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CHALLENGING THE TREASURY: UNITED DOMINION INDUSTRIES, INC. V. UNITED STATES¹

I. INTRODUCTION

“In this world nothing can be said to be certain but death and taxes.”² But consolidated corporate tax filers are finding a new way to make at least taxes less certain, though better defined, following the United States Supreme Court decision in *United Dominion Industries, Inc. v. United States* (“*United Dominion*”).³

The debate and discussion of tax avoidance, evasion, and abuse is extensive — individual taxpayers search for tax loopholes while corporations attempt to minimize tax liability with losses and deductions even though the corporation may, in fact, be making large profits.⁴

1. 532 U.S. 822 (2001).

2. Letter from Benjamin Franklin to Jean-Baptiste Leroy (Nov. 13, 1789), in *WORKS OF BENJAMIN FRANKLIN* ch. 6 (1818).

3. 532 U.S. 822.

4. See generally Graeme S. Cooper, Article, *Analyzing Corporate Tax Evasion*, 50 *TAX L. REV.* 33 (1994). Abuse, evasion and avoidance of tax are fairly well documented and debated, both here in the United States, and elsewhere. For example, one writer on an Australian web site comments:

The problem of tax avoidance is serious and has failed to be resolved over decades. To refer to aggressive tax avoidance as new is ridiculous. Decades of new laws (without retrospectivity) have failed to cage the tiger, proving that such laws will never succeed, because clever avoiders are always ahead of the changes.

Taxation Abuse, at <http://home.vicnet.net.au/~basils/tax.htm> (Nov. 24, 1998).

Examples of loopholes and abuse range from the mundane to the unusual—the city employee who found a way to avoid withholding taxes, see *Public Employees: Tax Evasion: Cheated and Taught Others to Cheat*, 7 *CITY LAW* 67 (2001), or the sham divorce, see Mark P. Gergen, *Business Purpose, Economic Substance, and Corporate Tax Shelters: The Common Knowledge of Tax Abuse*, 54 *SMU L. REV.* 131 (2001).

A good article on the issue of different types of tax abuse, avoidance and evasion is Cooper *supra*. For a good review of Internal Revenue Code § 7201, criminal tax evasion, see Stephanie A. Spanhel, Casenote, *Taxation - Criminal Tax Evasion - Elements of I.R.C. § 7201 - No Earnings and Profits, No Income: Must Taxes Actually Be Due?* *United States v. D’Agostino*, 145 F.3d 69 (2d Cir. 1998), 41 *S. TEX. L. REV.* 1475 (2000), which looks at different approaches to prosecution elements, and arguing that courts that allow prosecution in the absence of a tax deficiency are not looking at the realities of tax law.

As for corporations, the possibility of greatly reducing or eliminating tax liability is mostly a myth

For a consolidated corporate taxpayer,⁵ the list of business deductions and exclusions that help to limit the amount of taxable

when one considers the alternative minimum tax. 26 U.S.C. § 55 (2001). The alternative minimum tax applies both to individuals and to corporations, 26 U.S.C. § 55(b)(1) (2001), and imposes a tax, in addition to other taxes imposed by the Code, equal to the excess of the alternative minimum tax (defined in 26 U.S.C. § 55 (2001)) and the regular tax for the taxable year. 26 U.S.C. § 55(a) (2001). In the case of a corporation, the alternative minimum tax is equal to 20% of alternative minimum taxable income, beyond a given exemption amount, less any alternative minimum tax foreign tax credit for the taxable year. 26 U.S.C. § 55(b)(1)(B) (2001). The tax difference becomes more apparent when one considers the definition of alternative minimum taxable income given in 26 U.S.C. § 55(b)(2): alternative minimum taxable income is basically a corporation or individual's taxable income increased by the amount of certain tax-preferred deductions the taxpayer would be permitted to take. 26 U.S.C. § 55(b)(2) (2001). In other words, certain deductions that the IRS has decided are "tax preferred" are added back into the taxable income amount, and the alternative minimum tax is then determined based upon the taxable income amount plus any tax-preferred deductions, basically nullifying the effect of the deduction. *Id.* See also 1 STAND. FED. TAX REP. (CCH) ¶ 5101.01.

5. 26 U.S.C. § 1501 gives an affiliated group of corporations the privilege to file a consolidated tax return. All corporations that were members of the group for the taxable year must consent to the filing of a consolidated return and the consolidated return regulations. 26 U.S.C. § 1501 (2001). Only an affiliated group of taxpayers may file a consolidated return. See 26 U.S.C. § 1501. The term "affiliated group" is defined in 26 U.S.C. § 1504(a)(1):

- (A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if —
- (B)(i) the common parent owns directly stock meeting the requirements of paragraph (2) in at least 1 of the other includible corporations, and
- (ii) stock meeting the requirements of paragraph (2) in each of the includible corporations (except the common parent) is owned directly by 1 or more of the other includible corporations.

26 U.S.C. § 1504(a)(1) (2001). Paragraph (2) requires the parent of the affiliated group to own at least 80 percent of the total voting power of the stock of a corporation and have a value equal to at least 80 percent of the total value of the stock of that same corporation. 26 U.S.C. § 1504(a)(2) (2001). In essence, each corporation, beginning with the parent and following down a chain, must own at least 80 percent of the voting stock of the next corporation in the chain and also have a value of at least 80 percent of the total stock of the next corporation in the chain. The stock included in such 80 percent may not be stock that (1) cannot vote, (2) is "limited and preferred as to dividends and does not participate in corporate growth to any significant extent", (3) has certain redemption or liquidation rights, or (4) is not convertible to another class of stock. 26 U.S.C. § 1504(a)(4) (2001). Each member of the group must also be an "includible corporation." An "includible corporation" is basically any type of corporation except, for example, tax exempt corporations, S corporations, and foreign corporations, to name a few. 26 U.S.C. § 1504(b) (2001).

Filing a consolidated return accords certain recognized benefits to the consolidated group - most significantly the offsetting of operating losses and capital losses of one member against another member's profits as though the separate affiliates were one corporation rather than a chain of affiliated corporations. See 11 STAND. FED. TAX REP. (CCH) ¶ 33,168.0216, at 59,674. Consolidated taxpayers also face a number of disadvantages including deferral of intercompany loss recognition, possible decrease in loss carryover for an affiliate with a short tax year who joins the affiliated group, additional bookkeeping involved to keep track of deferred intercompany transactions, problems with minority shareholders and derivative suits, and possible accumulated earnings tax whenever the consolidated group's accumulated earnings and profits exceed \$250,000. 11 STAND. FED. TAX REP. (CCH) ¶ 33,168.0217, at 59,674-75.

income for a given year are sometimes determined in a different manner than for regular taxpayers.⁶

One of the many deductions available on the corporate tax front was the product liability loss (PLL),⁷ presently known as specified liability loss (SLL).⁸ The treatment of PLLs/SLLs today is, of course,

6. See Treas. Reg. §§ 1.1502-22 to 1-27 (2001). Common corporate deductions may be found in 26 U.S.C. §§ 162-174 (2001) and include, but are not limited to, the following: trade or business deductions, including salaries, travel expenses, and certain rentals (26 U.S.C. § 162 (2001)); deduction for interest on indebtedness (26 U.S.C. § 163 (2001)); deduction for selected taxes (26 U.S.C. § 164 (2001)); deduction for specific losses not compensated by insurance (26 U.S.C. § 165 (2001)); deduction for bad debts (26 U.S.C. § 166 (2001)); deduction for depreciation (26 U.S.C. § 167 (2001)); deduction for charitable contributions or gifts (26 U.S.C. § 170 (2001)); and net operating loss (NOL) deduction (26 U.S.C. § 172 (2001)). A consolidated taxpayer does not determine a number of these deductions on an individual affiliate level, but instead determines the amount of those deductions on the consolidated level (as though the group of corporations were actually a single corporation). For example, charitable deductions and capital losses/gains are determined only on a consolidated level for a consolidated taxpayer. See Treas. Reg. §§ 1.1502-22 to 1-27 (2001).

7. 26 U.S.C. § 172(j) (1982). Product liability loss (PLL) was defined as the lesser of:

- (A) the net operating loss for such year . . . , or
- (B) the sum of the amounts allowable as deductions under section 162 [ordinary and necessary expenses incurred in carrying on a trade or business] and 165 [losses that are, usually, incurred in carrying on a trade or business] which are attributable to —
 - (i) product liability, or
 - (ii) expenses incurred in the investigation or settlement of, or opposition to, claims against the taxpayer on account of product liability.

26 U.S.C. § 172(j)(1) (1982). PLLs were created by the Revenue Act of 1978. See JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE REVENUE ACT OF 1978, 232 (Prentice-Hall, Inc. 1979). Congress realized that the normal three-year carryback and seven-year carryforward provisions applicable to net operating loss (NOL) would not suit PLLs, and therefore included provisions to extend the carryback for PLLs to ten years while also retaining the available seven year carryforward. See *id.* For example, consider a taxpayer who had \$110,000 NOL for the 1985 taxable year, of which \$75,000 was calculated as PLL.

	Taxable Income	NOL Carryback	PLL Carryback
1984	10,000	10,000	0
1983	10,000	10,000	0
1982	10,000	5,000	5,000
1975-1981(7 tax years)	70,000 (10,000 per year)	--	70,000 (total)
Total		25,000	75,000

The remaining \$10,000 in loss could then be carried forward to the next seven years if the taxpayer had taxable income in any of those seven years. 26 U.S.C. § 172(j)(2) (1982) defined what qualified as product liability expenses (PLEs) and included damages attributable to physical or emotional harm to individuals, damage to property, or lost use of property if those damages were "on account of" any defect in a product sold, manufactured, or leased by the taxpayer. *Id.* The Joint Committee also noted some things that should be excluded from the definition of product liability: damages claimed under warranty claims (contractual damages), and damages based on services performed by the taxpayer (i.e. medical or legal malpractice). JOINT COMMITTEE ON TAXATION *supra* note 7, at 232. PLLs are currently included in "specified liability losses" (SLLs) 26 U.S.C. § 172(f) (2001). For a discussion of SLLs see *infra* note 8 and accompanying text.

8. See 26 U.S.C. § 172(f) (2001). PLLs were redefined as SLLs in 1990. See Omnibus

debated and questioned: each Court that has approached the issue of PLLs/SLLs for consolidated taxpayers has followed a different formula for calculation, each of which leads to a varied result.⁹ This note will try to make some sense of the *United Dominion* case and its implications on PLLs/SLLs in the consolidated corporate tax arena by analyzing some of the more difficult questions about PLLs/SLLs.

Part II¹⁰ explores the background and application of both carrybacks, generally, and PLL/SLL carrybacks, specifically, as well as the two prominent cases in the PLL/SLL controversy prior to *United Dominion* — *Intermet Corp. v. Commissioner* (hereinafter “*Intermet*”)¹¹ and *United Dominion Indus. Inc. v. United States* (hereinafter “*United Dominion I*”).¹² Part III¹³ looks at *United Dominion* specifically, including a statement of the facts, procedural history, and reasoning of the United States Supreme Court dealing with PLL carrybacks for consolidated taxpayers. Part IV¹⁴ delves into the implications of the *United Dominion* decision by determining what exactly the Court said, what the Court refrained from saying and the implications of both. Should a company that had no net operating loss (NOL)¹⁵ be permitted

Budget Reconciliation Act of 1990, Pub. L. No.101-508, 104 Stat. 1388 (1990). SLLs are, in general, losses attributable to certain product liability claims, and other statutory and tort claims. See 26 U.S.C. § 172(f) (2001); 11 STAND. FED. TAX REP. (CCH) ¶ 12,014.054, at 26,577. SLLs, defined by the current version of 26 U.S.C. § 172(f), include 1) all deductions attributable to product liability (the former definition of PLL) and 2) any amount allowable as a deduction under the chapter (26 U.S.C. § 1 et seq.) (other than § 468(a)(1) or § 468A(a)) which is in satisfaction of a liability under a Federal or State law requiring one of the following: reclamation of land, decommissioning of a nuclear power plant (or any unit), dismantling of a drilling platform, remediation of environmental contamination, or payment under any workers compensation act (defined by § 461(h)(2)(C)(i)). See 26 U.S.C. § 172(f) (2001). SLLs have also been described as a “deferred statutory liability . . . arising out of a federal or state law, where the act (or failure to act) giving rise to such liability occurs at least three years before the NOL year.” Meade Emory, Herbert J. Lerner, James P. Fuller, & Brian L. Cornell, *Unresolved Issues Remain for Ten-Year NOL Carrybacks*, 82 J. TAX’N 50, 50 (1995). SLLs may not exceed the NOL for the taxable year. 26 U.S.C. § 172(f)(2) (2001).

9. See generally *United Dominion*, 532 U.S. 822 (2001) (PLL carryback should be determined on a single entity basis); *United Dominion Indus., Inc. v. United States*, 208 F.3d 452 (4th Cir. 2000) (hereinafter “*United Dominion I*”) (PLL carryback should be determined on a separate entity basis), *overruled by United Dominion*, 532 U.S. 822 (2001); *Intermet Corp. & Subsidiaries v. Comm’r*, 209 F.3d 901 (6th Cir. 2000) (hereinafter “*Intermet*”) (SLL carryback should be determined on a single entity basis).

10. See *infra* notes 17-48 and accompanying text.

11. 209 F.3d 901.

12. 208 F.3d 452.

13. See *infra* notes 49-78 and accompanying text.

14. See *infra* notes 79-142 and accompanying text.

15. According to Black’s Law Dictionary, NOL is defined as “[t]he excess of operating expenses over revenues, the amount of which can be deducted from gross income if other

to pass on its PLL/SLL to its affiliated group of corporations as a deduction? If so, under what conditions? Should PLLs/SLLs be determined in a different manner for consolidated taxpayers than for regular corporate taxpayers? Will allowing consolidated taxpayers to compute PLLs/SLLs in a manner different from regular corporate filers create an unintended benefit to consolidated taxpayers, thus resulting in a substantial loss of tax revenue? Part V¹⁶ concludes the article in summation.

II. BACKGROUND

A. Carrybacks and PLLs/SLLs

Before understanding the importance of the PLL/SLL debate in the corporate tax arena, one must first understand the workings of tax

deductions do not exceed gross income.” BLACK’S LAW DICTIONARY 957 (7th ed. 1999). NOL results only where deductions for a taxable year exceed gross income. 26 U.S.C. § 172(c) (2001). In order to “set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year,” a taxpayer, under 26 U.S.C. § 172(b)(1)(A), could carryback for three years and carry forward for seven years its NOL. *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, 386 (1957). Presently, a taxpayer may carryback for two years and carryforward for twenty. 26 U.S.C. § 172(b)(1)(A) (2001). A taxpayer who has NOL does not have any taxable income for the tax year; a taxpayer who has taxable income for the year cannot have NOL.

