the reorganization, the stock owned by any set of 5 percent shareholders increased by 50 percentage points, then the NOL's disappeared. Subsec. (l)(5) couples its apparent generosity with a draconian penalty: if a firm meets the terms of (l)(5) it potentially enjoys the NOL's without the standard Sec. 382 reduction, but if it then shifts ownership within two years it loses those NOL's entirely.

Second, even if New GM does not claim the Subsec. (l)(5) benefit, it still jeopardizes much of its NOL's if ownership changes. Suppose New GM claimed the benefit of Subsec. (1)(6) instead. If within three years the stock owned by 5 percent shareholders increases by 50 percentage points, then the firm will be able to use only the "section 382 limitation" amount.

The problem for New GM lay in the fact that it exited its G reorganization with the U.S. government holding 61 percent of its stock. If the government recovers its investment by selling all of that stock within 2 (for Subsec. (l)(5)) or 3 (for Subsec. (l)(6)) years, it will probably cause a ownership change under the terms of Sec. 382. We say "probably" because we do not know how many other shareholders will trade during the same period. If it does trigger an "ownership change," it will either face the Sec. 382 limits to its NOL's under Subsec. (l)(6), or lose its NOL's entirely under Subsec. (l)(5).

In November 2010 the Treasury did reduce its stake in GM from 61% to 33%. If Treasury, or any other large shareholder, transfers an additional 22% of the stock, GM will face the Sec. 382 limits on its net operating losses.

The cases of AIG and Citigroup are even clearer. Already, the government has triggered an ownership change in both companies. The Treasury acquired a majority of AIG's stock, and it acquired enough of Citigroup's stock that combined with Citigroup's new capital issue it caused a 50% ownership change. Thus, by law both firms should lose their NOL's.

2. <u>The IRS Notices.</u> -- If the Treasury lets a firm claim an NOL to which the law does not entitle it, Treasury merely gives the firm a gift. TARP does authorize Treasury to give gifts. As a result, the superficial choice would seem to be: if Treasury wants to enrich a firm, it can either give it money under TARP or let it take an extra NOL. Either way, it transfers funds from the public fisc to the firm.

To give funds under TARP, however, Treasury must follow statutory guidelines. It must give its gifts in amounts and to firms and for purposes described by Congress in the legislation. When it unilaterally authorizes NOL's, by contrast, it escapes all those Congressional constraints.

And that is exactly what the Treasury did: from 2008 to 2010, it issued a series of "Notices" exempting firms in specified industries from the statutory restrictions under Sec. 382 on the use of NOL's. The statute establishing TARP authorized Treasury to issue "regulations and other guidance" to implement it,[21] and Sec. 382(m) authorized it to issue the regulations necessary to implement Sec. 382.

Treasury issued the first of these notices in mid-2008. Notice 2008-76 exempted from Sec. 382 the acquisition of stock of a loss corporation by the U.S. under the Housing and Economic Recovery Act of 2008.[22] The Notice covered Fannie Mae and Freddie Mac. Notice 2008-83 authorized banks to take certain deductions under 382(h).[23] Commonly called the "Wells Fargo Ruling," it was predicted to cost the government between $105 to $110 billion.[24] The Jones Day law firm estimated its cost at $140 billion.[25] (As we will see,

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[21] <u>Emergency Economic Stabilization Act of 2008</u>, P.L. 11-0343, 122 Stat. 3765, Sec. 101(c)(5).

[22] Notice 2008-76, 2008-39 <u>I.R.B.</u> http://www.irs.gov/irb/2008-39_IRB/ar01.html#d0e51 (September 29, 2008).

[23] Notice 2008-83, 2008-42 <u>I.R.B</u>. 905 (Sept. 30, 2008).

this Notice was terminated, so the actual costs were much smaller.) In Notice 2008-84, the Treasury announced that it would not test for ownership changes on days when the U.S. owned a 50-percent interest in a loss firm.[26]

Notice 2008-100 declared that an acquisition by Treasury of acquired stock in a loss corporation would not trigger the 382 limitations (2008-44. I.R.B. 1081). Since Treasury acquired New GM's Stock in a G reorganization qualifying under Sec. 382(l)(5), GM may have escaped the Sec. 382 limitations in its initial reorganization anyway. By contrast, firms like Citigroup and AIG were not G reorganizations.

Notice 2009-14 of Feb. 17, 2009 purported to "amplify" 2008-100 (2009-7 I.R.B. 516). In fact, it explicitly covered the auto industry, and provided that the Treasury's initial acquisition would not trigger the Sec. 382 limitations (again -- given that GM used a G reorganization, ultimately it would not need the assurance 2009-14 offered). Notice 2009-38 continued in much the same vein.[27]

Only in January 2010 -- half a year after GM's Sec. 363 sale -- would the Treasury tackle the firm's real Sec. 382 problem: what happens when Treasury sells its stock? To resolve this question, January 11th's Notice 2010-2 changes the law in two crucial ways (www.irs.gov/irb/2010-02_IRB/ar09.html). First:

> For purposes of measuring shifts in ownership by any 5-percent shareholder on any testing date occurring on or after the date on which an issuing corporation redeems stock held by Treasury that had been issued to Treasury pursuant to the Programs ..., the stock so redeemed shall be treated as if it had never been outstanding.

