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Redlark v. Commissioner: A Bird in the Hand for Noncorporate Taxpayers

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REDLARK V. COMMISSIONER: A "BIRD IN THE HAND" FOR NONCORPORATE TAXPAYERS?

INTRODUCTION

Before the Tax Reform Act of 1986, individual taxpayers could generally deduct interest regardless of whether the underlying indebtedness was considered personal or business-related. However, Internal Revenue Code ("I.R.C.") § 163(h)(1), added by the Tax Reform Act of 1986, denies interest deductions for "personal interest." "Personal interest" is defined negatively in that section; an exception preserves the deductibility of interest "on indebtedness properly allocable to a trade or business." Upon the enactment of I.R.C. § 163(h) the IRS took the position, via temporary treasury regulations, that all interest accruing on underpayments of individual income tax is personal and therefore nondeductible. While the

1. I.R.C. § 163(h)(1) (1994) ("In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.").

2. I.R.C. § 163(h)(2) (1994) (as amended by Section 1005(c)(4) of the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, 102 Stat. 3342, 3390). As originally enacted in 1986, I.R.C. § 163(h)(2)(A) read "interest paid or accrued on indebtedness incurred or continued in connection with the conduct of a trade or business." See infra notes 226-228 and accompanying text (discussing the failure of Congress to consider the applicable regulations when modifying the underlying statute). Treasury regulations generally define amounts that are considered "properly allocable" under the amended language. See, e.g., Temp. Treas. Reg. § 1.163-8T(c) (1987) (discussing "allocation of debt and interest expense").


Interest relating to taxes—(i) In general. Except as provided in paragraph (b)(2)(iii) of this section, personal interest includes interest—(A) Paid on underpayments of individual Federal, State or local income taxes and on indebtedness used to pay such taxes (within the meaning of § 1.163-8T), regardless of the source of the income generating the tax liability.

Id. at § 1.163-9T(b)(2) (emphasis added). The exception noted for paragraph (b)(2)(iii) provides that personal interest does not include interest:

(A) Paid with respect to sales, excise and similar taxes that are incurred in
temporary regulation effectively denies individuals a deduction for interest on all income tax deficiencies (even when the source of income is a trade or business), the statute permits the deduction of "business interest" generally. The proper treatment of deficiency interest attributable to changes in individual tax liability arising from a trade or business is therefore unclear.

The issue of whether the temporary regulation has erroneously interpreted the statute seems destined to split the circuits. In 1995, the Eighth Circuit validated the regulation in Miller v. United States.4 Earlier this year, however, in a case of first impression, the Tax Court invalidated the regulation in Redlark v. Commissioner.5 Redlark was a sharply divided decision; while the dissenting and majority opinions each gained the support of eight judges, the majority opinion was joined by three judges who concurred in the result.6 Not surprisingly, the IRS has appealed Redlark.7 If the Ninth Circuit affirms the Tax Court, as is expected,8 the final res-

connection with a trade or business or an investment activity; (B) Paid by an S corporation with respect to an underpayment of income tax from a year in which the S corporation was a C corporation . . . ; or (C) Paid by a transferee . . . (tax liability resulting from transferred assets) . . . with respect to a C corporation's underpayment of income tax.

Id. at § 1.163-9T(b)(2)(iii). See infra notes 198-208 and accompanying text (discussing these exceptions within the context of legislative history). Temp. Treas. Reg. § 1.163-8T provides a general framework for allocating interest based on expenditures or uses of debt proceeds. See infra notes 171-86 and accompanying text (discussing that section specifically and the interplay between the sections of the regulation).

4. 65 F.3d 687, 690 (8th Cir. 1995) [hereinafter Miller III] (holding that the regulation was a "reasonable interpretation of legislative intent"), affg 95-1 U.S. Tax Cas. (CCH) ¶ 50,068, 87,228 (D.N.D. 1994) [hereinafter Miller II], rev'g 841 F.Supp. 305 (D.N.D. 1993) [hereinafter Miller I].

5. 106 T.C. 31, 47 (1996) (holding that the regulation was an "impermissible reading of the statute").

6. The court-reviewed decision consisted of a majority opinion authored by Senior Judge Tannenwald, two concurring opinions (Judges Swift and Laro), and two dissenting opinions (Judges Ruwe and Halpern). Seven judges agreed with the majority opinion and one concurred in the result only. Two judges agreed with Swift's concurrence and four judges agreed with Laro's concurrence. Six judges agreed with one or both of the dissenting opinions.


8. See William L. Raby & Burgess J.W. Raby, Allocating Individual Tax Deficiency Interest, 70 TAX NOTES 573, 574 (1996) (noting that the Ninth Circuit is expected to affirm the Tax Court). Cf. Lee A. Sheppard, The Consumption Tax: Personal vs. Business, 70 TAX NOTES 641, 641 (noting that the last time the Ninth Circuit addressed an "easy question" about the interest deduction it "showed division, vacillation, and little appreciation of the code's overall structure before finally getting the right answer for the wrong reason"). This comment was in reference to Albertson's Inc. v Commissioner, 12 F.3d
olution of this issue may be left to the Supreme Court.

An analysis of the Redlark decision is important for a number of reasons. First, because a large proportion of all small businesses are conducted as sole proprietorships, many taxpayers may be affected by its outcome. Second, and perhaps most important, Redlark is fascinating because so many members of the Tax Court seem unable to agree about (1) whether the statute is ambiguous, (2) whether the related legislative history is ambiguous, and (3) what weight to give legislative history in interpreting the statute. For example, while the majority opinion emphasized the effect of existing judicial interpretations in interpreting the statute, the dissenting opinions (echoing the majority opinion in Miller III) emphasized the regulatory authority of the IRS. The differences in the Redlark opinions also serve to illustrate the tension between the relative importance of plain meaning and legislative history in statutory construction and the sometimes conflicting goals of discerning the most equitable or correct interpretation of the statute versus the need for efficiency and consistency in administration. Third, at its core, the deductibility of individual deficiency interest illustrates the difficulty of developing rules that distinguish between personal and business expenditures. This is a longstanding problem that is, or should be, of particular concern in many of the current proposals for tax reform (e.g., a consumption-type tax). Perhaps in part because of these underlying philosophical issues, commentators are polarized over the outcome in Redlark; while some agree

1529 (9th Cir. 1993) (dealing more generally with the characterization of "interest" on deferred compensation). See Sheppard, 70 TAX NOTES at 641.
9. See STAFF OF JOINT COMM. ON TAX'N, 104th CONG., 2D SESS., IMPACT ON SMALL BUSINESS OF REPLACING THE FEDERAL INCOME TAX 51 (Comm. Print 1996) (noting that, based on data from the IRS' Statistics of Income regarding the number of returns filed by different forms of business organizations from 1978 to 1993, nonfarm sole proprietorships made up nearly 75% of all businesses in 1993, and were never less than 69% of the total in any of the 16 years reviewed).
11. See id. at 222.
12. See generally, Sheppard, supra note 8, at 641. Nevertheless, the dissension among the Tax Court judges in Redlark will likely be fuel for the fire for those who argue that the complexity of the current Code makes a complete overhaul, or a switch to a different system, necessary for effective tax reform. And indeed, if supposedly expert Tax Court judges have so much trouble arriving at the correct interpretation of the law, perhaps "it is time to uproot the current disgraceful system and replace it with a clear, simple tax code." J. Kenneth Blackwell, There's Nothing EZ About IRS Forms, WALL ST. J., Apr. 16, 1996, at A14 (The author, the Treasurer of Ohio, was a member of the National Commission on Economic Growth and Tax Reform chaired by Jack Kemp).
that the Tax Court reached the correct conclusion, others believe that it was an "ill-considered decision." Finally, the Redlark holding may also apply in cases where deficiencies have arisen as a result of individual investment and passive activities.

One of the principal reasons for the Redlark majority's invalidation of the regulation was its deference to a body of pre-1987 case law that allowed the deduction of interest accruing on business-related tax deficiencies. Therefore, Part I of this Comment analyzes some of the more important cases leading up to Redlark. The majority's reliance on pre-1987 case law is but one facet of the majority's method of statutory interpretation, however. Its standard of review in examining the regulation, as well as its view of legislative history are also important pieces of the foundation of the decision. Therefore, Part II discusses various methods of interpretation used in the decision. Part III proposes that underlying philosophical issues were also significant contributing factors in the disjointed opinions within the Redlark decision. Part III presents an example of one of the more important implications of invalidating the regulation.

I. THE PATH TO REDLARK: CASE LAW PRECEDENT

In Redlark, Judge Tannenwald, writing for the majority, noted that any decision regarding the validity of the temporary regulations must be preceded by a determination of whether the interest in question could meet the statutory exception of I.R.C. § 163(h)(2)(A). While that section carves out an exception to the nondeductibility of personal interest for interest on indebtedness "properly allocable to a trade or business," this phrase is not defined within the statute. The Redlark majority reasoned that if interest constituted a business expense within the meaning of I.R.C. § 162(a) (and I.R.C. § 62(a)), it could, "as a result . . . be charac-

13. See, e.g., Lipton, supra note 10, at 222 (noting that the court reached the correct conclusion based on the reasoning presented by the concurring judges—a "plain language" interpretation of the statute).
14. See, e.g., Sheppard, supra note 8, at 641.
15. See infra notes 21-61 and accompanying text (discussing the majority's rationale for interpretation of the pre-1987 case law).
16. See Redlark, 106 T.C. at 33 ("Before proceeding to a determination of the effect of pertinent regulations, we must first consider whether the interest expense involved herein is sufficiently connected to the business [of the taxpayer] so as to satisfy the 'properly allocable to a trade or business' exception of section 163(h)(2)(A), without regard to the regulations.").
terized as interest 'on indebtedness properly allocable to a trade or business' within the meaning of I.R.C. § 163(h)(2)(A).”

The District Court in Miller I also relied on definitions of business interest under I.R.C. §§ 162 and 62 in defining the “properly allocable” phrase of I.R.C. § 163(h)(2)(A). It reasoned that because the language used in “new” I.R.C. § 163(h)(2)(A) closely tracked the language of I.R.C. §§ 162(a) and 62(a) (which were not amended), and because the courts had consistently held deficiency interest deductible under those sections, it could now rely on the precept that, absent evidence of contrary legislative intent, “the legislature is presumed to have approved of a statute’s judicial construction when that provision is reenacted in the same or substantially the same language.” Indeed, the Redlark majority also went on to note that a review of cases decided before I.R.C. § 163(h)(2)(A), but involving “the deductibility of interest on income tax deficiencies as a business expense, will throw light on this question and is therefore a significant element in our analysis of the impact of that section on petitioners’ claimed interest deduction.”

A. Deficiency Interest as an Ordinary and Necessary Trade or Business Expense: Pre-1987 Case Law

While the phrase “ordinary and necessary” is also not defined statutorily, there is an extensive body of case law establishing its general definition. Pre-1987 cases specifically addressing deficiency interest suggest that the definition of “ordinary and necessary” is drawn narrowly for that particular expense. The Redlark majority reviewed three principal pre-1987 cases in making its determination that deficiency interest was indeed previously deduct-

17. Id. at 34. Section 162 allows the deduction of “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.” I.R.C. § 162(a) (1994). Section 62 then specifies that such trade or business deductions are taken into account in determining a taxpayer’s adjusted gross income. I.R.C. § 62(a)(1) (1994) (“‘[A]justed gross income’ means, in the case of an individual, gross income minus ... deductions allowed by this chapter ... which are attributable to a trade or business carried on by the taxpayer.”).