A post World War I relief measure to provide some relief for businesses converting from war to peace time activity, the original NOL deduction and carryback was created by the Internal Revenue Act of 1918. 26 U.S.C. § 122 (1918); see Bryan P. Collins, Lawrence M. Garrett & Bonnie A. O’Brien, *Calculation of Consolidated Taxable Income: The Treatment of Specified Liability Losses*, 25 J. CORP. TAX’N 58 (1998). The NOL provisions authorized a taxpayer to carryback or carryforward any sustained net loss from a business. 26 U.S.C. § 122 (1918). Only the taxpayer who sustains the loss may take a deduction, though, in the case of a partnership, partners may divide the loss among themselves when filing individual returns. See *Huyler’s v. Comm’r*, 38 T.C. 773 (1962), *aff’d*, 327 F.2d 767 (7th Cir. 1964) (policy of allowing taxpayer to set of lean years against lush years requires the business and the taxpayer to be the same). For a good overview of early case law regarding NOL carryback and carryforward provisions, which changed constantly, see M.L. Cross, Annotation, “*Net Operating Loss*” and its Carry-back and Carry-over as a Deduction Under Internal Revenue Code, 9 A.L.R. 2d 330 (1950).

As with other deductions, the taxpayer has the burden of establishing entitlement to NOL carryback or carryforward. See *Binder v. United States*, 262 F. Supp. 713 (S.D.N.Y. 1966), *aff’d*, 371 F.2d 440 (2d Cir. 1966) (per curiam); *Jones v. Comm’r*, 25 T.C. 1100 (1956), *rev’d on other grounds*, 259 F.2d 300 (5th Cir. 1958) (returns alone are insufficient to establish entitlement to NOL carryback/carryforward); Also, in general, the Commissioner’s determination of NOL deduction is presumed to be correct, with the burden of showing error on the taxpayer. See *Hughes Tool Co. v. Comm’r*, 118 F.2d 472 (5th Cir. 1941); *United States v. Jaffray*, 97 F.2d 488 (8th Cir. 1938), *aff’d sub nom.*, 306 U.S. 276 (1939); *Smith v. Glenn*, 67 F.Supp. 262 (W.D. Ky. 1946); *Weber v. Kavanagh*, 52 F. Supp. 619 (E.D. Mich. 1943).

16. See *infra* Part V.

carrybacks in general. Carryback is defined as “an income tax deduction (esp. for [NOL]) that cannot be taken entirely in a given period but may be taken in an earlier period (usu[ally] the previous three years).”¹⁷ In the case of most losses, a taxpayer may carry back his loss for (currently) two or ten years, depending upon the type of loss, and may also carry forward any excess loss not absorbed by the carryback provision.¹⁸ After determining that the taxpayer has a loss for a particular year, the taxpayer may apply for a tentative carryback and, if the carryback is allowed, carry back that loss to a tax year in the carryback period as long as the taxpayer realized net income in that previous tax year.¹⁹ In effect, as long as the taxpayer remains the same, the taxpayer may take a deduction from net income earned within the carryback period by using the losses earned during a different year.²⁰

17. BLACK’S LAW DICTIONARY 205 (7th ed. 1999).

18. See 26 U.S.C. § 172 (2001). This is called a carryover or carryforward and is defined as “[a]n income-tax deduction (esp. for [NOL]) that cannot be taken entirely in a given period but may be taken in a later period.” BLACK’S LAW DICTIONARY 205 (7th ed. 1999).

19. A taxpayer who wishes to claim a carryback may apply the amount of loss against taxable income from any taxable year in the carryback period by applying for tentative carryback and then receiving a refund of excess tax moneys paid. For example, a taxpayer with \$20,000 in NOL carryback for 2001 may carry back that \$20,000 to the two years directly prior to that in which the NOL was realized. If the taxpayer had \$14,000 in taxable income for each of those two years, then the taxpayer could carry back \$14,000 of the loss to the second year back, and \$6,000 to the first year back. Then, if the taxpayer has NOL carryback of \$15,000 in the next tax year, the taxpayer may carry back only \$8,000 (original \$14,000 of taxable income less \$6,000 offset from carryback for prior tax year = \$8,000 remaining taxable income to carryback against). The remaining \$7,000 could be carried forward if the taxpayer has taxable income of at least \$7,000 over the applicable carryforward years. In order to receive the benefit of tax carrybacks, the taxpayer must file an application for a tentative carryback adjustment for the taxable year affected by the carryback. Treas. Reg. § 1.6411-1(b)(1) (2001). The most common types of carrybacks are: NOL carryback under 26 U.S.C. § 172(b) (2001); business credit carryback under 26 U.S.C. § 39 (2001); and capital loss carryback under 26 U.S.C. § 1212(a)(1) (2001). Any taxpayer, not just a corporation, may file for the right to carry back a loss or unused credit. Treas. Reg. § 1.6411-1(a) (2001).

The application for tentative carryback itself is *not* a claim for tax refund or credit. 26 U.S.C. § 6411(a) (2001). No taxpayer may file a refund suit in court to recover tax based on the application for tentative carryback if the application is disallowed by the IRS, Treas. Reg. § 1.6411-1(b)(2) (2001), but a taxpayer may file a regular refund action during any period allowed under statute regardless of the status of the application. 26 U.S.C. § 6511(d)(2) (2001) (NOL and capital loss carryback); 26 U.S.C. § 6511(d)(4) (2001) (credit carrybacks); see also Thrif-Tee, Inc. v. United States, 492 F. Supp. 530 (W.D.N.C. 1979), *aff’d*, 628 F.2d 1351 (4th Cir. 1980).

20. Finding that the consolidated taxpayer is the same taxpayer that incurred the loss presents an interesting issue due to the possibility that an individual affiliate may join or leave the group, or be created by the group. Such a problem is taken into account for carryback provisions through the idea of “separate return years”. A separate return year is basically any year in which the affiliate was not a member of the consolidated group. Treas. Reg. § 1.1502-79A(a)(1) (2001) basically states that, if an affiliated member of a consolidated taxpayer was not a member of the consolidated group for the taxable year for which the group wishes to carryback NOL to (or, in this case, PLL), the group must allocate a portion of the loss carryback to the affiliate and may not carryback that

Carrybacks allow a corporation to set off its lean years against its lush years to create a more average tax for the corporation from year to year.²¹ Carrybacks may also be calculated and dealt with differently for consolidated taxpayers than for regular corporate taxpayers.²²

PLLs, one type of carryback, were defined in 26 U.S.C. 172(b)(1)(I) as the lesser of (1) NOL and (2) losses attributable to product liability, or expenses incurred in investigation, settlement, or opposition, of claims against the taxpayer attributable to product

portion of loss to its consolidated return. When a separate return year is involved, the consolidated group still calculates the group's loss on a single entity basis - by calculating CNOL - and then applies a separate member approach to apportioning CNOL to the affiliate affected by a separate return year. Lawrence M. Axelrod & Jeremy B. Blank, *The Supreme Court, Consolidated Returns, and 10-Year Carrybacks*, 90 TAX NOTES 1383, 1387 (2001).

An exception to the apportionment of the separate return year rules is the "offspring rule" under Treas. Reg. § 1.1502-79(a)(2) (2001) and Treas. Reg. § 1.1502-21(b)(2)(ii)(B) (2001). In cases where the affiliate was not in existence, and was formed by the group, the portion of CNOL attributable to that member is still included in the group's CNOL carryback regardless of the fact that the affiliate was not in existence for the taxable year that the group is carrying back its loss. See Treas. Reg. § 1.1502-79A(a)(2) (2001); Treas. Reg. § 1.1502-21(b)(2)(ii)(B) (2001); Axelrod & Blank, *supra* at 1388; See also Libson Shops, at 386 (recognizing that carrybacks are not allowable in situations where there is no continuity of business; the entity must be the same taxpayer in order to take advantage of carrybacks).

The problem with separate return years may be illustrated through the following:

<u>Tax Year</u>	<u>Consolidated Group</u>	<u>Separate Taxpayer</u>
1974	A, B, C	D, E
1975	A, B, C, D	E
1977	A, B, D	C, E
1978	A, B, D, F (created by group)	C, E
1980	A, B, C, D, F, G (created by group)	E
1984	A, C, D, F, G	B, E

In carrying back PLL from the 1984 tax year, the consolidated group must apportion CNOL to D because D was a separate entity in 1974 (the ten year carryback year), and thus reduce the amount of PLL that the group may carryback to 1974 by the amount apportioned to D. As for F and G, both were not a member of the group in 1974, but both qualify as "offspring" of the group, and thus would not have CNOL apportioned. If the group had any carryback to 1977 or 1978, C would need to have CNOL apportioned as C was not a member of the group during those two years - thus separate return year provisions would apply. (As this illustration involves members prior to December 31, 1984, C might be able to reconsolidate with the group at that time - but under the present statute C could not reconsolidate with the group until after the 5 year minimum waiting period required by 26 U.S.C. § 1504(a)(3) (2001)). Of course, if C or D did not contribute to the losses of the group for the 1984 tax year, the group could still carry back the entire PLL amount to the group's consolidated return because no PLL amount would be apportioned to either C or D.

21. *Lisbon Shops*, 353 U.S. at 386 (recognizing that carrybacks are not allowable in situations where there is no continuity of business; the entity must be the same taxpayer in order to take advantage of carrybacks or the purpose of the provision is not met).

22. See Treas. Reg. § 1.1502-79A (2001) (outlining how a consolidated group apportions the amount of consolidated NOL carryback to a separate return year when the affiliate was not a part of the consolidated group). The difference, if any, in calculation and application of NOL and PLL/SLL carrybacks is the central issue in *United Dominion*.

liability.²³ This particular loss could be carried back for up to ten years, and forward for seven years.²⁴ Congress decided that an extended carryback period should apply to PLLs because (1) they tended to be large and sporadic; (2) the extended carryback period would reduce the possibility that large PLLs would create NOL in excess of taxable income; and (3) that the taxpayer who suffered large PLLs in any tax year should obtain an immediate tax benefit from a tax refund rather than have to speculate on future tax reductions based on carryforwards of PLLs.²⁵

SLL is the current equivalent of PLL and is defined under the current version of 26 U.S.C. § 172(f).²⁶ SLL may be carried back for ten years or forward for twenty years for the same reasons underlying carryback and carryforward of PLL.²⁷ SLL includes both the losses formerly attributable to PLL and other specified statutory and tort losses.²⁸

Calculation of PLLs/SLLs for regular corporate taxpayers is relatively straightforward: one simply takes the lesser of product liability expenses (PLEs) (or specified liability expenses (SLEs) in the case of SLLs) and net operating loss (NOL), and that amount is deductible as PLL/SLL.²⁹ Consolidated corporate tax filers, though, create a novel problem in PLL/SLL calculation: separate affiliates filing as a consolidated corporation do not determine individual NOL but only

23. For a discussion of PLLs *see supra* note 7 and accompanying text.

24. 26 U.S.C. § 172(b)(1)(I) (1982).

25. JOINT COMMITTEE ON TAXATION, *supra* note 7. For an extensive treatment of PLLs *see supra* note 7.

26. For a thorough discussion of SLLs *see supra* note 8.

27. 26 U.S.C. §§ 172 (b)(1)(A)(ii), 172(b)(1)(C) (2001).

28. SLLs include 1) deductions for product liability, and 2) certain allowable deductions for satisfaction of a liability under Federal or State law dealing with reclamation of land, decommissioning of a nuclear power plant, dismantling of a drilling platform, remediation of environmental contamination, or payment under any workers compensation act. *See* 26 U.S.C. § 172(f) (2001).

29. 26 U.S.C. § 172(j) (1982); 26 U.S.C. § 172(f) (2001). For example, if a regular corporate taxpayer has \$500 in taxable income, \$400 of PLEs/SLEs and \$200 in other deductions, the taxpayer would have NOL of \$100 (i.e. \$500-\$400-\$200 = -\$100). The taxpayer would only be permitted to include \$100 of its PLEs/SLEs as PLL/SLL (the lesser of NOL or PLEs/SLEs). If another taxpayer had \$100 in taxable income, the same \$400 of PLEs/SLEs and \$200 in other deductions, the taxpayer would have NOL of \$500 (i.e. \$100-\$400-\$200 = -\$500). In this case, the taxpayer could claim all \$400 of PLEs/SLEs as PLL/SLL because NOL (\$500) exceeds PLEs/SLEs (\$400). For a last example, if a taxpayer had \$1,000 in taxable income, and the same \$400 of PLEs/SLEs and \$200 in other deductions, the taxpayer would have positive income of \$400 (i.e. \$1,000-\$400-\$200 = 400), and would be unable to claim any deduction for PLL/SLL. Without NOL, a taxpayer may not claim PLL/SLL for the taxable year. *See* 26 U.S.C. § 172(f) (2001); 26 U.S.C. § 172(j) (1982).

determine separate taxable income which does not include the same deductions as NOL.³⁰ The statutes for calculating PLL/SLL specifically state that PLEs/SLEs must be compared to NOL.³¹ While the consolidated corporate tax filer does calculate a consolidated NOL (CNOL),³² there is no figure on the separate affiliate level comparable to NOL to compare PLEs/SLEs to in order to determine PLL/SLL.³³

B. Landmark Cases Prior to the United Dominion Decision

Thus the debate emerges: to what do consolidated corporate tax filers compare PLEs/ SLEs to determine PLL/SLL, and at what stage of the process should they make this comparison? Two very different approaches dominated the judicial interpretation of PLL/SLL computation for consolidated corporate tax filers prior to the *United Dominion* decision.³⁴ In *United Dominion I*, the first opinion dealing

30. See Treas. Reg. § 1.1502-12 (2001). The separate taxable income of an individual affiliate does not include certain consolidated amounts including the following specified under Treas. Reg. § 1.1502-12 (2001): NOL, capital gains or losses, gains or losses subject to § 1231, § 170 charitable deductions, § 922 (Western Hemisphere trade corporations deduction), and dividends received and paid under §§ 243(a)(1), 244(a), 245, or 247. See Treas. Reg. § 1.1502-12 (2001). See also *United Dominion I*, 208 F.3d at 455 n.8.