Picture the problem. Rather than sell its shares to other investors, the Treasury might sell its shares back to the firm. If it did so, the percentage held by the other investors would -- necessarily -- rise. In Notice 2010-2, the Treasury declared that the increase would not trigger Sec. 382. Second:

> If Treasury sells stock that was issued to it pursuant to the Programs ... and the sale creates a public group ("New Public Group"), the New Public Group's ownership in the issuing corporation shall not be considered to have increased solely as a result of such a sale.

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[24] Robert Willens, writing in the Washington Post, (www.washingtonpost.com/wp-dyn/content/article/2008/11/09/AR2008110902155_3.html).

[25] The law firm backtracked some months later to defend the Notice strongly and say that it was “quite modest” and “not a significant tax subsidy.” See Jones Day, Revisiting Notice 2008-83, (www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=5711). Jones Day had estimated the Wells Fargo merger alone to have benefitted by some $25 billion. The original Jones Day article was taken down from the web, but it is quoted in *Washington Post*, (www.washingtonpost.com/wp-dyn/content/article/2008/11/09/AR2008110902155_3.html). Just one other merger, PNC’s acquisition of National City, benefited by an estimated 5.1 billion dollars. See “PNC Stands to Gain From Tax Ruling; Acquisition of National City Will Bring Billions in Deductions, Experts Say,” Wall Street Journal, October 30, 2008.

[26] Citation.xxx

[27] Citation.xxx

Even if the Treasury sells its shares to the public, the sale will not trigger Sec. 382. Thus, in Notice 2010-2, the Treasury finally addressed New GM's Sec. 382 problem.

3. The statutory amendment. -- But could the Treasury legally issue Notice 2010-2? Could it legally issue any of these Sec. 382 notices?

Congress in its legislation objected to some of what Treasury did, validated some, and left most notices unaddressed. The issues of the Treasury's TARP-related Sec. 382 Notices came up in the American Recovery and Reinvestment Tax Act of 2009 (the "Stimulus Bill").

First, the Conference Committee added a provision to the tax code, Sec. 382(n)(1), to exempt from Section 382 advances of TARP funds which had an explicit requirement for a restructuring plan (neither the original House nor the original Senate version had anything like this--- see U.S. Government, conference report(2009) at 560-561:

> The limitation contained in subsection (a) shall not apply in the case of an ownership change which is pursuant to a restructuring plan of a taxpayer which—
>
> (A) is required under a loan agreement or a commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and
>
> (B) is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.
>
> (2) SUBSEQUENT ACQUISITIONS.—Paragraph (1) shall not apply in the case of any subsequent ownership change unless such ownership change is described in such paragraph.

The same auto-industry Sec.382 exemption (but explicitly for auto companies) had been proposed in December 2008 in a bailout bill that passed the House and was supported by Republican President Bush but was killed by Senate Republicans.[28]

Second, the Act authorized the Wells Fargo notice as far as bank mergers that happened before January 16, 2010, but not afterwards. The drafters explained that Congress did this because it found Treasury's various TARP notices outrageous but thought it should save taxpayers who relied on them anyway. The drafters continued:[29]

> Congress finds as follows:
>
> (1) The delegation of authority to the Secretary of the Treasury, or his delegate, under section 382(m) does not authorize the Secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers;

[28] "Auto bailout dies in Senate: Big 3 could opt for bankruptcy after a late compromise attempt fails to satisfy GOP opponents." Los Angeles Times, December 12, 2008 (http://articles.latimes.com/2008/dec/12/business/fi-autobailout12). "Grab Coveted Losses, Buy a Car Company The Auto-Industry Bailout Is stalled, but here's an opportunity to secure highly sought-after net operating losses in an acquisition," CFO.com, December 12, 2008 (www.cfo.com/article.cfm/12793360?f=related).

[29] P.L. 111-5 (American Recovery and Reinvestment Tax Act of 2009) (paragraph indentation added). P.L. 111-5, section 1261.

(2) Internal Revenue Service Notice 2008-83 is inconsistent with the congressional intent in enacting such section 382(m);
(3) the legal authority to prescribe Notice 2008-83 is doubtful;
(4) however, as taxpayers should generally be able to rely on guidance issued by the Secretary of the Treasury, legislation is necessary to clarify the force and effect of Notice 2008-83 ....

4. Notice 2010-2. -- Now return to Notice 2010-2, and ask the obvious question: given Sec.382(n), why did Treasury issue the Notice? It did so because Subsec.(n) did not cover a sale by the Treasury to the public. Subsec.(n)(1)(A) may have covered the Treasury's initial stock acquisition. After all, the Treasury took its equity interest as part of its TARP investment, so perhaps it "required" the stock "under a loan agreement." Ironically, however, Treasury did not need Sec.382(n) for GM -- since GM restructured itself as a tax-free G reorganization. And Sec.382(n) was not applicable to the purchases of equity in Citigroup and AIG, because they were financial firms, not manufacturers.

Subsec.382(n)(1) did not protect GM from Treasury's re-sale of the the stock it acquired. When Treasury lent GM the money, it did not "require" its own re-sale under the loan agreement. It would be an odd agreement that required the lender to sell any stock it obtained. And if it did not require the re-sale, then Sec. 382(n)(1) did not exempt Treasury's sale of its shares to the public from the Sec. 382 limitations.

