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Should Ambiguous Revenue Laws Be Interpreted in Favor of Taxpayers?

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Should Ambiguous Revenue Laws Be Interpreted in Favor of Taxpayers? *By Steve R. Johnson*

There was a time when courts construed, or said that they construed, ambiguous federal tax statutes in favor of taxpayers. That time is long past. Or is it? This article examines whether, because of a recent Supreme Court case, the pro-taxpayer constructional preference may be resuscitated, and whether it should be.

I. Phase I: The Old Rule

In 1927, the Supreme Court remarked: "The provision [at issue] is part of a taxing statute: and such laws are to be interpreted liberally in favor of the taxpayers."[1] Eight years later, it said: "The rule obtains that a taxing statute, if of doubtful intent, should be construed favorably to the taxpayer."[2] For the time, these statements were not aberrational. Scores of decisions, by both the Supreme Court and lower federal courts, from the 1890's into the 1940's invoked similar principles.

It would be uncritical to accept such assertions at face value. In many tax cases of the period, courts spoke not of the pro-taxpayer constructional preference or even asserted a pro-Government one.[3] In others, the Government ultimately prevailed, despite the seeming closeness of the case and reference to the pro-taxpayer presumption.[4] Undoubtedly, some judges of the period did not accept a pro-taxpayer preference and some others gave it only lip service. Nonetheless, it is clear that many other judges and many leading tax practitioners did believe that such a preference did and should exist.[5]

II. Phase II: Abandonment of the Old Rule

Since the 1940's, the pro-taxpayer principle has been a rare visitor in federal tax decisions. It has been replaced by two contrary constructional principles, which have been invoked in literally thousands of more modern cases and which, cumulatively, put a sizeable "thumb on the scale" in the Government's favor in tax cases. These are the principles that (1) Congress intended to exert the full measure of its constitutional power to tax, thus that inclusions into income are construed broadly[6] and (2) deductions are a matter of legislative grace, thus should be construed narrowly.[7]

This replacement is not surprising historically. Judges are not immune to broad social trends. Pro-government and anti-government attitudes alternate, swinging like an irregular pendulum. When the former is in the ascendancy, assuring government ample revenue to discharge its duties predominates. When the latter replaces it, protection of taxpayers achieves greater imperative.

The period when courts were invoking a pro-taxpayer rule of construction roughly corresponded with the *Lochner* etc. heyday of substantive due process limits on government regulation. Then, the Great Depression, World War II, and the Cold War taught the nation to look to a powerful federal government to protect us. This was the same period when the pro-Government preferences drove the pro-taxpayer preference out of judicial currency. With the Reagan Revolution, the Supreme Court's revitalization of federalism, and Republican capture of Congress, one would expect the pendulum to swing again. In tax legislation, the fruits included the various Taxpayers Bills of Rights, culminating in the 1998 IRS Restructuring and Reform Act and the 2001 tax act. Is the stage set for reemergence of the pro-taxpayer constructional preference?

III. Phase III: A New Day or a False Dawn?

As stated, the old pro-taxpayer rule lay dormant for over half a century, echoes of it being heard only rarely, usually in penalty cases or state tax cases. Thus, its recent return to the universe of discourse was striking.

On June 4, 2001, the Supreme

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Court handed down its decision in *United Dominion Industries, Inc. v. United States*.[8] The case involved interpreting a portion of the consolidated return regulations. The Court applied various statutory construction principles.[9] Particularly interesting were Justice Thomas' concurrence and Justice Stevens' dissent. Justice Thomas wrote: "In cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter [the Government]."[10]

One would have expected Justice Stevens' dissent to rejoin that that "traditional canon" was long dead. Indeed, the most recent of the four cases (one of them a state case) cited by Justice Thomas was decided in 1927. However, Justice Stevens did not. Indeed, he agreed that "Justice Thomas accurately points to a tradition of cases construing 'revenue-raising laws' against their drafter,"[11] and he identified the pro-Government presumptions not as the controlling current rules but only as a "countervailing tradition," and one that Justice Stevens appeared to limit to deduction and exclusion cases.[12]

IV. Evaluation

Together the Thomas and Stevens's opinions in *United Dominion* raise the possibility of return of the old pro-taxpayer constructional preference. There are two aspects of the question: (1) whether it will return and (2) whether it should.

