What We Talk About When We Talk About Tax Shelters

Lawrence Zelenak[*]

ABSTRACT: This Response to Jonathan H. Choi's recent Article, Beyond Purposivism in Tax Law*, endorses Choi's preference for purposivist approaches to the interpretation of tax statutes, but notes and explains three areas of disagreement. First, this Response proposes a different definition of a tax shelter, under which the "puzzle" motivating Choi's analysis disappears. Second, this Response explains how an inductive approach to tax shelter analysis can produce important insights likely to be missed by Choi's preferred deductive approach. Finally, this Response criticizes Choi's conclusion that "the normative [policy] preferences of tax experts" should prevail over legislative intent; this Response instead urges a* via media*, which would give considerable weight to the normative preferences of experts, yet avoid Choi's elevation of the views of unelected experts over those of an elected Congress.*

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INTRODUCTION

In *Beyond Purposivism in Tax Law,* Jonathan H. Choi begins by borrowing a "popular definition" of a tax shelter: "a tax shelter complies with the text of the statute, but not the statute's underlying purpose."[1] From that definition, it would follow for a purposivist—and, when it comes to interpreting the Internal Revenue Code ("I.R.C." or "the Code"), both Choi and I are

* Pamela B. Gann Professor, Duke Law School.

1. Jonathan H. Choi, *Beyond Purposivism in Tax Law*, 107 IOWA L. REV. 1439, 1440 (2022).

purposivists—that to label a transaction a tax shelter is to conclude that it does not (or at least should not) work. For Choi, this results in a puzzle because "analysis of specific purposes and structural principles would also invalidate any number of tax structures widely [and correctly] considered legitimate."[2] Choi describes and evaluates three such "tax structures" in some detail: (1) "double-dummy" mergers (treated as nonrecognition transactions under I.R.C. § 351); (2) the deductibility of prepayments (by twelve months or less) of business expenses by cash-method taxpayers; and (3) "check-the-box" entity classification elections.[3]

To resolve this puzzle, Choi proposes a revised definition of a tax shelter: "a better and more direct test of whether a transaction is a tax shelter is simply whether it violates the normative preferences of tax experts."[4] Choi goes on to explain that in applying this revised purposivist approach to tax shelter analysis, Treasury and the Internal Revenue Service in *ex ante* regulations and other prospective guidance should emphasize "pragmatic purposivism," with their readings of the Code "based on their judgment of which interpretation would lead to the best policy outcomes."[5] Courts, however, in making *ex post* determinations of the tax consequences of completed transactions, should be guided by "doctrinalist purposivism" focusing on the applicability (or not) of the economic substance doctrine[6] and other anti-abuse doctrines such as the sham transaction, step transaction, and substance-over-form doctrines.[7]

Choi's Article is among the most thoughtful and creative contributions to the tax shelter policy literature in recent decades. His explanation of why administrators and judges should approach tax shelter questions differently is particularly enlightening. Despite my admiration for the Article—and despite my general agreement with Choi that the tax shelter problem calls for some sort of purposivist approach to statutory interpretation—I disagree with a few aspects of Choi's analysis. In this Response I explain those disagreements. Part I explains why I favor a quite different definition of tax shelter, and why the choice of definition matters. Part II contrasts Choi's predominately deductive approach to tax shelter analysis—starting with broad concepts and abstract principles, and then applying those concepts and principles to particular cases[8]—with my preference for a more inductive approach: deciding particular cases ad hoc, based on a "thick" analysis of facts and law, and deriving general principles from the results of cases decided inductively. Finally, I take issue with Choi's conclusion that when principles of "faithful agency" in statutory interpretation conflict with the "normative [policy]

2. *Id.* at 1442.

3. *Id.* at 1451–59.

4. *Id.* at 1442. Choi later restates and elaborates on this claim. *Id.* at 1467.

5. Choi, *supra* note 1, at 1470.

6. This is codified at I.R.C. § 7701(o) (2018).

7. Choi, *supra* note 1, at 1473.

8. *See id.* at 1445–48 (discussing purposivism in general before applying it to particular cases).

preferences of tax experts," experts' preferences should prevail.[9] In contrast, I urge that when a tax shelter creates a situation not contemplated by Congress when enacting the statutory provision at issue, the interpretive goal should be to treat the shelter as the enacting Congress would have wanted it treated if it *had* contemplated the shelter transaction. I explain that in practice this approach still gives considerable weight to the normative policy preferences of experts, while avoiding Choi's elevation of the policy preferences of unelected experts over those of an elected Congress.

