



January 1984

Formulation and Application of the Tax Benefit Rule: Hillsboro National Bank v. Commissioner

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Recommended Citation

Marjorie D. Arneson, Note, *Formulation and Application of the Tax Benefit Rule: Hillsboro National Bank v. Commissioner*, 37 Sw L.J. 1009 (1984)
<https://scholar.smu.edu/smulr/vol37/iss6/4>

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NOTES

FORMULATION AND APPLICATION OF THE TAX BENEFIT RULE: *HILLSBORO NATIONAL BANK V. COMMISSIONER*

THE decision in *Hillsboro National Bank v. Commissioner* reflects the United States Supreme Court's consolidation of two cases: *Hillsboro National Bank v. Commissioner* and *United States v. Bliss Dairy, Inc.* Since the underlying facts in each case are different, they are set out separately.

HILLSBORO NATIONAL BANK V. COMMISSIONER

Until 1970 the State of Illinois assessed a property tax on shares held by stockholders of incorporated banks.¹ Banks customarily paid the tax on behalf of the shareholders and took a deduction for the payments.² In 1970 the Illinois Legislature amended the state constitution to prohibit ad valorem taxation of personal property owned by individuals.³ The amendment was soon challenged as a violation of the equal protection clause of the United States Constitution,⁴ so the legislature directed that the tax be collected and placed in escrow⁵ pending a decision on the constitutionality

Editor's Note: Unless otherwise indicated all statutory references are to the Internal Revenue Code of 1954, as amended, which is codified in title 26 of the United States Code. Internal Revenue Code sections are cited to the 1976 permanent edition and/or current supplement of the United States Code, if therein. Otherwise, code sections are cited to the main edition and/or current supplement of the United States Code Annotated published by West Publishing Company. All Treasury Regulations are cited by section number and may be found in 26 C.F.R. (1983) unless otherwise indicated.

1. ILL. REV. STAT. ch. 120, § 557 (Smith-Hurd 1970) (repealed 1982).

2. I.R.C. § 164(e) (1976) provides:

Where a corporation pays a tax imposed on a shareholder on his interest as a shareholder, and where the shareholder does not reimburse the corporation, then—

(1) the deduction allowed by subsection (a) shall be allowed to the corporation; and

(2) no deduction shall be allowed the shareholder for such tax.

3. ILL. CONST. of 1870, art. IX-A (1970). "Ad valorem" taxation is a tax laid in the form of a percentage on the value of the property. See *Powell v. Gleason*, 50 Ariz. 542, 74 P.2d 47, 50 (1937).

4. U.S. CONST. amend. XIV, § 1. The Illinois Supreme Court held the amendment unconstitutional in *Lake Shore Auto Parts Co. v. Korzen*, 49 Ill. 2d 137, 273 N.E.2d 592, 599 (1971).

5. Pub. Act 77-2133, § 1, 1972 Ill. Laws 942 (codified as ILL. REV. STAT. ch. 120, § 676.01) (repealed 1982).

of the amendment by the United States Supreme Court. Hillsboro National Bank paid the required taxes for 1972 and took the corresponding deduction. After the United States Supreme Court upheld the amendment prohibiting such taxation,⁶ the amounts in escrow, with accrued interest, were refunded directly to the shareholders.⁷ Hillsboro did not include the refund in income on its 1973 tax return, and the Commissioner of Internal Revenue assessed a deficiency against the bank for the amount of the refund. The Tax Court held that the refund of taxes to the shareholders must be included in Hillsboro's 1973 income.⁸ The Court of Appeals for the Seventh Circuit affirmed,⁹ and the United States Supreme Court granted certiorari. *Held, reversed*: The tax benefit rule does not require that a corporation include in income any refund of taxes to shareholders when the corporation, in an earlier year, has paid the tax for the shareholders and taken a corresponding deduction. *Hillsboro National Bank v. Commissioner*, 103 S. Ct. 1134, 75 L. Ed. 2d 130 (1983).

UNITED STATES V. BLISS DAIRY, INC.

Bliss Dairy, Inc. was operated as a closely held corporation until 1973. During that year the dairy deducted the full cost of cattle feed purchased, even though a substantial portion of the feed was still on hand at the end of the taxable year. After one day of operation in the next tax year, Bliss adopted a plan of liquidation and distributed all of its assets to its shareholders. The assets distributed included a substantial portion of the cattle feed purchased for use in its business and expensed in the previous year.¹⁰ Bliss did not report the distribution as income, relying on the nonrecognition provisions of section 336 of the Internal Revenue Code.¹¹ The shareholders continued to operate the dairy in noncorporate form and filed an election under section 333 to limit the gain recognized by the shareholders on liquidation.¹² The shareholders' basis in the corporation's stock was

6. *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 364-65 (1973).

7. Hillsboro National Bank was not notified of the refunds, which the County Treasurer sent directly to the shareholders.

8. *Hillsboro Nat'l Bank v. Commissioner*, 73 T.C. 61, 68 (1979). The court did find that the portion of the refunds representing accrued interest was not includable in the bank's income. *Id.* at 71.

9. *Hillsboro Nat'l Bank v. Commissioner*, 641 F.2d 529 (7th Cir. 1981).