This put Treasury in a bind. Congress claimed not to like the way the Treasury helped the financial institutions. It declared that it had not authorized Treasury to issue the Notices it did.[30] But absent a Notice, Treasury would trigger the Sec. 382 limitations at GM when it sold its stock.

Apparently, Treasury responded: "Congress won't mind." To move $18 billion to New GM, it needed to be able to assure the firm and its investors that GM would continue to have access to the accumulated losses after Treasury sold its stock. Sec. 382(n) did not offer that assurance. Through Notice 2010-2, Treasury offered it anyway.

IV. Rationale, Deference, and Reliance:

A. A Rationale for the Notices?

Treasury does not explain why the Notices promote the policy behind Sec. 382. Beth Davidson (2011) nicely lays out the case Treasury might have made (without endorsing it; she later gives the counterargument too):

> Section 382(m) gives the Secretary authority to issue regulations "necessary or appropriate to carry out the purposes of" section 382, so one must look to the purpose of section 382.

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[30] Although Congress spoke sternly in the Stimulus Bill of how the Wells-Fargo Notice infringed on its authority as legislature, it made no comment on the other dubious notices that Treasury had issued by February 2009. A footnote on p. 560 of the Stimulus Bill conference report (U.S. Congress, 2009) mentions the Treasury Notices 2008-39, 2008-100 and 2009-14 without commenting on their validity.

> As a broad matter, section 382 is meant to prevent the trafficking in losses and to preserve "the integrity of the carryover provisions," which perform an "averaging function by reducing the distortions caused by the annual accounting system." More specifically, Congress was concerned with matching items of income and loss.
>
> The TARP Guidance did not violate these principles by trafficking in losses, in the generally understood meaning of the phrase. The government did not acquire shares in these banks in order to use their loss carryforwards; it did so to stabilize the financial sector. Looking beyond the acquirer's motives, because the government does not pay taxes, it is not even capable of trafficking in losses in the traditional sense. The TARP Guidance also did not violate the integrity of the carryover provisions. Losses created by TARP banks remain with the bank – they will only be used to offset income of that bank. When shares are sold to the public, the guidance was careful to limit its application to buyers in the public group. This prevents another corporation from acquiring the bank to use its NOL's. Losses of a TARP bank will not be able to be used by any other institution by means of a TARP-related acquisition. From the perspective of avoiding the trafficking in losses and maintaining the integrity of the carryover provisions, the TARP Guidance were "appropriate to carry out the purposes of" section 382. [footnotes omitted]

This is unsatisfactory. The Treasury does not pay taxes, but the other investors in New GM do. For them, the ability to invest in a company that earns its income tax-free for the indefinite future is a major advantage.

What is more, the purpose behind a section does not matter when its language is clear. Sec. 382 routinely covers transactions not motivated by tax avoidance, and the Treasury does not exempt them from the section by appealing to "purpose". Sec. 382 covers non-abusive transactions because it is, at root, a "prophylactic rule." By their very nature, prophylactic rules cover transactions one would not necessarily cover if "purpose" were all that mattered.

That the government buys stock does not itself imply that different ownership change rules should apply. The U.K., for example, imposes a rule similar to Sec. 382. It does not make special allowance for government-owned stock. As KPMG explained:

> The UK tax code contains similar provisions preventing the carry forward of losses following a 50 percent or more ownership change, but only when there is a 'major change in the nature or conduct of the trade' within three years of the change of ownership. But, in contrast to the position in the US, the acquisition of shares by the UK government does count in measuring whether there has been an ownership change.[31]

The U.S. statute does not exempt government-owned stock, and neither does the U.K.'s.

Ultimately, tax benefits did play a major role in these transactions. By letting New GM keep NOL's to which it was not legally entitled, Treasury gave the firm (and its owners, including the UAW) $18 billion more in assets. Had the Administration tried to give GM $18 billion forthrightly, voters might have complained. By hiding the gift in an obscure tax section, it reduced that electoral scrutiny. But the investors who bought New GM shares

[31] KPMG, Frontiers in Tax: People thinking beyond borders in Financial Services, at (www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Pages/Frontiers-in-Tax-People-thinking-beyond-borders.aspx (July 2010).

noticed. They paid a higher price than they otherwise would have paid.[32] And necessarily, the UAW, the government of Canada, and the former bondholders also noticed.

B. Court Deference:

The executive branch continually interprets statutes as it issues regulations. Courts do too, and often make interpretations that outsiders such as ourselves consider ridiculous. It is generally accepted that courts should be allowed to have the final word in interpretation nonetheless. Could it be that the executive branch, in interpreting tax law, similarly has the final word? In fact, courts have ruled it does not, a sensible rule. Courts do defer to executive branch interpretations of statutes in many circumstances, but not in those like the TARP Notices.

On January 11, 2011, the U.S. Supreme Court made clear in Mayo Foundation v. U.S., 131 S. Ct. 704 (2011), that courts should treat tax regulations just like any other regulations. The case concerned a statute that exempted students from FICA withholding. In 2004, the Treasury promulgated regulations under which medical residents were not students. The Mayo Clinic challenged the regulation, and the Court held it valid. Courts should treat tax regulations like any other, it explained.