I. WHAT WE TALK ABOUT WHEN WE TALK ABOUT TAX SHELTERS

"Tax shelter" is a term thrown about rather casually in tax policy discussions, rather than a term of art with a precise technical meaning.[10] As Choi documents, some commentators have favored the definition he takes as the starting point for his analysis, under which a shelter is a transaction compliant with the statutory text but not with the statutory purpose.[11] In my view, however, a very different definition of tax shelter is equally widely used and more analytically helpful. Under this alternative definition, a tax shelter is a transaction designed to "produce[] [an] *artificial* tax loss[]"—that is, a tax loss where the taxpayer has no corresponding economic loss, or where the tax loss far exceeds the economic loss—which loss can be used to offset (in other words, to "shelter") a taxpayer's income from sources unrelated to the shelter.[12] In substance, this definition closely resembles Michael Graetz's more witty and memorable definition of a tax shelter as "a deal done by very smart people that, absent tax considerations, would be very stupid."[13]

It is crucial to the definition that the tax loss be artificial, at least in significant part. As long as a taxpayer's marginal tax rate is less than one hundred percent, there is no incentive to incur a real economic loss just to produce a deductible tax loss in the amount of the economic loss. If, for example, a taxpayer could create a deductible $10,000 loss by incinerating one hundred Franklins, a taxpayer in the top (thirty-seven percent) bracket could thereby reduce his tax bill by $3,700, but only by incurring a pre-tax loss of $10,000. When the embers cool, the taxpayer would be $6,300 poorer. Burning money would be a tax shelter only if a taxpayer could wave an unlit

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9. *Id.* at 1442, 1467 (emphasis omitted).

10. *But see* I.R.C. § 6662(d)(2)(C)(ii), defining a tax shelter as any "plan or arrangement" having as "a significant purpose . . . the avoidance or evasion of Federal income tax." The definition applies only for the narrow purpose of determining whether a taxpayer is entitled to a reduction of the taxpayer's accuracy-related penalty under I.R.C. § 6662 because the taxpayer's tax return position was supported by substantial authority, or because the taxpayer adequately disclosed the taking of the position on the return.

11. *See* Choi, *supra* note 1, at 1440.

12. RICHARD SCHMALBECK, LAWRENCE ZELENAK & SARAH B. LAWSKY, FEDERAL INCOME TAXATION 685 (5th ed., 2018).

13. Lynnley Browning, *How to Know When a Tax Deal Isn't a Good Deal*, N.Y. TIMES (Sept. 10, 2008), https://www.nytimes.com/2008/09/10/business/businessspecial3/10TAX.html [https://perma.cc/ZJC3-6RPA].

match over the pile of Franklins, chant "I deem thee burned" three times, return the unharmed bills to the mattress, and nevertheless claim a $10,000 tax loss.[14]

This definition differs from Choi's starting point definition in two ways. First, under this definition, to conclude that a transaction is a tax shelter is not to conclude that it necessarily does not—or should not—work. For example, where the passive loss rules do not apply, taxpayers are generally free to create deductible artificial tax shelter losses by making debt-financed investments in business assets eligible for accelerated cost recovery system ("ACRS") deductions.[15] If, as is often the case, the ACRS deductions are substantially greater than economic depreciation, such a transaction is a tax shelter under the artificial loss definition. It absolutely does not follow, however, that because the transaction is a tax shelter it is illegitimate under current law.

Second, under this definition, taxpayer-favorable results that do not involve the sheltering of unrelated income are not tax shelters, whether or not the hoped-for taxpayer-favorable results depend on the exploitation of a gap between legislative text and statutory purpose. The accompanying grid illustrates how a transaction may be a shelter under both definitions, under one definition but not the other, or under neither:

14. A plausible extension of this tax shelter definition would include a transaction relating to a real economic loss, where the taxpayer had suffered the economic loss *before* entering into the tax shelter transaction, and the point of the shelter transaction was to enable the taxpayer to realize and deduct the loss without significantly changing the taxpayer's economic position. For a classic (and successful) example of this, see generally Cottage Sav. Ass'n. v. Comm'r, 499 U.S. 554 (1991).

15. For the passive loss rules, see I.R.C. § 469. Taxpayers are generally not subject to the passive loss rule with respect to activities in which they "materially participate." I.R.C. § 469(c)(1)(B). For the ACRS rules (providing for cost recovery allowances without reference to the actual decline in value of a taxpayer's ACRS property), see I.R.C. § 168.