31. 26 U.S.C. 172(j)(1) (1982); 26 U.S.C. § 172(f) (2001).

32. Treas. Reg. § 1.1502-21(e) (2001) defines CNOL. CNOL takes into account the following items: separate taxable income, consolidated capital gains and losses, consolidated § 1231 net loss, consolidated charitable contributions deduction, consolidated dividends received deduction, and consolidated § 247 deduction. See *id.*

33. See *United Dominion*, 532 U.S. at 832-33 (stating that there is no equivalent of NOL for the individual affiliate of a consolidated group); *But see United Dominion I*, 208 F.3d at 460-61 (arguing that a consolidated corporation should use separate NOL as defined by Treas. Reg. § 1.1502-79(a)(3) to calculate PLL because separate NOL was roughly equivalent to NOL on an individual taxpayer level).

34. See *United Dominion I*, 208 F.3d 452; *Intermet*, 209 F.3d 901. *Amtel, Inc. v. United States*, 31 Fed. Cl. 598 (1994), *aff'd*, 59 F.3d 181 (Fed. Cir. 1995), is another case that often comes up in the PLL/SLL debate. Although *Amtel* was specifically given deference by the Fourth Circuit Court of Appeals in *United Dominion I*, the United States Supreme Court decision in *United Dominion* apparently found the case far removed from the issue at hand: *Amtel* is not cited once in the majority, concurring, or dissenting opinion. See *United Dominion*, 532 U.S. 822. *United Dominion* and the National Association of Manufacturers and The National Manufacturer's Alliance (who filed an amicus brief in the case) apparently found *Amtel* to be so distinguishable as not of note also, and the case did not come up in oral argument before the United States Supreme Court. See United States Supreme Court Official Transcript, *United Dominion Indus. Inc. v. United States*, 2001 WL 327616 (2001) (No. 00-157); Brief for United States *infra* note 66; Amicus Brief *infra* note 66.

Amtel, Inc. ("Amtel") filed a consolidated return for the 1975 tax year as the parent of an affiliated group of companies including The Litwin Corporation ("Litwin") and Litwin Panamerican Corporation ("Panamerican"). *Amtel*, 31 Fed. Cl. at 599. AMCA International Corporation ("AMCA") acquired *Amtel*, Litwin and Panamerican in 1977, and included those three entities in its consolidated federal tax returns. *Id.* In 1985, AMCA filed a consolidated return claiming \$6.1

with this specific issue, the Fourth Circuit Court of Appeals held that PLL should be calculated on a “separate entity basis” and created a measure of income, different from both CNOL and separate taxable income, to compare PLE to in order to determine PLL.³⁵ Within a month of this decision, the Sixth Circuit Court of Appeals handed down its decision in *Intermet* which stated that SLL should be calculated on a “single entity basis” by comparing SLE with CNOL.³⁶

1. United Dominion Indus., Inc. v. United States (“United Dominion I”)

The Fourth Circuit, in *United Dominion I*,³⁷ held that a corporate consolidated taxpayer must determine PLL separately for each affiliate.³⁸

million in PLL, some attributable to the three subsidiaries even though they had positive separate taxable income for the tax year. *Id.* In 1987, AMCA filed to carry back \$32,413 of the PLL from the 1985 consolidated return to offset income reported by Amtel, Litwin, and Panamerican in the 1975 tax year, a “separate return year” because the three subsidiaries did not belong to the consolidated group during the 1975 tax year. *Id.* The Federal Claims Court held that Amtel, Litwin and Panamerican could not carryback any of the PLLs from 1985 to its consolidated 1975 return because the three affiliates did not have NOL in the 1985 tax year. *Id.* at 600. When a corporation seeks to carryback any loss to a separate return year, the IRS has chosen to treat that entity on a separate basis by apportioning the CNOL of the group. *Id.* Because the apportioned amount of CNOL is equal CNOL multiplied by the fraction created by separate NOL of the corporation over the sum of separate NOLs for all of the members of the group, Amtel, Litwin, and Panamerican portion of AMCA’s NOL would equal:

$$\frac{\$0.00 \text{ (Amtel's Separate NOL)}}{85.5 \text{ million (AMCA's CNOL)}} \times \$85.5 \text{ million (AMCA's CNOL)} = \$0.00$$

Because Amtel, Litwin, and Panamerican were not apportioned any amount of AMCA’s CNOL, they could not carryback any amount to their 1975 consolidated tax return. *Amtel*, 31 Fed. Cl. at 601. The court rejected Amtel’s argument that a corporation should determine the apportionment of PLL carryback based on a fraction that dealt specifically with PLL on the separate and consolidated levels, and not with separate NOL (which would leave Amtel with a \$32,413 PLL carryback). *Id.*

Express explanations for the irrelevance of *Amtel* on this issue is found in: the decision of the District Court for the Western District of North Carolina in *United Dominion Indus., Inc. v. United States*, 1998 WL 725813 (W.D.N.C. 1998) (hereinafter “*United Dominion Trial*”) (“*Amtel* neither governs nor collaterally estops prosecution of this case [*United Dominion Trial*]” because the “question [in *Amtel*] was whether losses might be carried back to a separate return year,” and not, as in *United Dominion*, whether those losses were characterized as PLL. *United Dominion Trial*, 1998 WL 725813 at *8) and in *Intermet*, 209 F.3d at 908 (“[E]xplicit statutory or regulatory provisions supported the separate member approach that the court[] adopted in *Amtel*”, and that there were no such provisions that governed the debate over whether SLL should be determined on a single or separate entity basis for a consolidated corporation.).

35. 208 F.3d 452. For an explanation of “separate entity basis” see *infra* notes 67, 70 and accompanying text.

36. 209 F.3d 901.

37. For the facts of this case, see the Statement of the Facts for *United Dominion*, *infra* at Section IIIA.

38. *United Dominion I*, 208 F.3d at 458.

The Court reasoned that, “an interpretation removing the close nexus between such expenses and whether the affected company operated at a loss is inconsistent with the regulations.”³⁹ Only by calculating PLL on an individual affiliate, “separate entity,” level could one prevent a profitable affiliate suffering no true loss from passing on PLE to the consolidated group as PLL.⁴⁰ After this determination, the Court explained in detail that PLE should be compared to separate NOL⁴¹ to determine the affiliate’s PLL, but offered little reasoning for its decision.⁴²

2. Internet Corp. v. Commissioner

The Sixth Circuit in *Intermet*,⁴³ on the other hand, held that the

39. *Id.*

40. *Id.*

41. Treas. Reg. § 1.1502-79A(a)(3) (2001) defines separate NOL in a formula for apportioning CNOL to an individual affiliate for a separate taxable year - a year that the affiliate was not a member of the consolidated group. Separate NOL is calculated by taking separate taxable income (defined by Treas. Reg. § 1.1502-12) without any deduction under § 242, and then adjusted by taking into account the affiliate’s portion of a number of items that are taken into account to calculate CNOL. *See* Treas. Reg. § 1.1502-79A(a)(3). In other words, separate NOL is separate taxable income plus a portion of the deductions calculated at a consolidated level that would normally be added into a taxpayer’s NOL.

42. *United Dominion I*, 208 F.3d at 461. The Fourth Circuit indicated that the regulations could be interpreted as allowing two possible methods for the calculation of PLL: PLL equaled either the amount of PLE that did not exceed the consolidated group’s negative separate taxable income, or the amount of PLE that did not exceed the consolidated group’s separate NOL. *Id.* at 458. The Court then immediately recognized that separate taxable income was not a close equivalent of NOL, and that the IRS had “present[ed] no affirmative reason to justify using a group member’s ‘separate taxable income’ to limit the member’s contribution to ‘product liability loss.’” *Id.* at 459-60. The Court adopted separate NOL as the figure for comparison because separate NOL more closely resembled NOL than separate taxable income, and because such treatment resulted in “logical consistency.” *Id.* at 460. The regulations already provided a “simple and direct method” for determining the amount of PLE to be included as PLL by creating separate NOL, so the Court adopted separate NOL as the figure for comparison. *Id.* For more reasoning of the Fourth Circuit Court of Appeals *see infra* note 65 and accompanying text.

43. *Intermet Corporation* was the common parent of an affiliated group of corporations that manufactured precision iron castings for automotive and industrial equipment producers which filed consolidated returns from 1984 through 1992. *Intermet*, 209 F.3d at 902. In 1992, *Intermet* claimed that it incurred \$3,940,085 in SLEs as a result of expenses incurred by one affiliate - Lynchburg Foundry, Co. (“Lynchburg”), a member of the group for the period from 1984 through 1992. *Id.* at 902-03. (For a discussion of the relationship between PLEs/PLL and SLEs/SLL *see infra* notes 7-8, 29 and accompanying text.) Lynchburg had positive separate taxable income for the 1992 tax year, but *Intermet* had a total of \$25,701,038 in CNOL. *Intermet*, 209 F.3d at 903. In 1994, *Intermet* filed an amended tax return to carry back to 1984 Lynchburg’s claimed SLEs as SLL under ten year carryback provisions. *Id.* The IRS disallowed the carryback, and issued a notice of deficiency for the 1984 tax year. *Id.* *Intermet* filed a petition in the United States Tax Court contesting the deficiency, and the Tax Court found for the IRS. *Id.* The Tax Court reasoned that the SLEs did not qualify as SLL because, under the provisions, they were not “taken into account” in computing

single entity approach should be used in determining SLL carryback.⁴⁴ The Sixth Circuit stated that, although CNOL was calculated in a different manner than NOL, the consolidated regulations specifically required a taxpayer to apply all Code provisions to “the group.”⁴⁵ Not only did CNOL represent the group’s NOL, but the IRS admitted that CNOL had direct significance in applying an SLL carryback — only a consolidated corporation with CNOL could take advantage of an SLL carryback.⁴⁶ Similar to the Fourth Circuit, the Sixth Circuit also immediately recognized the unsuitability of separate taxable income as a comparison figure.⁴⁷ In adopting the single entity approach, the Court directly attacked *United Dominion I* stating that “the court offered no analysis to support its conclusion,” so that the Sixth Circuit was “unpersuaded by the Fourth Circuit’s approach.”⁴⁸

Internet’s CNOL for 1992. *Id.* Internet timely appealed the judgment of the Tax Court to the Sixth Circuit Court of Appeals, alleging that the SLEs were in fact “taken into account” in determining the CNOL of Internet for the 1992 tax year because Lynchburg’s SLEs would have a direct impact on Internet’s CNOL regardless of whether Lynchburg has positive or negative separate taxable income. *Id.*

44. *Id.* at 902. PLL is the predecessor of SLL. For a detailed discussion of SLL, and the similarities and difference between SLL and PLL see *infra* note 8 and accompanying text.

45. *Internet*, 209 F.3d at 906.

46. *Id.*

47. *Id.*

48. *Id.* at 907-08. The 6th Circuit also recognized that the IRS, through several Technical Advice Memoranda, had adopted and applied differing interpretations of the SLL carryback for consolidated corporations, such inconsistency in treatment impacting the reasonableness of the IRS’s interpretation. *Id.* at 907. The Court recognized that Technical Advice Memoranda were not be binding either on the IRS or the Court under I.R.C. § 6110(j)(3), but the Court stated that it could consider the Memoranda as evidence of the reasonableness of the IRS’s treatment of the SLL carryback for consolidated taxpayers. *Id.* See also *Wolpaw v. Comm’r*, 47 F.3d 787, 792 (6th Cir. 1995). While the IRS had not changed its position on allowing SLL for affiliates with positive separate taxable income, the Court felt that “the IRS’s shifting and incongruous reasoning in reaching [the] result highlight[ed] the fundamental flaw: its position does not comport with the current purpose and language of the Code and regulations.” *Internet*, 209 F.3d at 908. The IRS was in fact “trying to fit a square peg into a round hole.” *Id.* One commentator felt that *Internet* actually proved that the IRS’s interpretation must have been incorrect due to the “changing, differing, and shifting” positions of the IRS. Jeffrey A. Hyman, *6th Circuit Decision in Internet: IRS Not Entitled to Deference on Ten-Year Carryback Issue*, 20 VA. TAX REV. 587, 591 (2001). “[T]he IRS’ development and subsequent abandonment of arguments evidences that it is grasping for straws to come up with any rationale possible to support an incorrect conclusion.” *Id.*

Next, the IRS reasoned that the Code’s SLL provision must apply on a separate member basis because the provision referred to “the taxpayer”. *Id.* at 908. Treas. Reg. § 1.1502-80, which applied Code provisions to a consolidated group to the extent that the regulations did not exclude such an application, was interpreted by the IRS to support their position that each affiliate was actually “the taxpayer”. *Id.* The Court noted, though, that the IRS in *Internet* not only had not referred to the regulation default rule, but had actually referred to *Internet*, and not Lynchburg, as the “taxpayer” throughout the appeal. *Id.*

III. STATEMENT OF THE CASE

A. Statement of the Facts

United Dominion Industries, Inc.'s predecessor in interest, AMCA International Corporation ("AMCA"), acted as parent company to a group of affiliated taxpayers.⁴⁹ AMCA properly elected to file consolidated tax returns for the years 1983 through 1986.⁵⁰ For each of these tax years, AMCA reported CNOL that exceeded the total amount of PLEs aggregated by its twenty-six (26) individual members.⁵¹ AMCA included the entire amount of the PLEs for all twenty-six (26) individual members in calculating its PLL for ten year carryback — the method commonly called the "single entity" approach.⁵² AMCA simply compared CNOL to the total aggregate amount of PLEs for the years in question to determine PLL for the entire consolidated group.⁵³

During this same time period, the five individual affiliates at issue in the case generated PLEs between 1983 and 1986.⁵⁴ The same five individual affiliates also had positive separate taxable income for the years from 1983 through 1986.⁵⁵ AMCA disregarded the fact that these

49. *United Dominion*, 532 U.S. at 826.

50. *Id.* at 827. A parent corporation may elect to file a consolidated tax return, in lieu of separate returns, under 26 U.S.C. § 1501 as long as each affiliate of the group consents to consolidated return regulations in 26 U.S.C. § 1502 before the last day for the filing of such return.

51. *Id.* The affiliated group reported between \$140 million and \$85 million in CNOL for the years from 1983 to 1986. During that same time period the group reported, at the most, \$5.5 million, and, at the least, \$3.5 million, in PLEs.

52. *Id.*

53. *Id.* Treating the group as though it were a single corporation is the essence of the "single entity" approach.