Under the well-known "Chevron" rule by which it sometimes defers to executive agencies (Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984)), explained the Supreme Court, courts should first ask whether Congress had "directly addressed the precise question at issue". If not, then they should defer to the agency unless the rule was "arbitrary or capricious in substance, or manifestly contrary to the statute."(Mayo, p. 711). It would not, the Court explained, "carve out an approach to administrative review good for tax law only. ... The principles underlying our decision in Chevron apply with full force in the tax context" (p. 713).

Nonetheless, this deferential standard applies only when Congress intended to delegate to the agency, and the agency followed standard rule-making procedures. Continued the Court (p. 714):

> We have explained that "the ultimate question is whether Congress would have intended, and expected, courts to treat [the regulation] as within, or outside, its delegation to the agency of 'gap-filling' authority." [Long Island Care at Home, Ltd. v. Coke, 551 U.S. 157, 173 (2007)]. In the *Long Island Care* case, we found that *Chevron* provided the appropriate standard of review "[w]here an agency rule sets forth important individual rights and duties, where the agency focuses fully and directly upon the issue, where the agency uses full notice-and-comment procedures to promulgate a rule, [and] where the resulting rule falls within the statutory grant of authority."

Notice 2010-2 fails both of those requirements. First, Congress expressly declared that it did not intend to delegate this authority to Treasury. Notice 2010-2 applied only to financial institutions, automobile companies, and other specific TARP recipients. Yet "section 382(m) does not authorize the Secretary to provide," Congress announced in its Committee Report, "special rules that are restricted to particular industries or classes of

[32] Note that this reduces the net cost to the government of the Notice -- since the Treasury will be able to re-sell its shares at a higher price.

taxpayers." As a result, the earlier TARP Notice 2008-83 was "inconsistent with the congressional intent" and of only "doubtful" "legal authority." Notice 2010-2 is precisely such an industry-specific rule.

Second, Notice 2010-2 is not a regulation. It is a "notice." The Mayo Court declared Chevron appropriate where an agency uses "full notice-and-comment procedures to promulgate a rule."[33] By contrast, the Supreme Court explained in Christiansen v. Harris County, 529 U.S. 576 (2000):

> Interpretations such as those in opinion letters --like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law -- do not warrant *Chevron*-style deference. Instead, interpretations contained in formats such as opinion letters are [governed by Skidmore].

Turning now to Skidmore v. Swift & Co., 323 U.S. 134 (1944), the Supreme Court considered the agency's logic, but made its own decision (p. 140):

> "We consider that the rulings, interpretations and opinions of the Administrator ... constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."

In United States v. Mead Corp.,533 U.S. 218 (2001), the Court went further and declared that as a general rule an agency interpretation would have to go through notice and comment to receive Chevron deference. In Notice 2010-2, Treasury did not try to reason or persuade. It simply declared the rule so. As Patrick Smith (2011) puts it (pp. 1260, 1261):

> "*Mayo* benefits taxpayers by clarifying that the *Mead* principles apply in tax. When the *Mead* test is applied to revenue rulings, revenue procedures, and notices, the conclusion is that they are not among the types of agency guidance that receive *Chevron*'s high level of deference. …
>
> Any pre-*Mayo* case law on the status of revenue rulings, revenue procedures, and notices should generally be considered obsolete unless the opinion reflects *Mead* analysis. The clear conclusion that those forms of guidance do not qualify for the level of deference described in *Chevron* is another benefit to taxpayers from *Mayo*."

Because the Treasury did not follow notice-and-comment procedures, the GM Notices would not qualify for Chevron deference, even if the statutes they purport to interpret were indeed ambiguous.[34]

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[33] The Treasury is notorious for its cavalier attitude towards the Administrative Procedure Act. In *Intermountain Insurance Service of Vail v. Commissioner of Internal Revenue Service*, No. 10-1204 (June 21, 2011), p. 32 (DC Circuit, 2011) the Commissioner "simultaneously issued immediately effective temporary regulations and a notice of proposed rulemaking for identical final regulations and then held a 90-day comment period [receiving just one comment] before finalizing the regulations." The opinion goes on to say that this procedure is "typical of the Commissioner's practice."

[34] We should mention a caveat. In *Intermountain Insurance,* cited earlier, the court gave *Chevron* deference to Treasury regulations in Treasury's appeal even though those regulations were written after Treasury had already lost in Tax Court. Perhaps Treasury could re-issue the GM regulations with a pretence of notice and comment. The tax provision at issue in Intermountain, however, is important and has resulted in split circuits (3 to 2) and so is likely to go to the Supreme Court. "Circuit Split Deepens on Six-Year Period for Basis

C. Taxpayer Reliance:

Suppose the TARP Notices were invalid. Should taxpayers be able to rely on them anyway, since it is the fault of Treasury and not the taxpayer?[35] Notice 2010-2 provides:

> Taxpayers may rely on the rules described in Section III of this notice. These rules will continue to apply unless and until there is additional guidance.

This is profoundly self-serving, of course. The Treasury cannot change the law by fiat. A bureaucrat cannot give his friend funds illegally, and then protect that friend by declaring his friend's reliance protected. If a court held Notice 2010-2 illegal, GM could not cite the Notice as authority for deducting $45 million in NOL's anyway.