18. See Miller I, 841 F.Supp. at 309 (referring to the original incarnation of I.R.C. § 163(h)(2)(A)).

19. Id.

20. Redlark, 106 T.C. at 34-35.

21. See, e.g., Welch v. Helvering, 290 U.S. 111, 113-14 (1933) (defining “ordinary” as variable and “affected by time and place and circumstance,” and “necessary” by whether the expense is appropriate and helpful to the taxpayer’s business).
ible under the more general rules, at least in certain circumstances. *Standing v. Commissioner* decided by the Tax Court in 1957, was one of the first cases involving the deductibility of interest on tax deficiencies. The underlying tax adjustments in *Standing* were clearly attributable to the taxpayers' lumber business, which was conducted as a sole proprietorship. In *Standing*, the Tax Court compared deficiency interest to legal expenses incurred by the taxpayer (which are deductible as business expenses) noting: "[W]e are unable to perceive any real distinction between an expenditure for attorney's fees made to secure payment of the earnings of the business and a like expenditure to retain such earnings after their receipt."

Relying on its holding in *Standing*, the Tax Court in *Polk v. Commissioner* held shortly thereafter that interest on a tax deficiency arising from an adjustment to the valuation of inventories was deductible as an ordinary and necessary business expense. In affirming *Polk*, however, the Tenth Circuit made several comments suggesting that, instead of being analogous, as was held in *Standing*, the deductibility of deficiency interest as a business expense should be more limited than attorneys' fees. For example, the court found that attorneys' fees in defense of litigation against a taxpayer are "ordinary" because "such litigation results in numerous instances and is to be expected." However, "the same cannot be said, as a matter of course, of penalty interest." In the latter instance, whether or not interest expenses qualify depends on the "peculiar facts" of each case. The court summarized the difference as "[t]he field, within which it can be said that penalty interest on a deficiency assessment of taxes against a taxpayer, charged with the duty of filing a correct return, constitutes an ordinary and

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22. 28 T.C. 789 (1957), aff'd, 259 F.2d 450 (4th Cir. 1958).
23. Id.
24. *Standing*, 28 T.C. at 790 (noting that the revenue agent's report said "[t]he additional tax is due to increase in business income").
25. Id. at 794 (quoting Kornhouser v. United States, 276 U.S. 145, 153 (1928)).
26. 31 T.C. 412 (1958), aff'd, 276 F.2d 601 (10th Cir. 1960).
27. See *Polk*, 31 T.C. at 415.
28. See *Commissioner v. Polk*, 276 F.2d 601, 603-04 (10th Cir. 1960).
29. Id. at 603.
30. Id.
31. Id.
necessary expense arising out of the operation of the business, is much narrower than in the case of attorneys' fees."

Polk is something of an anomaly because the inventory to be valued consisted of livestock, which the affirming appellate court admitted was inherently difficult to value. While allowing the deduction, the Polk Court warned that interest is not deductible as a business expense "merely because it [arises] in connection with the taxpayer's business and [is] proximately related thereto." Further, "[u]nless it can be said that the failure to properly evaluate inventories, which form a part of a taxpayer's return, arises because of the nature of the business, and is ordinarily and necessarily to be expected, interest on a deficiency assessment does not arise out of the ordinary operation of the business and may not be deducted." Therefore, while Polk is cited by the majority in Redlark in support of the conclusion that there was a consistent body of pre-1987 case law allowing deficiency interest deductions, a strict interpretation of the Polk holding would suggest that many common tax adjustments may not qualify.

In Reise v. Commissioner, the Tax Court continued to build on the reasoning of Standing and Polk by allowing deficiency interest on state income taxes as a business expense deduction in calculating a taxpayer's net operating loss. In Reise, again, there was no issue that the adjustments related to the taxpayers' underlying business. In adopting the rulings of Standing and Polk, the Tax Court found that its previous holding in Aaron v. Commissioner was no longer tenable.

32. Id.
33. See Polk, 276 F.2d at 603 ("Under such facts, it is to be expected that a final analysis and examination of the return will result in a valuation considerably different from that adopted by the taxpayer.").
34. Id. at 602.
35. Id. at 603.
36. For example, it would seem that the adjustments in Redlark (related to errors made in converting revenue from an accrual to a cash basis) were theoretically "avoidable." Such conversions are a rather common accounting practice, where errors should not really be "expected." If the majority's reliance on Polk means that a certain level of taxpayer negligence is acceptable, issues about what an acceptable level is will likely vary by taxpayer and reviewing court. See infra notes 245-48 and accompanying text (discussing Judge Halpern's view that the majority opinion does not provide a workable rule for future cases).
37. 35 T.C. 571 (1961), affd, 299 F.2d 380 (7th Cir. 1962).
38. See id. at 578-580.
39. See id. at 572 (deliberating on the issue of whether income from the taxpayer's hide and skins sales business should have been reported on an accrual rather than a cash basis).
should be overturned. In Aaron, the Tax Court had held that state income taxes were not deductible as a trade or business expense for purposes of calculating net operating losses. The provision at issue in Aaron and Reise stated that the deductibility of nonbusiness expenses for net operating loss purposes was limited to the amount of a taxpayer's nonbusiness income, but no such statutory limitation applied to deductions "attributable to" the operation of a trade or business. In defining "attributable to" as used in that section, the Aaron court had held that "the connection contemplated by the statute is a direct one rather than a remote one." This meant that while taxes paid on real property used in the business would be deductible, state income taxes incurred on business profits would not. In overturning Aaron, the court in Reise noted that neither Standing nor Polk had referenced it. The Reise court now believed that the latter decisions were "sound and correct," and that the language and holding in Aaron should no longer be regarded as a "proper and correct construction" of the section at issue.

The Tax Court has distinguished the holdings of Standing, Polk, and Reise on at least one occasion, however. In Tanner v. Commissioner, the Tax Court held that because of specific legislative history, state income taxes are not comparable to deficiency interest and are consistently nondeductible for purposes of calculating adjusted gross income. In Tanner, the taxpayer had constructed arguments for the deductibility of state income taxes for adjusted gross income purposes based on the holdings of both Standing and Reise. The taxpayer argued that if expenses and interest relating to income tax deficiencies are deductible per Standing,

40. 22 T.C. 1370 (1954).
41. See Reise, 35 T.C. at 579.
42. See id. at 576.
43. See id. at 573 (citing § 122(d)(5) of the Internal Revenue Code of 1939). Current I.R.C. § 172(d)(4) contains substantially the same provision: "In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business." I.R.C. § 172(d)(4) (1994).
44. See Reise, 35 T.C. at 573.
45. Id. at 577 n.6.
46. See id. at 578.
47. See id. at 579.
48. Id.
49. 45 T.C. 145, 149-50 (1965), aff'd per curiam, 363 F.2d 36 (4th Cir. 1966).
50. See id. at 149-51.
then "certainly a tax itself based on business income should be so deductible." The Tax Court responded that, while the court in *Standing* had found that neither the committee reports nor the regulations specifically mentioned deficiency interest, the relevant committee reports and regulations did specifically provide that state income taxes, even though arising from business income, were never to be deductible in computing gross income. The taxpayer then argued that because state taxes were deductible for purposes of calculating net operating losses per *Reise*, they should be so deductible in calculating adjusted gross income. The Tax Court responded again that although the argument was "not without logic," it must be rejected because "[t]he net operating loss provisions and the provision with regard to the computation of adjusted gross income are not interdependent." Further, as in the argument based on *Standing*, while committee reports and regulations concerning the deductibility of state income taxes for net operating loss purposes were silent, those sources clearly denied the deduction for adjusted gross income purposes.

Since these pre-1987 cases held that deficiency interest from a trade or business conducted as a sole proprietorship was deductible, at least in certain circumstances, it should logically follow that interest incurred on adjustments related to a trade or business conducted via a flow-through entity should have been similarly held to be deductible. However, in *True v. United States* a case involving pre-1987 law that was affirmed by the Tenth Circuit, interest on deficiencies arising from businesses conducted as partnerships and S corporations was found not to be deductible as a trade or business expense. In arriving at a result that the court admitted sounded "somewhat like a page from Alice in Wonderland," the court held that if the interest payments were considered business expenses, they would have to be taken at the partnership or S corporation level and not by the individual taxpayer. However,  

51. *Id.* at 149.  
52. See *id.* at 150.  
53. See *id.*  
54. *Tanner*, 45 T.C. at 150.  
55. See *id.*  
56. 93-2 U.S. Tax Cas. (CCH) ¶ 50,461, 89,424 (D. Wyo. 1993), *aff'd per curiam without published opinion*, 35 F.3d 574 (10th Cir. 1994).  
57. See *id.* at 89,427.  
58. *Id.*  
59. See *id.*
since those entities are not obligated to pay tax, deficiency interest could not be deducted at that level either. The court therefore concluded that deficiency interest payments related to adjustments of partnership or S corporation income are "merely personal" and "can not attain the character of a business expense."

B. Post-1986 Case Law: The Tax Court Avoids the Issue

While the general issue of the deductibility of deficiency interest has been presented to the Tax Court on a number of occasions since the addition of I.R.C. § 163 in 1986, until Redlark, the facts presented never compelled the court to directly address the validity of the temporary regulation. For example, in Rose v. Commissioner the Tax Court expressly stated that it was neither ruling on the validity of the regulation nor expressing an opinion with regard to its invalidation in Miller I in denying the taxpayer's deduction of deficiency interest. In Rose, the taxpayers claimed only that the deficiency interest constituted investment interest under I.R.C. § 163(h)(2)(B), attributable to a gain from a partnership in which the taxpayer was a general partner. Citing Polk, the court noted that the taxpayers had not shown that the tax deficiency was "a normal or usual incident of the partnership's business." In fact, since the taxpayers had stipulated that the interest expense arose solely because of their "failure to timely pay taxes on their income," the court found that "[t]heir decision to pay the income taxes after the due date [was] inherently personal."

In James W. Tippin a taxpayer facing bankruptcy under Chapter 11 made "adequate protection payments" to the IRS on his delinquent taxes. The IRS applied some of the payments to interest, and the taxpayer subsequently attempted to claim a related

60. See id. The merit of this conclusion is beyond the scope of this Comment. But see infra notes 258-65 and accompanying text (discussing briefly its importance in the context of the Redlark decision).
61. True, 93-2 U.S. Tax Cas. (CCH) ¶ 50,461, at 89,427.
62. 69 T.C.M. (CCH) ¶ 50,484(M), 1914 (1995).
63. Id. at 1915 n.3. See also infra notes 73-81 and accompanying text (discussing Miller I).
64. See Rose, 69 T.C.M. (CCH) ¶ 50,484(M), at 1915 n.2.
65. Id. at 1916.
66. Id.
68. Id. at 521-22. "Adequate protection payments" are used in bankruptcy cases to preserve secured creditors' positions (e.g., additional or replacement liens on other property). Id. at 522 n.3.
Even though the taxpayer was a lawyer operating as a sole proprietor and the "adequate protection payments" made to the IRS related to his law office receivables, the Tax Court held that there was "no showing that the interest was an ordinary and necessary expense of [the taxpayer's] law practice, or of any other business carried on by [the taxpayer]." Thus, as in *Rose*, the Court never had to reach the issue of, and specifically disclaimed any opinion on, the validity of the temporary regulation.

In summary, while the *Redlark* majority was technically correct in holding that a consistent body of pre-1987 case law allowed the deduction of deficiency interest, it can hardly be said that those cases define an expansive rule. The threshold for satisfying the general requirements of "ordinary and necessary" trade or business expenses in pre-1987 cases, as well as the "properly allocable" language of I.R.C. § 163(h)(2)(A) in post-Tax Reform Act of 1986 cases, is high. It perhaps even "requires documentation that shows how the position taken made good business or investment sense." Cases brought both before and after the Tax Reform Act of 1986 therefore suggest that the circumstances that give rise to a review of the validity of the temporary regulation are narrow. On the one hand, adjustments like those in *Redlark*, clearly directly-related and approaching the level of the "expected" or "unavoidable" adjustments described in *Polk*, will certainly trigger a court's review of the validity of the regulation. On the other hand, a record virtually bereft of any support for a valid business nexus certainly will not. The harder question, then, is when those cases that fit somewhere in between will trigger such review.

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69. *See id.* at 522-23.
70. *Id.* at 529. The court distinguished the taxpayers' situation from *Polk*, stating:

    Unlike the taxpayer in *Polk*, here petitioner has not made a showing that the 1983 income tax deficiency on which he paid interest arose as a normal or usual incident of his law practice. . . . Indeed, the record is completely silent as to the source of income, or other circumstances, that gave rise to this income tax deficiency.