54. The five affiliates at issue in the case are Jesco, Inc ("Jesco") (acquired in 1978 and sold to an unrelated purchaser in 1995), Cherry-Burrell Corporation ("Cherry-Burrell") (formed in 1975 and liquidated in 1991), Amtel, Inc. ("Amtel") (acquired in 1977), The Litwin Corporation ("Litwin") (a subsidiary of Amtel Inc. that was acquired with Amtel in 1977), and Litwin Panamerican Corporation ("Panamerican") (also an Amtel subsidiary acquired with Amtel in 1977). See *United Dominion I*, 208 F.3d at 453.

The PLEs for each separate affiliate in question for the years 1983 to 1986 are as follows:

	1983	1984	1985	1986
Jesco	\$166,042	\$1,402,931	\$1,292,733	\$127,682
Cherry-Burrell	34,608	192,287	8,642	87,760
Amtel	0	12,135	13,218	7,549
Litwin	5,250	0	14,139	8,909
Panamerican	19	1,987	5,056	502
TOTAL	\$205,919	\$1,605,342	\$1,333,788	\$232,402

See *United Dominion Trial*, 1998 WL 725813 at *1.

55. Amtel did not report positive separate taxable income for 1983; Litwin did not report positive separate taxable income for 1984. *Id.* at *1.

affiliates had positive separate taxable income for the tax years, and included the entire PLE amounts from each individual affiliate as PLL for consolidated tax purposes.⁵⁶ AMCA sought to carry back the losses for ten years, pursuant to carryback rules, to AMCA's tax consolidated tax returns for the years 1973 to 1976.⁵⁷

B. Procedural History

In 1986 and 1987, AMCA petitioned the Internal Revenue Service for refunds of taxes paid based on its calculations of PLLs.⁵⁸ The IRS initially ruled in favor of allowing AMCA's requested refunds based on PLL carrybacks to AMCA's consolidated tax returns, however the Joint Committee on Internal Revenue Taxation of U.S. Congress reversed the IRS determination.⁵⁹

Following the reversal, AMCA filed a refund action in the United States District Court for the Western District of North Carolina.⁶⁰ The District Court agreed with AMCA, deciding that an affiliated group should determine the group's PLL on a single entity basis.⁶¹ The District Court stated that as long as CNOL exceeded the affiliated group's total PLEs for a taxable year, the entire amount should properly be considered PLL subject to a ten year carryback.⁶²

56. *United Dominion*, 532 U.S. at 827.

57. *Id.*

58. *Id.* at 828; *See also United Dominion I*, 208 F.3d at 453. This is the standard procedure for carrybacks. *See supra* note 19 and accompanying text for a discussion of carryback procedures.

59. *United Dominion*, 532 U.S. at 828; *See also United Dominion I*, 208 F.3d at 453. The Joint Committee on Internal Revenue Taxation of the United States Congress controls refunds exceeding a certain amount pursuant to 26 U.S.C. § 6405(a) (2001). The Internal Revenue Service determined that the PLEs claimed by the five affiliates that incurred positive separate taxable income for the taxable year did not create PLLs that could be carried back ten years. *Id.* Because each of the affiliates had earned positive separate taxable income, the IRS reasoned, the affiliates could not have PLLs under the plain meaning of 26 U.S.C. § 172. *Id.*

60. *United Dominion*, 532 U.S. at 828; *See also United Dominion I*, 208 F.3d at 453.

61. *See United Dominion Trial*, 1998 WL 725813.

62. The District Court felt that the entire issue was straightforward. *See id.* The Court simply stated that if an affiliate was a part of the group in a certain tax year, then the correct way to determine PLL was to compare PLL to CNOL. *Id.* at *6. After finding that PLL carryback was a subset of NOL carryback, the Court then discussed how to apportion PLL carrybacks to those affiliates who were not part of the group for a certain return year according to the apportionment of NOL carrybacks under Treas. Reg. § 1.1502-79(a)(1)(i). *Id.* at *7. For individual affiliates who had separate taxable income, no portion of the PLL could be carried back to a separate return year. *Id.* But because none of the PLL could be excluded from use on the group's return, as long as the group's CNOL exceeded the PLL not apportioned to separate return years, the group could carryback the entire amount. *Id.* In the case at hand, all of the PLL could be carried back ten years to the consolidated taxpayer's returns because, even after apportioning the required parts of CNOL to the affiliates for their separate return years, the reduced CNOL apportioned to the consolidated

The United States Court of Appeals for the Fourth Circuit reversed the District Court's decision stating, that PLL should be determined on a "separate entity" basis so that each affiliate separately determined PLL and then added them together.⁶³ The Appellate Court reasoned that a profitable company should not be allowed to pass its PLE to the consolidated group as PLL, because no true loss had been incurred by the affiliate.⁶⁴ The Appellate Court also noted that allowing calculation of PLLs on a single entity approach would encourage tax evasion by inducing companies to buy other companies with large PLEs just to get the PLL carryback benefits.⁶⁵

C. United States Supreme Court Decision

1. The Majority Opinion

The United States Supreme Court granted certiorari in order to quell the debate between the Fourth Circuit and the Sixth Circuit's as to whether the single entity or the separate entity approach to calculating PLL should be the correct interpretation.⁶⁶ In an eight-to-one majority

group still exceeded PLL. *Id.*

63. See *United Dominion I*, 208 F.3d 452. While the IRS originally espoused the belief that PLEs should be compared to the separate taxable income of an individual affiliate to determine if there should be any PLL carryback, the Appellate Court recognized that separate taxable income was not the equivalent of NOL for an individual corporate tax filer. *Id.* at 459. The Fourth Circuit decided that PLE should be compared to an individual affiliate's separate NOL to calculate PLL. *Id.* at 460-61. Each affiliate's PLL amount, then, would be added together to compute the amount of PLL the consolidated group could carryback. *Id.* at 461. Treas. Reg. § 1.1502-79(a) does provide a mechanism for calculation separate NOL, but is specifically restricted to use in situations where a separate affiliate needs to calculate what portion of CNOL it may carryback to a separate tax year (a year that the separate affiliate was not a member of the affiliated group). See Treas. Reg. § 1.1502-79A (2001).

64. *United Dominion I*, 208 F.3d at 458.

65. *Id.* The Appellate Court agreed with the Joint Committee of Taxation that an affiliate with positive separate taxable income could not claim the entire amount of their PLE as PLL simply because there was no loss within the meaning of the statute. *Id.* Also, the Appellate Court was especially concerned with preventing consolidated corporate taxpayers from receiving a double deduction for PLLs, or any other tax treatment more favorable than that afforded to individual corporate taxpayers. *Id.* The single entity approach, it said, would cause "income blending" where the losses of unprofitable affiliates could be used to offset income from profitable affiliates who had few losses, thus mitigating tax liability. *Id.*

66. *United Dominion*, 532 U.S. at 827-28. The Brief for the Government argued that a corporation with profit should not be able to take the benefit of a carryback that was meant to aid corporations with NOL. Brief for United States at 27-29, *United Dominion*, 2001 WL 125814 (2001) (No. 00-157). The Government felt that separate taxable income was roughly equivalent to NOL, and should be used as a measuring device to determine PLL. *Id.* at 21-24, 26. The consolidated return statutes and regulations, the Government explained, should not be construed to

decision, the United States Supreme Court adopted the single entity approach for calculating PLL for the consolidated corporate taxpayer.⁶⁷

give a consolidated corporate taxpayer special treatment. *Id.* at 30-32. Allowing calculation of PLL on a single entity level would "permit significant tax avoidance abuses". *Id.* at 40-41.

United Dominion argued that other carrybacks were determined on a consolidated level only, and that PLL, therefore, should also be determined on the consolidated level. Brief for United Dominion at 13-18, *United Dominion*, 2001 WL 41010 (2001) (No. 00-157). Because there existed no equivalent measure of NOL for the individual affiliates (as separate taxable income was not equivalent due to lacking deductions available in NOL calculation), a consolidated taxpayer must be allowed to compare PLE to the only NOL they calculate: CNOL. *Id.* at 16-17. Any other method of computation would violate the text of the statute. *Id.* at 18-19. The only support for the separate entity approach espoused by the Government, and supported by the 4th Circuit decision, relied on a regulation that was completely irrelevant. *Id.* at 30-33.

The National Association of Manufacturers (NAM), the nation's largest and oldest industrial trade association representing over 14,000 companies and 350 member associations in all sectors of the nation's economy, and the Manufacturers Alliance/ MAPI Inc., a nonprofit research and educational organization that represents 450 multinational corporations from a broad range of manufacturing industries and contributes to development of the Internal Revenue Code in areas including carryovers, filed an Amicus Brief in this case. Amicus Brief, *United Dominion*, 2001 WL 27578 (2001) (No. 00-157). The Amici Curiae explained that each individual affiliate was not actually a separate taxpayer. *Id.* at 7. Instead, the group itself is the only taxpayer when the affiliates elect to file a consolidated return. *Id.* at 5-7. Because the purpose of PLL was to help the consolidated group set off the lush years against the lax years, the purpose could only be met by allowing calculation of PLL on the single entity basis. *Id.* at 8-9. The separate entity approach, on the other hand had a multitude of problems: it was unworkable in a practical sense, *id.* at 22-24; it violated the text of the statutes, *id.* at 15-18; it was incoherent and made no sense, *id.* at 19; and it added unnecessary complexity to the consolidated return process that was already overly complex, *id.* at 20-21.

67. *United Dominion*, 532 U.S. at 829. The dichotomy between single entity and separate entity approaches is common in the consolidated taxpayer arena. See Axelrod & Blank, *supra* note 20, at 1391. The difference between the two approaches is best illustrated through the following example ("STI" is separate taxable income):

Member	PLEs	Negative STI		Deduction: Single Entity	Deduction: Separate
A		\$500	\$ 1,500	\$500	\$ 500
B		\$400	\$ 200	\$400	\$ 200
C		\$600	\$ 0	\$600	\$ 0
TOTALS		\$ 1,500	\$ 1,700	\$ 1,500	\$ 700

In this first illustration, the single entity approach obviously allows a consolidated taxpayer to carryback a greater amount of PLEs as PLL than an individual taxpayer with separate departments which incurred the same amounts of loss as the separate affiliated members of the consolidated group.

But consider the following with regard to the same taxpayer above:

	Consolidated Taxpayer: Single		Separate Single Taxpayer
NOL (if for single taxpayer)	\$ 6,500	\$ 6,500	\$ 6,500
PLEs	\$ 1,500	\$ 1,500	\$ 1,500
Charitable Deduction	\$ 5,000	\$ 5,000	\$ 5,000
(Negative STI - aggregate)	\$ 1,700	\$ 1,700	\$ N/A
PLL Deduction	\$ 1,500	\$ 700	\$ 1,500

Because separate taxable income for a consolidated taxpayer does not take into account some deductions allowable for a single taxpayer in calculating NOL, such as charitable deductions, dividends received deductions, and capital gains/losses to name a few, comparisons should not be

The Supreme Court held that the single entity approach was more straightforward,⁶⁸ and that there was no equivalent of NOL to compare PLE to except at the consolidated level.⁶⁹ The Court further held that not only did the separate entity approach espoused by the IRS not comply with the plain language of the statute, but that it demanded the creation of a legal fiction not warranted by the statute (as evidenced by the treatment of the case at the Appellate Court).⁷⁰ The Court also pointed out that the single entity approach created no more of a double deduction for PLL carrybacks than it did for any of the other three-year carrybacks permitted by statute,⁷¹ and that the IRS already had a

made as between separate entity and single entity approaches for consolidated taxpayers alone. Rather, one must also compare the results from both of those approaches with the effects of the inflated amount represented by separate taxable income. Looking at the issue in this light helps to make a little more sense of the issue at hand.

68. *United Dominion*, 532 U.S. at 829. Not only would allowing a consolidated corporate taxpayer to compare PLE to CNOL to determine PLL allow for more equivalent treatment of consolidated and regular corporate taxpayers, but the method also “has a further virtue entitled to some weight in case of doubt: it is (relatively) easy to understand and apply.” *Id.* at 831.

69. *Id.* The Court explained that the issue was actually quite simple: until NOL was determined, there could be no PLL. *Id.* at 829. In other words, one must compare PLL to NOL, and because a consolidated taxpayer calculated only CNOL, there would be no PLL until PLE could be compared to CNOL. *Id.* at 830-31. The Court noted that a few provisions, 26 U.S.C. § 1503(f)(2), Treas. Reg. § 1.1502-79, and Treas. Reg. § 1.1502-12, referred to separate NOL in a different context, but that this was actually evidence that only CNOL mattered because separate NOL was not defined in the PLE/PLL context. *Id.* at 830. “Not only are they inapplicable to the question before us, but, as one commentator has observed, their references to separate NOLs ‘stem[] more from careless drafting than meaningful design.’” *Id.* at 831 n.7 (quoting Don Leatherman, *Are Separate Liability Losses Separate for Consolidated Groups?*, 52 TAX LAW., 663, 705 (1999) [hereinafter Leatherman, *Separate Liability Losses*]). The Court stated that the only way to maintain comparable treatment of PLL between regular corporate taxpayers and consolidated corporate taxpayers would be to determine PLL for a consolidated corporation by comparing PLE to CNOL. *United Dominion*, 532 U.S. at 830-31.

70. As opposed to the single entity approach, the Court felt that the case for separate entity approach “is not so easily made.” *United Dominion*, 532 U.S. at 831. The separate entity approach requires one to find something equivalent to NOL on the consolidated level prior to calculation of CNOL, but none of the substitutes suggested by the Government of the Court of Appeals works. *Id.* As already discussed, separate taxable income for a consolidated corporate taxpayer is not the same as NOL for a regular corporate taxpayer. *See supra* note 30 and accompanying text.

Not only was the separate entity approach too problematic and not in accord with the statute, but the Government’s reliance upon the definition of separate NOL referred to by Treas. Reg. § 1.1502-79 and defined by Treas. Reg. § 1.1502-12 was misplaced. *United Dominion*, 532 U.S. at 833. While § 1.1502-79 created a figure closer to the NOL than separate taxable income by undoing what was required by § 1.1502-12 in defining separate taxable income, “section 1.1502-79(a)(3) unbakes the cake for only one reason, and that reason has no application here.” *Id.* § 1.1502-79(a)(3) applied only to instances when a consolidated corporation wished to carry back a loss to a “separate return year”, and should, therefore, not be relied upon in any other tax calculations for a consolidated taxpayer. *Id.* Because the case at bar did not deal with carrybacks attributable to separate return years, the provisions had no application to the case at bar. *Id.*

71. *Id.* at 834-35. For more on this double deduction argument, and the reasoning destroying

mechanism to prevent the tax abuse feared by the government by utilizing 26 U.S.C. § 269(a).⁷²

2. Concurring Opinion — Justice Thomas

In a concurring opinion, Justice Thomas emphasized that not only did the provisions require the single entity approach, but that statutory construction required construing any ambiguous statute against the government.⁷³ Justice Thomas pointed out that, especially in the case of complex regulations such as the consolidated return provisions at issue, revenue raising laws should be construed against the drafter.⁷⁴

3. Dissenting Opinion — Justice Stevens

On the other hand, Justice Stevens argued that the ambiguity created by the statute should be construed narrowly.⁷⁵ Where there is an

it see *infra* note 107 and accompanying text.