The relevant question goes to penalties: may a taxpayer who relies on the Notices avoid civil and criminal penalties? As Cheryl Block explains:[36]

> As with revenue rulings and revenue procedures, announcements and notices can provide substantial authority sufficient to relieve taxpayers from the negligence and substantial understatement penalties and, consequently, may be relevant to whether certain penalty provisions apply.

Sec. 6662 of the code imposes a penalty for any "substantial understatement of income tax." Subsec. (d)(2)(B) protects a taxpayer who relies on "substantial authority." According to the Treasury, its own "Notices" are "substantial authority" (Rogovin & Korb [2008], Reg. 1.6662-4(d)(3)(iii)), though it also explains the "weight accorded an authority depends on its relevance and persuasiveness" (Reg. 1.6662-4(d)(3)(ii)).

Consider the weight appropriate to Notice 2010-2. First, the Treasury itself declares it "substantial authority." This is of course again self-serving. Acting on behalf of the Administration, the Treasury has manipulated tax procedure to route $18 billion to its supporters' car company. In essence, it also argues that its manipulation insulates those favored taxpayers from "substantial underpayment" penalties.

Second, Notice 2010-2 does not try to persuade. It simply declares. But if an IRS notice were to announce that Microsoft did not have to pay taxes because Bill Gates paid the Treasury Secretary $1 million in bribes, the announcement would hardly give Microsoft substantial authority. Here, the Democratic administration has given a massive tax benefit to

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Overstatements," Journal of Accountancy, Karyn Bybee Friske & Darlene Pulliam, May 2011 (www.journalofaccountancy.com/Issues/2011/May/BasisOverstatement.htm).

[35] Before the Treasury and other owners (including the 10% given to Old GM) sell enough stock to trigger the 50% threshold, use of the NOL's would be legal even without Notice 2010-2. GM is now, however, a publicly traded company and has told the public that the NOL's are part of its assets, though without 2010-2 they will not be if the Treasury sells its stake. Thus, the immediate question would be whether GM has thereby violated federal securities laws.

[36] Cheryl Block, citation.xxx Not in the article we cite.

one of the party's biggest supporters. Like other labor unions, the UAW provided the Obama campaign with elaborate assistance. Some of the help came in person, and some came as money. From 1989 to 2010, the UAW spent over $27 million on political campaigns, 98 percent of it on behalf of the Democratic party.[37] In 2008 alone, it spent $2,119,937 on political campaigns, $2,101,187 of that for Democrats.[38]

Suppose that Notice 2010-2 had said:

> The President is grateful to the UAW for the assistance it provided his party. In gratitude for that political support, the Treasury announces that, should it sell the stock that was issued to it pursuant to the Programs ... and should the sale creates a public group ("New Public Group"), the New Public Group's ownership in the issuing corporation shall not be considered to have increased solely as a result of such a sale.

The only difference between this hypothetical notice and the real Notice 2010-2 is explicit character of the reason for the largesse. It is an odd approach to statutory interpretation that would make a Notice illegal if articulates its reason, but legal if it leaves the reason unsaid.

V. Legislative Resolution

A. Introduction:

Return to the problem at stake: the manipulation of the highly arcane minutiae of the corporate tax rules to route huge sums to favored groups. The question is what anyone can do about it.

Political remedies are unlikely to work. Voters do not understand transactions like this well enough to punish a candidate in the next election. Much less will they impeach anyone for a transaction like this. Voters understand politicians who take briefcases stuffed with cash; they do not understand G reorganizations and NOL carryforwards. Congress has complained, asking TARP's Inspector-General to investigate the validity of the Notices and their motivation.[39] Senator Jim Bunning even introduced a bill with the sole purpose of repealing Notice 2010-2.[40] Unless Congress can override the Notices by a veto-proof 2/3 majority, however, it can do little more than badger the Administration with its oversight authority and complain to the public.

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[37] Top All-Time Donors, 1989-2010, OpenSecrets.org (www.opensecrets.org/orgs/list.php?order=A).

[38] United Auto Workers, OpenSecrets.org (www.opensecrets.org/orgs/totals.php?id=D000000070&cycle=2010).

[39] Office of the Special Inspector General for the Troubled Asset Relief Program, *Engagement Memo – Review of the Section 382 Limitation Waiver for Financial Instruments Held by Treasury* (Aug. 10, 2010) (www.sigtarp.gov/reports/audit/2010/Engagement%20Memo%20-%20Review%20of%20the%20Section%20382%20Limitation%20Waiver%20for%20Financial%20Instruments%20Held%20by%20Treasury.pdf).

[40] S. 2916 [111th], A bill to provide that Internal Revenue Service Notice 2010-2 shall have no force and effect… The bill was sent to committee and never returned.