*Id.* at 530. The court noted that the fact that the IRS obtained a secured interest in the receivable of the law practice as collateral for the late taxes was not sufficient to support a business nexus. *Id.* at 530 n.10.
71. *See id.* at 529 n.9.
C. Miller: Treatment of Pre-1987 Case Law

Miller I appears to be the first case in which a court directly attempted to resolve the conflict between the statute and the temporary regulations. In brief, the Millers had formed a corporation to market grain grown on their family farm that had a fiscal year ending several months prior to the Millers' calendar tax year. During the spread between taxable years, the Millers treated any funds received from the corporation for sales of grain as "loans" that were not recognized as personal income until the following personal tax year. Not surprisingly, the IRS disregarded the loan arrangement and made corresponding adjustments to the Millers' farm income for the years in question. The Millers attempted to deduct the interest imposed on the resulting deficiencies. Given the constraints discussed above (i.e., that the taxpayer's position should make good business or investment sense), these facts would not appear to require a court's direct evaluation of the validity of the temporary regulations.

Nevertheless, the district court in Miller I initially held that the temporary regulation was invalid to the extent it provided a per se rule of nondeductibility. A taxpayer appeal backfired, however, when the Eighth Circuit upheld the regulation as a reasonable interpretation of the statute. The principal difference between the holdings of the district and appellate courts in the Miller decisions is essentially the same as the split between the majority and dissent opinions in Redlark. As mentioned above, the district court in

74. See Miller II, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 at 87,231. The court later found that the corporation was essentially only a "trade name" or conduit and indistinguishable from the family farm itself. See id.
75. See id.
76. See id.
77. See id. at 87,232.
78. See Miller I, 841 F. Supp. at 310 (holding as a matter of law that "the agency's construction of the term 'personal interest' in I.R.C. § 163(b)(2)(A), to include interest on income tax deficiencies derived from business income, is overly broad. The IRS's implementing regulation is therefore invalid on this point."). The court eventually determined that the "loans" were an "obviously improper income deferral scheme," and therefore the interest on the underlying deficiency was not an ordinary and necessary business expense. Miller II, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 at 87,232.
79. See Miller III, 65 F.3d at 691 ("Thus, contrary to the conclusion of the district court, the provision in [Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A)] that the interest paid on underpayments of income taxes is per se nondeductible personal interest is valid. . . ").
80. See supra note 18 and accompanying text.
Miller I interpreted legislative history as demonstrating that Congress did not intend to depart from the pre-1987 case law that allowed the deduction of deficiency interest "to the extent that such interest can be characterized as an ordinary and necessary business expense." 81

In Miller II the district court clarified that the holding in Miller I, invalidating the temporary regulation, was merely a continuation or acknowledgment of the pre-1987 case law of Polk, Standing, and Reise. 82 Citing Polk extensively, the Miller II court then concluded that to meet the limited exception under I.R.C. § 163(h)(2)(A), the underlying tax deficiency "must be the result of an error which is typical of, and reasonably anticipated in, the commercial field in which the taxpayer engages." 83 Finding that "no 'hard-headed' businessman ... would have been willing to incur the income tax deficiencies and concomitant interest expenses" 84 that the Millers did, the district court granted the government's motion for summary judgment. 85

The Eighth Circuit was far more deferential to the regulatory authority of the IRS and did not really address the import of the pre-1987 cases. Instead, it relied solely on the construction of the statutory language and regulations (as well as legislative history) in finding that the regulation was a permissible construction of the statute. 86 The court noted that even if it thought the taxpayer's argument (that the Tax Reform Act of 1986 was not intended to alter the holdings of the pre-1987 case law) had "some logical force," it would not have affected its decision. 87 The majority in Redlark noted that the Miller III decision was therefore "without conclusion as to the pre-section 163(h) state of the law." 88

82. See Miller II, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 at 87,230.
83. Id. at 87,232.
84. See Miller II, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 at 87,232.
85. See id.
86. See Miller III, 65 F.3d at 691 ("Because [Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A)] is neither inconsistent with the language of the statute nor at odds with the legislative history and directly tracks the statement of the staff committee in the General Explanation, we conclude the regulation represents a permissible construction of the statute.").
87. Id. at 690.
88. Redlark, 106 T.C. at 38.
D. Redlark: Treatment of Pre-1987 Case Law

The facts of Redlark meet all the criteria discussed above as necessary to implicate the validity of the regulation—they clearly fall within the I.R.C. §§ 162 and 62 “trade or business” relatedness restrictions. In fact, in Redlark, the IRS had stipulated that a portion of the deficiencies assessed against the taxpayers, who conducted a valid unincorporated business, was directly attributable to errors made in converting business revenue from an accrual basis to a cash basis.9 Nevertheless, Judge Tannenwald noted that the issue of whether the interest qualified for deduction under I.R.C. § 162(a) (and “as a result” under the “properly allocable” language of I.R.C. § 163(h)(2)(A)—should the temporary regulation be found invalid) was not resolved by the IRS’ stipulation.90 As discussed above, the court began its analysis by reviewing the pre-1987 case law to make what it considered to be an independent, ancillary determination that the “properly allocable to a trade or business” exception was satisfied.91

The majority conceded that while “there is some confusion in the reasoning of the decided cases,” their “bottomline conclusions” were clear; exceptions to the general rule of deductibility under I.R.C. § 162 will only arise if there is explicit legislative direction that such results were intended.92 In dissent, Judge Halpern characterized this portion of the majority’s analysis as resting on a belief that the pre-1987 cases were “woven into the fabric of the Code in such a way that only a specific act of Congress could remove them.”93 In a final example of the majority’s deference to pre-1987 case law, the court recognized its own prior holding in Tanner in concluding that the statute was sufficiently ambiguous to warrant a review of legislative history.94 Clearly, however, the majority’s ensuing analysis was colored by the backdrop of Standing, Polk, and Reise.

89. See id. at 32.
90. Id. at 34.
91. See supra notes 16-17, 20 and accompanying text.
92. Redlark, 106 T.C. at 37.
93. Id. at 74 (Halpern, J., dissenting).
94. See id. at 39.
In contrast, the dissents of both Judges Ruwe and Halpern in *Redlark* downplayed the significance of the pre-1987 case law. For example, Judge Ruwe reasoned that the principal cause of the outcomes observed in those cases relied on by the majority was a lack of guidance as to the proper treatment of deficiency interest in the relevant statute, regulations, or legislative history. By applying the reasoning of the court in *Tanner*, he found that the legislative history and temporary regulations from the Tax Reform Act of 1986 put deficiency interest on an even footing with state income taxes, and therefore called into question the viability of the pre-1987 cases cited by the majority. Judge Ruwe’s dissent also cites *True* in support of his argument that invalidating the regulation results in “discrimination” between sole proprietorships versus partnerships and S corporations. It should be noted, however, that the court’s reasoning in *True* did not involve the “relatedness” issue as formulated above, but rather an “entity” issue about whether the interest was properly considered attributable to the individual taxpayers’ business or to the businesses of their partnerships and S corporations.

Judge Halpern’s dissent suggests that the majority’s reliance on the pre-1987 case law was misplaced because the cited cases involved questions where “the distinction between business and personal interest was otherwise unimportant.” Further, he points

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95. See id. at 59 (Ruwe, J., dissenting).
96. See id. (“Like the situation presented to us in *Tanner*, both the legislative history and contemporaneous regulations support a holding that the interest paid on petitioners’ late income tax payment constitutes nondeductible ‘personal interest.’”). Of course, the rules relating to state income taxes discussed in *Tanner* do not speak to the deductibility of deficiency interest, and while prior case law did establish that state income taxes are not deductible, it “lends no particular support to the expansion of that rule”—in and of itself. See Raby & Raby, supra note 8, at 574. Judge Ruwe’s argument seems to be rather that the Conference Committee Report and Blue Book relating to the Tax Reform Act of 1986, as forms of guidance, were similar to those sources relied on in *Tanner*. See infra notes 203-07 and accompanying text.
97. See *Redlark*, 106 T.C. at 60 (Ruwe, J., dissenting).
98. See *True*, 93-2 U.S. Tax Cas. ¶ 50,461, at 89,426-27 (focusing on the language of I.R.C. § 62(a)(1) allowing trade or business deductions “attributable to a trade or business carried on by the taxpayer”). The court downplayed the obvious inconsistency in tax treatment between, for example, sole proprietorships and partnerships, noting that “[a]lthough the Trues’ choice of business entity may not have yielded the results they desire in this instance, they must bear the consequences of those choices and may not disown the burdens associated with those choices.” Id. See also infra notes 254-67 and accompanying text (discussing the “discrimination” resulting from the invalidation of the regulation in *Redlark*).
out that the "properly allocable" language of I.R.C. § 163(h)(2)(A) is charged with the treatment of all interest expense and not just deficiency interest. Because he finds that the pre-1987 cases do not present a "coherent scheme of interest allocation," he concludes that "[i]t would be a very small tail wagging a very large dog if we were to let those cases determine what is a proper method of interest allocation for all classifications of indebtedness." He notes that the majority's reliance on pre-1987 cases, while allowing it to hold that deficiency interest will be deductible in some circumstances, does not result in the development of workable guidelines for allocating interest in future cases.

E. IRS Arguments Regarding Pre-1987 Case Law

The IRS apparently did not propose any of the arguments regarding the pre-1987 cases voiced by the dissenting judges in Redlark. Instead, relying on the language quoted above from Polk, the IRS tried to argue that deficiency interest is not generally a deductible business expense so that any pre-1987 cases allowing a deduction were just "unfounded and wrong." In response, the Redlark majority noted that while the Polk language "narrows the types of situations where the ordinary and necessary business expense requirement" can be satisfied, it did not support a rule of per se nondeductibility. As Judge Laro noted in his concurrence in Redlark: "The nuts and bolts of this case is that the Commissioner continues to disagree with the pre-TRA (Tax Reform Act of 1986) judicial view that an individual engaged in a trade or business may deduct from gross income the amount of interest on a Federal income tax liability that is attributable to his or her business." Indeed, by choosing to argue that the pre-1987 cases were decided incorrectly, rather than attempting to distinguish them from the instant case based on the changes included in the Tax Reform Act of 1986 (or any of the arguments suggested by the dissent), the IRS arguably made it easier to characterize the tem-

100. See id.
101. Id.
102. See id. at 75.
103. See supra notes 34-35 and accompanying text.
104. Redlark, 106 T.C. at 36.
105. Id. at 37. This seems obvious given that the taxpayer was allowed the deduction in Polk.
106. Id. at 57 (Laro, J., concurring).
107. See supra notes 93-102 and accompanying text.
porary regulation as an unwarranted attempt by the IRS to change the result of the pre-1987 decisions. Further, the IRS' arguments regarding pre-1987 case law were likely not strengthened by its rather inconsistent position regarding this issue generally. For example, the IRS initially filed a nonacquiescence in response to Standing, maintaining that neither deficiency interest nor legal and accounting fees were deductible for purposes of determining adjusted gross income. However, the IRS filed an acquiescence to Reise, allowing that deficiency interest is deductible for purposes of determining net operating losses.

F. Summary

In summary, it seems that neither the Redlark majority opinion nor the dissenting opinions present completely satisfying characterizations of the viability of the pre-1987 case law as it applies to the temporary regulation at issue here. For example, the majority's treatment does not appear to recognize that the "sea change" that occurred with regard to the treatment of interest deductions by individuals as a result of the Tax Reform Act of 1986 had any effect on the viability of pre-1987 case law. However, the structure of I.R.C. § 163(h), with its general prohibition and specifically enumerated exceptions, does suggest a presumption against the deductibility of interest generally for individuals. Such a presumption clearly did not exist in the pre-1987 world of Standing, Polk, and Reise. Further, as discussed above, those cases allow the deduction of deficiency interest in only rather limited circumstances. However, the Redlark dissenters' arguments regarding a more limited role for the related precedent are not entirely convincing either. For example, while it is true that before the Tax Reform Act of 1986 there were perhaps fewer occasions for individuals to worry

108. See 1958-1 C.B. 7. The complete nonacquiescence was later withdrawn and an acquiescence regarding the classification of legal and accounting fees incurred in the process of settling a federal income tax dispute was substituted. 1992-20 I.R.B. 4; 1993-1 I.R.B. 5.