72. *United Dominion*, 532 U.S. at 838. Tax abuse remained a major concern by the Government in this case. See *id.*; Brief for United States, *supra* note 66, at 40-41. The Government feared that a presently unprofitable corporation with substantial income in past years, for example a manufacturing company, would be encouraged to acquire a profitable corporation with large PLEs, for example a tobacco company, file a consolidated return, and “create an otherwise nonexistent ‘product liability loss’ for the new affiliated group” that would allow the corporation to claim large tax refunds. *United Dominion*, 532 U.S. at 837; Brief for United States, *supra* note 66, at 40. In this way, a corporation could take advantage of PLL carrybacks by utilizing the PLEs of a corporation that consistently made a profit and never really incurred a loss of any sort. *United Dominion*, 532 U.S. at 837.

73. *United Dominion*, 532 U.S. at 838-39 (Thomas, J., concurring).

74. *Id.* at 839 (Thomas, J., concurring). Traditional canons of construction, Justice Thomas explains, require construing revenue-raising laws against their drafter as evidenced by a multitude of cases. *Id.* (Thomas, J., concurring). See *Bowers v. New York & Albany Lighterage Co.*, 273 U.S. 346, 350 (1927) (“The provision is part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers”); *United States v. Merriam*, 263 U.S. 179, 188 (1923) (“If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer”); *Benziger v. United States*, 192 U.S. 38, 55 (1904) (“This provision of the statute should be liberally construed in favor of the [taxpayer], and if there were any fair doubt as to the true construction of the provision in question, the courts should resolve the doubt in his favor”); *American Net & Twine Co. V. Worthington*, 141 U.S. 468, 474 (1891) (“We think the intention of [C]ongress that these goods should be classified as [taxable] is plain; but, were the question one of doubt, we should still feel obliged to resolve that doubt in favor of the [taxpayer], since the intention of [C]ongress to impose a higher [tax] should be expressed in clear and unambiguous language.”); *Leavell v. Blades*, 237 Mo. 695, 700-701, 141 S.W. 893, 894 (Mo. 1911) (“When the tax-gatherer puts his finger on the citizen[,] he must also put his finger on the law permitting it”).

75. Justice Stevens notes that the statute in question is not, in fact, a revenue raising statute, but a statute that creates an exception to general revenue laws for the benefit of the taxpayer. *United Dominion*, 532 U.S. at 839 n.1 (Stevens, J., dissenting). In those cases, the courts have generally narrowly interpreted the statute in favor of the Government. *Id.* (Stevens, J., dissenting); See, e.g., *INDOPCO, Inc. v. Comm’r*, 503 U.S. 79, 84 (1992) (“this Court has noted the ‘familial

ambiguity in the Code, both the IRS and Congress prefer to fix the ambiguity with executive action — in this case, via a Treasury Regulation.⁷⁶ Justice Stevens believed the Court should have deferred to the interpretation of the IRS, especially in light of legitimate policy concerns espoused by the Government,⁷⁷ and upheld the separate entity approach to calculating PLL.⁷⁸

rule' that 'an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer.'"); *Interstate Transit Lines v. Comm'r*, 319 U.S. 590, 593 (1943) ("We examine the argument in the light of the now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer."); *Deputy v. Du Pont*, 308 U.S. 488, 493 (1940) ("[Allowance] of deductions from gross income does not turn on general equitable considerations . . . [but] depends upon legislative grace . . . and only as there is clear provision therefore can any particular deduction be allowed."); *New Colonial Ice Co., v. Helvering*, 292 U.S. 435, 440 (1934) ("The power to tax income . . . is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefore can any particular deduction be allowed."); *Woolford Realty Co. v. Rose*, 286 U.S. 319, 326 (1932) ("A taxpayer who seeks an allowance for losses suffered in an earlier year, must be able to point to a specific provision of the statute permitting the deduction, and must bring himself within its terms.")

76. *United Dominion*, 532 U.S. at 840-41 (Stevens, J., dissenting); *See, e.g., Nat'l Muffler Dealers Ass'n Inc. v. United States*, 440 U.S. 472, 476-77 (1979) ("[T]his Court customarily defers to the regulation, which, 'if found to 'implement the congressional mandate in some reasonable manner,' must be upheld' . . . because 'Congress has delegated to the [Secretary of the Treasury and his delegate, the] Commissioner [of Internal Revenue], not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code.'")

77. *United Dominion*, 532 U.S. at 842 (Stevens, J., dissenting). While in agreement with the majority as to their rejection of the double deduction argument of the Government, Justice Stevens states that "[a]bsent a clear textual anchor, I would credit the Secretary of the Treasury's concerns about the potential for abuse created by the petitioner's reading of the statutory scheme, and affirm the decision of the Court of Appeals on this basis." *Id.* Looking at the statute, Justice Stevens examined a clear dichotomy existing between the normal treatment accorded a consolidated corporation (as a single entity) and the fact that each individual affiliate belonging to a consolidated corporation still retained its status as an individual taxpayer both legally and literally. *Id.*; *See Woolford Realty*, 286 U.S. at 328 ("The fact is not to be ignored that each of two or more corporations joining . . . in a consolidated return is none the less a taxpayer"); 26 U.S.C. § 7701(a)(14) (1982) (defining a "taxpayer" as "any person subject to any internal revenue tax", where a related provision defines "person" to include corporations).

Justice Stevens found the Government's fear of tax abuse extremely compelling. *United Dominion*, 532 U.S. at 842 (Stevens, J., dissenting). He recognized that Congress had no intention of permitting a consolidated return to create additional opportunities to foster tax avoidance and abuse. *Id.*; *See also Woolford Realty*, 286 U.S. at 330 (rejecting "the notion that Congress in permitting a consolidated return was willing to foster an opportunity for juggling so facile and so obvious"). While the majority may have been correct that the Secretary might be able to curb such abuse through the use of 26 U.S.C. § 269, Justice Stevens felt that the court should leave that judgment to the Congress and the IRS. *United Dominion*, 532 U.S. at 842 (Stevens, J., dissenting).

78. *United Dominion*, 532 U.S. at 842 (Stevens, J., dissenting). Justice Stevens writes that any inference one might draw from the fact that the Secretary has only detailed how to calculate NOL for a consolidated corporate taxpayer as CNOL is counterbalanced by the fact that PLE is never mentioned as a deduction on the consolidated level. *Id.* at 841; *See also* Treas. Reg. § 1.1502-

IV. ANALYSIS

A. *Deciphering the United Dominion Puzzle*

The *United Dominion* case may appear deceptively straightforward, but if that were the case, the United States Supreme Court would probably never have granted certiorari.⁷⁹ The extremely divergent split between Circuits⁸⁰ certainly caught the eye of the Supreme Court — the PLL/SLL calculation debate for consolidated corporate taxpayers has existed since the creation of this special carryback in 1978.⁸¹ The question at bar certainly needed a definitive answer interpreting the

12. Justice Stevens agreed with the majority that the calculation of separate NOL under Treas. Reg. § 1.1502-79(a)(3) was more equivalent to NOL than separate taxable income, and, therefore, would affirm the Court of Appeals decision in its entirety. *United Dominion*, 532 U.S. at 842 (Stevens, J., dissenting).

79. One commentator notes that the “*United Dominion* decision resolved a narrow issue that some observers might say was not worthy of the Court’s attention.” W. Eugene Seago, *Supreme Court Takes a Favorable Approach to Specified Liability Losses on Consolidated Returns*, 95 J. TAX’N 175, 181 (2001). *United Dominion* was the first Supreme Court decision interpreting a consolidated return regulation for 67 years. The last cases concerning consolidated return regulations were decided in 1934. See *McLaughlin v. Pacific Lumber Co.*, 293 U.S. 351 (1934) (a consolidated return must clearly reflect income and may not be used to allow a taxpayer to use the same losses more than once to reduce income); *Helvering v. Morgan’s, Inc.*, 293 U.S. 121 (1934) (only one ‘taxable year’ is at issue where a company files a fractional separate and a fractional consolidated return for the same year); *Charles Iffeld Co. v. Hernandez*, 292 U.S. 62 (1934) (filing of a consolidated return implies consent to the consolidated regulations and such return may not be used to attempt to deduct the same losses twice).

80. See *United Dominion I*, 208 F.3d 452; *Intermet*, 209 F.3d 901. *United Dominion I* is more fully examined *supra* at notes 37-42 and accompanying text. *Intermet* is more fully examined *supra* at notes 43-48 and accompanying text. The IRS notes this in a mildly amusing portion of oral argument stating that “if the opponent agreed with us, we wouldn’t of course be here.” Oral Argument, *supra* note 34, at 32. The Supreme Court decision was certainly anticipated:

At this point [1998], the [IRS] seems willing to pursue the position that the amount of SLLs that may be carried back by a consolidated group must be determined on a separate company basis. Taxpayers will likely pursue the opposite position with equal resolve. Ultimately, the issue may have to be resolved by the courts. Nevertheless, based on the technical and policy analysis described above [in the article], the authors believe that the [IRS] ought to take a second look at the issue before proceeding to litigation.

Collins, Garrett, and O’Brien, *supra* note 15, at 71.

81. For a detailed history of carrybacks, including PLL/SLL carrybacks, see *supra* notes 17-33 and accompanying text. A number of academics have hypothesized as to what the correct calculation method should be for consolidated taxpayers that incurred PLEs/SLEs. A few came to the conclusion that PLL/SLL should be determined on a separate entity basis. See, e.g., Emory, Lerner, Fuller, & Cornell, *supra* note 8. Others, of course, decided that PLL/SLL should be determined on a single entity basis. See e.g., Axelrod & Blank, *supra* note 20; Collins, Garrett, & O’Brien, *supra* note 15; Leatherman, *Separate Liability Losses*, *supra* note 69; Don Leatherman, *Current Developments for Consolidated Groups*, 486 PLI/TAX 389 (2000) [hereinafter Leatherman, *Consolidated Groups*].

consolidated provisions. However, after looking specifically at what the Court said, what issues it did not address, and what challenges it left behind for all parties involved, *United Dominion* may take its place more as a commentary on agency inaction than it could ever be considered a comment on statutory and regulatory interpretation.

B. What Exactly Did the United States Supreme Court Say?

In what manner should a consolidated corporate taxpayer calculate PLL? The Supreme Court, using four types of legal arguments,⁸² held that the consolidated group's PLL must be figured on a consolidated basis in the first instance, and not by aggregating PLLs separately determined affiliate by affiliate.⁸³

1. The Text of the PLL/SLL Provisions

The Court explicitly stated that the text of Section 172(j)(1) made clear that until a taxpayer calculated NOL, CNOL in the case of a consolidated taxpayer, there could be no PLL.⁸⁴ Nothing in the text of the regulations changed this basic relationship between NOL and PLL for a consolidated taxpayer, so PLL must be calculated in the same way for any taxpayer.⁸⁵ The only regulation that defined separate NOL for an affiliate was inapplicable by definition, and was also probably more the

82. The breakdown of legal arguments into four different categories is thankfully attributed to the teachings of Professor Wilson Huhn who teaches, among other things, Constitutional Law at the University of Akron. Professor Huhn actually discusses five types of legal arguments used to support a legal position: text, intent, precedent, tradition, and policy. Textual arguments may include plain meaning, canons of construction, intertextual, and intratextual arguments. Intent deals specifically with legislative history or other evidence relating to what the enacting party intended to accomplish with the specific enactment. Precedent relates specifically to past case law interpreting either the same, or any similar, question. Tradition, dealing with something one might call societal precedent, usually does not exist on its own, but as a codependent of another type of argument. Policy arguments, consequentialist arguments looking at the effects a decision would have on future cases and individuals, also do not often exist independent of another type of argument. See Wilson R. Huhn, *Teaching Legal Analysis Using a Pluralistic Model of Law*, 36 GONZ. L. REV. 433 (2000/2001).

83. *United Dominion*, 532 U.S. at 824. The entire case is actually a characterization issue: what amount of a taxpayer's NOL can be carried back for ten years, instead of the limited two year (at present) carryback for regular NOL. For example:

	PLEs	NOL	PLL carryback (10 year)	NOL carryback (2 year)
Corporation A	\$10,000	\$20,000	\$10,000	\$10,000
Corporation B	\$ 0	\$20,000	\$ 0	\$20,000
Corporation C	\$25,000	\$20,000	\$20,000	\$ 0

84. *Id.* at 829.

85. *Id.* at 830.

result of careless drafting than meaningful design.⁸⁶ The regulations gave no statutory basis for using separate NOL or separate taxable income to compute PLL, and, therefore, they may not be used.⁸⁷ Because there was no dispute that all of the amounts claimed as PLL were, in fact, PLEs, application of the text of Section 172(j)(1) allowed the entire amount, up to CNOL, to be carried back up to ten years.⁸⁸

The Court dismissed, as though completely of no consequence, the argument made both by the IRS and the dissent of Justice Stevens that the text of the provisions was ambiguous.⁸⁹ However, the Court's immediate discard of this argument remains completely understandable. The plain meaning of the relevant statute stated that PLL was the lesser of PLE and NOL.⁹⁰ The fact that PLE was not accorded consolidated treatment along with a number of other consolidated attributes⁹¹ was discounted simply by noting the timing of the statutory enactment: PLL/SLL did not exist when the original consolidated deduction provisions were enacted, and therefore their absence from these provisions merely shows that the Treasury failed to update the provisions.⁹²

86. *Id.* at 831, n 7 (citing Leatherman, *Separate Liability Losses*, *supra* note 69, at 705).

87. *Id.* at 832-33.

88. *Id.* at 835.