B. The Standing Problem:

All this leaves a lacuna in the law. As the GM Notices illustrate, it leaves an $18 billion lacuna. To explore how Congress might try to address the problem, consider the following fantasy IRS Notice:

> Internal Revenue Bulletin: 2010-999
> February 24, 2011
> Notice 2011-999
>
> Application of Title 26 to Certain Persons Pursuant to the Emergency Economic Stabilization Act of 2008
>
> I. BACKGROUND
>
> Section 7805(a) of the Internal Revenue Code ("the Code") provides that except where such authority is expressly given to any person other than an officer or employee of Treasury, the Secretary shall prescribe all needful rules and regulations for the enforcement of Title 26, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.
>
> Section 101(c)(5) of EESA provides that the Secretary is authorized to issue such regulations and other guidance as may be necessary or appropriate to carry out the purposes of EESA.
>
> II. GUIDANCE REGARDING A CERTAIN PERSON
>
> Any funds received by J. Mark Ramseyer or Eric B. Rasmusen shall not constitute "income" under Sec. 61 of the I.R.C., and shall be entirely exempt from taxation.
>
> DRAFTING INFORMATION
>
> The principal author of this notice is John B. Doe of the Office of Associate Chief Counsel (Individual). For further information regarding this notice, contact Robert B. Roe at (202) 999-9999 (not a toll-free call).

Few readers would dispute the notion that Notice 2011-999 straightforwardly violates the Code. It does not even try to argue that sparing us from the income tax furthers the purposes of the EESA. If it did, you, our readers, would laugh. But you could not laugh in court. You would not have standing.

Under current law, voters cannot challenge these transactions in court (see Hickman [2008] for discussion). If a rule benefits some people but does not harm others, nobody will have "standing" to challenge it. Justice Powell articulated the point most famously:

> I cannot now imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else. [Simon v. E. Ky. Welfare Rights Org., 426 U.S. 26, 46 (1975)(Powell, J., concurring)]

A more recent example appeared in a Chrysler case in which Justice Roberts held that taxpayers lacked standing to challenge other people's tax benefits. The plaintiffs argued that Chrysler's tax breaks hurt them:

> Plaintiffs principally claim standing by virtue of their status as Ohio taxpayers, alleging that the franchise tax credit "depletes the funds of the State of Ohio to which the Plaintiffs contribute through their tax payments" and thus "diminishes the total funds available for lawful uses and imposes disproportionate burdens on them." [DaimlerChrysler Corp. v. Cuno, 547 U.S. 332,342 (2006)]

Justice Roberts said "No."

> As an initial matter, it is unclear that tax breaks of the sort at issue here do in fact deplete the treasury: The very point of the tax benefits is to spur economic activity, which in turn increases government revenues.
>
> Plaintiffs' alleged injury is also "conjectural or hypothetical" in that it depends on how legislators respond to a reduction in revenue, if that is the consequence of the credit. Establishing injury requires speculating that elected officials will increase a taxpayer-plaintiff's tax bill to make up a deficit; establishing redressability requires speculating that abolishing the challenged credit will redound to the benefit of the taxpayer because legislators will pass along the supposed increased revenue in the form of tax reductions. Neither sort of speculation suffices to support standing. [DaimlerChrysler, 547 U.S. at 344]

Various authors have proposed reforms to the standing rules (e.g. Rosenburg (1996)). Unfortunately, their proposals simultaneously increase the incidence of frivolous suits, venue shopping, and collusive litigation, as Stearns (1995) points out. In the name of policing frivolous litigation, GM (and Ramseyer and Rasmusen) keep their special deals. Although Treasury cannot get away with arbitrary interpretations of the statutes that increase someone's taxes (since that person would have standing to object in court), it can get away with equally unreasonable interpretations that reduce someone's taxes.[41]

One might also think that giving away tax breaks was criminal. In fact, the Anti-Deficiency Act, 31 U.S.C. Sec. 1341, makes it a criminal offense for a government officer or employee to give away government money that Congress did not appropriate (he may not "make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation," 31 U.S.C. Sec. 1341(a)(1)(A)). If he does, 31 U.S.C. Sec. 1350 provides that he may be fined up to $5,000 or imprisoned for up to 2 years, and 31 U.S.C. Sec. 3528 requires him to repay the improper expenditure.

Should the Treasury Secretary fear the possibility of spending two years in jail and having to repay 12 billion dollars (perhaps splitting the amount with his predecessor, Henry Paulson)? Treasury Secretaries have thought about this before; in a November 2008 speech Mr. Paulson said that because of the Anti-Deficiency Act, Treasury could not have bailed out Lehman Brothers (Remarks by Secretary Henry J. Paulson, Jr., (www.vcstar.com/news/2008/nov/20/Paulson-transcript/?partner=RSS)).

There are several reasons why the Secretary need not fear at the present time. To start, the Anti-Deficiency Act speaks of "expenditures." A "tax expenditure," no matter how big or unlawful, might reasonably be excluded from its scope. Whether it is excluded probably does not really matter, though. 31 U.S.C. Sec. 3528(b)(1)(B) allows the Comptroller General to relieve the spendthrift official from liability for repayment if the expenditure was made in good faith or not specifically prohibited by law (see also 31 U.S.C. Sec. 3527). What is more, criminal charges would have to brought by the Attorney General

[41] For examples of how Treasury gets around Supreme Court decisions using taxpayer-favorable (and hence unreviewable) regulations, see Polsky (2004).

or his subordinates, and they are part of the Administration. We do not allow private prosecutions for federal crimes.[42]

Thus, U.S. law must be changed if we are to be able to deal with unlawful tax expenditures in any way other than trying to explain them to voters so as to unseat the offending official at the next election.

C. Three Alternatives:

1. The Canadian Rules. In Canada, a taxpayer does have standing. Public-interest standing was extended to taxpayers in *Harris v Canada(Minister of National Revenue),* [2001] 4 F.C. 37 (Ct. of App.).