109. See 1969-2 C.B. XXV (acquiescence in result only). The IRS also later filed an acquiescence to Polk in this regard. Id. See also Rev. Rul. 70-40, 1970-1 C.B. 50 (holding that both state income taxes and deficiency interest on both state and federal income taxes are "attributable to a taxpayer's trade or business" for net operating loss calculation purposes).

110. Sheppard, supra note 8, at 641 ("In 1986, Congress repealed the deduction for personal interest except for residential mortgage interest. ... This was a sea change—and not just for heavily indebted consumers—because it basically implies a presumption against deduction of interest by individuals.").
about the characterization of interest as business or nonbusiness (because it was all generally deductible), such characterization was still vitally important for a number of reasons, as represented by the cases cited by the majority. 111

Finally, it is interesting that one of the only points upon which both the majority and dissenting opinions agreed was that the court’s previous holding in Tanner directed at least a further review of legislative history. 112 The differing references to the Tanner decision illustrate that the pre-1987 case law is of course merely a part of the statutory interpretation. 113 As discussed below, competing sources of guidance in a court’s examination of the validity of a tax regulation include the “plain language” or ambiguity of the provision itself, its contemporaneous and subsequent legislative history, and the framework of any related regulations (as well as existing judicial interpretations of the provision). Practically then, the weight to be properly accorded any one particular source of guidance is necessarily dependent on the court’s view of the relative strength of all the others. The following discussion examines the framework that the Redlark court used to integrate the principles of the pre-1987 case law with other sources of guidance.

111. In Standing, for example, a timing issue was implicated because the taxpayers were on a cash-basis for nonbusiness items and accrual basis for business items. See Standing v. Comm’r, 259 F.2d 450, 452 (4th Cir. 1958). However, since the taxpayers in Standing had previously elected to take the standard deduction, they likely did not get the benefit of the full effect of the change to a below-the-line deduction. See id. This latter point was also the concern in Tanner. See Tanner v. Comm’r, 45 T.C. 145, 146 (1965). Notably, Polk and Reise both involved net operating loss calculations. See supra notes 26-27, 37-38 and accompanying text.

112. See supra notes 94-96 and accompanying text (discussing the Redlark court’s use of Tanner); see infra notes 191-224 and accompanying text (discussing the Redlark court’s analysis of legislative history). However, the majority and dissent diverged concerning the effect of legislative history on the validity of the regulation.

113. See supra notes 16-20 and accompanying text (discussing the Redlark majority’s reliance on pre-1987 case law to interpret the “properly allocable” phrase of I.R.C. § 163(h)(2)(A)). Such an ordering is perhaps warranted because it is predictive of the outcome. If a court, as did the majority in Redlark and the district court in Miller I, determines that existing case law is to be accorded deference, subsequent legislative and administrative changes will be held to a higher level of scrutiny. In contrast, those judges who have given greater emphasis to the administrative power of the IRS or the literal language of the statute seemed to reach the viability of the case law almost as an afterthought. See, e.g., Redlark, 106 T.C. 74-75 (Halpern, J., dissenting).
II. STATUTORY AND REGULATORY INTERPRETATION

The judicial interpretation of tax regulations is unique when compared to other areas of administrative law because of the complexity of the underlying statutes, frequency with which they are amended, and generally lengthy accompanying legislative history. While courts reviewing tax regulations usually begin with an examination of the statutory text, they only rarely find the interpretive answer to be obvious at that point. Redlark is a prime example of this practice. Perhaps due to its specialization, the Tax Court seems more inclined than other courts to delve into legislative history to determine the validity of a regulation. As mentioned above, Redlark is noteworthy because the Tax Court judges, who are supposed to be experts on tax law, could not agree about so many different points of interpretation. Even when the court appeared to agree on at least the theoretically appropriate standard of review, the judges seemed to apply it differently in practice and certainly disagreed about the result of the standard’s application to the regulation at issue.

A. Standard of Review

At the outset it should be noted that temporary regulations, such as those involved here, are accorded the same weight as final regulations. However, so-called interpretive regulations are accorded less weight, at least in theory, than legislative regulations. In practice, this distinction may be very minor. Only legislative regulations have the legal effect of statutes in changing existing law; the purpose of interpretive regulations is generally considered to be to clarify existing law. Interpretive and legislative tax regulations are usually distinguished by the source of au-

115. See id. at 54.
116. See id. (noting that “[t]he more specialized the court, the more detailed and lengthy is the examination”).
117. See Peterson Marital Trust, 102 T.C. 790, 797 (1994).
118. See infra notes 123-24 and accompanying text.
119. See Aprill, supra note 114, at 60 (“[T]he distinction between legislative and interpretive regulations is often blurred in practice, and the supposedly diverse standards of judicial review tend to converge and even to coalesce.”) (quoting Boris I. Bittker & Lawrence Lokken, FEDERAL TAX’N OF INCOME, ESTATES AND GIFTS, ¶ 110.4.2 at 110-30 (1981)). See also Lawrence C. Zelenak, Should Courts Require the Internal Revenue Service to be Consistent? 40 N.Y.U. TAX L. REV. 411, 427 n.100 (1985)).
120. See Aprill, supra note 114, at 55-56.
authority under which the regulation was promulgated: regulations promulgated under the authority of I.R.C. § 7805(a) are considered interpretive, while regulations promulgated under the authority of a specific code section are considered legislative.\textsuperscript{121} Most tax regulations, including the temporary regulation at issue in \textit{Redlark}, are considered interpretive by the Treasury and the IRS.\textsuperscript{122}

As noted above, interpretive regulations are in theory owed less deference than legislative regulations.\textsuperscript{123} In practice, however, interpretive tax regulations are accorded significant deference.\textsuperscript{124} For example, the traditional standard for the review of interpretive tax regulations, as stated in \textit{National Muffler Dealers Ass'n v. United States},\textsuperscript{125} presumes deference; it holds that interpretive regulations should be upheld as long as they implement a congressional mandate in some reasonable manner.\textsuperscript{126} Further, “[t]he choice among reasonable interpretations is for the Commissioner, not the courts.”\textsuperscript{127} The \textit{National Muffler} standard of reasonableness is determined via a review of whether the regulation “harmonizes” with the plain language, origins, and purpose of the statute.\textsuperscript{128} Relevant factors in determining reasonableness under the \textit{National Muffler} standard include: “the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner’s interpretation, and the degree of scrutiny Congress had devoted to the regulation during subsequent re-enactments of the statute.”\textsuperscript{129} As could be expected, “the various factors used to test . . . deference permit courts considerable leeway.”\textsuperscript{130} Thus, in practice \textit{National Muffler} has been somewhat unevenly applied.\textsuperscript{131}

\begin{itemize}
  \item\textsuperscript{121} See \textit{id.} at 56-57.
  \item\textsuperscript{122} See \textit{id.}\textsuperscript{123} at 57.
  \item\textsuperscript{123} See \textit{Redlark}, 106 T.C. at 38 (citing United States v. Vogel Fertilizer Co., 455 U.S. 16, 24-25 (1982)).
  \item\textsuperscript{124} See April, \textit{supra} note 114, at 59 (noting that “in tax, deference to the administrative agency rather than independent judicial judgment has been the default rule”).
  \item\textsuperscript{125} 440 U.S. 472, 476 (1979) (reviewing the validity of regulations that defined the term “business league” for purposes of I.R.C. § 501(c)(6)).
  \item\textsuperscript{126} See April, \textit{supra} note 114, at 58.
  \item\textsuperscript{127} \textit{National Muffler Dealers}, 440 U.S. at 488.
  \item\textsuperscript{128} See \textit{id.} at 477.
  \item\textsuperscript{129} \textit{Id.}
  \item\textsuperscript{130} April, \textit{supra} note 114, at 61.
  \item\textsuperscript{131} \textit{Id.}
\end{itemize}
The traditional *National Muffler* standard has apparently been largely replaced by the standard later developed in *Chevron U.S.A. Inc. v Natural Resources Defense Council, Inc.* Under *Chevron*, the court is to "use ‘traditional tools of statutory construction,’ particularly legislative history, to determine congressional intent at step one and defer to an interpretation of the agency defended on any basis at step two." Some courts (including the Supreme Court and the Tax Court) have recently reformulated the *Chevron* standard to reflect a textualist viewpoint. Applied by those favoring a "plain meaning" philosophy, the first step of *Chevron*, as reformulated, looks only to the statutory text. The second step defers to any reasonable interpretation of the agency, including those unrelated to legislative history.

While the Tax Court has theoretically adopted *Chevron* in reviewing regulations, in practice, the Tax Court’s application of the *Chevron* standard basically reiterates the principles of *National Muffler*. As Judge Tannenwald has noted:

> we are inclined to the view that the impact of the traditional, i.e., *National Muffler* standard, has not been changed by *Chevron*, but has merely been restated in a practical two-part test with possibly subtle distinctions as to the role of legislative history and the degree of deference to be accorded to a regulation.

As applied by the Tax Court, if an inquiry into whether Congress has directly addressed the precise question at issue results in a “yes,” then “that is the end of the matter.” If, however,
the court determines Congress has not directly addressed
the precise question at issue, the court does not simply
impose its own construction on the statute. . . . Rather, if
the statute is silent or ambiguous with respect to the specif-
ic issue, the question for the court is whether the agency’s
answer is based on a permissible construction of the stat-
ute.139

While Tax Court opinions do not generally presume that the mean-
ing of the statute is plain, in practice, legislative history is generally
only considered in step two (to judge whether the IRS’ position
is reasonable.)140 As the majority noted in Redlark, if the regulation
“fills a gap or defines a term in a way that is reasonable in
light of the legislature’s revealed design,” in step two, the court
will accord the regulation “controlling weight.”141

The majority in Redlark appears to have applied a less deferen-
tial version of the Chevron standard—in fact it more closely resembles National Muffler. Judge Tannenwald began his statutory inter-
pretation with the language of I.R.C. § 163(h) itself.142 Even
though he found the language otherwise unambiguous (because of
the doctrine developed in pre-1987 case law), as noted above,143
he relied on Tanner for the proposition that in a “comparable situa-
tion” the court found sufficient ambiguity to review legislative
history.144 If the majority had not deferred to its previous holding
in Tanner in this way, it would not have gone on to its “step two”
examination of the regulatory framework and legislative history.145

Judge Halpern’s dissent in Redlark also relied upon
NationsBank v. Variable Annuity Life Ins. Co.146 for the appropri-
ate standard of review. He said the court must address two ques-
tions: (1) whether I.R.C. § 163(h) is “silent or ambiguous” with
regard to either (a) the standard for determining “properly alloca-

139. Id. (footnotes omitted).
140. See Aprill, supra note 114, at 67.
141. Redlark, 106 T.C. at 39 (quoting Chevron, 467 U.S. at 844.)
142. See id. See also infra notes 155-160 and accompanying text.
143. See id.
144. Id.
145. See infra notes 191-92 and accompanying text (discussing how the Redlark majori-
ty would have found that standing alone I.R.C. § 163(h)(2)(A), without regard to legisla-
tive history, would have been insufficient to support the regulation).
146. 115 S. Ct. 810, 813-14 (1995) (relying mainly on Chevron to describe the appro-
priate standard of review).
ble" interest, or (b) the "specific issue at hand" (which he phrased as "whether interest paid with respect to an individual's Federal income tax liability is deductible"); and (2) whether the temporary regulation is a "permissible interpretation" of the statute "in that it 'fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design.'" Because he found the statutory language ambiguous and the "tracing" methodology contained within the regulations a permissible interpretation, Judge Halpern found the Chevron/NationsBank tests satisfied and the regulation valid.48