10. Bliss Dairy was a cash basis taxpayer and as such properly deducted the expense when paid. A cash basis taxpayer computes income by deducting actual cash expenditures in a given accounting period from actual cash receipts instead of allocating receipts and disbursements to the accounting period in which earned or incurred. 2 J. MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 12.01, at 6 (rev. ed. 1982). The deduction was allowed under I.R.C. § 162(a) (West 1978 & Supp. 1983), which allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

11. I.R.C. § 336 (West Supp. 1983). Section 336 provides that "no gain or loss shall be recognized to a corporation on the distribution of property in complete liquidation." *Id.* § 336(a).

12. *Id.* § 333 (1976). Section 333, in general, limits the gain recognized by qualified electing shareholders when the liquidation is made pursuant to an adopted plan and the distribution of all property occurs within one calendar month. A shareholder recognizes ordinary income on the liquidating distribution to the extent of his ratable share of the

allocated among the assets received,¹³ including the cattle feed.¹⁴ The shareholders then deducted their new basis in the feed as a business expense for the 1973 tax year.¹⁵ The Commissioner of Internal Revenue increased Bliss's corporate income for 1973 by \$60,000, asserting that the value of the grain distributed to the shareholders should have been included in income.¹⁶ Bliss paid the tax assessment and sued for a refund. The district court granted Bliss's motion for summary judgment, and the Court of Appeals for the Ninth Circuit affirmed.¹⁷ *Held, reversed and remanded*: The tax benefit rule overrides the nonrecognition provision in section 336 and requires the inclusion in income of a previous deduction when events occur that are fundamentally inconsistent with that earlier deduction. *Hillsboro National Bank v. Commissioner*, 103 S. Ct. 1134, 75 L. Ed. 2d 130 (1983).

I. DEVELOPMENT OF THE TAX BENEFIT RULE

The tax benefit rule provides that the recovery of an amount previously deducted is income in the year recovered.¹⁸ In order for the rule to apply, the taxpayer must have taken a deduction that resulted in a tax benefit.¹⁹ The inclusionary and exclusionary components of the rule are examined to determine the taxability of such recovery.²⁰ Under the exclusionary aspect of the rule, any recovery not previously resulting in a tax benefit is ex-

corporation's earnings and profits. *Id.* § 333(a), (c). Additional gain to the extent the value of money, stock, or securities received on liquidation exceeds his ratable share of the corporation's earnings and profits is recognized as capital gain. Any remaining gain is not recognized. *Id.* § 333(e).

13. When a shareholder receives several assets in liquidation he apportions his total basis among all the assets according to their relative fair market values. Treas. Reg. § 1.334-2.

14. The record did not disclose the precise amount of basis that the shareholders allocated to the unused cattle feed. The parties agreed, however, that the shareholders received a stepped-up basis in the feed, since the deduction taken in 1973 had reduced the basis of the feed to zero.

15. I.R.C. § 162 (1976).

16. The unconsumed cattle feed was later determined to have a value of \$56,565.

17. *Bliss Dairy, Inc. v. United States*, 645 F.2d 19 (9th Cir. 1981) (per curiam). The court relied on its prior decision in *Commissioner v. South Lake Farms, Inc.*, 324 F.2d 837 (9th Cir. 1963), and rejected a conflicting decision in the Sixth Circuit, *Tennessee-Carolina Transp., Inc. v. Commissioner*, 582 F.2d 378 (6th Cir. 1978), *cert. denied*, 440 U.S. 909 (1979).

18. *See, e.g.*, *First Trust & Sav. Bank v. United States*, 614 F.2d 1142, 1144 (7th Cir. 1980); *Connery v. United States*, 460 F.2d 1130, 1132 n.1 (3d Cir. 1972); I J. MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 7.34, at 114-21 (rev. ed. 1981).

19. *See, e.g.*, *Nash v. United States*, 398 U.S. 1, 3 (1970) ("recovery of an item that has produced an income tax benefit in a prior year is to be added to income in the year of recovery"); *Rosen v. Commissioner*, 611 F.2d 942, 943 (1st Cir. 1980) (charitable deduction); *Alice Phelan Sullivan Corp. v. United States*, 381 F.2d 399, 402 (Ct. Cl. 1967) (charitable contribution of real property); *Lime Cola Co. v. Commissioner*, 22 T.C. 593, 601 (1954) (deduction for defective purchase); *Birmingham Terminal Co. v. Commissioner*, 17 T.C. 1011, 1013 (1951) (railroad retirement losses reimbursed by government).