89. *United Dominion*, 532 U.S. at 840 (Stevens, J., dissenting); *See also* Leatherman, *supra* note 69, at 669-70. Leatherman also argues that the plain meaning of the relevant regulations failed to address treatment of SLLs for a consolidated group. *Id.* at 669. Because the Code fails to dictate a specific method of calculation, Leatherman argues, one should then turn to the regulations and interpret them in light of the recognized purposes of tax neutrality and administrability. *Id.* at 670.

90. 26 U.S.C. § 172(j) (1978) (calculation of PLL); 26 U.S.C. § 172(f)(2) (calculation of SLL).

91. Some separate items that are computed on a consolidated basis, rather than separately, include CNOL deduction, capital net gain, § 1231 net loss, charitable contributions deduction, and § 247 deductions. *See* Treas. Reg. § 1.1502-21; Treas. Reg. § 1.1502-12(a)-(n); Treas. Reg. § 1.1502-11(a).

92. *See United Dominion*, 532 U.S. at 836. The Court recognized that there was no good reason to consider the treatment of PLL on a consolidated basis at the time the regulation which details other consolidated items was drawn. *Id.* The regulation pre-dated the statutory creation of PLLs by 12 years. *Id.*; *See also* Revenue Act of 1978 § 371, Pub. L. No. 95-600 92 Stat. 2859 (1978); Leatherman, *supra* note 81, at 393, n.5.

Omission of PLEs or PLLs from the series set out for consolidated treatment in the 1966 regulation therefore meant absolutely nothing. The issue, then, is the significance, not of omission, but of failure to include later: has the significance of the earlier regulation changed solely because the Treasury has never amended it, even though PLL is now a separate carryback? We think it unlikely.

United Dominion, 532 U.S. at 836.

Another argument that supports this view goes something as follows: the fact that CNOL, the only NOL for a consolidated group, must be used as a measuring stick to determine PLL specifically mandates consolidated treatment for PLE/PLL making mention elsewhere of

The Court's reliance on textual arguments simply reiterates well known tenets of legal argument: if a party wishes to prevail in the future on an issue, the plain meaning of the text must strongly support that party's interpretation. Ambiguity of a statute or regulation will not be well supported by reference to other provisions inapplicable by definition to the situation at hand.

2. The Intent of Congress in Enacting the PLL/SLL Provisions

The consolidated tax return provisions were enacted to create more comparable treatment between consolidated and single taxpayers.⁹³ Using separate taxable income as a substitute for NOL could make a difference between such taxpayers, thus according inequitable treatment to consolidated and single taxpayers — a result not intended by Congress.⁹⁴ If the Treasury wanted to change this result, the Secretary had (and still has) the power to amend the regulations to make their application and intent more clear.⁹⁵ In amending the regulations, the Secretary must simply refrain from contradicting the language or intent of the statutory provisions.⁹⁶

The Court had no need to rely primarily on intent arguments in *United Dominion* because the text of the statute and relevant provisions supported the single entity approach almost entirely.⁹⁷ As explained below, the Court also, undoubtedly, realized the giant and mistaken step it would take by declaring that Congress intended that a consolidated group should always be treated like a single business.⁹⁸

3. Precedent and its Effects on the PLL/SLL Debate

Traditional statutory interpretation as followed by the courts would most likely dictate the same result in this case.⁹⁹ In the past, the courts

consolidated treatment for this expense both redundant and unnecessary. See Collins, Garrett, & O'Brien, *supra* note 15.

93. *United Dominion*, 532 U.S. at 830, 834. While this may be true, a consolidated taxpayer is treated alternatively as a single taxpayer or as separate entities: the hybrid approach. See *infra* note 123. But this statement by the Court does not, in any way, imply that a consolidated group should always be treated like a single business entity. See *infra* notes 118-23 and accompanying text.

94. *United Dominion*, 532 U.S. at 831.

95. *Id.* at 838. See 26 U.S.C. § 1502 (2001).

96. *United Dominion*, 532 U.S. at 838.

97. See *infra* notes 82-92 and accompanying text.

98. See *infra* notes 118-23 and accompanying text.

99. There has been an ever-increasing trend to interpret legislation only by its plain meaning. See Michael Livingston, *Congress, the Courts, and the Code: Legislative History and the*

have favored a text-based approach to regulatory interpretation, refraining from deciding cases based strictly on the possible purposes behind the regulation.¹⁰⁰ Relying heavily upon textual arguments, the Supreme Court, in *United Dominion*, adhered to this simple principle of statutory interpretation created through precedent.¹⁰¹

Another precedent based observation made by the Supreme Court notes the Treasury's very relaxed attitude toward amending regulations to track Code changes.¹⁰² While the consolidated regulations did not specifically provide for calculation of consolidated PLEs/SLEs, as it did allow for consolidated treatment of some other inclusions and

Interpretation of Tax Statutes, 69 TEX. L. REV. 819 (1991). Of course, one must be careful in strictly adhering to the plain language of a statute, as evidenced by a statute in Missouri that, if read literally, would have outlawed all sex in Missouri. See Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492, 493 (1995); Joe Lambe, "Sex Illegal in Missouri? Perhaps," CLEVELAND PLAIN DEALER, Nov. 25, 1994, at 26A. As to tax provisions, one commentator notes that strict plain meaning interpretation is a "wooden approach [that] invites a mind-numbing, desultory technical analysis that may overlook the fundamental principles." Leatherman, *Separate Liability Losses*, *supra* note 69, at 663. While a number of commentators agree that courts should look beyond textual arguments and consider context, intended audience, legislative history, and other evidence of regulatory purpose, they often diverge as to the extent a court should consider these things. See Ilyse Barkan, *New Challenges to Use of The Plain Meaning Rule to Construe the IRC and Regs*, 69 TAX NOTES 1403, 1404 (1995) [hereinafter *Collaborative Model*] (even dictionary definitions have meanings that may be subjective and require context); William D. Popkin, *Law-Making Responsibility and Statutory Interpretation*, 68 IND. L. J. 865, 872 (1993) [hereinafter *Law-Making*] (plain reading should be made in light of drafter's conception of grammar and style, and not just consider surface textualism); See also Livingston, *supra* at 826-31; Geier, *supra* at 497, 510-11 (use a structural analysis including limited context); William D. Popkin, *The Collaborative Model of Statutory Interpretation*, 61 S. CAL. L. REV. 543, 598 (1988) (even if text has plain meaning, does not mean that provision has a plain meaning); but see John F. Coverdale, *Text as Limit: A Plea for a Decent Respect of the Tax Code*, 71 TUL. L. REV. 1501 (1997) (Court may make antitextual arguments in order to close tax loopholes and achieve results consistent "in keeping with their perceptions of how the Code is intended to work," but the Courts should not do so in the tax field due to the need for "formal rules rather than flexible standards"); Don Leatherman, *Musings on Current Consolidated Issues*, 459 PLI/TAX 487, 498-99 (1999) [hereinafter *Musings*] (Tax court made interpretation of consolidated return regulations less certain by using textual, not contextual, approach - the court "invites a winding, technical foray through the consolidated return regulations for each consolidated question not directly answered in the Code or regulations").

100. The courts, however, tend to follow a much more strict approach to tax provision interpretation, and usually refrain from making any major purpose or policy arguments to support their interpretation. Leatherman, *Separate Liability Losses*, *supra* note 69, at 669 (Courts eschew any tax neutrality debates and usual follow regulations plain meaning).

101. See *United Dominion*, 532 U.S. at 822; see also *supra* note 99.

102. *United Dominion*, 532 U.S. at 836. See Axelrod & Blank, *supra* note 20, at 1391 ("[The] Treasury has often been delinquent in adapting regulations to reflect statutory changes"); Leatherman, *Separate Liability Losses*, *supra* note 69, at 708-09 ("Given the snail's pace at which regulations have been updated to reflect Code changes, we would be unwise to assume that government inaction reflects affirmative policy").

deductions,¹⁰³ this was more likely another needed change that was overlooked by the Treasury.¹⁰⁴ The Court explicitly stated that the failure to amend the regulations to conform to Code changes was “more likely a reflection on the Treasury’s inattention than any affirmative intention on its part to say anything at all.”¹⁰⁵ Through this simple proclamation, *United Dominion* may pave the way for future tax litigation by giving some deference to the taxpayer who can show that the Treasury has failed to amend regulations to keep up with the changing tax Code.

4. Foreseeable Consequences and Policy Considerations

Application of the single entity approach is relatively easy to understand, whereas use of the separate entity approach would cause constant confusion to taxpayers.¹⁰⁶ More importantly, the double

103. See Treas. Reg. § 1.1502-21; Treas. Reg. § 1.1502-12.

104. *United Dominion*, 532 U.S. at 836.

105. *Id.* at 837.

106. *Id.* at 831. Tax legislation and regulations are often extremely complex and in need of simplification. See generally Howard J. Hoffman, *The Role of the Bar in the Tax Legislative Process*, 37 TAX L. REV. 413 (1982) (“The Code’s undue complexity is perhaps its most conspicuous flaw”). Consolidated regulations alone are often daunting and confusing. One commentator notes that the current consolidated regulations “are formidably long and have no logical starting or ending point,” and that “[o]ne begins reading the [r]egulations and soon wonders when the rules can begin to be assimilated in a manner that would enable one to compute a tax liability.” Seago, *supra* note 79, at 177. The separate entity approach could also arguably cause increased litigation and administrative cost in order to determine the correct amount of qualifying PLEs/SLEs incurred by each separate affiliate.

What is interesting is that the Court gives no indication as to why this is true. Separate taxable income, separate NOL, and CNOL all have one thing in common: they all are determined by reference to a set equation. See Treas. Reg. §§ 1.1502-11(a), 1.1502-21(e) (2001) (CNOL); Treas. Reg. §§ 1.1502-79A, 1.1502-12 (2001) (separate NOL); Treas. Reg. § 1.1502-12 (2001) (separate taxable income). It is not the actual calculation of separate taxable income, separate NOL, or CNOL that is not simple or straightforward. What, then, makes using something other than CNOL confusing? It can not be the nature of those calculations. It must lie in the reasoning behind adopting either separate NOL or separate taxable income over CNOL. Both the Respondent’s and Petitioner’s Briefs rely on counter presumptions relating to the intent of Congress in its creation of consolidated taxpayer provisions: the IRS presumes that each affiliate is actually a separate taxpayer which can not have a loss if it also has income while United Dominion presumes that each affiliate is actually only part of the single entity, as each division of a non-consolidated taxpayer would be. See Brief for United States, *supra* note 66; Brief for United Dominion, *supra* note 66. In other words, they differ on the definition of “taxpayer” and neither has any truly miraculous argument to show in what manner the group should be treated in this context. See *infra* notes 117-23 and accompanying text.

But that may not have been the real confusion either. The real confusion may have ensued from the Respondent IRS’s Brief and the transcript of the Oral Argument before the Supreme Court. See Brief for United States, *supra* note 66; Oral Argument, *supra* note 34. The Brief was not very clear or concise; it reiterated the presumption of Congress’ intent multiple times

deduction feared by the IRS did not exist because separate taxable income was simply an accounting construct, and not a tax event.¹⁰⁷ The Court noted that tax avoidance abuse would occur whether the single or separate entity approach was adopted, and Section 269 allowed the IRS to disallow deductions associated with tax-motivated behavior.¹⁰⁸ The adoption of the single entity approach might open some new tax loopholes, but the Treasury retains the power to implement specific provisions to prevent tax avoidance abuses in this context.¹⁰⁹

Another policy consideration, clarity of statutory construction and interpretation, was also squarely dealt with: the Supreme Court itself refrained from drafting an opinion that would cause confusion as to the issue of PLL/SLL carryback computation for consolidated groups. Specifically, the Court “avoided an extended foray through the consolidated return regulations,” and issued a “restrained opinion that focused primarily on the technical tax issues” in the case at bar.¹¹⁰ By avoiding making statements as to general tax policy that could underlie the *United Dominion* decision, the Court will certainly prevent a multitude of future tax litigation that could have been brought based on a

without supporting it; its wording was difficult to decipher; its reasoning was mildly flawed (why, for example, should the Court defer to the Treasury as to use of separate NOL instead of CNOL, but should NOT defer to the Treasury if it had chosen to use separate taxable income? Both run contra to the text of the statute and relevant regulations.) The oral argument transcript is also disconcerting to read: the Court constantly attacked the position of the IRS while the IRS constantly interrupted the questions of the Court and skirted issues the Court wished to question. See Oral Argument, *supra* note 34.

107. *United Dominion*, 532 U.S. at 833. Not only was this not a tax event, the amount of NOL not characterized as PLL was still capable of carryback - it was simply limited to a shorter carryback period. If the separate entity approach of the IRS was adopted, less of the total CNOL at issue in *United Dominion* would be characterized as ten year carryback resulting, possibly, in more taxes due to the IRS. But this is not necessarily true. If, for example, the group had enough profits in the limited NOL carryback period (two or three years) to offset the entire NOL carryback against, and then the group remained profitable in the future, the difference between whether the entire amount was carried back ten or two years would be irrelevant. This is why the double deduction argument was discarded: if carrying an amount back two or three years would not be a double deduction, why should carrying it back ten years? While this does give the taxpayer a greater window of profits to offset his losses, it can not be an unintended double deduction. See Collins, Garrett & O'Brien, *supra* note 15. One commentator found the Fourth Circuit's belief in the double deduction argument very amusing:

[A]mazingly the Tax Court, in *Internet*, agreed with the analysis of the IRS [finding that there was a double deduction] . . . Fortunately, the Sixth Circuit, properly schooled in the associative principle of arithmetic (which holds that the groupings of items in the case of addition and subtraction have no effect on the result) rejected the analysis of the IRS.

Axelrod & Blank, *supra* note 20, at 1394.

108. *United Dominion*, 532 U.S. at 838.

109. *Id.*; See 26 U.S.C. § 1502 (2001).

110. Don Leatherman, *Consolidated Groups*, *supra* note 81, at 88.

looser analysis of the consolidated regulations.¹¹¹

C. What Exactly Did the Supreme Court Avoid Saying?

After considering the issue actually decided by the Court, *United Dominion* remains striking as to the issues apparent but unresolved or uncommented upon in the case at bar.