Tax Shelter Definitions Compared

	Artificial loss to offset unrelated income (a shelter under Zelenak's preferred definition of a shelter)	**No artificial loss (not a shelter under Zelenak's preferred definition of a shelter)**
Transaction complies with statutory text but not with purpose (a shelter under Choi's starting point definition)	1. Classic abusive shelters. Examples include *Knetsch v. United States*, *ACM Partnership v. Commissioner*, and many, many others.[16]	2. Choi's three examples: double-dummy mergers, prepaid expenses of cash-method taxpayers, and check-the-box entity classification.[17]
Transaction complies with both text and purpose (not a shelter under Choi's starting point definition)	3. A transaction (not subject to I.R.C. § 469) based on interest expense deductions and economically artificial ACRS deductions; the home mortgage interest deduction.[18]	4. The vast majority of positions taken by taxpayers on tax returns, which are consistent with both statutory text and statutory purpose, and which do not result in artificial tax losses.

Although Choi and I disagree about the characterizations of items in both Box 2 and Box 3, the more significant disagreement concerns Box 2. The fact that the items in Box 2 are tax shelters under Choi's starting point definition sets up the puzzle his Article aims to solve: how to explain why the items in Box 2 are *not* generally considered tax shelters—and rightly

16. In *Knetsch v. United States*, 364 U.S. 361, 362–66 (1960), the taxpayer attempted to create an artificial loss by combining deductible interest expense with tax-deferred "inside build-up" in the value of an annuity purchased with the borrowed funds generating the taxpayer's interest expense. Although the transaction complied with the literal language of the statute (at the time of the transaction), the Supreme Court ruled against the taxpayer on the basis of the sham transaction and substance-over-form doctrines. *Id.* at 365–70. In *ACM P'ship v. Comm'r*, 157 F.3d 231, 233–44 (3d Cir. 1998), the taxpayer attempted to create a deductible artificial loss in a transaction relying on partnership tax rules and the regulations governing the taxation of contingent payment installment sales. Although the transaction complied with the literal language of the relevant provisions, the Court ruled that the transaction lacked economic substance, and so disallowed the claimed loss on the basis of the economic substance doctrine (pre-codified version). *Id.* at 245–54.

17. As discussed below, Choi's conclusions that these three structures do not comply with statutory purposes is debatable. *See infra* notes 20–21 and accompanying text. For purposes of the grid, however, I accept Choi's classification. Also, as discussed below, a strained argument could be made that the deductibility of prepaid expenses of cash-method taxpayers results in tax shelters under my preferred definition. *See infra* note 23 and accompanying text.

18. For transactions based on interest expense and ACRS deductions, see *supra* note 15 and accompanying text. For the home mortgage interest deduction, see I.R.C. § 163(h)(3). Owning and living in a mortgaged home is a tax shelter under my preferred definition, regardless of whether the homeowning taxpayer thinks of it as a tax shelter. The interest expense deduction creates a tax loss from homeownership that can be used to shelter other income (usually salary) from tax, and the loss is artificial to the extent the interest expense is economically offset by the combination of tax-free imputed rental income from the owner-occupied dwelling and tax-free unrealized appreciation in the home's value.

so—despite their seeming to fit the starting point definition.[19] One *might* quibble with Choi's conclusions that the three tax treatments in Box 2 fail to comply with the Code's underlying purposes. For example, the underlying purpose of the statutory blessing of cash-method accounting[20]—despite the fact that the cash method does a worse job than the accrual method of accurately reflecting economic income—is that the simplicity advantages of the cash method outweigh its accuracy disadvantages in some contexts. To my mind, the regulation specifying that the cash method's simplicity overrides economic accuracy in the case of expenses prepaid by no more than twelve months strikes a balance between simplicity and accuracy that is in keeping with the spirit of the Code's authorization of cash-method accounting.[21] Similar arguments could be made that nonrecognition treatment for double-dummy transactions under I.R.C. § 351 and check-the-box entity classification are consistent with legislative purposes. But for purposes of this discussion, let's assume, *arguendo*, that Choi correctly characterizes all three treatments as contrary to statutory purpose, with the result that they would be considered tax shelters under his starting point definition. The resulting puzzle—that those treatments would be tax shelters under Choi's starting point definition, but that neither Choi nor other tax experts think of them as shelters—provides the motivation for Choi's Article and leads to his proposal for a new definition of tax shelters based on the normative preferences of tax experts.[22]

By contrast, under my preferred tax shelter definition, the three items in Box 2 are not tax shelters because they do not produce artificial losses (whether or not they are consistent with legislative purposes).[23] Thus, the puzzle that drives Choi's entire analysis simply does not exist under the artificial loss tax shelter definition, for two reasons: (1) Choi's three examples are not tax shelters under the artificial loss definition; and (2) even if they were tax shelters under that definition, it would not follow from their classification as tax shelters that they do not—or should not—work. Working from the artificial loss tax shelter definition, consideration of Box 2-type items creates no puzzle and furnishes no reason to reconsider the definition.