While not all appellate courts have adopted the Chevron standard in reviewing interpretive tax regulations, the Eighth Circuit apparently has. In Miller III, the Eighth Circuit mentioned both Chevron and National Muffler before launching into a rather lengthy review of the legislative history of I.R.C. § 163(h). The court framed its role by reference to practically all of the language from Chevron promoting deference to the agency’s regulation.49 After finding the statute itself ambiguous, it followed Chevron’s guidance in determining that because the regulation was neither inconsistent with the language of the statute nor at odds with the legislative history, it was a permissible construction.50

At least in theory, the Ninth Circuit does not consider the Chevron standard applicable to interpretive tax regulations.51 It has continued to apply the principles of National Muffler in a two-step process: (1) examining the statutory language to determine whether the regulation is in reasonable harmony with it, then (2) using legislative history to review origin and purpose to determine whether the regulation is a reasonable interpretation.52 Theoretically, differences in the outcome of Redlark on appeal could result from the application of the two standards (Ninth Circuit vs. Tax Court), although it is unclear how different in practice the two will be. However, because National Muffler-type methods are generally considered even less deferential than Chevron-type methods, the apparent consensus among commentators that the Ninth Circuit will

147. Redlark, 106 T.C. at 66 (citing Nationsbank, 115 S. Ct. at 813-14).
148. See id.
149. See Miller III, 65 F.3d at 689-90.
150. See id. at 691.
151. See Aprill, supra note 114, at 74. Indeed, the regulation at issue in Chevron was legislative, not interpretive. Id. at 62-63.
152. See id. at 70, 74 (citing Pacific First Fed. Sav. Bank v. Comm'r, 962 F.2d 800 (9th Cir. 1992)).
uphold the Tax Court's invalidation of the regulation in Redlark seems well-founded.153

B. Statutory Language

A judge's conclusion about the ambiguity or clarity of the statutory language of I.R.C. § 163(h), like the deference accorded to existing judicial interpretation, is predictive of whether he will find the temporary regulation valid. This is largely because under the standards above, legislative history will be considered as a possibly redeeming factor in saving a regulation only if the statute is deemed ambiguous.154

As is the practice in most tax cases, the majority in Redlark begins the interpretive section of its analysis with the statutory language of I.R.C. § 163. The majority identifies the key phrase of I.R.C. § 163(h)(2)(A) as "interest paid or accrued on indebtedness properly allocable to a trade or business."155 Without using the term "unambiguous," the majority notes that, without more, that language would allow the taxpayer to prevail.156 This conclusion is based on the pre-1987 cases that found deficiency interest of the type involved in Redlark to be an ordinary and necessary business expense.157 Of course, the majority's recognition of existing case law in its determination of whether the statute is ambiguous makes sense if it is accepted that "Congress does not legislate in a vacuum."158 The "properly allocable" language of I.R.C. § 163 may then be easily cast as an unambiguous recognition of the principles of Standing, Polk, and Reise line of cases.159 However, in a reference to Tanner, the majority then consistently deferred to its own precedent, noting that "in a comparable situation dealing with the deduction of State income taxes in computing adjusted gross income, we found sufficient ambiguity to cause us to look at the legislative history and approve a regulation denying such a deduction."160

The concurring opinions relied even more heavily on "plain language" analysis in concluding that the statutes were unambigu-

\[\text{References}\]

153. See id. at 77. See also supra note 8 (discussing commentators' views on the likelihood of the Ninth Circuit upholding Redlark).
154. See Lipton, supra note 10, at 222.
156. See id.
157. See id. See also supra notes 16-20 and accompanying text.
158. Lipton, supra note 10, at 222.
159. See id. at 221.
ous. For example, Judge Swift found that regardless of the pre-1987 case law the "statute speaks for itself." He determined that "if there is no question about what an item of interest expense relates to, and is allocable to, then the statute is clear and, if the expense relates to the taxpayers’ business, the statute allows the deduction." Judge Laro also noted that the "statute speaks for itself," and that "legislative history should be sought to embellish the text only when the meaning of the words therein is ‘inescapably ambiguous.’" He concluded that the text was clear such that "the beginning and end of our inquiry should be the statutory text, and we should apply the plain and common meaning of the statute." Even so, Judge Laro noted that a "plain reading" of a statute may be altered by "clear legislative intent that is contrary to the text." He therefore proceeded to consider whether there was any "clear and unequivocal legislative intent" to support the regulation’s contrary position to the text.

At the other end of the spectrum, one commentator has described the dissents in Redlark as statutory analyses “in search of an ambiguity.” The dissenting opinion authored by Judge Ruwe specifically adopted the reasoning of the Eighth Circuit in Miller III on this point. Citing Chevron, the Eighth Circuit held in Miller III that because Congress did not specifically define the business interest exception within the statute, there was an implicit legislative delegation of authority to the Commissioner to clarify whether deficiency interest is “properly allocable” to a trade or business. Similarly, Judge Halpern’s dissent found the statute’s

161. Id. at 48 (Swift, J., concurring).
162. Id. (holding that because the regulation provided that interest expense is not deductible, regardless of whether there is a question about what the interest related to, it constitutes an "erroneous attempt to redefine the substantive provision" of the statute).
163. Id. at 54-55 (Laro, J., concurring) (quoting Garcia v. United States, 469 U.S. 70, 76 n.3 (1984)).
164. Id. at 55 (quoting TVA v. Hill, 437 U.S. 153 (1978), and citing United States v. Am. Trucking Assoc., 310 U.S. 534, 543-544 (1940)).
165. Redlark, 106 T.C. at 56.
166. Id.
167. Lipton, supra note 10, at 222. Lipton notes that the problem with the dissenting judges’ and Miller III courts’ reasoning is that they assume that the statute is unclear, or in other words, that Congress does legislate in a vacuum. See id.
168. See Redlark, 106 T.C. at 58 (Ruve, J., dissenting) (“I disagree with the majority for reasons already well stated by the Court of Appeals for the Eighth Circuit in Miller v. United States.”).
169. See Miller III, 65 F.3d at 690 (citing Chevron, 467 U.S. at 844) ("[I.R.C. § 163(h)(2)(A)], however, does not define what constitutes business interest. Therefore, there is an implicit legislative delegation of authority to the Commissioner to clarify whether
exception for business interest ambiguous because Congress did not indicate a method of allocation or specify a result for the “specific issue at hand”—whether deficiency interest was deductible. 170

In summary, the Redlark decision contains three answers to the pivotal threshold question of whether the statutory language is ambiguous: (1) the majority’s holding that it is not when considered in the context of pre-1987 case law; (2) the concurring opinions’ conclusions that it is not—standing on its own; and (3) the dissenting opinions’ determinations that it is.

C. Regulatory Framework

Against this backdrop it is not surprising that the three came to different conclusions about the propriety of the regulatory framework relating to the deductibility of interest on tax deficiencies. Judge Tannenwald noted that even though both the IRS and taxpayers failed to directly address Temporary Treasury Regulation § 1.163-8T, because § 1.163-9T, the section at issue, specifically referenced that regulation, he would “deal first” with it.171 Temporary Treasury Regulation § 1.163-8T gives meaning to the statute’s “properly allocable” language by providing an allocation method based on the underlying expenditure, or use of debt proceeds.172 The majority noted that, because it could be argued that “the proceeds of an individual’s income tax indebtedness cannot be considered as expended in a trade or business,” Temporary Treas-

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170. Redlark, 106 T.C. at 67 (Halpern, J., dissenting) (“The term ‘properly allocable’ is ambiguous, because Congress has not indicated the method by which, or the assumptions under which, taxpayers, the Service, and the courts are to decide whether a particular indebtedness is ‘properly allocable’ to a trade or business. Clearly, there is more than one way to allocate interest. . . . More importantly, the statute is silent with respect to the specific issue at hand—whether interest with respect to an individual’s Federal income tax liability is deductible.”).

171. Id. at 40. See supra note 3 (quoting Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A) (1987) which references § 1.163-8T as it relates to underpayments of individual taxes and indebtedness used to pay such taxes).

172. See Redlark 106 T.C. at 40 (citing Temp. Treas. Reg. § 1.163-8T(c)(1) which provides: “Debt is allocated to expenditures in accordance with the use of the debt proceeds . . . debt proceeds and related interest expense are allocated solely by reference to the use of such proceeds. . . .”). See generally § 1.163-8T(a)(1) (providing that “[t]his section prescribes rules for allocating interest expense for purposes of applying sections 469 (the ‘passive loss limitation’) and 163(d) and (h) (the ‘non-business interest limitations’);”); § 1.163-8T(a)(3) (“In general, interest expense on a debt is allocated in the same manner as the debt to which such interest expense relates is allocated . . . [and] [d]ebt is allocated by tracing disbursements of the debt proceeds to specific expenditures”).
surv Regulation § 1.163-9T(b)(2)(i)(A), providing that such interest is always personal, could be considered just a specific example of the expenditure method of allocation of § 1.163-8T. However, perhaps in reference to the NationsBank "specific issue at hand" language, the majority went on to question whether the IRS exceeded its authority by applying the expenditure method specifically to deny all deductions of deficiency interest. The IRS had argued that, under an application of the expenditure method, individual taxpayers' payments of deficiency interest could never be considered trade or business expenses because individual income taxes (which it ostensibly considered the underlying "debt" or "expenditure") are always to be considered personal or "consumption expenditures." The majority found this result unreasonable however, holding:

Whatever the merits of such method of allocation may be in other contexts, we do not think that the Secretary of the Treasury should be entitled to use the authority conferred by section 7805(a) to construct a formula which excludes an entire category of interest expense in disregard of a business connection such as exists herein.

Further, the majority was unconvinced by the IRS' conclusion that § 1.163-8T requires that an "income tax deficiency is ipso facto a consumption expenditure." The majority cited Temporary Treasury Regulation § 1.163-8T(c)(3)(ii) (regarding the allocation method applicable to debt assumptions not involving cash disbursements) for the proposition that it is permissible to "analyze the elements of the income tax indebtedness to determine whether its imputed expenditure is properly allocable to business activity."

173. See id. And, in fact, this is essentially the IRS' argument. See infra notes 178-80 and accompanying text.
174. See supra notes 146-47 and accompanying text.
175. See Redlark, 106 T.C. at 40 ("The question to be resolved is whether section 7805(a) provides a sufficient basis to justify the application of the expenditure method of allocation set forth in section 1.163-8T(c) ... to the factual situation involved herein.").
176. See Lipton, supra note 10, at 220.
177. Redlark, 106 T.C. at 40.
178. Id. at 41-42.
179. Id. at 42. See Temp. Treas. Reg. § 1.163-8T(c)(3)(ii) ("If a taxpayer incurs or assumes a debt in consideration for the sale or use of property, for services, or for any other purpose, ... and no debt proceeds are distributed to the taxpayer, the debt is treated for purposes of this section as if the taxpayer used an amount of the debt proceeds equal to the balance of the debt outstanding at such time to make an expenditure for such property, services, or other purpose.").
In fact, the majority notes that such an analysis "would be consistent with the overall legislative purpose in enacting section 163(h), namely to end the deduction for interest incurred to fund consumption expenditures." The majority therefore considered Temporary Treasury Regulation § 1.163-9T "sufficiently elliptical" to allow its validity to be "independently determined" without further reference to § 1.163-8T.

Judge Swift's concurring opinion also followed the logic noted in the majority opinion that Temporary Treasury Regulation § 1.163-8T does not necessarily dictate that deficiency interest could not be allocated to a trade or business. In fact, he took this reasoning one step further. He found that Temporary Treasury Regulation § 1.163-8T(c)(3)(ii) not only provided an alternative rationale for allowing an allocation based on the underlying components of the tax, but compelled that result because the "underlying activity in question" that gave rise to the tax deficiency and to the Government's extension of credit to petitioners" clearly related to the taxpayers' business. In a footnote, Judge Laro also noted that "but for" Temporary Treasury Regulation § 1.163-9T(b)(2)(i)(A), "there should be no dispute" that deficiency interest is properly deductible, because under § 1.163-8T the interest is connected to taxes paid on business income.