20. For a detailed discussion of both the inclusionary and exclusionary elements of the rule, see Bittker & Kanner, *The Tax Benefit Rule*, 26 U.C.L.A. L. REV. 265, 272-81 (1978); O'Hare, *Statutory Nonrecognition of Income and the Overriding Principle of the Tax Benefit Rule in the Taxation of Corporation and Shareholders*, 27 TAX L. REV. 215 (1972).

cluded from income, whereas under the inclusionary component any recovery of a previous benefit must be included in income.²¹

The tax benefit rule was initially developed by the courts.²² Congress codified the exclusionary element of the tax benefit rule in section 22(b)(12) of the Internal Revenue Code of 1939,²³ which became section 111 of the 1954 Code.²⁴ Although section 111 expressly addresses only the exclusionary aspect of the rule, several courts have interpreted the section as an implied ratification of the inclusionary element of the rule.²⁵ In defining the amount of a recovery that is excluded from income, section 111 refers only to bad debts, prior taxes, and delinquency amounts as falling within the rule's tax benefit treatment. Treasury Regulations, however, have broadened the categories of deductions that must be recouped under the rule to include all losses or expenditures,²⁶ and courts now commonly

21. See *Home Mut. Ins. Co. v. Commissioner*, 639 F.2d 333, 343 (7th Cir. 1980), cert. denied, 451 U.S. 1017 (1981); *Anders v. United States*, 462 F.2d 1147, 1149 (Ct. Cl.), cert. denied, 409 U.S. 1064 (1972); *Putoma Corp. v. Commissioner*, 66 T.C. 652, 664 n.10 (1976), aff'd, 601 F.2d 734 (5th Cir. 1979); *Birmingham Terminal Co. v. Commissioner*, 17 T.C. 1011, 1013 (1951); *South Dakota Concrete Prods. Co. v. Commissioner*, 26 B.T.A. 1429, 1432 (1932).

22. See, e.g., *Dobson v. Commissioner*, 320 U.S. 489, 506 (1943) (sale of stock rescinded); *Unvert v. Commissioner*, 656 F.2d 483, 484 (9th Cir. 1981) (interest deduction), cert. denied, 456 U.S. 961 (1982); *National Bank of Commerce v. Commissioner*, 115 F.2d 875, 877 (9th Cir. 1940) (bad debt deduction); *Philadelphia Nat'l Bank v. Rothensies*, 43 F. Supp. 923, 925 (E.D. Pa. 1942) (bad debt deduction); *Alice Phelan Sullivan Corp. v. United States*, 381 F.2d 399, 402 (Ct. Cl. 1967) (charitable contribution); *Capitol Coal Corp. v. Commissioner*, 26 T.C. 1183, 1195 (1956) (cancellation of debt), aff'd, 250 F.2d 361 (2d Cir. 1957), cert. denied, 356 U.S. 936 (1958); *Estate of Block v. Commissioner*, 39 B.T.A. 338, 341-42 (1939) (deduction for tax payment), aff'd sub nom. *Union Trust Co. v. Commissioner*, 111 F.2d 60 (7th Cir.), cert. denied, 311 U.S. 658 (1940).

23. Internal Revenue Code of 1939, § 22(b)(12).

24. I.R.C. § 111 (1976 & Supp. V 1981). Section 111 provides:

(a) General Rule.

Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the *recovery exclusion* with respect to such debt, tax, or amount.

(b) Definitions.

For purposes of subsection (a)—

. . . .

(4) Recovery exclusion.

The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle . . . reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

Id. § 111(a)-(b) (1976) (emphasis added).

25. See *Dobson v. Commissioner*, 320 U.S. 489, 505-06 (1943); *Alice Phelan Sullivan Corp. v. United States*, 381 F.2d 399, 402 (Ct. Cl. 1967); *Putoma Corp. v. Commissioner*, 66 T.C. 652, 664 n.10 (1976), aff'd, 601 F.2d 734 (5th Cir. 1979); *Bittker & Kanner*, *supra* note 20, at 271-72.

26. Treas. Reg. § 1.111-1. The regulation states, however, that deductions for depreciation, depletion, amortization, and amortizable bond premiums are not subject to the recovery exclusion. *Id.* § 1.111-1(a).

apply the rule beyond the items listed in section 111.²⁷ Under the rule, therefore, the recovery of any item that reduced tax liability in a previous year may represent taxable income in the year of recovery.²⁸

The tax benefit rule furthers the effectiveness of the annual accounting system.²⁹ Without the rule, a taxpayer could abuse the accounting principle that transactions be treated as final at year end so that tax consequences can be determined and reported.³⁰ For example, the propriety of a particular deduction may be affected by changed circumstances if the transaction spans several years. Because the taxpayer has taken a deduction that would not have been allowed had the recovery occurred in the same year,³¹ he has gained an advantage over a taxpayer who engaged in a similar transaction where both events occurred in a single year. The tax benefit rule is intended to alleviate some of these inequities by according similar tax treatment to transactions that span more than one accounting period.³²

Courts applying the tax benefit rule have encountered difficulty in determining what type of event in a later year requires an adjustment in income. The decisions are not entirely consistent, and the conflicting conclusions drawn by the circuit courts have been the subject of several legal commentaries.³³ In applying the rule, the circuit courts follow one of two theories, the inconsistent event theory³⁴ or the recovery theory.³⁵ The

27. See, e.g., *Connery v. United States*, 460 F.2d 1130, 1133 (3d Cir. 1972) (recovery of advertising expense deduction); *Mayfair Minerals, Inc. v. Commissioner*, 456 F.2d 622, 623 (5th Cir. 1972) (per curiam) (deductions of accrued utility rate refunds); *Bishop v. United States*, 324 F. Supp. 1105, 1111 (M.D. Ga. 1971) (sale of breeder hens fully deducted); *S.E. Evans, Inc. v. United States*, 317 F. Supp. 423, 426-27 (W.D. Ark. 1970) (sale of previously expensed parts and supplies).