19. *See* Choi, *supra* note 1, at 1449–60.

20. *See generally* I.R.C. §§ 446(c)(1), 448 (describing cash-method accounting).

21. Treas. Reg. § 1.263(a)-4(f) (2022).

22. *See* Choi, *supra* note 1, at 1467.

23. The statement in the text is clearly true for double-dummy transactions and check-the-box entity classification. An argument could be made that deductions for prepaid expenses fit my tax shelter definition–that a taxpayer suffers no economic loss upon prepayment of an expense because the cash outlay is offset by whatever right it creates for the taxpayer, so that the resulting deduction has no corresponding economic loss. On the other hand, the taxpayer has made an actual cash outlay in the amount of the permitted deduction, and the loss is artificial only in the sense that it is claimed one year sooner than the economics of the situation would dictate.

II. Inductive and Deductive Ways of Thinking About Tax Shelters

Choi's analytical approach in his Article is deductive; he starts with broad concepts and abstract principles (purposivism in general, as well as pragmatic purposivism and doctrinal purposivism), and then applies those concepts to particular cases.[24] In my own thinking about tax shelters, I usually find it more helpful to proceed inductively: to start with a particular tax shelter transaction, and to decide whether that tax shelter should work based on a "thick" analysis of both the facts of the shelter and all relevant law and policy. The results are necessarily somewhat ad hoc and intuitive, but after consideration of a number of such cases, some general principles of statutory interpretation—as applied to tax shelters—should emerge.

Both Choi's preferred top-down deductive approach and my preferred bottom-up inductive approach have value; whether one gravitates more to one or the other is as much a matter of temperament as it is of considered judgment. And thinking about tax shelters both deductively and inductively is likely to result in greater enlightenment than exclusive reliance on one approach or the other.

As a demonstration of the added value of an inductive approach to tax shelters, consider the *Black & Decker* contingent liability tax shelter, to which Choi devotes considerable attention in his Article.[25] Although Choi goes into greater detail in the case of this shelter—which he describes as possibly "the most famous modern tax shelter"[26]—than with most of the examples he considers, his deductive approach is still less concerned with the particulars of the shelter than an inductive approach would be. As a result, his analysis of *Black & Decker* misses what I consider *the* crucial point.

Some background on the corporate tax provisions at issue in *Black & Decker* is necessary, before turning to the facts of the contingent liability shelter. If a taxpayer—or several taxpayers acting pursuant to a single plan—transfers property to a corporation in exchange for stock of the corporation, and the taxpayer—or the taxpayer plus other transferors of property under the plan—owns at least eighty percent of the stock of the transferee corporation immediately after the transfer, then I.R.C. § 351 provides that the taxpayer recognizes neither gain nor loss on the exchange.[27] If, however, the taxpayer receives in the exchange other property (in tax jargon, "boot"), in addition to stock of the transferee corporation, then the taxpayer must recognize gain equal to the lesser of the taxpayer's gain realized or the value of the boot received.[28] Section 358 governs the taxpayer's basis

24. *See* Choi, *supra* note 1 at 1444–60.

25. *Id.* at 1450–51, 1460–62, 1471 (discussing Black & Decker Corp. v. United States, 436 F.3d 431 (4th Cir. 2006)).

26. *Id.* at 1450.

27. I.R.C. § 351(a).

28. *Id.* § 351(b).

in the stock received in the § 351 exchange.[29] The § 358 stock basis rules are designed to build into the stock a potential gain equal to the gain that the taxpayer realized but was not required to recognize on the § 351 exchange.[30] Thus, the stock basis equals the taxpayer's basis in the property transferred to the corporation by the taxpayer, increased by any gain recognized by the taxpayer, and decreased by the value of any boot received.[31]