If the twin goals of administrative efficiency and consistency are held to be most important, the analysis of the relevant regulatory framework in Judge Halpern's dissent provides a compelling argument for accepting the validity of the regulation. His argument regarding the regulatory framework itself is based on four principal findings: (1) that the statutory term "properly allocable" is ambiguous; (2) that the "tracing method" of Temporary Treasury Regulation § 1.163-8T is a valid interpretation of the term "properly allocable" generally; (3) that "a reasonable case can be made for the proposition that all deficiency interest is personal;" and (4) that § 1.163-9T(b)(2)(i)(A) is "nothing more than a fact-specific appli-

181. Id.
182. Id. at 49 (Swift, J., concurring) (holding that the related deficiency interest was properly allocable to the business under the regulation and therefore deductible under the statute).
183. Id. at 55 n.6 (Laro, J., concurring) (citing Fort Howard Corp. and Subs. v. Comm'r, 103 T.C. 345, 352 (1994) ("An expense is incurred 'in connection with' the conduct of a trade or business if it is associated with or logically related.").
The touchstone of Judge Halpern's analysis, which mirrors the IRS' argument in this regard, is that "money expended for Federal income taxes constitutes a consumption expenditure, and not a cost of earning income. If that is the case, under the tracing method, deficiency interest (or interest on any borrowing to pay taxes) is personal interest, regardless of the reason the deficiency arose. As Judge Halpern notes, while this approach is "wooden," it is nonetheless "unambiguous."

In summary, the Tax Court in Redlark again split along three lines. The majority considered the regulatory framework surrounding the section at issue sufficient to rebut the presumption that the expenditure allocation method must stop at the level of the tax itself and not "look through" to its underlying components. The concurrences considered such evidence as indicative that a "look through" method was indeed the mandated result. Finally, the dissenting judges found that the expenditure allocation method of the regulations was a permissible means of implementing the presumption that all amounts expended for individual income tax represent nondeductible consumption expenditures.

D. Contemporaneous Legislative History

As discussed above, the Tax Court generally uses legislative history only in the second step of the Chevron methodology. It is important to note, however, that the majority in Redlark prefaced its discussion of the available "contemporaneous" legislative history by stating that it would have found the provisions of I.R.C. § 163(h)(2)(A), standing alone, insufficient to support the regulation. It was with this attitude that the majority began to evalu-
ate the import of the two relevant sources of contemporaneous legislative history: the Conference Committee Report\textsuperscript{192} and the General Explanation of the Tax Reform Act of 1986.\textsuperscript{193} As perhaps could be expected at this point, the Redlark court as a whole did not agree on whether language in the Conference Committee Report was ambiguous, or what weight should be accorded the General Explanation.

1. Conference Committee Report

Standing in direct contradiction to the general belief that extensive legislative history accompanies tax rules,\textsuperscript{194} the Conference Committee Report is the only legislative history of section 163(h) that directly addresses the issue.\textsuperscript{195} Even so, that reference is spare. After restating some of the statutory language,\textsuperscript{196} the report adds only one cryptic sentence: "Personal interest also generally includes interest on tax deficiencies."\textsuperscript{197} Much of the debate about the significance of this small piece of legislative history begins with a single word in this sentence, "generally."

At first blush, most would agree that the word "generally" as used above was probably intended to mean that there will be some instances when deficiency interest is \textit{not} to be considered personal interest. The IRS has argued that "generally" was intended to reflect an exception for the deductibility of interest on past-due business taxes, like sales and excise taxes, which is specifically provided for in the regulations.\textsuperscript{198} Therefore, at least in the context of

Anita Consol., Inc. v. Comm'r, 50 T.C. 536, 560 n.13 (1968)).


\textsuperscript{193} Staff of Joint Comm. on Tax'n, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986 (Comm. Print 1987) [hereinafter Blue Book].

\textsuperscript{194} See supra note 114 and accompanying text.

\textsuperscript{195} See Redlark, 106 T.C. at 42.

\textsuperscript{196} Including, as the majority noted, the statement that "[p]ersonal interest is any interest, other than interest incurred or continued in connection with the conduct of a trade or business . . . investment interest, or interest taken into account in computing the taxpayer's income or loss from passive activities for the year." \textit{Id}. (citing the Conference Committee Report, supra note 192 at 154).

\textsuperscript{197} Conference Committee Report, supra note 192 at 154.

\textsuperscript{198} See Redlark, 106 T.C. at 44. The regulations specifically exclude interest due on such taxes from the definition of personal interest. \textit{See Temp. Treas. Reg. § 1.163-9T(b)(2)(iii)(A)} (1987). Also, the Eighth Circuit must have found this argument persuasive. In Miller III the court repeated the sentence from the Conference Committee Report without analyzing it. \textit{See Miller III,} 65 F.3d at 687. Nevertheless, the court characterized it as being supportive of the regulation's reasonableness. \textit{Id}. \textit{See also} Dan L. Mendelson and
an individual’s ability to deduct interest on federal income tax deficiencies, the meaning of the term “generally” is further dependent on the meaning of the term “deficiencies.”

The majority in Redlark noted that the word “deficiencies” has “a long-established and well-known meaning” and should be considered a “term of art.” The majority also noted that it should be assumed that the conference committee used the word in this well-established sense—to mean income, estate, and gift taxes only. Given that, the majority holds that it is merely “logical” to conclude that what is excluded by the term “generally” is interest that constitutes an ordinary and necessary business expense. The majority finds its explanation far less strained than that of the IRS (and Eighth Circuit), which requires that “generally” be read as “always” and that the interpretation of the word “deficiencies” be expanded “beyond its accepted meaning.”

In his dissent, however, Judge Ruwe concluded that the term “generally” modifies “tax deficiencies” and not “income tax deficiencies.” Thus, in Judge Ruwe’s judgment, it was likely added in recognition of the fact that Congress had specifically excluded some interest on certain estate taxes from the definition of personal interest. He therefore held that the use of “generally” “was both technically correct and consistent with the regulation’s holding that all interest on individual income tax deficiencies is personal interest.” He went on to note that this context further suggests that the allowance of a deduction was intended as a rare exception to the norm. It should not, therefore, “include the very common situation where an ‘income tax deficiency’ is based on adjustments to items reported on an individual’s Schedule C.”

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199. Redlark, 106 T.C. at 44.
200. See id.
201. See id. at 45.
202. Id.
203. Id. at 58-59 (Ruhe, J., dissenting).
204. Redlark, 106 T.C. at 58-59 (referring to I.R.C. § 163(h)(2)(E), which holds that “interest on estate taxes imposed by section 2001 is, in certain circumstances, not personal interest”).
205. Id. at 59 (emphasis added).
206. See id.
207. Id. At least one commentator agrees with Judge Ruwe’s interpretation of the sentence. See Sheppard, supra note 8, at 642 (“Throwing common sense to the wind, the majority read the word ‘generally’ . . . to mean that interest on income tax deficiencies is
ly, Judge Halpern, in his dissent, came up with yet another way that deficiency interest paid by an individual could have been the exception intended by the use of the term "generally" (i.e., would not be considered "personal interest" yet would not be in conflict with the regulations). In addition to his conclusion that the Conference Committee Report does not exclusively support the majority’s interpretation of the statute, he also notes that the “aspect of the report relied on by the majority is ambiguous and should be given little weight in determining what deficiency interest is personal interest.” He concludes that the ambiguity of the report only supports the conclusion that the regulation at issue here is valid because the statute itself is ambiguous.

In summary, Judge Halpern appears to have the best of this argument. After all, there is no better index of ambiguity than the fact that the Tax Court itself cannot agree about the statement’s meaning. Further, while perhaps in other contexts a one-line statement should have more stature, it would be a slender thread on which to hang a per se rule of nondeductibility. Finally, it is interesting that none of the opinions emphasized the sea-change aspect of the Tax Reform Act of 1986 in the context of measuring the import of the “generally” phrase included therein.

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208. See Redlark, 106 T.C. at 73 (referencing Haden Co. v. Comm’r, 165 F.2d 588, 591 (5th Cir. 1948), which concerned interest paid on an income tax deficiency attributable to the transfer of assets).
209. Id. at 74.
210. See id.
211. In examining the import of Temp. Treas. Reg. § 1.163-8T, the majority opinion referenced the “overall legislative purpose” of the enactment of I.R.C. § 163(h) as being to “end the deduction for interest incurred to fund consumption expenditures,” but did not similarly measure the import of “generally” from this portion of the Conference Committee Report. See supra note 180 and accompanying text. The Conference Committee Report appears to be more supportive of Judge Halpern’s conclusion that the “generally” phrase should be given little weight than of the majority’s conclusion that a “look through” interpretation of the expenditure method within the temporary regulations better accords with legislative intent. See supra notes 172-73 and accompanying text.
2. General Explanation of the Tax Reform Act of 1986 ("Blue Book")

No such ambiguity was present regarding the following statement from the Blue Book accompanying the Tax Reform Act of 1986:

Personal interest also includes interest on underpayment of individual Federal, State or local income taxes notwithstanding that all or a portion of the income may have arisen in a trade or business, because such taxes are not considered derived from the conduct of a trade or business.212

In a footnote at this point, the Blue Book went on to add:

Personal interest does not include interest on taxes, other than income taxes, that are incurred in connection with a trade or business. (For the rule that taxes on net income are not attributable to a trade or business, see Treas. Reg. Sec. 1.62-1(d), relating to nondeductibility of State income taxes in computing adjusted gross income.)213

While the Blue Book gives support to the IRS' position, the IRS could not "salvage" it in Redlark. The majority held that the Blue Book:

[Is] not part of the legislative history although it is entitled to respect. . . . Where there is no corroboration in the actual legislative history, we shall not hesitate to disregard the General Explanation as far as congressional intent is concerned. . . . Given the clear thrust of the conference committee report, the General Explanation is without foundation and must fall by the wayside. To conclude otherwise would elevate it to a status and accord it a deference to which it is simply not entitled.214

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212. Redlark, 106 T.C. at 43 (quoting the Blue Book, at 266).
213. Id. (quoting the Blue Book at 266 n.60). Of course, as discussed above, the rules relating to state income taxes do not address deficiency interest generally. While prior case law did establish that state income taxes are clearly nondeductible, it "lent no particular support to the expansion of that rule through the type of reasoning by analogy reflected in either the Blue Book or the . . . temporary regulation derived from it." Raby & Raby, supra note 8, at 574.
214. Redlark, 106 T.C. at 45-46 (footnotes and citations omitted).
The majority specifically mentioned the statement of one commentator that "[t]he Blue Book is on especially weak ground when it adopts anti-taxpayer positions not taken in the committee reports." In a footnote, the majority went on to point out that while the Tax Reform Act of 1986 was itself the product of the 99th Congress, the Blue Book was published during the 100th Congress, and was therefore not even "entitled to the respect it might otherwise be accorded if it had been prepared for the Congress which enacted sec. 163(h)."

In his concurrence, Judge Laro also noted that the Blue Book, while entitled to respect, is not legislative history and was not approved by the Congress before its release. Judge Laro added that "we should not be bound by statements in the 1986 Bluebook that are unsupported by and contrary to section 163 and its legislative history." He described the purpose of the Blue Book as:

[Providing] in one volume, a compilation of the legislative history or a piece of tax legislation. While the document is most helpful as a handy reference volume it also gives some guidance. Where the Blue Book's explanation differs from that in a conference report it may serve to alert the reader that a technical correction is needed to reconcile the views.

