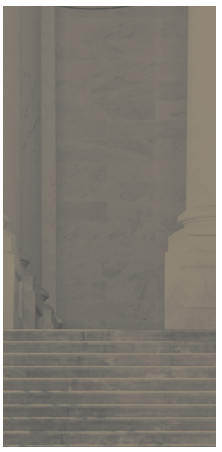
SOCIETY OF ACTUARIES

Article from:

Taxing Times

May 2014 – Volume 10, Issue 2



BLUE BOOK BLUES: THE SUPREME COURT DISCOUNTS THE VALUE OF THE JOINT COMMITTEE'S BLUE BOOKS IN *U.S. v. WOODS*

By John T. Adney

For many decades, the staff of the Joint Committee on Taxation of the U.S. Congress has prepared a summary, at or near the end of a congressional session, of significant tax legislation enacted during that session. This summary, officially known as a "General Explanation" and more commonly called the "Blue Book" because it is enclosed within blue covers, typically repeats the formal legislative history of enacted legislation—the House Ways and Means Committee and Senate Finance Committee reports, the Conference report, and sometimes floor colloquies and statements deemed important to the legislation. The Joint Committee staff may also supplement this history with additional discussion explaining or clarifying aspects of the enactment. In the latter connection, taxpayers and their representatives have been known to ask the staff to make such additions, all after the houses of Congress have moved on to other business.

Taxpayers, lawyers and accountants advising or representing taxpayers, and the Internal Revenue Service (IRS) itself have made use of the Blue Books' statements regarding the various tax enactments in deciphering the import or arguing about the meaning of Internal Revenue Code ("IRC" or the "Code") provisions. Many have found the Blue Books helpful as convenient repositories of what Congress has done, or at least what it said about what it did, in adding to or amending the Code. Perhaps more significantly, taxpayers, the IRS, and others have from time to time cited to statements in the Blue Books as authority for the positions they are taking or are urging on others. The status of the Blue Books as sources of authoritative guidance for interpreting the Code's rules is of particular interest to the life insurance industry, as much of the legislation enacted in the 1980s that today governs the federal income tax treatment of the industry's companies and products is described in Blue Books issued by the Joint Committee staff (in 1982, 1984 and 1986). Quite often under that legislation, the legislative history represents much of the authority construing the Code's provisions, and certain passages in the Blue Books speak to subjects not addressed anywhere else. By way of example, a footnote in the insurance-related matter in the 1984 Blue Book instructed actuaries on how to identify the interest rate and the mortality and expense charges used in the IRC section 7702 calculations for fixed premium universal life contracts; the substance of the footnote does not appear in the House and Senate committee reports.

> Certain passages in the Blue Books speak to subjects not addressed anywhere else.

Recently, the Supreme Court of the United States had occasion to consider just what official credence should be accorded to Blue Books. In *United States v. Gary Woods*, 571 U.S. ___, 134 S. Ct. 557 (2013), the Court considered whether the IRC section 6662(b)(3) 20 percent penalty for tax underpayments attributable to "substantial valuation misstatements" applied to an underpayment resulting from what the Court characterized as a basis-inflating tax shelter transaction. According to the Court's opinion, Mr. Woods and his employer, Billy Joe McCombs, participated in an "offsetting-option" tax shelter (called by the ominous acronym "COBRA") designed to generate large paper losses that they could use to reduce their taxable income. The tax shelter plan involved the use of an ostensible partnership and the creative application of the Code's partnership tax rules, whereby the basis of Messrs. Woods and McComb in partnership interests they subsequently disposed of was claimed by them to be a substantial, positive amount. In this manner, the disposition of the interests produced a loss of some $45 million, which in turn sheltered a comparable amount of the taxpayers' income. The IRS thought, to the contrary, that their basis in the partnership interest should be zero, and in this connection it asserted against the taxpayers both a tax deficiency and the 20 percent penalty for substantial valuation misstatements, concluding that the taxpayers' elevated basis claim was a misstatement warranting the penalty.