If the taxpayer's boot received takes the form of debt relief, the debt relief is not treated as boot triggering immediate recognition of gain,[32] but the debt relief is nevertheless treated like cash boot in determining the taxpayer's basis in stock received.[33] This treatment of debt relief builds into the stock received by the taxpayer the amount of gain the taxpayer realized but did not recognize on the § 351 exchange. Suppose, for example, that in a § 351 exchange Taxpayer ("A") transfers to X Corporation an asset with a basis of $60 and value of $100, subject to a $60 mortgage (debt incurred by A to acquire the asset), and receives in exchange X Corporation stock worth $40 and $60 of debt relief. A's gain realized is $40 ([$40 + $60] amount realized - $60 basis), but because the debt relief is not treated as boot, A recognizes no gain. A's basis in the X Corporation stock, under the rules of § 358, is zero: $60 basis of transferred property minus $60 debt relief (treated like cash) equals zero. This builds into the X Corporation stock a potential gain of $40 ($40 value - $0 basis), which properly equals the excess of A's $40 gain realized over A's $0 gain recognized. Reaching this sensible result requires reducing A's basis in the X Corporation stock by the amount of the debt relief. To put the point another way: because the tax system assumed at the outset that A would repay the $60 debt—by allowing A to include the amount of the debt in A's basis in the asset—it must require A to account for the debt relief when it becomes clear that A will never have to repay (by reducing A's basis in the X Corporation stock by the amount of the debt relief).

But now suppose the same facts, except that instead of being acquisition indebtedness—which was reflected in A's basis in the transferred asset—the $60 debt consists of the accounts payable of A's unincorporated cash-method business. The tax system has never assumed that A would pay off his accounts payable: the accounts payable have not increased A's basis in any asset, and because A is a cash-method taxpayer, he is not entitled to business expense deductions unless and until he makes payments on his accounts.[34] Because

29. *Id.* § 358.

30. Peracchi v. Comm'r, 143 F.3d 487, 489–91 (9th Cir. 1998).

31. I.R.C. § 358(a)(1).

32. *Id.* § 357(a). There are two exceptions. Under I.R.C. § 357(b), debt relief is treated as boot if the taxpayer's principal purpose with respect to the debt relief was a tax avoidance purpose (or, if not a tax avoidance purpose, "was not a bona fide business purpose"). And under I.R.C. § 357(c)(1), debt relief triggers gain recognition to the extent the amount of the debt relief exceeds the taxpayer's total basis in assets transferred by the taxpayer to the corporation.

33. *Id.* § 358(d)(1).

34. Treas. Reg. § 1.446-1(c)(1)(i) (2022).

the tax system did not give A any favorable front-end tax treatment when the accounts payable arose, there is no need for the tax system to account for A's relief from the payables. Consistent with this logic, the applicable gain recognition and basis provisions, taken together, provide that a taxpayer can simply ignore relief from "a liability the payment of which . . . would give rise to a deduction" in calculating his stock basis under § 358.[35] So, in this version of the hypothetical, A's basis in his X Corporation stock is simply his $60 basis in the transferred asset, *not* reduced by the $60 of accounts payable assumed by X Corporation. This builds into A's X Corporation stock a potential *loss* of $20; if A sold the X Corporation stock for its current value of $40, A's $60 basis would exceed his amount realized by $20. The result is consistent with tax logic. Suppose A had cashed out his business by selling his asset ($100 value, $60 basis) and paying off his accounts payable with a portion of the amount realized. He would have realized a $40 gain on the asset sale and would have been entitled to a $60 deduction upon payment of the accounts payable. Thus, there was a net loss of $20 lurking in A's pre-incorporation business, and precisely that amount of loss is built into the X Corporation stock by the § 358 basis rules. So much for the corporate tax law background.

Now for the *Black & Decker* contingent liability shelter. In 1998, Black & Decker's actuaries estimated the corporation's contingent employee health benefit claims for future years (1999 through 2007) at $560 million.[36] Even though Black & Decker was an accrual-method taxpayer—and thus generally able to deduct business expenses as liabilities accrue, rather than having to wait until payment[37]—it could not deduct *these* expenses in 1998 because it did not satisfy the "all-events" test for business expense accruals. Under the applicable accounting method regulation, an accrual-method taxpayer cannot deduct an expense until "the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability."[38] Although Black & Decker might have been able to forecast with reasonable accuracy its total contingent health care liabilities for all of its employees, it could not do so with respect to particular claims of individual employees.[39] Therefore, it could not satisfy the all-events test with respect to that $560 million in 1998.[40] It would, of course, have been

35. I.R.C. §§ 357(c)(3) (gain recognition); *id.* § 358(d)(2) (basis).

36. Black & Decker Corp. v. United States, 436 F.3d. 431, 433 (4th Cir. 2006).

37. Treas. Reg. § 1.461-1(a)(2) (2022).

38. *Id.* The regulation is promulgated under I.R.C. § 461(a), which somewhat unhelpfully merely states that a deduction is allowed in "the proper taxable year under the method of accounting used in computing taxable income."

39. *Black & Decker Corp.*, 436 F.3d at 433.