Prediction - My suspicion is that the possibility held out by the Court's June 4, 2001 decision will be another casualty of the events of and after Sept. 11, 2001. As explained earlier, doctrines often are not independent, isolated phenomena but are concretizations of moving political and ideological moods. The "limit government" movement that gained many victories in the past 20 years has been put on hold by the climate induced by terrorist attack on the United States and our worldwide response to it. If this climate causes another pendulum swing, the *United Dominion* suggestion is likely to be stillborn.

Desirability - Even if my prediction is right, it is the nature of the pendulum eventually to swing back. When, years or decades from now, the national mood turns again, would the Republic be better or worse off were the old rule restored?

My own view is "better off," especially if the rule were properly limited. Three points:

1. A relative of the old tax rule is the principle, still widely applied in contract actions, that an ambiguous instrument will be interpreted adversely to the party that drafted it.[13] That principle is designed to encourage parties to draft carefully and to punish those who don't. Of course, the Government drafts the tax statutes, and there are plenty of ambiguous ones.[14] I doubt that resurrecting the old presumption would lead to better drafting, but the state of tax legislative drafting is so low that, for me, punishment would be condign.
2. If, as I believe, the old rule should be restored, a key question is whether it should be a weak or a strong presumption. A weak presumption would operate only as a tiebreaker, i.e., only when the taxpayer's and Government's arguments are in equipoise. However, absolute equipoise is so rare that a weak presumption would be little more than symbolic. On the other hand, a strong presumption could be abused, were it interpreted to apply whenever the taxpayer raised any colorable argument. Thus, I recommend a middle course: the presumption would apply only when real and genuine doubt existed as to the statute's meaning.
3. Another question is whether the presumption should operate for all taxpayers. I think not. A major current problem in tax administration is corporate tax shelters. It would be ill to give aid and comfort to those pernicious arrangements. Well-heeled individuals and entities can pay for sophisticated tax advice. I would confine the presumption to other taxpayers. The eligibility rules for attorneys' fee shifting under I.R.C. § 7430 and for burden-of-proof reversal under I.R.C. § 7491 could be adopted as the line of demarcation as to the pro-taxpayer construction preference. NL

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ENDNOTES

[1] Bowers v. New York & Albany Lighterage Co., 273 U.S. 346, 350 (1927).
[2] McFeely v. Commissioner, 296 U.S. 102, 111 (1935).
[3] E.g., Deputy v. du Pont, 308 U.S. 488, 493 (1940); New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435, 440 (1934); Woolford Realty Co. v. Rose, 286 U.S. 319, 326 (1932).
[4] E.g., Irwin v. Gavit, 268 U.S. 161, 168 (1925).
[5] See, e.g., Erwin N. Griswold, "An Argument Against the Doctrine that Deductions Should Be Narrowly Construed as a Matter of Legislative Grace," 56 Harv. L. Rev. 1142 (1943).
[6] E.g., Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429 (1955).
[7] E.g., INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992).
[8] 121 S. Ct. 1934 (2001).
[9] In particular, the majority opinion contains an instructive treatment of the expressio unius canon. See id. at 1942-43.
[10] Id. at 1944.
[11] Id. at 1944 n.l.
[12] Id.
[13] E.g., Banks v. Banks, 648 So. 2d 1116, 1121 (Miss. 1994). Another analogy is the rule of lenity applied in criminal cases and sometimes in civil penalty cases. E.g., United States v. Callanan, 173 F. Supp. 98, 100 & n.3 (E.D. Mo. 1959).
[14] Federal tax legislation, including the precision of its drafting, has been on a downwards trajectory for 15 to 25 years.