1. Separate NOL issue

First, the clear concise opinion of the Court refrained from additional extraneous dicta dealing with issues not implicated by the present case: the *United Dominion* decision leaves unanswered the question of how a consolidated group should apportion any PLL/SLL ten-year carryback among affiliates where the group's members have changed over the past ten years.¹¹² The Supreme Court specifically, though erroneously, stated that “[n]o separate return years are at issue before [the court]; all relevant NOL carrybacks relevant here apply to years in which the five corporations were affiliated in the group.”¹¹³ In fact, all five affiliates in question were not members of the consolidated group in 1973-1975.¹¹⁴ But the Court did not need to “unbake[] the cake” using Treasury Regulation 1.1502-79 to determine what amounts each affiliate could properly carry back to any separate return years because each affiliate had positive separate taxable income and, therefore, could not carry back any portion of the PLL.¹¹⁵

111. See Axelrod & Blank, *supra* note 20, at 1395 (“If the High Court . . . refrains from sweeping statements that could be misapplied in future tax controversies, its decision will have advanced the state of the law”).

112. See *United Dominion*, 532 U.S. at 822; Jared H. Gordon, *Unbaking the Consolidated Cake: Deciphering the Impact of United Dominion*, 28 J. CORP. TAX’N 3 (2001).

113. *United Dominion*, 532 U.S. at 833.

114. See *United Dominion Trial*, 1998 WL 725813 at *1; See also Gordon, *supra* note 112, n.13. The ten year carryback provision would cause the PLLs in *United Dominion* to be carried back to tax years beginning with 1973. All five affiliates in question were not members of the consolidated group in 1973-1974, and filed separate returns for 1975-1976. *United Dominion Trial*, 1998 WL 725813 at *1. For a more thorough review of separate return years see *supra* at note 20.

115. *United Dominion*, 532 U.S. at 833. Justice Souter calls apportionment of the consolidated group’s CNOL and PLL carrybacks to affiliates for separate return years “unbak[ing] the cake.” *Id.* The applicable regulation, Reg. 1.1502-79(a)(3), does not actually take apart CNOL and apportion it to separate return years, but simply divides CNOL among the consolidated group and the affiliates seeking to carry back a portion of CNOL, including PLL, to a separate return year. Basically, a separate return year is any year in which the affiliate was not a member of the consolidated group. See Treas. Reg. 1.1502-79A. For a more extended explanation of separate return years, see *infra* at note 20. Treas. Reg. 1-1502-79A(a)(3) defines the portion of NOL attributable to a member for a separate return year as:

As the Supreme Court had no reason to address the issue, apportionment of PLL/SLL carryback for a consolidated corporation remains in dispute.¹¹⁶ As with calculation of PLL/SLL for a consolidated group, no regulation specifically details this computation. Two possible options emerge: (1) use Treas. Reg. § 1.1502-79 and Treas. Reg. § 1.1502-21 to apportion PLL/SLL to each affiliate according to the rules set for apportionment of CNOL, or (2) determine the amount of CNOL apportioned to each affiliate that consisted of qualifying PLEs/SLEs and then carry back the lesser of the qualifying expenses or the apportioned CNOL.¹¹⁷

CNOL of the group x SEPARATE NOL of the affiliate

Total SNOL of all members of group contributing to losses for the years
Therefore, since each affiliate in question had positive separate taxable income, and no separate NOL, none of them could carry back any portion of the CNOL or PLL. (CNOL x 0 = 0).

116. See *United Dominion*, 532 U.S. at 822; see also Gordon, *supra* note 112. This issue also collaterally appeared in *Amtel*, but was not discussed in that opinion because the circumstances mandated only a straightforward application of Treas. Reg. § 1.1502-79A. *Amtel*, 31 Fed. Cl. 598 (table); see Collins, Garrett, & O'Brien, *supra* note 15; Leatherman, *supra* note 69.

117. See Gordon, *supra* note 112. Gordon gives a wonderful example (Example 2 in his article) of the practical differences between these two approaches which is adapted below with different terminology:

Member	Qualifying Expenses	Apportioned CNOL	10 yr NOL Carryback: Separate Return Year	
			Method 1	Method 2
A	0	60 (30%)	30 (30%)	0
B	20	0 (0%)	0 (0%)	0
C	60	40 (20%)	20 (20%)	40
D	20	100 (50%)	50 (50%)	20
Totals	100	200	100	60

Method 1 uses the same apportionment for PLL/SLL as detailed for CNOL in Treas. Reg. § 1.1502-79 and Treas. Reg. § 1.1502-21. Thus both PLL/SLL and CNOL are attributed to each affiliate's separate return year on a pro rata basis regardless of whether the affiliate actually had any qualifying expenses. Method 2 simply allows each affiliate to carry back the lesser of apportioned CNOL or qualifying expenses to the separate return year. The remaining \$40 of SLL/PLL is not actually lost in Method 2, but simply becomes a "pure consolidated attribute" that the group would carry back. See *id.*

Method 1, consistent with the pure single entity approach, actually takes the CNOL and slices it into pieces that are apportioned to each affiliate for its separate return year. In accordance with this theory, the CNOL piece actually retains its original attributes - thus if 50% of the original CNOL was attributable to qualifying expenses, then, as above, that same 50% would remain PLL/SLL when apportioned to the affiliate. See Axelrod & Blank, *supra* note 20, at 1383, 1395. This first approach actually directly contradicts the IRS's position in *United Dominion* that would prohibit an affiliate who had no actual loss (PLL/SLL loss) from being permitted to carryback such a loss. See Brief for United States, *supra* note 66.

Method 2, also known as the "consolidated first" approach, is not necessarily contradictory of the Supreme Court's reasoning in *United Dominion*. See Leatherman, *Separate Liability Losses*, *supra* note 69, at 718. The Court never stated that a consolidated group should consistently be treated like a single taxpayer. See *infra* notes 118-23 and accompanying text. This method would also help to prevent loss shifting (an affiliate would not be able to offset its separate return year income with PLL/SLL carryback when the affiliate itself did not incur any qualifying expenses for the tax year)

2. Who is Really the Taxpayer?

The second measure of restraint by the Court can be seen in its lack of defining who the taxpayer really is: is the consolidated group the only taxpayer or is each affiliate a separate taxpayer? “The original justification for the consolidated return provisions was that individual members of a controlled group of corporations should, as a matter of equity and convenience, be taxed as a single business unit.”¹¹⁸ Given the emphasis that both United Dominion and AMA/MAPI (as *amicus curiae*) placed upon the intent of Congress to treat a consolidated corporation like a single business, it is interesting to note that the Supreme Court chose not to support its opinion with this argument.¹¹⁹ The Court actually questioned the IRS on this matter during oral argument, pointing out how the consolidated group was treated like a single business and a single taxpayer.¹²⁰ The mild interest stemming

and promote tax neutrality of business decisions. *See* Gordon, *supra* note 112, at 7; *See also infra* notes 124-25 and accompanying text. In 1997 the IRS, in Technical Advice Memoranda 9715002, stated that the correct approach was the separate entity approach, regardless of the increasing trend treating consolidated corporations as a single entity. *See* Collins, Garrett, & O’Brien, *supra* note 15.

118. H.R. REP. NO. 100-391, pt. 2, at 1089 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2313-1, 2313-704 (citing S. REP. NO. 617, at 9 (1918)).

119. *See* Brief for United Dominion, *supra* note 66, at 11, 20-21, 36-37; *See also* Brief of *Amicus Curiae*, *supra* note 66, at 3-4, 8-9.

120. *See* Oral Argument, *supra* note 34. Not only did the Court question the IRS about this issue, but this was the first question from the Court:

QUESTION: Mr. Jones, can I just ask one preliminary question? The statute refers to in the case of a taxpayer which has a product liability loss—now, who is the taxpayer?

MR. JONES: Well, the taxpayer in the 172 context is plainly the individual corporation. That’s the way that all of the provisions of the Code are written. They are written to apply to the individual taxpayer.

QUESTION: And each of the corporations —

MR. JONES: The only —

QUESTION:—is the taxpayer in your view?

MR. JONES: Each of these corporations is a taxpayer.

QUESTION: Did they each file a return?

MR. JONES: The only way that they avoid filing a separate return is by electing under 1.1502 to file a consolidated return. And so the question is, how do you go from the provisions of the Code that dictate how we treat —

QUESTION: How many checks does the —

MR. JONES: —separate taxpayers.

QUESTION: —when they file the return, how many people—how many different corporations give the Government money?

MR. JONES: Well, each of them is severally liable, and so the answer —

QUESTION: The question is how many give them money, not whether they —

MR. JONES: Well, I don’t know. The answer can vary. Sometimes a check can be drawn from each of the corporations or by any one of them. They are severally liable for this tax. That is to say each of them is liable for the consolidated tax. To understand how —

from the Court's restraint to make a definite statement on this matter, though, is short lived when one realizes the great impact such a declaration by the Supreme Court would have had on other consolidated provisions.¹²¹ Any determination by the Court that the only true taxpayer was the consolidated group, and that each affiliate was not a separate taxpayer, would directly contradict statutes and provisions dealing with consolidated groups.¹²² While the consolidated group might be the only true taxpayer at issue in *United Dominion*, the Court looked beyond the circumstances of the case and realized what type of argumentative ammunition it would be granting to future taxpayers. Only by refraining from such a statement could the Court maintain the intricate system regarding consolidated provisions which alternatively treat a consolidated corporate taxpayer as a single taxpayer or as a group of separate affiliated taxpayers — an approach often called the “hybrid approach.”¹²³

QUESTION: For the whole tax?

MR. JONES: Yes, sir.

QUESTION: I mean, you can get the whole thing out of any one of them, not just the aliquot portion attributable to that one.

MR. JONES: That's correct. That's Section 6.

QUESTION: And indeed you wouldn't know what the aliquot portion would be.

Oral Argument, *supra* note 34, at 23-25.

MR. JONES: . . . And that brings me to my third point which is there is no requirement that there be a perfectly equivalent treatment between individual taxpayers and the consolidated taxpayer. If that was a requirement, we wouldn't have consolidated returns.

QUESTION: You just used the term consolidated taxpayer —

Oral Argument, *supra* note 34, at 27.

121. For examples of ways in which consolidated corporations are presently treated as a group of separate affiliated taxpayers see *infra* note 123. Defining a consolidated group as a single taxpayer for every conceivable purpose would not only change the application of these provisions, but would often cause distortion of reported income. See *Leatherman, Consolidated Groups, supra* note 110, at 93.

122. See *Treas. Reg. 1.1502-80 (2001)* (the Code is applicable to the consolidated group to the extent that the consolidated return regulations do not exclude its application). The Tax Court has interpreted this regulation to mean that “where the consolidated return regulations do not require that corporations filing such returns be treated differently from the way separate entities would be treated, these corporations shall be treated as separate entities when applying provisions of the code.” *H. Enter. Int'l. Inc., v. Comm'r*, 105 T.C. 71, 85 (1995) (quoting *Gottesman & Co. v. Comm'r*, 77 T.C. 1149, 1156 (1981)). This interpretation is, of course, disputed. See *Intermet*, 209 F.3d 901; *Seago, supra* note 79, at 180.

123. The hybrid approach to treatment of consolidated groups is intended to “clearly [] reflect the income tax liability of the group and each member.” *Leatherman, Separate Liability Losses, supra* note 69, at 667 (internal quotations omitted); see also *FRED W. PEEL, JR. ET AL., CONSOLIDATED TAX RETURNS* § 6.04 (3d ed. 1990). The hybrid approach to consolidated

3. Tax Neutrality

The Supreme Court also refrained from making a policy decision better and more appropriately left to Congress: whether the consolidated provisions are guided by the policy of tax neutrality. Many academics have argued that the interpretation of consolidated return provisions by the courts is often guided by the concept of favoring tax neutrality in business-making decisions.¹²⁴ The single entity approach embraces tax

corporations is well documented and discussed. *See, e.g.*, David F. Abbott, "A Matter of Equity and Convenience" - *The Nature of the Consolidated Return as Reflected in Recent Developments*, 67 TAXES 1072, 1074-75 (1989); Axelrod and Blank, *supra* note 20; James L. Dahlberg, *Aggregate vs. Entity: Adjusting the Basis of Stock in a Subsidiary Filing a Consolidated Return*, 42 TAX L. REV. 547 (1987); Andrew J. Dubroff & John Broadbent, *Consolidated Returns: Evolving Single and Separate Entity Themes*, 72 TAXES 743, 744-47 (1994); Leatherman, *supra* note 69 at 665-70 *Separate Liability Losses*; Andrew M. Mellon, *Consolidated Returns Regulations - Summary of Provisions*, 7 NAT'L TAX MAG. 105 (1929).

For example, a consolidated group is treated like a single entity in determining gross income, gain (including net capital gain and net section 1231 gain), loss (including net section 1231 loss), deductions (including charitable and dividends received deductions), and federal income tax (which is based upon consolidated taxable income determined by combining the group's gross income, gains, losses, and deductions). *See* Leatherman, *Separate Liability Losses*, *supra* note 69, at 666. A consolidated group is also treated like a single entity for purposes of relinquishing any NOL carryback available - the common parent must elect to relinquish the carryback, and any separate affiliate may not choose to carryback any portion of NOL following such election. Treas. Reg. § 1.1502-21T(b)(3)(i)(2001). *See, e.g.*, Letter Ruling 8145027; Letter Ruling 8448004; *see also* Collins, Garrett, & O'Brien, *supra* note 15, at 66-67'. In creating the consolidated tax return, Congress intended to treat the affiliated group like a single business, downplay the separate tax existence of each affiliate, and make business decisions (like the transfer of assets between affiliates) more tax neutral. *Id.* at 667. *See infra* notes 124-25 and accompanying text.

A group, also, is often treated like a group of separate, affiliated, taxpayers. For example, each affiliate retains pre-consolidation tax attributes, each recognizes gain or loss on the sale of an asset to another member of the group, each determines its profits and earnings separately, each may carry back a portion of the group's losses to a separate return year, and each determines its own method of accounting as though it filed a separate tax return. Leatherman, *Separate Liability Losses*, *supra* note 69, at 668. Each affiliate also retains the ability to act as a separate entity by issuing stock, taking out loans, or filing for bankruptcy on its own initiative. *Id.* at n.28. Provisions that cause the consolidated group to be treated like a group of separate entities make the decision to acquire or dispose of a member more tax neutral. *Id.* at 668. For example, limitations on carrybacks reduce the chances of loss trafficking (purchasing the tax losses of another corporation). *Id.* at 677 and n.86; *see generally* Daniel L. Simmons, *Net Operating Losses and Section 382: Searching for a Limitation on Loss Carryovers*, 63 TUL. L. REV. 1045 (1989).