28. *Nash v. United States*, 398 U.S. 1, 3 (1970) (deduction for estimated bad debts).

29. *Home Mut. Ins. Co. v. Commissioner*, 639 F.2d 333, 343 (7th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981); *Estate of Munter v. Commissioner*, 63 T.C. 663, 678 (1975) (Tannenwald, J., concurring).

30. *Home Mut. Ins. Co. v. Commissioner*, 639 F.2d 333, 343-44 (7th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981).

31. See *Bishop v. United States*, 324 F. Supp. 1105, 1111 (M.D. Ga. 1971); *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 86 (1971), *aff'd per curiam*, 456 F.2d 622 (5th Cir. 1972).

32. See *Home Mut. Ins. Co. v. Commissioner*, 639 F.2d 333, 344 (7th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981); *Estate of Munter v. Commissioner*, 63 T.C. 663, 678 (1975) (Tannenwald, J., concurring); *South Dakota Concrete Prods. Co. v. Commissioner*, 26 B.T.A. 1429, 1432 (1932). See generally Bittker & Kanner, *supra* note 20, at 267-70.

33. Epstein, *The Tax Benefit Rule in Corporate Liquidations*, 6 TAX ADVISER 454, 456-57 (1975); Feld, *The Tax Benefit of Bliss*, 62 B.U.L. REV. 443, 451-54 (1982); Forte, *Corporate Liquidations—Sections 336 and 337 of the Internal Revenue Code—Parity Between a Direct Sale of Assets and a Stock Purchase—Another Look at Tennessee-Carolina and R.M. Smith*, 3 W. NEW ENG. L. REV. 199, 215-21 (1980); Morrison, *Assignment of Income and Tax Benefit Principles in Corporate Liquidations*, 54 TAXES 902, 903-04 (1976); Reveley & Pratt, *Tax Benefit Rule: What Constitutes a Recovery? Sixth and Ninth Circuits Disagree*, 57 TAXES 416, 417-18 (1979); Note, *The Tax Benefit Rule and Corporate Liquidations: Baiting the "Trap for the Unwary"*, 4 J. CORP. L. 681, 692-703 (1979).

34. See *Hillsboro Nat'l Bank v. Commissioner*, 641 F.2d 529, 531 (7th Cir. 1981); *First Trust & Sav. Bank v. United States*, 614 F.2d 1142, 1145-46 (7th Cir. 1980); *Rosen v. Commissioner*, 611 F.2d 942, 943-44 (1st Cir. 1980); *Tennessee-Carolina Transp., Inc. v. Commissioner*, 582 F.2d 378, 382-88 (6th Cir. 1978), *cert. denied*, 440 U.S. 909 (1979); *Estate of*

inconsistent event theory, first enunciated in *Estate of Block v. Commissioner*,³⁶ maintains that "[w]hen recovery or some other event which is inconsistent with what has been done in the past occurs, adjustment must be made in reporting income for the year in which the change occurs."³⁷ In *Block* the estate received a large tax refund as a result of an amendment in the state inheritance laws. The Board of Tax Appeals sustained a deficiency against the estate and required the estate's executor to include the refund of estate taxes in income in the year recovered.³⁸ The Board reasoned that if the adjustment were not made the estate would have received the refund tax-free.³⁹

The Sixth Circuit adopted and elaborated on the inconsistent event theory in *Tennessee-Carolina Transportation, Inc. v. Commissioner*.⁴⁰ The taxpayer in that case purchased all the capital stock of Service Lines, Inc. Service Lines temporarily operated as a subsidiary and then liquidated and merged into its parent, Tennessee-Carolina Transportation Company. Pursuant to the liquidation, all the assets of the subsidiary were distributed to the parent, including previously expensed tires and tubes. The parent company allocated the purchase price of the stock to the newly acquired assets based on relative fair market values.⁴¹ The company then deducted the amount allocated to the tires and tubes as a business expense on its consolidated income tax return. The court of appeals held that the parent was required to include the value of the distributed tires and tubes in the subsidiary's income.⁴² The court stated that the tax benefit rule applied to corporate liquidations under section 336 of the Code⁴³ and that an inconsistent event sufficient to invoke the tax benefit rule occurred when the parent received the previously expensed tires and tubes with a stepped-up

Block v. Commissioner, 39 B.T.A. 338, 341-43 (1939), *aff'd sub nom.* Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir.), *cert. denied*, 311 U.S. 658 (1940).

35. The Ninth Circuit Court of Appeals is the only circuit court that has followed this theory. See *Bliss Dairy, Inc. v. United States*, 645 F.2d 19, 20 (9th Cir. 1981) (per curiam); *Estate of Schmidt v. Commissioner*, 355 F.2d 111, 114 (9th Cir. 1966); *Commissioner v. South Lake Farms, Inc.*, 324 F.2d 837, 839 (9th Cir. 1963). The theory has also been followed, however, by a district court in the Tenth Circuit in *Ballou Constr. Co. v. United States*, 526 F. Supp. 403, 407-08 (D. Kan. 1981), *vacated and remanded sub nom.* Hillsboro Nat'l Bank v. Commissioner, 103 S. Ct. 1134, 75 L. Ed. 2d 130 (1983).