While neither of the dissents addressed the weight to be accorded the Blue Book, the IRS and the Eighth Circuit in Miller III (although it cited many of the same cases as the majority in Redlark) came to a contrary conclusion regarding its importance. While the IRS conceded that the Blue Book was "not controlling authority on legislative intent because it was prepared by committee staff after the enactment of the statute," the IRS argued that it is "nevertheless . . . 'a valuable aid to understanding the statute,' and is 'entitled to great respect.'" The IRS went on to argue

215. Lipton, supra note 10, at 221 (quoting Livingston, What's Blue and White and Not Quite as Good as a Committee Report: General Explanations and the Role of "Subsequent" Tax Legislative History, 11 AMER. J. TAX POL'Y 91 (1994)).
216. Redlark, 106 T.C. at 45 n.7.
217. See id. at 56-57 (Laro, J., concurring).
218. Id. at 57.
219. Id. at 54 n.5 (quoting MERTENS, LAW OF FEDERAL INCOME TAXATION § 3.20, at 31 (1994)) (alteration in concurring opinion).
that "absent any definitive legislative history that is more revealing (and here there is none), it is proper to give substantial weight to a General Explanation."221 The Eighth Circuit in Miller III also "added its voice to those who accept the post-enactment interpretations of the Joint Committee staff as evidence of congressional intent."222 While the district court in Miller I had effectively ignored the Blue Book because it did not rise to the level of legislative history,223 the appellate court, citing most of the cases relied on by the IRS, concluded that it was nevertheless "highly indicative of what Congress did, in fact, intend."224

In summary, while none of the judges held that the Blue Book was ambiguous, their conclusions on the proper weight it should be accorded ranged from "none" to "great." Not surprisingly, the weight accorded seems dependent on the reviewer's existing conclusions regarding the ambiguity of the statute and Conference Committee Report. In general, however, all would seem to agree that statements contained in a Blue Book may be used to clarify existing legislative intent found elsewhere, but not to establish it independently or correct it.

n.15 (11th Cir. 1992); McDonald v. Comm'r, 764 F.2d 322, 336 n.25 (5th Cir. 1985) [hereinafter Brief for Respondent]. The majority had cited Estate of Wallace for the proposition that the Blue Book is to be disregarded if there is no evidence of congressional intent within the "actual legislative history." Redlark, 106 T.C. at 45.

221. Brief for Respondent, supra note 220, at *8 (citing Bank of Clearwater v. United States, 7 Cl. Ct. 289, 294 (1985); FPC v. Memphis Light, Gas & Water Div., 411 U.S. 458, 472 (1973); Estate of Hutchison v. Comm'r, 765 F.2d 665, 670 (7th Cir. 1985)). The majority had cited Estate of Hutchison for the proposition that while the Blue Book was not part of legislative history, it was entitled to respect. See Redlark, 106 T.C. at 45.

222. Mendelson & Conjura, supra note 198, at 353.

223. See Miller I, 841 F. Supp. at 309 ("Post-enactment explanations such as those prepared by the Joint Committee's staff do not, however, rise to the level of legislative history in their persuasiveness"). The district court had found the legislative history of the Tax Reform Act of 1986 "silent on the specific issue of deductibility of deficiency interest derived from business income," and had agreed that "there would be no need for the word 'generally' if all interest on tax deficiencies is personal interest." Id.

224. Miller III, 65 F.3d at 690 (quoting Estate of Hutchinson, 765 F.2d at 669-70; citing FPC v. Memphis Light, Gas & Water Div., 411 U.S. 458, 472 (1973) (finding that legislative history is a "compelling contemporary indication" of the effect of a statutory provision); Estate of Wallace, 965 F.2d at 1050-51 n.15 (legislative history is a "valuable aid to understanding the statute"); and McDonald v. Comm'r, 764 F.2d 322, 336 n.25 (5th Cir. 1985) (legislative history is "entitled to great respect.").
E. Subsequent Legislative History

The IRS’ final argument regarding legislative history was that Congress’ failure to express dissatisfaction with the temporary regulation in subsequent legislation was an indication that the regulation was reasonable. The majority agreed that a review of subsequent legislative history is an element of the National Muffler standard and pertinent to determining the validity of a regulation. However, it felt that the legislative actions relied on by the IRS were not of the “type contemplated by the Supreme Court.”

The IRS had first argued that Congress’ failure to express dissatisfaction with the regulation in the 1988 amendment of I.R.C. § 163(h)(2)(A) was evidence of the regulation’s reasonableness. In response, the majority suggested that because (1) the regulation was temporary, (2) the amendment was not intended to make a substantive change in statutory language, and (3) the amendment was enacted within 11 months of the issuance of the regulations, the 1988 amendment was made too soon to have considered the impact of the regulation and would not have included an expression of dissatisfaction with its per se effect.

The IRS had also pointed to a Senate Finance Committee proposal included in the Omnibus Budget Reconciliation Act of 1990 that would have eliminated the deduction of deficiency interest by corporate taxpayers. The IRS argued that this was evidence of subsequent legislative history involving deficiency interest but not expressing dissatisfaction with the regulation. Although never enacted, in explaining the proposal the Committee had stated:

Individuals are not permitted to deduct personal interest.

For this purpose, personal interest includes interest on

225. Redlark, 106 T.C. at 46.
228. See Redlark, 106 T.C. at 46.
229. See Brief for Respondent, supra note 220, at *9.
underpayments of the individual's income taxes, even if all or a portion of the individual's income is attributable to a trade or business.\textsuperscript{231}

The majority discounted this evidence as well, noting that it was only a proposal entered into the Senate record; it was never approved by Congress and apparently was not even reviewed by the House.\textsuperscript{232} Finally, the majority explained that the proposal actually strengthened the case against the validity of the regulation since it demonstrated that Congress "knew how to restrict the deductibility of interest if it so intended."\textsuperscript{233}

While neither dissenting opinion discussed the import of subsequent legislative history, the Eighth Circuit in \textit{Miller III} apparently accepted the argument that the 1988 amendment of I.R.C. § 163(h) was evidence of Congress' tacit approval of the regulation. It cited its own precedent holding that Congress' failure to change a challenged regulation when amending a relevant statutory provision "is an indication that Congress did not perceive the regulation to be unreasonable or inconsistent with Congressional intent."\textsuperscript{234} It seems likely that the Ninth Circuit will also recognize this aspect of \textit{National Muffler} on appeal.\textsuperscript{235} However, it is unclear whether it will accept the two pieces of legislative history as evidence of Congress' tacit acquiescence to the regulation.

\section*{III. PHILOSOPHICAL AND PRACTICAL CONSIDERATIONS:
THE IMPLICATIONS OF INVALIDATING
THE TEMPORARY REGULATION}

As is evidenced by the preceding discussion of each source of guidance reviewed by the majority, the Tax Court as a whole actually agreed about very few of the issues presented in \textit{Redlark}. One commentator has noted that when the Tax Court is so divided, "the 'right' answer may depend more on philosophical leanings than application of the law."\textsuperscript{236} While this is a bit of an overstatement, underlying philosophical leanings undoubtedly played a

\begin{thebibliography}{99}
\bibitem{231} Brief for Respondent, \textit{supra} note 220, at *9 (citing 135 CONG. REC. S15711 (daily ed. Oct. 18, 1990) (statement of Senate Finance Committee)).
\bibitem{232} \textit{See Redlark}, 106 T.C. at 46.
\bibitem{233} \textit{Id.} at 46-47.
\bibitem{234} \textit{Miller III}, 65 F.3d at 690 (quoting \textit{Hefti v. Comm'r}, 983 F.2d 868, 872 (8th Cir. 1993)).
\bibitem{235} \textit{See supra} notes 151-153 and accompanying text.
\bibitem{236} Lipton, \textit{supra} note 10, at 222.
\end{thebibliography}
large part in the *Redlark* decision and may provide a rationale for the resulting fractured opinions. For example, beliefs about the role of textualism and judicial deference, the concept of income taxes as a nondeductible consumption expenditure, and the relative importance of consistency in the application of tax laws all seem to underlie some of the divisions among the opinions. Finally, while the language in *Redlark* suggests that the application of the exception in I.R.C. § 163(h)(2)(A) will be viewed narrowly, some commentators have remarked that the *Redlark* holding as to deficiencies arising from a trade or business may also be capable of being applied to those deficiencies arising from investment and passive activities.

**A. Income Taxes and Related Expenses as Consumption Expenditures**

The majority in *Redlark* rejected the notion that all individual income tax is a nondeductible consumption expenditure. The majority believed that the IRS' argument that Temporary Treasury Regulation § 1.163-9T was just an example of the otherwise valid tracing or allocation methodology "proved too much." Judge Tannenwald noted that even if the Redlarks' entire deficiency clearly related to the trade or business, the application of the regulation would still require that none of the interest be deductible. To him, then, this was "an unrealistic application of our tax laws," given the lack of specific legislative intent and the thrust of pre-1987 case law. At issue is which allocation method better reflects the "overall legislative purpose" of enacting I.R.C. § 163(h)—"to end the deduction for interest incurred to fund consumption expenditures"—the majority's, which "looks through" the total individual tax amount to its components, or the dissents', which traces back only as far as the tax itself.

In direct contrast to the majority, Judge Halpern's dissent argued that deficiency interest should be treated as a consumption expenditure (and therefore nondeductible) because the underlying

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237. Id. at 221. See also *Redlark*, 106 T.C. at 47 ("One final comment. Suppose that the only income reported on the return of petitioners had been Schedule C income ... and that the entire deficiency related to the type of errors that the courts have previously concluded were expected to occur in the ordinary course of business. E.g., Polk v. Comm'r, 31 T.C. 412 (1958).")

238. Id. at 221. See *Redlark*, 106 T.C. at 47.

239. Id.

240. Id. at 42.
tax deficiency is itself a nondeductible consumption expenditure.\textsuperscript{241} (Or as Judge Ruwe put it: "Interest on a individual's income tax liability represents a personal expense because the underlying tax obligation is personal.")\textsuperscript{242} In Judge Halpern's view:

The payment of Federal income taxes is a civic duty, not a matter of business contract or investment advantage. All taxpayers, as well as others (citizens and noncitizens) receive benefits on account of the funding of the Federal Government. The payment of Federal income taxes reduces a taxpayer's wealth otherwise available for consumption. Thus, Federal income tax payments exhibit characteristics not common to business (or investment) expenditures. . . .

If Federal income taxes constitute consumption, and not a trade, business, or investment expense, then, under a tracing rule, such as the rule of section 1.163-8T . . . the inescapable \textit{and reasonable} conclusion is that any deficiency interest, or interest on a borrowing to pay income taxes, is personal interest.\textsuperscript{243}

Further, as noted by Judge Ruwe in dissent:

An individual's income tax liability is based on an amalgamation of income derived from all sources and deductions, credits, exclusions, exemptions, filing status, income bracket, and other considerations. Income from an unincorporated business is merely one of the many components necessary to determine what is still in essence a tax on an individual's personal accessions to wealth from whatever source derived.\textsuperscript{244}

As discussed above, though it may be "wooden," a consideration of all deficiency interest as attributable to consumption does avoid the inherent ambiguity in the majority's holding (and perhaps inherent in apportioning such an "amalgamation"). In dissent, Judge Halpern pointed out that, except for providing support that clear cases like \textit{Miller} will not meet the statutory exception, the majority opinion provides no guidance about what will qualify.\textsuperscript{245} He notes

\begin{itemize}
\item \textsuperscript{241} See id. at 72 (Halpern, J., dissenting).
\item \textsuperscript{242} Id. at 60 (Ruze, J., dissenting).
\item \textsuperscript{243} \textit{Redlark}, 106 T.C. at 71-72 (Halpern, J., dissenting) (emphasis in original).
\item \textsuperscript{244} Id. at 60 (Ruze, J., dissenting).
\item \textsuperscript{245} Id. at 75 (Halpern, J., dissenting).
\end{itemize}
that it would be "difficult to discern a coherent scheme of interest allocation" by relying exclusively on *Standing, Polk, and Reise*. Indeed, the majority's holding seems destined to result in inconsistent treatment by courts and taxpayers, and therefore in increased judicial inefficiencies. Even so, the lack of predictability inherent in the majority's rule is not as troubling as it would be in other instances because no taxpayers are likely to plan to incur deficiency interest.