40. As noted in the appellate opinion in *Black & Decker*, the parties involved in the transaction understood that the $560 million deduction was not ripe under the "all-events" test; hence the need for the shelter. *Id.* at 433–38.

entitled to deduct $560 million in later years, as claims ripened and contingencies disappeared, but it could not do so in 1998.[41]

Not content to wait to claim its deduction, Black & Decker entered into a contingent liability tax shelter in 1998 in the hopes of accelerating the deduction.[42] At the urging of a tax shelter promoter, Black & Decker formed a new corporation, BDHMI, and in a § 351 exchange transferred $561 million cash to BDHMI in exchange for: (1) BDHMI's assumption of Black & Decker's $560 million of contingent employee health care liabilities; and (2) all the BDHMI stock, worth $1 million.[43] Because the $560 million contingent liability fit the statutory definition of a disregarded liability—"a liability the payment of which . . . would give rise to a deduction"[44]—Black and Decker took the position that its basis in the BDHMI stock was simply equal to the $561million transferred cash, without reduction by the $560 million of debt relief.[45] When Black & Decker promptly sold the BDHMI stock for its $1 million value, Black & Decker took the position that it had realized a capital loss of $560 million.[46] Although a corporation can deduct capital losses only against capital gains,[47] Black & Decker had more than $300 million of capital gains it was eager to offset.[48]

Did the shelter work? In granting Black & Decker's motion for summary judgment, the District Court ruled that it did, finding that the $560 million loss followed from the mechanical application of the relevant statutory provisions, and that the transaction survived challenges under the various anti-abuse doctrines.[49] The Fourth Circuit agreed with the District Court concerning the mechanical application of the statutory provisions, but nevertheless remanded the case for trial to determine whether the shelter survived scrutiny under the sham transaction doctrine.[50]

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41. As the discussion in the text indicates, the $560 million loss claimed by Black & Decker reflected an actual economic cost to the corporation. Although the shelter significantly accelerated the deductibility of that economic cost, it did not create an artificial tax loss unrelated to economic realities. As such, in my terms it is a tax shelter only under the expanded definition of tax shelter, which includes *Cottage Savings*-type situations. For a brief discussion of the expanded definition, see *supra* note 14.

42. *Black & Decker Corp.*, 436 F.3d at 433–34.

43. *Id.*

44. I.R.C. § 357(c)(3).

45. *Black & Decker Corp.*, 436 F.3d at 434. Although Black & Decker also took the position that the $560 million debt relief did not have to be taken into account for purposes of § 357(c)(1)–under which gain must be recognized to the extent debt relief exceeds basis in transferred assets–that was not crucial, because even if the debt relief counted for purposes of that provision it would not have exceeded the $561 million of basis from the transferred cash.

46. *Id.* at 434.

47. I.R.C. § 1211(a).

48. *Black & Decker Corp.*, 436 F.3d at 433.

49. Black & Decker Corp. v. United States, 340 F. Supp. 2d 621, 623–24 (D. Md. 2004).

50. *Black & Decker Corp.*, 436 F.3d at 441–43. What the court described as the "sham transaction" doctrine is more commonly referred to as the economic substance doctrine. The economic substance doctrine was judge-made law as of 2006, but today a version of the doctrine

Both the Fourth Circuit in deciding that the viability of the shelter was dubious considering the sham transaction doctrine, and Choi in explaining why "the pragmatic purposivist could easily conclude that this shelter should be prohibited,"[51] focus exclusively on analyses of the structure and purpose of the stock basis rules of § 358. The problem with this focus is that the statutory (and regulatory) policy contravened by the contingent liability shelter is not the policy underlying the basis rules of § 358. Rather, it is the policy of the all-events test for the deductibility of the expenses of accrual-method taxpayers, as set forth in the regulations interpreting § 461.

The entire point of all the BDHMI rigamarole was to accomplish an end run around to the all-events test, by using the creation and sale of BDHMI and the basis rules of § 358 to generate a current deduction—in the form of a capital loss on the sale of BDHMI stock—for expenses that otherwise had not ripened to the point of deductibility. The crucial purposivist inquiry in evaluating the shelter should not have been whether the shelter was contrary to the purpose underlying the treatment of disregarded liabilities under §§ 357 and 358. From the government's point of view, focusing on the statutory purpose for the § 358 basis rules is not helpful here. The logic underlying the non-reduction of basis on account of the taxpayer's relief from liabilities the payment of which would have been deductible by the taxpayer, is that there is no need for the tax system to account for the taxpayer's relief from liabilities that the tax system had never previously taken into account.[52] In other words, as long as the tax system had ignored the liabilities while they existed, it is perfectly logical for the tax system also to ignore the liabilities when they go away. That is the purpose of the non-reduction of basis under § 358(d)(2), and the taxpayer had a strong argument that the taxpayer's desired result was entirely consistent with the purpose of § 358.