36. 39 B.T.A. 338 (1939), *aff'd sub nom.* Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir.), *cert. denied*, 311 U.S. 658 (1940).

37. 39 B.T.A. at 341.

38. *Id.* at 340. The estate had paid and deducted federal estate taxes from 1929 to 1931. The taxes were determined after allowing a credit for estate taxes paid to the State of Indiana. When the Indiana inheritance tax laws were amended in 1931 the estate's tax liability increased and the estate was thereby entitled to a larger credit against its federal estate tax liability. After receiving a refund from the IRS for the overpayment and interest, the estate reported only the interest as income on its 1932 tax return.

39. *Id.* at 340.

40. 582 F.2d 378 (6th Cir. 1978), *cert. denied*, 440 U.S. 909 (1979).

41. *Id.* at 380. The allocation was made in accordance with I.R.C. § 334(b)(2) (1976) (current version at *id.* (West Supp. 1983)).

42. 582 F.2d at 383.

43. *Id.* at 380. The court expressly rejected the contrary holding of the Ninth Circuit Court of Appeals. *Id.* at 380 n.13; see *Commissioner v. South Lake Farms, Inc.*, 324 F.2d 837, 839 (9th Cir. 1963) (tax benefit rule inapplicable to § 336 corporate liquidations).

basis.⁴⁴ Alternatively, the court held that even if an actual recovery is necessary to invoke the rule, such a recovery had occurred in this case.⁴⁵ Focusing on the transfer of the assets to the parent corporation, the court further held that the subsidiary experienced an instantaneous recovery at the moment it transferred fully expensed assets to its parent for value.⁴⁶

The Seventh Circuit Court of Appeals subsequently followed the *Tennessee-Carolina* decision in *First Trust & Savings Bank v. United States*.⁴⁷ The *First Trust* case arose out of the same series of events that initiated *Hillsboro National Bank v. Commissioner*. In *First Trust*, however, the Internal Revenue Service sent the refunds to the bank as a joint payee with the shareholders, and the bank forwarded the checks to the individual stockholders. The Seventh Circuit Court of Appeals found the event sufficiently inconsistent with the prior deduction to invoke the tax benefit rule.⁴⁸ The court refused to impose liability in the absence of an actual recovery, but found that such a recovery occurred when the bank received the refunds before distributing them to the shareholders.⁴⁹

The Ninth Circuit Court of Appeals took a different view of the application of the tax benefit rule, using the recovery theory in *Commissioner v. South Lake Farms, Inc.*⁵⁰ After planting crops and expensing the costs of production of the crops, South Lake Farms, Inc. was purchased by another corporation and subsequently liquidated. The acquiring corporation calculated its basis in the crops by reference to the price of the stock,⁵¹ and subsequently included sales of the crop in income, while deducting the costs of harvesting as an expense. The Internal Revenue Service unsuccessfully argued that the taxpayer must include either the value of the crops or the original expense deduction as income. The court held that South Lake had received no recovery and that the tax benefit rule did not override the provisions of section 336.⁵²

Another disagreement between the circuits centers on the treatment of gains on property distributed in a liquidation⁵³ and, in particular, on

44. 582 F.2d at 382.

45. *Id.* The court ruled that when the tubes and tires were fully deducted by Service Lines they were, so far as the law contemplated, consumed. *Id.*

46. *Id.*

47. 614 F.2d 1142 (7th Cir. 1980).

48. *Id.* at 1146.

49. *Id.* The Seventh Circuit further extended the inconsistent event theory in *Hillsboro Nat'l Bank v. Commissioner*, 641 F.2d 529 (7th Cir. 1981).

50. 324 F.2d 837 (9th Cir. 1963).

51. I.R.C. § 334(b)(2) (1976) (current version at *id.* (West Supp. 1983)). Section 334(b)(2) provides that the basis of property received by a corporation in a complete liquidation of another corporation is equal to the adjusted basis of the stock in the liquidated corporation. *Id.*

52. 324 F.2d at 839; see I.R.C. § 336 (West Supp. 1983). Although the IRS objected to the decision in Rev. Rul. 74-396, 1974-2 C.B. 106, 107, the Ninth Circuit subsequently reaffirmed *South Lake Farms* in *Bliss Dairy v. United States*, 645 F.2d 19 (9th Cir. 1981) (*per curiam*).