George Harris alleged that the Minister of National Revenue acted in bad faith and violated his fiduciary duty when he overruled his professional staff and made a favorable tax ruling (an "advance ruling") at the request of influential taxpayers, the billionaire Bronfman family.[43] Harris asked the court for a declaration that the Minister of National Revenue was obliged to try to collect the taxes from a particular transaction.

An appellate court ruled that Harris did have standing, saying that

> In Borowski, Martland J. for the majority held that to obtain public interest standing, a plaintiff must (1) demonstrate that there is a serious issue as to the invalidity of legislation, (2) that the plaintiff has a genuine interest, and (3) there is no other reasonable and effective manner to bring the issue before the court. [*Harris v Canada (Minister of National Revenue),* [2001] 4 F.C. 37 (Ct. of App.), referring to Minister of Justice of Canada et al. v. Borowski [1981] 2 S.C.R. 575)]

A few years after Borowski gave standing for constitutional-law issues, Finlay v. Canada (Minister of Finance), [1986] 2 S.C.R. 607, extended it to standing for statutory issues. Therefore the Harris court gave standing to Harris to contest the application of the tax code. In *Harris v. Canada (Minister of National Revenue),* 2001 DTC 5322 (Trial Div.), the trial court even granted Harris's application for discovery of internal government documents relating to the Bronfmans' requests for an advance ruling.

Harris did lose his case in the end, but on the merits rather than on standing. In *Harris v Canada (Minister of National Revenue),* [2002] 2 F.C. 484 (Trial Div.), the trial court ruled against Harris on the merits, finding no bad faith on the part of the government and no fiduciary duty violation. It even accepted his argument that he was entitled to be paid for out-of-pocket costs because he had benefited the public by arguing the case despite his loss (which in Canada would ordinarily mean he would pay the other side's costs, though in this case the government waived its claim against him).

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[42] Another obstacle to unlawful tax rules, in principal, might be the ethical code of the Bar. What would a Good Man IRS attorney do if asked to authorize an unlawful Notice? What would a Bad Man IRS attorney do, out of fear of the Bar? We do not know what the Good Man would do, but we are sure the Bad Man need not fear disbarment. See Kwon (2010) for a discussion of the ethical obligations of IRS attorneys generally.

[43] "Judge Scolds Tax Officials, but Crusader Loses Case," The Globe and Mail, December 20, 2001, p. A1 (www.fpp.co.uk/docs/people/Bronfman/Globe201201.html).

English courts have also given people standing to contest tax policy, albeit only if a genuine public interest is at stake. See the 1978 R.S.C., Ord. 53 and Inland Revenue Comrs v National Federation of Self-Employed and Small Businesses Ltd, [1981] 2 All ER 93 (House of Lords). In that case, the Federation challenged a tax amnesty given to casual employees in the printing industry. The Federation lost, but only because the Law Lords all agreed that the government clearly had the discretion to grant an amnesty in this particular case.

Thus, one policy change for the United States would be to adopt the Canadian or English law of standing. We are hesitant to propose this change, however, because of the problems the United States has had with frivolous litigation, forum shopping, and activist judges (on which see, for example, the forthcoming book edited by F. Buckley).

2. Congressional litigants. -- To limit Treasury's ability to offer special deals to political favorites we offer two alternatives that might yet constrain frivolous suits. First, Congress could offer standing to members of Congress:

Tax Regulation Enforcement Bill

> Any two members of Congress shall have standing to challenge in court any interpretative or other notices, rules, regulations, or guidelines of the Internal Revenue Service as arbitrary and capricious. The members bringing the action need not be current members of Congress and need not have voted for or against the statute in question. Should they win, they shall each be entitled to liquidated damages of $1,000. The Declaratory Judgement Act (28 U.S.C. sec. 2201) shall not apply to this legal action.[44] As a remedy, the Court may issue injunctions as appropriate, but not temporary restraining orders or preliminary injunctions.
>
> Any number of these suits may be filed concurrently. They shall be filed in any District Court of the United States.

Limiting challenges to just the grounds of "arbitrary and capricious" Treasury rules would narrow the range of suits drastically. The court need only look at the first part of the Chevron test, ruling for the Treasury unless the statute is unambiguously contrary to the Treasury position. Yet these challenges would narrow the range of unlawful actions Treasury could take even more. There at most dozens of ways the ambiguities in a sentence can be construed, but there is an infinite number of "interpretations" that are totally unfounded. A Congressmen could not successfully challenge an IRS interpretation of "after several years" as being anywhere from 2 to 10 years, but he could challenge an interpretation as "after 200 years" or "after the taxpayer has travelled to Kashmir".[45]

Requiring two Congressmen rather than one will help to reduce the number of frivolous suits -- though we recognize that we will not eliminate them. We originally thought to require five congressmen rather than two but recalled how in 1940 Vichy the resolution

[44] The Tax Anti-Injunction Act of 1867, 26 U.S.C. Sec.7421(a), says: "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed". This provision would continue to apply, and would restrict our new statute to injunctions to collect more tax but not less. We suspect that this would help prevent Congressmen from filing frivolous suits to demonstrate sympathy with their constituents.