124. *See, e.g.*, Axelrod & Blank, *supra* note 20, at 1386 ("Ideally, the decision to operate several businesses as separate corporations rather than as divisions of a single corporation should have no bearing on the tax result of certain transactions."); Collins, Garrett, and O'Brien, *supra* note 15, at 70' (the separate entity approach espoused by the IRS places too much emphasis on the location of assets within a consolidated group thus "creat[ing] an artificial tax impediment to achieving what should be (and is) an underlying objective of the consolidated return regulations: . . . Optimiz[ation of] business efficiencies."); Leatherman, *supra* note 69 *Separate Liability Losses* (careful review of consolidated regulations reveals promotion of two policies: tax neutrality in forming new members or transferring assets between members and tax neutrality in acquiring or

neutrality: only under the single entity approach does consolidated PLL/SLL not depend upon the location of assets within the group or any decision by the group to acquire, incorporate, or liquidate a member.¹²⁵ Though the Court “obliquely acknowledged the neutrality principle in its opinion,”¹²⁶ the Court refused to specifically endorse this principle for the same reason that it refrained from stating that the group was the only true taxpayer — the Court did not wish to provide some zealous party

disposing of a member); see also David W. LaRue, *A Case for Neutrality in the Design and Implementation of the Merger and Acquisition Statutes: The Post-Acquisition Net Operating Loss Carryback Limitations*, 43 TAX L. REV. 85 (1987).

Congress has noted this intent in the past as well:

The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. . . . The failure to recognize the entire business enterprise means drawing technical legal distinctions, as contrasted with the recognition of actual facts. The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one in the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, and from its investments, and from each and every one of its agencies. It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes.

S. Rpt. No. 960, 70th Cong., 1st Sess., (1928).

125. Leatherman, *supra* note 81, at 397-98 *Consolidated Group*. Take the following example where each lettered asset was one that created SLE/PLE for that tax year, indicated by an asterisk, and that Parent used asset A as consideration for acquisition of the stock of affiliate B in 1984.

Year	Parent: Assets	PLE/SLE	Affiliate: A Assets	PLE/SLE	: B Assets	PLE/SLE
1973	A	0	B,C	0	Not yet acquired	
1974		0	B,C	0	A	0
1986	B	0	C*	50	A*	100
1988	B*	100	C	0	A	0
1989	B	0	C	0	A	0

Assume the group has CNOL of \$200 for tax years 1986 and 1988 which is wholly incurred by the parent, and each affiliate has positive separate taxable income for those tax years if they are in existence. Under the single entity approach, the group could carryback as PLL/SLL \$150 in 1986 and \$100 in 1988. Under the separate entity approach, though, ONLY the \$100 incurred by Parent in 1988 could be carried back as PLL/SLL. If Parent had retained asset A, instead of transferring it to Affiliate B (or simply did not acquire or incorporate Affiliate B thus retaining asset A), then the \$100 incurred in 1986 could also be carried back as PLL/SLL. Also, if an affiliate liquidated into Parent, for example if Affiliate A liquidated into Parent in 1986 after Affiliate A incurred the \$50 PLE/SLE, then the Parent could claim PLL/SLL: \$50 under the separate entity approach or \$150 under the single entity approach. In other words, only in applying the separate entity approach does both the placement of assets within a group and the decision to acquire, incorporate, or liquidate a member affect the availability of PLL/SLL carrybacks. If each affiliate were in fact a separate division of a single corporate taxpayer, there would be no question that the entire \$150 in 1986 and \$100 in 1988 could be carried back as PLL/SLL.

126. Leatherman, *supra* note 110, at 90.

the opportunity to twist interpretation of consolidated group tax provisions that did not necessarily accord with this unspoken policy.¹²⁷

4. Deference to Administrative Agency Interpretation

Of course, any opinion usually includes just enough dicta to provide fodder for the future fires of litigation. In *United Dominion*, the Supreme Court did not, in the majority opinion, explain why the position of the IRS should be given no deference.¹²⁸ The dissenting opinion by Justice Stevens correctly pointed to a long list of case law that accords deference to the IRS and Treasury in interpretation of tax provisions (like that at bar) which created an exception from a general revenue duty.¹²⁹ The concurring opinion of Justice Thomas attempted to correct this oversight, but simply (and incorrectly) classified the regulation at bar as a revenue-raising law, and thus one that should be construed against the taxpayer.¹³⁰

The Sixth Circuit decision in *Intermet* offers the only hope for explanation of the Supreme Court's refusal to give the IRS interpretation deference: deference will not be accorded to agency interpretation where the agency has taken inconsistent positions or reasoning on the same issue.¹³¹ Of course, the Supreme Court may specifically have avoided the topic of deference simply because it did not apply to the present case. There remains a vast difference between according deference to the explicit wording of a specific regulation, on the one hand, and according

127. See Axlerod & Blank, *supra* note 20, at 1395 (challenging the Supreme Court to draft the *United Dominion* opinion narrowly to avoid "sweeping statements that could be misapplied in future controversies").

128. Following *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the courts regularly defer to an agency's reasonable interpretation of a statute that the agency is responsible for administering. As to the IRS, *Connecticut General Life Insurance Co. v. Commissioner*, 177 F.3d 136 (3d Cir.), *cert. denied*, 528 U.S. 1003 (1999), indicated that deference should be given to any reasonable IRS interpretation, even where that interpretation is first adopted for litigation. This position is directly contradicted, though, by *Intermet*, 209 F.3d 901, which held that the IRS is not entitled to deference where the IRS has a history of adopting differing and inconsistent interpretations. See *supra* note 48. An agency must earn deference through consistent interpretation, and will not receive deference on an interpretation it has abandoned. See Hyman, *supra* note 48. See generally Ellen P. Aprill, *Muffled Chevron: Judicial Review of Tax Regulations*, 3 FLA. TAX REV. 51 (1996); Linda Galler, *Emerging Standards for Judicial Review of IRS Revenue Rulings*, 72 B.U. L. REV. 841 (1992).

129. See *supra* note 75 and accompanying text.

130. See *supra* note 74 and accompanying text. One commentator remarks that the concurring opinion by Justice Thomas made the administrative branch appear "as though it did not understand the rules it wrote". Seago, *supra* note 79, at 181.

131. See *supra* note 48 and accompanying text. See also Collins, Garrett, & O'Brien, *supra* note 15; Seago, *supra* note 79.

the same deference to a point that is simply not addressed by the regulations.¹³² Regardless of any explanation for the Supreme Court's failure to defer to the IRS interpretation, future litigants may still wield this unintended trampling of deference as a sword against future litigants, and the IRS may be more careful in demanding deference for any point not addressed by the regulations.

5. Observations on Legal Arguments by Tax Practitioners

The Supreme Court explicitly stated that the single entity approach was more straightforward and simple to apply.¹³³ But the reasoning behind this is a little more vague — separate taxable income, separate NOL, and CNOL all are determined by a set equation.¹³⁴ It was not the calculation of these things in themselves, then, that could be so confusing. If the Supreme Court could make any comment on the drafting and arguing of legal issues, it might be well made in this case: one need only read through the brief of the Respondent IRS to experience the confusion that may have defeated the IRS's arguments for the separate entity approach.¹³⁵

While the arguments made by the IRS were certainly legally supportable, the brief itself could require the services of an experienced tax practitioner to translate each argument for any other member of the legal profession. While the Court, at oral argument, attempted to clarify the arguments of the IRS, a reading of the oral argument simply serves to buttress the Court's concern that the separate entity approach is simply unworkable. Not once did the IRS explain how the separate entity approach would work, nor why the consolidated provisions explicitly supported the separate entity approach.¹³⁶

D. The Supreme Court's Challenge to the Treasury and IRS

While *United Dominion* dealt specifically with PLL calculation for

132. “[I]t seems that the IRS was arguing a point that the Regulations simply did not address[, and W]hen the Service attempted to ‘force’ the regulations into the specific issue, the government could not avoid embarrassment.” Seago, *supra* note 79, at 181.

133. *United Dominion*, 532 U.S. at 831.

134. CNOL is defined by Treas. Reg. §§ 1.1502-11(a), 1.1502-21(e); Separate NOL is defined by Treas. Reg. §§ 1.1502-79A, 1.1502-12; Separate taxable income is defined by Treas. Reg. § 1.1502-12.

135. See Brief for United States, *supra* note 66.

136. See Oral Argument, *supra* note 34. As a student of the law, and not yet a practitioner in tax or any other legal field, each reader is, of course, entitled to draw his own conclusions as to the effects inexperience has on such an observation.

a consolidated corporate taxpayer, an underlying theme actually recurred throughout the majority opinion: the Supreme Court was challenging the Treasury to start amending regulations to stay abreast of Code changes.¹³⁷

If the government were to conclude that § 269 provided too little protection [to prevent tax avoidance abuses] and that it simply could not live with the single-entity approach, the Treasury should exercise the authority provided by the Code, 26 U.S.C. § 1502, and amend the consolidated return regulations.¹³⁸

The Treasury's relaxed approach to amending its regulations to track Code changes is well documented . . . The absence of any amendment to § 1.1502-12 that might have added PLEs or PLLs to the list of items for mandatory single-member treatment therefore is more likely a reflection of the Treasury's inattention than any affirmative intention on its part to say anything at all.¹³⁹

The long and well-documented indifference to amending Treasury regulations may be due to administrative problems in keeping up with the multitude of new statutory tax provisions and ever-increasing number of applications for those provisions.¹⁴⁰ If the Treasury could

137. *United Dominion*, 532 U.S. at 836-37. The Court implicitly rejected the argument of the IRS that the Court was actually enacting judicial regulations by adopting the single-entity approach. At oral argument, the IRS specifically stated its fear of judicial legislation: "[W]hat we're also saying is that the Secretary is the one who is supposed to adopt these legislative rules, and we don't think that the Court needs to." Oral Argument, *supra* note 34, at 34. The IRS also, though, admitted that the only reason the case was before the Supreme Court was because there was a conflict of legal interpretation. "We've won this in some courts, we've lost it in other courts. There's a conflict, which is why we're here." *Id.* at 33.

There is no question that the Secretary of the Treasury has the ability to amend the regulations at issue to support the separate-entity approach espoused by the IRS. *See* 26 U.S.C. § 1502. The IRS voiced agreement of this in oral argument: "[T]here is no question that the Secretary can adopt—could adopt a rule that [accorded separate entity treatment to PLL/SLL carrybacks." Oral Argument, *supra* note 34, at 40. Of course, by amending the regulations to achieve this result, the IRS feared that the Secretary would no longer be able to allow for consolidated treatment of other items like charitable deductions and the like.

If we're going to have a separate net operating loss definition for individual corporations, it would have to be only for this issue, and then it would have to take account of, well, we're no longer treating these as consolidated on the other—on the consolidated return. We would have to make some adjustments there, too.

Id. at 40-41.

138. *United Dominion*, 532 U.S. at 838.

139. *Id.* at 836-37.

140. *See* Axelrod & Blank, *supra* note 20, at 1391 ("[The] Treasury has often been delinquent in adapting regulations to reflect statutory changes"); Leatherman, *supra* note 69, at 708-09 *Separate Liability Losses* at 708-09. ("Given the snail's pace at which the regulations have been updated to reflect Code changes, we would be unwise to assume that government inaction reflects affirmative policy"). The absence of consolidated return regulations on specific topics was also

keep up with the ever-changing Tax Code, Justice Stevens' wish regarding tax provisions might be accomplished: "When we [the Supreme Court] deal 'with a subject so complex as to be the despair of judges, 'an ounce of deference is appropriate.'"¹⁴¹ One might actually argue that the majority gave great deference to the Treasury and the IRS, reserving only the one ounce necessary to answer the long neglected PLL/SLL computation question.¹⁴²

While *United Dominion* will remain important as interpreting the PLL/SLL carryback provisions for consolidated corporate taxpayers, the affirmative push by the Court to the Secretary of the Treasury may prove to be an even more important aspect of the decision.

V. CONCLUSION

The Supreme Court decision in *United Dominion* helps to clear up

addressed in *Gottesman*, 77 T.C. at 1149. In that case, the taxpayer argued that where no official guidance existed any reasonable method should be permissible to calculate accumulated earnings tax including the method contained in the most recently withdrawn proposed regulation. The Tax Court agreed, stating that "[w]e cannot fault petitioner for not knowing what the law was in this area when the Commissioner, charged by Congress to announce the law (sec. 1502), never decided what it was himself." *Id.* at 1157.

141. *United Dominion*, 532 U.S. at 838 (Stevens, J., dissenting) (internal citations omitted) (quoting *Dobson v. Comm'r*, 320 U.S. 489, 498 (1943)). This is the same argument made by the IRS in their brief:

Congress has directed the Secretary of the Treasury—rather than the courts—to devise rules to ensure that consolidated returns achieve a full and clear reflection of income. 26 U.S.C. [§] 1502 . . . Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code." *United States v. Correll*, 389 U.S. [299] at 307 [(1967)]. Deference to the agency's interpretations "helps guarantee that the rules will be written by 'masters of the subject,' *United States v. Moore*, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect." *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979).

Brief for United States, *supra* note 66, at 28, n.19.

142. One commentator noted:

The Supreme Court answered how a consolidated group should compute its consolidated PLL and wisely left broader issues to be resolved through regulations or legislation. The IRS can seize the moment. It can address the tax-avoidance transaction it identified in litigating *United Dominion* . . . The IRS could address the broader concern [about consolidated groups attempting to acquire a member with readily anticipated PLEs/SLEs] through regulations. It can also state universal principles that may aid in interpreting the consolidated return regulations, principles that may make the regulations simpler and better able to accommodate changes in the Code. However, it should not adopt a single-entity or separate-corporation default rule. Neither default rule is likely to fulfill the guiding directive for the consolidated return regulations "clearly to reflect the income tax liability" of the group and each member and to "prevent avoidance" of that tax liability. That directive requires a hybrid approach . . .

Leatherman, *Consolidated Groups*, *supra* note 110, at 93.

an area of law disputed nearly since its creation. Consolidated corporate taxpayers should determine PLL/SLL carryback using a single entity approach. The Court was very careful in limiting its opinion to only those arguments necessary to support its decision. The Court specifically refrained from including any statements in the opinion that (1) would decide issues not in question; or (2) give future litigants ammunition that might support arguments directly in contravention of the obvious intent of Congress. Not only did the Supreme Court interpret tax provisions sorely in need of clarification, the Court also left behind an important challenge to the Treasury. The Treasury has been notorious for failing to track Code changes by amending its regulations. Hopefully, following *United Dominion*, the Treasury will attempt, as much as administratably possible, to keep tax regulations up to date and relatively clear.

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