Writing for a unanimous Court, Justice Antonin Scalia's opinion agreed with the IRS. With regard to the issue specifically before the Court, i.e., whether the district court that first considered the case had jurisdiction to determine that the valuation misstatement penalty applied, the opinion concluded that the district court could make that determination, reversing a contrary position adopted by the Fifth Circuit Court of Appeals. Much of the discussion in the Supreme Court's opinion centered on the applicability of this penalty and the jurisdiction of the district court to determine it in a so-called TEFRA partnership-level proceeding. At one point in the discussion, however, Justice Scalia came to one of his favorite subjects: the use of legislative history in the construction of congressional enactments. (For detail on the views of "textualists," as the Justice and others describe themselves, as well as for considerable commentary on the use and misuse of legislative history, see Antonin Scalia and Bryan W. Garner, *Reading Law: The Interpretation of Legal Texts* [Thomson/West 2012].)

Near the end of the Court's opinion, Justice Scalia addressed an argument raised by the taxpayers that was premised on the Blue Book issued by the Joint Committee staff in connection with legislation in 1981. In particular, the taxpayers had pointed to footnote 2 on page 333 of the "General Explanation of the Economic Recovery Tax Act of 1981" in support of their argument against application of the valuation misstatement penalty. The Court's opinion characterized the passage in the footnote as discussing "two separate, non-overlapping [tax] underpayments, only one of which is attributable to a valuation misstatement," and thus concluded that the passage was distinguishable from the facts of the *Woods* case. But the opinion did not stop merely by pronouncing the taxpayers' argument unpersuasive. Even before reaching the Blue Book text at issue, the Court spoke of the Blue Books as commentaries "written after passage of the legislation" that "d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law]," quoting from the Ninth Circuit Court of Appeals' decision in *Flood v. United States*, 33 F. 3d 1174, 1178 (1994). Then, citing to its own jurisprudence, the Supreme Court said that "[w]e have held that such '[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation.'" While acknowledging that its own decisions "have relied on similar documents in the past, see *FPC v. Memphis Light, Gas & Water Div.*, 411 U. S. 458, 471–472 (1973), our more recent precedents disapprove of that practice."

The Court's opinion in *Woods* then drove something like a stake through the heart of any claim that the Blue Books could be cited as authority—and perhaps through the heart of those who would like to advocate the books' authoritative use, too. Specifically, the Court said, "[o]f course the Blue Book, like a law review article, may be relevant to the extent it is persuasive." That thought demotes the Blue Books down from the shelves of the statutes, and perhaps even down to the level of the article you are now reading. In any event, this should discourage parties arguing in front of the federal courts, and the Supreme Court in particular, from referencing the Blue Books in their filings.

The Supreme Court did not say in *Woods* that the staff of the Joint Committee on Taxation must cease and desist from publishing Blue Books; that would likely constitute a breach of the constitutional separation of powers. Nor should the Joint Committee staff even consider taking such a step. In addition to providing excellent tools for researchers in their collection and summary of official legislative history, the Blue Books serve as the voice of the Joint Committee staff in identifying issues in recent enactments, such as provisions warranting technical correction. Also, with due respect to the Court's suspicion of those who would add to the official

CONTINUED ON **PAGE 14**

John T. Adney is a partner with the Washington, D.C. law firm of Davis & Harman LLP and may be reached at *jtadney@davis-harman.com.*

gloss on an enactment after the President's signature has dried, the fact is that the Joint Committee staff members are heavily involved in the development of new or altered Code provisions and necessarily speak with more credibility than, say, academics writing articles. The Court, moreover, did not say that the IRS must completely ignore statements made in the Blue Books as it interprets the provisions of the Code. Under the regulations dealing with the IRC section 6662(b)(2) penalty for substantial understatement of income tax, and assuming the IRS does not alter the regulations in light of *Woods*, the Blue Books remain as a form of authority in determining whether there is "substantial authority" for a tax return position. *See* Treas. Reg. sec. 1.6662-4(d)(3)(iii).

The import of *Woods* is, in essence, that if anyone (even including the IRS) is planning to defend a chosen interpretation of a Code provision by pointing to legislative history, it should not include in those plans the use of the Blue Books, as such, in arguments to the courts. This teaching must carry over to tax advisors as well, for in rendering opinions on the construction of the Code, tax advisors must rely on authorities existing at the time the advice is rendered to assess (apart from penalties) how a court would decide the issue. While such authorities would include formal legislative history, they now would not appear to encompass the Blue Books themselves. ◂