[45] "After the taxpayer has travelled to Kashmir" is ridiculous, of course. But we must keep in mind that the Bad Man asks not whether an interpretation is ridiculous, but whether he can get away with it.

that France needed a new constitution passed by 395 to 3 in the Chamber of Deputies and 229 to 1 in the Senate.[46]

Allowing more than one suit and in different courts will prevent collusive suits that block review. If only the Tax Court had jurisdiction, for example, then a pro-Treasury plaintiff could bring suit there, "take a dive," and refrain from appealing -- thereby blocking a real plaintiff.[47]

3. A Qui Tam Statute. -- An alternative to allowing Congressmen to challenge Treasury Notices would be a qui tam statute. A short version, worded for contrast to allow many more suits than our previous statute, might go as follows:

Qui Tam Tax Regulation Enforcement Bill

> It shall be illegal for any employee of the Treasury Department to misinterpret a federal statute. Any employee found willfully to have misinterpreted a statute shall pay a civil fine of $500. Any two members of Congress may bring a civil action against such violator in any District Court of the United States.

Conceptually, the qui tam statute performs much the same function as the standing rule. Unfortunately, it does present the same (non-trivial) risk of frivolous litigation. Either version enables two members of Congress to file suit to challenge any action by the Treasury to route funds to politically favored institutions.

It may seem imprudent to enlarge the power of the courts in a notoriously litigious United States already known for accusations that judges abuse their power by imposing their personal political views. The policy area we are opening up to judicial review, however, is not one known for judicial activism. Indeed, it is generally thought that judges dislike deciding tax cases. Even Justice Antonin Scalia, who made his name in administrative law in his academic career, said, "The constitutional work can be dull, too, but it's not like the tax code. Philosopher-kings do not read the Internal Revenue Code, believe me."[48] Justice William Douglas, famed for his expertise in business law and his activism, wrote to an ill Justice Black, "Take good care, lie low, and forget about these dull tax cases – which are now droning on and on..." (Richards,2001). And Judge Learned Hand, known for his common-law decisions in private law, said in 1947:

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[46] The Collapse of the Third Republic, W. Shirer (1969) p. 933. Two Socialist and one Radical deputy voted against; the only dissenting senator was the right-wing Marquis de Chambrun.

[47] Congress cannot completely delegate the executive power to enforce the laws. In *Unique Product Solutions, Ltd. v. Hy-Grade Valve, Inc.* (February 23, 2011, N.D. Ohio), the court held that the President could not give a private plaintiff complete authority to pursue a criminal case against someone who labeled a product as patented after the patent expired. To do so was, it explained, an unconstitutional delegation of the President's duty to "take care" that the laws be faithfully executed.

[48] "A Look at the Hidden World of U.S. Associate Justice Antonin Scalia," National Post, June 12, 1992 as quoted in Richards (2001). Note too what former tax lawyer Justice Blackmun said: "If one's in the doghouse with the Chief, he gets the crud. He gets the tax cases and some of the Indian cases, which I like, but I've had a lot of them." (thinkexist.com/quotation/if_one-s_in_the_doghouse_with_the_chief-he_gets/208404.html—original, probably from Robert Woodward and Scott Armstrong (2005) The Brethren, Simon & Schuster.)

"In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross- reference to cross-reference, exception upon exception – couched in abstract terms that offer no handle to seize hold of – leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness."

One can only imagine what the less economics-minded judges must think about tax cases. Yet it is perhaps in tax cases—particularly business tax cases--- that even the limited intelligence of the courts most exceeds the intelligence of the voter, even as it is there that we can expect judges to face the least temptation to care enough about policy to impose their own preferences instead of trying to follow the law.[49] Legislatures, in contrast, while also having neutral ideological preferences, can use the opacity of tax law to transfer large sums of money to sophisticated supporters or to conceal extravagance with public funds. Criminal procedure presents the opposite combination of relative expertise and ideological conflict of interest. Judges seem to like deciding this kind of case, if we look at the willingness of the U.S. Supreme Court to accept cert, despite the fact, or perhaps because of the fact, that they involve situations that the average voter can understand and laws which politicians cannot use to transfer money from one interest group to another (see Stuntz, 1997, 2006, for close analysis of the pathological judicialization of the criminal justice process).

VI. Conclusions

Authority over tax administration is authority easy to abuse. I.R.S. Notice 2010-2 and its predecessors purported to exempt companies partly owned by the government from taxes they would have had to pay had their owners been entirely private. The case of GM is the clearest in terms of the bailout of a favored constituency, because that transaction resulted in a large subsidy to a labor union that had strongly supported the Administration's party. Yet all of the Notices helped hide the real cost of the TARP bail-outs from the public. It is hard for Congress to overturn executive actions that have no basis in statute, requiring as it does the agreement of 2/3 of both the Senate and the House of Representatives to override a Presidential veto. The natural place to check invalid interpretations of statutes is in the courts. Currently no one has standing to challenge tax interpretations that benefit a few at the expense of taxpayers in general. Toward that end, we propose giving standing to members of Congress.

[49] The incentives and expertise of Supreme Court clerks are perhaps just as important, since they customarily do the first cut of cert petitions in deciding which cases are worth consideration by the Court. How many clerks have taken a tax course? We have not found articles on the self-interest of clerks in cert petition triage, but on more measurable consideration in tax cases and cert, see Staudt (2004).

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