Instead, the crucial purposivist inquiry should have been whether the shelter was contrary to the purposes of the all-events test under § 461(a) and Treas. Reg. § 1.461-1(a)(2).[53] I will not attempt a detailed analysis of that

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is codified at I.R.C. § 7701(o). The Fourth Circuit noted that Congress had added § 358(h) to the Code in 2000, and that if that new provision applied it would clearly entitle Black & Decker to a basis of only $1 million in its BDHMI stock, thereby stopping the would-be shelter dead in its tracks, even without consideration of the several anti-abuse doctrines. *Black & Decker Corp.*, 436 F.3d at 434–35. It also noted, however, that § 358(h) was not retroactive, and thus did not apply to Black & Decker's 1998 transaction. *Id.* at 435.

51. Choi, *supra* note 1, at 1471.

52. *Supra* text accompanying notes 35–36.

53. I.R.C. § 461(a); Treas. Reg. § 1.461-1(a)(2) (2022). Choi does not discuss the all-events test and its purposes in his analysis of *Black & Decker*. The Fourth Circuit quotes an unnamed investor in BDHMI who zeroed in on the issue: "As one of BDHMI's outside investors put it, 'The rationale behind the establishment of the subsidiary [BDHMI] is that a loss equal to the reserve for the liabilities can be recognized upfront for tax purposes . . . .'" *Black & Decker*, 436 F.3d at 434. That is, however, the only mention in the entire Fourth Circuit opinion of the real point of the shelter. *Id.* at 432–43. For another acknowledgment of the real point of contingent liability shelters, see I.R.S. Notice 2001-17, 2001-9 I.R.B. 730 (describing contingent liability shelters generally, and noting that the shelters "are being marketed to taxpayers for the purpose of accelerating . . . tax deductions").

question here, but I will note the obvious point that a transaction designed to avoid an otherwise applicable provision is *prima facie* contrary to the purpose of the avoided provision, especially if (as here) there is little or no non-tax business purpose or economic substance to the transaction. Whichever way one ultimately resolves that purposivist inquiry, my point is simply that it *is* the right question, and that a details-intensive bottom-up shelter analysis is more likely to spotlight that question than is a top-down deductive approach.

CONCLUSION: PURSUING PURPOSIVISM WHILE RESPECTING FAITHFUL AGENCY

As much as I appreciate Choi's vote of confidence in the normative preferences of tax experts, Choi's recommendation that the validity of would-be tax shelters be determined according to those expert preferences strikes me as a bridge too far. It would give the last word on whether a particular tax avoidance strategy succeeds or fails not to the elected members of Congress, but to unelected tax policy experts—whether expert status is determined by some sort of consensus, or by self-identification. Consider two features of the current I.R.C., both of which are almost unanimously condemned by tax policy experts, not merely as bad policy, but as reflecting a deep legislative misunderstanding of the basic logic of an income tax: the tax-free step-up in basis at death,[54] and the deduction for unrealized appreciation in property donated to charity.[55] Each provision violates my normative preferences—and, I suspect, the normative preferences of the vast majority of other tax experts—and they do so from the perspective of my tax policy expertise.[56] Yet, subject to all the usual caveats about the artificiality of attributing intentions to a multi-member legislative body, Congress clearly intends both the basis step-up at death and the charitable deduction for unrealized appreciation.[57] The adverse policy judgments of experts cannot and should not override Congress's constitutionally-granted—and frequently exercised—power to enact bad tax policy.[58]

54. I.R.C. § 1014. For a detailed examination of the origins of the provision, and of later efforts (ultimately unsuccessful) to reform it, see LAWRENCE ZELENAK, FIGURING OUT THE TAX: CONGRESS, TREASURY, AND THE DESIGN OF THE EARLY MODERN INCOME TAX 85–99, 110–25 (2018).

55. Treas. Reg. § 1.170A-1(c)(1) (2022). Although the rule is explicitly expressed only in a regulation, by specifying certain situations in which a deduction for unrealized appreciation in donated property is *not* available, I.R.C. § 170(e) implicitly confirms the general rule stated in the regulation. For a detailed examination of the origins of the charitable deduction for unrealized appreciation, and of later (ultimately unsuccessful) reform efforts, see ZELENAK, *supra* note 54, at 99–109, 125–32.