53. This disagreement is also the result of the conflicting decisions between the Sixth and Ninth Circuits in *Tennessee-Carolina* and *South Lake Farms*. See generally Note, *Tax*

whether section 336 should be treated like section 337⁵⁴ under the tax benefit rule.⁵⁵ When previously expensed property is sold in a corporate liquidation, the tax benefit rule overrides the nonrecognition provisions of section 337, resulting in inclusion of the gain in income.⁵⁶ In discussing the treatment to be accorded section 336, both commentators⁵⁷ and courts⁵⁸ have urged parity between sections 336 and 337. In order to resolve the conflict between the circuits, the Supreme Court granted certiorari in *Bliss* and *Hillsboro*.⁵⁹

II. HILLSBORO NATIONAL BANK V. COMMISSIONER

In the consolidated cases of *Hillsboro National Bank v. Commissioner* and *United States v. Bliss Dairy, Inc.* the United States Supreme Court considered the applicability of the tax benefit rule in two separate corporate tax situations. The Court held that the tax benefit rule requires additions to income for recoveries when events occur that are fundamentally inconsistent with an earlier deduction, unless a nonrecognition provision of the Internal Revenue Code prevails over the tax benefit rule.⁶⁰ The holding resulted in the recognition of income from the liquidation in *Bliss Dairy*, but no recognition of income from the tax refunds in *Hillsboro National Bank*.⁶¹ The majority opinion, written by Justice O'Connor,⁶² first

Treatment of Previously Expensed Assets in Corporate Liquidations, 80 MICH. L. REV. 1636, 1646-52 (1982) (nonrecognition of gains under I.R.C. § 336 (West Supp. 1983)).

54. I.R.C. § 337 (West 1978 & Supp. 1983). Section 337 deals with the sale or exchange of corporate assets in a liquidation rather than distribution as under *id.* § 336 (West Supp. 1983). It provides for nonrecognition of gain or loss from the sale or exchange of corporate assets if all assets are distributed within a 12-month period. *Id.* § 337(a) (1976).

55. See generally Epstein, *supra* note 33 (origin and application of § 336 and § 337); Feld, *supra* note 33 (nonrecognition provision in § 336 should be overridden by tax benefit rule); Morrison, *supra* note 33 (parity of treatment between § 336 and § 337 transactions); O'Hare, *supra* note 20 (detailed discussion of application of tax benefit rule to § 336 and § 337); Note, *supra* note 33 (comparing § 336 and § 337 liquidations); Note, *supra* note 53 (advocating recognition of gains under § 336 through tax benefit rule).

56. O'Hare, *supra* note 20, at 226. Several courts have upheld the tax benefit rule in such situations. See *Citizens' Acceptance Corp. v. United States*, 462 F.2d 751, 756 (3d Cir. 1972); *Connery v. United States*, 460 F.2d 1130, 1134 (3d Cir. 1972); *Spitalny v. United States*, 430 F.2d 195, 197-98 (9th Cir. 1970); *Commissioner v. Anders*, 414 F.2d 1283, 1287 (10th Cir.), *cert. denied*, 396 U.S. 958 (1969); *West Seattle Nat'l Bank v. Commissioner*, 288 F.2d 47, 50 (9th Cir. 1961); *Bishop v. United States*, 324 F. Supp. 1105, 1111 (M.D. Ga. 1971); *S.E. Evans, Inc. v. United States*, 317 F. Supp. 423, 425-26 (W.D. Ark. 1970); *Estate of Munter v. Commissioner*, 63 T.C. 663, 676-77 (1975); *Anders v. United States*, 462 F.2d 1147, 1149 (Ct. Cl.), *cert. denied*, 409 U.S. 1064 (1972); *Citizens Fed. Sav. & Loan Ass'n v. United States*, 290 F.2d 932, 936-37 (Ct. Cl. 1961).

57. Epstein, *supra* note 33, at 458; Feld, *supra* note 33, at 459; Morrison, *supra* note 33, at 919; Note, *supra* note 33, at 702-03; Note, *supra* note 53, at 1654.

58. *Tennessee-Carolina Transp., Inc. v. Commissioner*, 582 F.2d 378, 380-81 (6th Cir. 1978), *cert. denied*, 440 U.S. 909 (1979); *Estate of Munter v. Commissioner*, 63 T.C. 663, 677 (1975).

59. The Supreme Court had previously addressed the tax benefit rule in two cases, neither of which involved a nonrecognition provision of the Code. See *Nash v. United States*, 398 U.S. 1 (1970); *Dobson v. Commissioner*, 320 U.S. 489 (1943).

60. 103 S. Ct. 1134, 1138, 75 L. Ed. 2d 130, 139 (1983).

61. *Id.* at 1154, 75 L. Ed. 2d at 158.

62. Chief Justice Burger and Justices White, Powell, and Rehnquist joined the opinion of the Court.

discussed the importance of the annual accounting system and the judicially developed tax benefit rule. Emphasizing that the purpose of the rule was not simply to tax recoveries, but "to approximate the results produced by a tax system based on transactional rather than annual accounting," the Court rejected the formulations of the tax benefit rule advanced by both the taxpayers and the government.⁶³ The taxpayers contended that the rule required an actual recovery in later years, but the Court concluded that an actual recovery requirement would not serve the purposes of the rule.⁶⁴ The government had urged that the rule is invoked when an event occurs "which eliminates the factual premise upon which the deduction was originally claimed."⁶⁵ The majority determined, however, that although an unforeseen event that proves an earlier deduction erroneous may require the application of the tax benefit rule, that result is not inevitable.⁶⁶ The Court stated that proper application of the tax benefit rule requires that it be invoked to cancel out an earlier deduction only when "the later event is fundamentally inconsistent with the premise on which the deduction was initially based."⁶⁷ The Court, therefore, distinguished between unexpected events, which do not necessarily invoke the rule, and inconsistent events, which do.⁶⁸ The majority considered its formulation of the tax benefit rule clearly consistent with earlier cases establishing the rule.⁶⁹ The Court noted that in *Estate of Block v. Commissioner*⁷⁰ and other cases⁷¹ the later events that had been used to invoke the rule were often characterized as inconsistent.⁷² The majority also stated that the ap-

63. 103 S. Ct. at 1142, 75 L. Ed. 2d at 144.