On the other hand, concerns about efficiency have not resulted in per se nondeductibility for other expenses relating to tax deficiencies. For example, following the dissents' logic, tax return preparation fees and the like should theoretically also be nondeductible since they too are associated with an underlying consumption expense. However, under Revenue Ruling 92-29, the IRS considers litigation expenses and tax preparation fees incurred in determining state and federal income taxes related to a trade or business conducted as a sole proprietorship to be deductible in determining a taxpayer's adjusted gross income. There is no compelling reason to treat these expenses differently from interest. If these types of expenses may be apportioned to business activities in some rational manner, it would seem that deficiency interest could be as well.

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246. *Id.* at 74.
247. See *supra* note 36 and accompanying text (discussing how the majority's reliance on *Polk* may be viewed as allowing a certain level of taxpayer "negligence"). If, for example, taxpayers in certain industries, or with certain levels of sophistication, are treated differently by courts (or the IRS in practice), issues of inconsistency or "discrimination" may also be raised. See *infra* notes 254-67 and accompanying text.
248. Although, theoretically, invalidating the regulation could affect prospective decisions about settlement agreements (e.g., taxpayers could bargain with agents about what portion of the total adjustment will be considered attributable to a trade or business).
250. See *Redlark*, 106 T.C. at 58 n.7 (Laro, J., concurring) ("Given the Commissioner's position with respect to these litigation expenses and tax preparation fees, I am unable to fathom why she continues to believe that the interest on a tax deficiency that is allocable to a trade or business is not also deductible.").
251. There may be valid policy reasons for encouraging (or at least not discouraging) taxpayers to incur tax return preparation fees but discouraging taxpayers from incurring deficiency interest. Further, the *Polk* court did distinguish between the more "ordinary" character of return preparation and litigation expenses versus deficiency interest. See *supra* notes 27-32 and accompanying text.
252. Of course, the IRS may be more willing to rely on objective evidence in the form of professional billings that identify time spent on business matters for the apportionment of tax return preparation fees and the like.
The issue of whether a particular expense should be considered as personal or business-related is not a new one. Much of the Redlark court's struggle with the principles discussed above seems due to its indecision regarding this more fundamental issue. As one commentator noted, Redlark is also "noteworthy" because it involves this issue of the "business versus personal dichotomy that is the centerpiece of the consumption tax schemes being bandied about lately." Based on Redlark, if a consumption-based tax is adopted taxpayers are in for a bumpy ride unless those schemes present clearer direction than existing law regarding deficiency interest.

B. The Importance of Consistency or "Nondiscrimination"

As discussed above, the IRS' current position would seem to promote the inconsistent treatment of expenses related to income tax deficiencies. While litigation fees and tax return preparation fees relating to sole proprietorship deficiencies are deductible, interest is not. Further, while interest is deductible for purposes of calculating net operating losses, it is not deductible for calculating adjusted gross income. The fact that the IRS appears to be treating expenses related to tax deficiencies inconsistently only matters if (1) there is no rational basis for the distinction, and (2) the IRS should be held to a duty of consistency. With regard to the latter, the IRS takes the position that it has no duty to treat even clearly similarly situated taxpayers consistently, and generally the courts have accepted this position. That is not to say that consistency does not have a place in a court's analysis of whether an IRS interpretation is reasonable, however. For example, "[t]he Supreme Court has indicated, in dictum, that consistency of treatment is an important consideration in determining whether the Commissioner has abused his discretion under [I.R.C.] § 7805(b)."

Further, in Rowan Cos. v. United States, the Supreme Court considered whether the IRS had been consistent in its interpretation of the statute to be a factor in determining whether the related regulations were valid.

253. Sheppard, supra note 8, at 641.
254. See Zelenak, supra note 119, at 411.
255. Id. at 421 n.64 (quoting Auto. Club v. Comm'r, 353 U.S. 180, 186 (1957)). I.R.C. § 7805(b) concerns the retroactive application of rulings and regulations. See id.
257. See Zelenak, supra note 119, at 443 (discussing regulations involving whether employer-provided meals and lodging must be considered wages for FICA and FUTA pur-
Finally, the Supreme Court, in *National Muffler*, noted that one policy served by deference to the IRS in validating interpretive regulations was ensuring that "like cases will be treated alike."258 While this aspect of *National Muffler* was not specifically noted in *Redlark*, it was perhaps a factor in the majority's recognition of the apparent discrimination between classes of taxpayers caused by the regulation. In concluding that the regulation's effective exclusion of all interest, even in the presence of a clear business connection, made it unreasonable, the majority noted that "[s]uch a result discriminates against the individual who operates his or her business as a proprietorship instead of in corporate form where the limitations on the deduction of 'personal interest' would not apply."259

However, Judge Ruwe argued that invalidating the regulation gives rise to "an even greater disparity in treatment" because deficiency interest would then be deductible by individuals conducting business as sole proprietorships but not as S corporations or partnerships.260 He argued that "[c]onsistent treatment of individual taxpayers can be best achieved by recognizing that interest on individual income tax deficiencies is personal interest regardless of whether the adjustment giving rise to the deficiency pertains to a proprietorship, a partnership, or an S corporation."261

Judge Ruwe may be correct. However, it does not necessarily follow that because flow-through entities do not get the deduction, individuals should not get it either. Judge Ruwe relied on the Tenth Circuit's holding in *True* for the proposition that individuals may not deduct interest related to deficiencies of their businesses conducted as S corporations and partnerships.262 As discussed above, however, *True* appears to turn on "aggregate/entity" concepts and not relatedness.263 Thus, partnership and S corporation-related deficiency interest would theoretically still not be deductible from adjusted gross income under that holding, irrespective of whether the regulation at issue here was invalidated. Further, it

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258. Id. at 426 (quoting *National Muffler v. United States*, 440 U.S. 472, 477 (1979)).
260. Id. at 60 (Ruwe, J., dissenting) (referring to *True v. Comm'r* in which the Tenth Circuit held that interest on pre-1987 tax deficiencies arising from partnerships and S corporations was not deductible). *See supra* notes 56-61 and accompanying text.
262. *See id.*
263. *See supra* note 98 and accompanying text.
may be that *True* was just wrongly decided. As discussed above, the holding has the rather anomalous result of denying a deduction for deficiency interest at both the individual and entity level.\(^{264}\) Also, as the Tax Court noted in *Rose, True* was an "unpublished opinion of questionable precedential value."\(^{265}\)

Finally, Judge Halpern noted in dissent that the majority does not explain why Congress cannot in fact discriminate between classes of taxpayers, like corporations and individuals, if it wants to.\(^{266}\) Judge Ruwe also recognized this fact. As he wrote, "[s]urely, the majority does not question Congress' authority to allow corporations, which are treated as separate taxable entities, to deduct items that individuals may not."\(^{267}\) Of course, it seems likely that given the majority's other conclusions, Judge Tannenwald was not questioning Congress' authority to distinguish between entities, but rather the IRS' lack of authority to do so via regulations.

If the situations discussed here are appropriately termed inconsistencies under the *National Muffler* standard, they should be considered in whether the IRS' interpretation is reasonable. In this case, however, the discrimination between taxpayers noted by both the majority and Judge Ruwe may not be evidence of such inconsistencies. Inconsistent treatment will necessarily result between either (1) individuals, S corporations, and partnerships versus corporations (if the regulation is validated), or (2) individuals and corporations versus S corporations and partnerships (if the regulation is invalidated). In either case, there is at least a rational basis for each distinction. Conversely, however, there does not seem to be any good reason for the inconsistent treatment of expenses related to deficiencies and interest, or of deficiency interest in calculating net operating losses or adjusted gross income, that results under the temporary regulation.

*C. Practical Observations*

Beyond the more technical aspects of the decision presented above, there are also a few common sense observations that result from an examination of the opinions. No one could deny that per se rules in tax law are more efficient. Even though some conces-
sions are made to equity, they result in the predictability needed for the efficient ordering of taxpayer affairs and greater judicial economy. For deficiency interest, while the need for predictability is mitigated, certainly judicial economy is still a concern. However, as a practical matter, there is little reason for a per se rule of nondeductibility of interest where other expenses related to tax deficiencies are deductible and where deficiency interest may be taken into account in calculating net operating losses. Any incremental judicial economy must be mitigated by these rules allowing taxpayers to make allocation calculations. Further, even though cries for equity might be hushed, given the posture of deficiency interest generally, judicial deference to administrative authority is not warranted in reviewing a rule that results in a per se rule of nondeductibility. Similarly, it would also seem that such a per se rule should be clearly stated within the statute and supported by more than either equivocal or after-the-fact legislative history. From such a common sense view, the majority’s attempt to maintain an equitable rule, even at the expense of an efficient one, looks better all the time.

D. Implications of Redlark for Deficiencies Arising from Investment or Passive Activities

When I.R.C. § 163(h) was amended in 1988 to substitute the “properly allocable” language in place of the “in connection with” language, the stated purpose of the amendment was to “[permit] consistent application of a standard for allocation of interest.”268 In addition to the exception for interest properly allocable to a trade or business discussed here, I.R.C. § 163(h)(2) also contains specific exceptions for interest allocable to property held for investment and related to passive activities under I.R.C. § 469.269 Therefore, under the holding of Redlark, “it would appear that the deduction of investment and passive activity interest might at least have a reasonable basis.”270 Further, as Judge Swift’s concurrence

268. Raby & Raby, supra note 8, at 575 (quoting the Conference Committee Report, supra note 220).
270. Raby & Raby, supra note 8, at 575. The authors note that while the language of those sections is slightly different, “it would seem logical” that the business allocation reasoning of Redlark (whatever that means in practice) would also apply there. Id. However, if True stands, it would still theoretically bar deductions related to flow-through
pointed out, Temporary Treasury Regulation § 1.163-8T(c)(3)(ii) (regarding the allocation of interest when no debt proceeds are disbursed) includes a provision referring to not only the sale and use of property, and services, but “for any other purpose” as well. In addition to deficiency interest arising from trade or business adjustments, this language could also encompass investment and I.R.C. § 469 activities. A specific example of the application of this reasoning might be the deduction of interest paid under I.R.C. § 453A, which generally requires that taxpayers pay interest on the “deferred tax liability” arising from certain installment obligations.

CONCLUSION

It is difficult to determine whether Redlark is truly a “bird in the hand” for noncorporate taxpayers. Its survival will largely depend on how a reviewing court integrates the interdependent sources of guidance on statutory interpretation. As proposed here, this will in turn depend on the reviewing judges’ beliefs about more philosophical issues. For example, in Redlark, whether the statutory language was deemed ambiguous seemed to depend on whether the judge accepted the notion that Congress recognizes case law precedents in legislating. Whether the “expenditure method” of regulations generally was reasonable seemed to depend on whether the judge believed that a consumption expenditure philosophy should block further examination of the portions of individual tax. And, coming full circle, the role legislative history should play seemed largely to depend on whether the judge had already determined that the statute in question was ambiguous. When differing views about textualism and the level of deference to be accorded administrative agencies are added to the mix, predicting the viability of Redlark becomes an even riskier proposition.

entities. See supra notes 56-61 and accompanying text.

271. Redlark, 106 T.C. at 49.

272. See Raby & Raby, supra note 8, at 575. Any related interest deduction will still be subject to the usual limitations applicable to that section, however. See Jeffrey R. Davis and Barry R. Friefeld, Some Interest on Tax Deficiencies May be Deductible, 52 TAX’N FOR ACC. 196, 199 (1994).

273. See William L. Raby, When Outside Basis Exceeds Inside Basis in the S Corporation, 65 TAX NOTES 107 (1994) (describing the tax-free distribution of installment sale proceeds from the liquidation of S corporations undertaken in order to minimize capital losses). Again, however, the limitation in True would theoretically apply in this case.
Whether it survives or not, the Tax Court’s decision in Redlark is a testament to the complexity inherent in the current tax law. A reader’s initial reaction to the many opinions contained in the Redlark decision is simply to wonder how taxpayers and practitioners can be expected to consistently interpret what the Tax Court cannot. Thus, perhaps Redlark will serve as ammunition for the proponents of comprehensive tax reform, although the business versus consumption classification issues it raises remain to be addressed in many of the current reform proposals. To the extent that Redlark can engender reforms that effectively resolve those issues, it will indeed provide lasting benefit for noncorporate taxpayers.

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