56. By contrast, my normative preference might be for a top marginal rate well above the current thirty-seven percent, but that would be based more on my general political outlook rather than on any expert insights into the logical structure of an income tax.

57. This is clear both from the language of the I.R.C. and from the history recounted in ZELENAK, *supra* note 54, at 83–132.

58. U.S. CONST. art. I, § 8, cl. 1 (general "[p]ower [t]o lay and collect [t]axes"); *id.* amend. XVI (specific power to impose an unapportioned income tax).

I suspect Choi might agree—even if only reluctantly—and would propose some narrowing of the scope of his "normative preferences of tax experts" principle. For example, perhaps the principle would apply only when the statutory text relevant to the transaction in question reaches some critical level of ambiguity. Even as so narrowed, Choi's suggestion is too radical for my taste, because it disregards the principle that courts and agencies, as legally empowered interpreters of legislation, should endeavor to be faithful agents of the legislature. Choi correctly explains that "purposivism in tax law has largely followed the 'faithful agent' model of purposivism, where interpreters subordinate their judgments to the will of the legislature."[59] He concludes his Article, however, by advocating "interpretive possibilities beyond faithful-agent purposivism."[60] At least in some situations, then, Choi really does propose to elevate the policy preferences of unelected tax experts above those of Congress. This is the point at which Choi and I part ways, and I suspect many otherwise sympathetic readers of Choi's Article will have the same reaction.

There is, however, a way to achieve much of what Choi hopes to achieve with his "normative preferences" approach without abandoning faithful agency in the process. When confronted with a would-be tax shelter, based on an interpretation or application of a statutory provision clearly not anticipated by the enacting Congress,[61] courts and tax administrators should ask themselves, "If the enacting Congress *had* anticipated that taxpayers would engage in transactions like this one, based on a contestable reading of the relevant statutory provisions, would Congress have approved of such transactions, or would Congress have revised the statutory language to make it clear that such transactions do not work?"[62] To be sure, this approach has problems of its own. It is counterfactual (asking what Congress *would have*

59. Choi, *supra* note 1, at 1448 (citation to sources discussing general principles of faithful-agent purposivism omitted).

60. *Id.* at 1484.

61. *Black & Decker* is a fine example, as are many other tax shelter cases. *See generally supra* notes 36–49 and accompanying text.

62. Congress sometimes legislates prospectively against particular types of tax shelters, once it becomes aware of the existence of such shelters. As noted in the discussion of *Black & Decker*, *supra* note 50, Congress enacted § 358(h) to shut down contingent liability shelters. Congress enacted the new provision, without retroactive effect, after the tax year at issue in *Black & Decker*, but long before the appellate decision in the case. Under the approach I propose, the question arises whether the later enactment of an anti-shelter provision sheds any light on what the earlier Congress would have thought about such tax shelters had it been aware of them. On the one hand, the fact that the later Congress–which *was* aware of such shelters–decided to shut them down suggests that the earlier Congress might have been of the same view. On the other hand, the fact that the later Congress thought it necessary to enact legislation explicitly blocking the shelter suggests the later Congress thought it possible (at least) that the shelter worked under prior law. In any event, the membership of Congress–including party control–changes over time, so there is no guarantee that the earlier Congress would have shared the views of the later Congress. All things considered, tax administrators and the courts would generally do well to disregard the later enactment of anti-shelter legislation in deciding what the original enacting Congress would have done if it had been aware of such shelters.

thought, *if it had* thought), and thus unavoidably speculative. And when the approach is employed by tax experts with their own normative preferences, it is susceptible to wishful thinking, whereby what the enacting Congress would have thought turns out to be remarkably similar to the experts' policy preferences.

Nevertheless, unlike Choi's normative-preferences-of-experts approach, this approach at least aspires to faithful agency and to governance by elected legislators rather than governance by unelected tax experts in universities, think tanks, and law and accounting firms. If the approach is applied thoughtfully and honestly, by interpreters committed to faithful agency, the wishful thinking problem should be manageable. At the same time, it seems reasonable to start from a rebuttable presumption that "what Congress would have thought if it had thought about it" would have been consistent with good tax policy. The presumption could be rebutted by evidence that the enacting Congress had little use for the normative preferences of tax experts—either in general, or in the narrower context at issue. In short, this approach could go a considerable distance in the direction Choi would like the law to go, without requiring Choi's dubious rejection of faithful-agent purposivism. I hope he will consider this a friendly and constructive amendment to his thoughtful proposal for a revised approach to statutory interpretation in the tax shelter context.