64. *Id.* at 1143, 75 L. Ed. 2d at 145. The Court viewed the tax benefit rule as a method "to achieve rough transactional parity in tax." *Id.* Therefore, application of the rule only in the event of an actual recovery is not sufficient to fulfill the purposes of the rule. Every subsequent event necessitating an income adjustment to achieve tax parity will not occur as an actual recovery. *Id.* at 1143-44, 75 L. Ed. 2d at 145-46.

65. Brief for the Commissioner and the United States at 20.

66. 103 S. Ct. at 1144, 75 L. Ed. 2d at 146. As an example of an unforeseen event that does not invoke the application of the rule, the Court postulated the following example: A company prepays a month's rent on December 15, 19X1. The company takes a deduction on its 19X1 tax return for the entire amount. On January 10, 19X2 the leased premises are destroyed by fire. *Id.*

67. *Id.*

68. *Id.* Justice Stevens argued in dissent that the majority's distinction between "fundamentally inconsistent events" and "inconsistent events" created a hybrid standard of the rule that is, at best, a vague guideline. *Id.* at 1161, 75 L. Ed. 2d at 167. The majority, however, countered this objection with the proposition that the application of the tax benefit rule turns upon the difference between unexpected and inconsistent events. *Id.* at 1143 n.15, 75 L. Ed. 2d at 146 n.15.

69. *Id.* at 1145, 75 L. Ed. 2d at 148.

70. 39 B.T.A. 338 (1939), *aff'd sub nom.* Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir.), *cert. denied*, 311 U.S. 658 (1940).

71. *Barnett v. Commissioner*, 39 B.T.A. 864, 867 (1939) ("When some event occurs which is inconsistent with a deduction taken in a prior year, adjustment may have to be made by reporting a balancing item in income for the year in which the change occurs."); *South Dakota Concrete Prods. Co. v. Commissioner*, 26 B.T.A. 1429, 1432 (1932) ("[W]hen an adjustment occurs which is inconsistent with what has been done in the past in the determination of tax liability, the adjustment should be reflected in reporting income for the year in which it occurs.").

72. 103 S. Ct. at 1145, 75 L. Ed. 2d at 148. Justice Stevens, however, argued that all the

proach taken in *Hillsboro* and *Bliss* conformed to the Court's latest consideration of the tax benefit rule in *Nash v. United States*.⁷³ Finally, the Court emphasized that the tax benefit rule must be applied on a case-by-case basis, considering in each instance the purpose and function of the Code provisions allowing the original deductions.⁷⁴

Turning to the effect of nonrecognition provisions on the tax benefit rule, the majority noted that when the later event is within a nonrecognition provision of the Code there is "inherent tension" between the tax benefit rule and the nonrecognition provision.⁷⁵ The Court again refused to adopt a standard rule, emphasizing that the decision to apply the rule turns upon a determination of whether the deductions taken were inconsistent with later events and whether nonrecognition provisions prevail over the tax benefit rule.⁷⁶

In applying these rulings to *Hillsboro*, the Court focused on the intent of Congress in granting corporations a deduction under section 164(e).⁷⁷ The majority found that Congress was concerned with the reason for an act of payment by the corporation, not with the ultimate use of the funds by the state, in enacting section 164(e).⁷⁸ Thus, the Court concluded that the direct refund of taxes to the shareholders, rather than to the corporation, did not require application of the tax benefit rule to negate the previous deductions taken by the bank because the corporation had not received a refund.⁷⁹ The majority pointed out that Congress probably did not intend to deny the corporation a deduction if the state refunded the tax payments to shareholders.⁸⁰ The Court expressly rejected the Commissioner's contention that the refund to the shareholders was equivalent to a payment of a dividend by the corporation and, as such, inconsistent with the original

cases cited by the majority, with the possible exception of *Barnett*, involved a recovery. Stating that inconsistency alone has never been sufficient to invoke the rule, Justice Stevens contended that the emphasis has always been placed on the presence of a recovery. *Id.* at 1156, 75 L. Ed. 2d at 161 (Stevens, J., dissenting).

73. 398 U.S. 1 (1970). *Nash* dealt with the transfer of net accounts receivable from a partnership to a corporation formed by the partnership members. The Commissioner determined that the partnership must include the amount of the bad debt reserve in income as the reserve was no longer needed. The Supreme Court held the tax benefit rule inapplicable because there had been no recovery by the partnership when it received stock worth only the net value of the receivables. *Id.* at 3-5. The majority in *Hillsboro* noted that *Nash* involved neither a recovery nor an inconsistent event. Therefore, they argued, their present formulation of the rule did not in any way conflict with the *Nash* decision. 103 S. Ct. at 1147 n.25, 75 L. Ed. 2d at 150 n.25. In dissent, however, Justice Stevens concluded that the opinion of the Court could not be reconciled with *Nash*. Emphasizing the Court's use of the word "recovery" in *Nash*, he argued that the Court had formulated a new doctrine when they rejected the recovery theory in *Hillsboro*. *Id.* at 1157-58, 75 L. Ed. 2d at 162-63.

74. 103 S. Ct. at 1144, 75 L. Ed. 2d at 147.

75. *Id.* at 1144-45, 75 L. Ed. 2d at 147.

76. *Id.* at 1147, 75 L. Ed. 2d at 150.

77. I.R.C. § 164(e) (1976).

78. *Id.* at 1149, 75 L. Ed. 2d at 152 (citing *Hearings on H.R. 8245 Before the House Comm. on Finance*, 67th Cong., 1st Sess. 250-51 (1921) (statement of Dr. T.S. Adams, Tax Advisor, Treasury Department)).

79. 103 S. Ct. at 1149, 75 L. Ed. 2d at 153.

80. *Id.*

deduction.⁸¹ Arguing that the corporate tax laws do not permit the deduction of dividends, the Commissioner urged that the refund resulted in an unallowed deduction. The Court observed, however, that in some circumstances a deductible dividend is contemplated by the Code.⁸² The Court noted that the only effect of section 164(e) is to allow a corporation to take a dividend deduction.⁸³ On the basis of this analysis, the majority concluded that the corporation is not required to recognize income on the transaction by reason of the refund of taxes to the shareholders.⁸⁴

In resolving the issue in *Bliss*, the Court stated that when a corporation expenses assets under section 162(a),⁸⁵ the later conversion of the assets to nonbusiness use is an inconsistent event that invokes the tax benefit rule and requires the previous deduction to be included in income.⁸⁶ The Court further stated, however, that this general rule will not always apply when a Code provision shields the taxpayer from recognition of gain.⁸⁷ Because *Bliss* involved a nonrecognition provision, section 336,⁸⁸ the Court examined the history of the section⁸⁹ and concluded that section 336 does not prevent application of the tax benefit rule.⁹⁰ Relying on Senate and House Reports,⁹¹ the majority concluded that section 336 is designed to prevent recognition of market appreciation that has not been realized by an arm's-length transfer to an unrelated party, rather than to shield all types of income that might arise from the disposition of an asset.⁹² In addition, the Court noted that courts have always applied the assignment of income doctrine⁹³ to distributions in corporate liquidations.⁹⁴ The Court therefore held that section 336 does not override the tax benefit rule.⁹⁵ The majority further held that section 337,⁹⁶ the companion provi-

81. *Id.* at 1148, 75 L. Ed. 2d at 152.

82. *Id.*

83. *Id.*

84. *Id.* at 1149, 75 L. Ed. 2d at 153.

85. I.R.C. § 162(a) (West 1978 & Supp. 1983).

86. 103 S. Ct. at 1150, 75 L. Ed. 2d at 153.

87. *Id.*, 75 L. Ed. 2d at 154.

88. I.R.C. § 336 (West Supp. 1983).

89. The Court noted that the enactment of § 336 in the 1954 Code was, in effect, a codification of the doctrine in *General Utils. & Operating Co. v. Helvering*, 296 U.S. 200, 206 (1935). 103 S. Ct. at 1151, 75 L. Ed. 2d at 155. The doctrine provides that "a corporation recognizes no gain when it distributes appreciated property to its shareholders, whether as a dividend or other distribution from an ongoing corporation or as a distribution in partial or complete liquidation." Feld, *supra* note 33, at 444.

90. 103 S. Ct. at 1151, 75 L. Ed. 2d at 155.

91. S. REP. NO. 1622, 83d Cong., 2d Sess. 258, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4621, 4678-80; H.R. REP. NO. 1337, 83d Cong., 2d Sess. A90, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4017, 4063-64.

92. 103 S. Ct. at 1151, 75 L. Ed. 2d at 155.

93. The assignment of income doctrine prevents high bracket taxpayers from shifting income to persons subject to a lower tax rate in order to reduce the overall tax burden on the parties. See *Helvering v. Horst*, 311 U.S. 112, 118-19 (1940); *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930).

94. 103 S. Ct. at 1151, 75 L. Ed. 2d at 155 (citing *Siegel v. United States*, 464 F.2d 891 (9th Cir. 1972), cert. dismissed, 410 U.S. 918 (1973); *Williamson v. United States*, 292 F.2d 524 (Ct. Cl. 1961)).

95. 103 S. Ct. at 1152, 75 L. Ed. 2d at 156.

sion to section 336,⁹⁷ likewise does not override the tax benefit rule.⁹⁸ Because Congress had apparently acquiesced in earlier cases applying this construction of section 337, the Court concluded that Congress intended similar construction for the corresponding language of section 336.⁹⁹ These considerations led the Court to conclude that Bliss could not avoid the tax benefit rule upon liquidation; therefore, the previous deduction was includable in income to the extent of the cost of the grain on hand at the time of liquidation.¹⁰⁰

Justice Stevens, joined by Justice Marshall, concurred in the decision in *Hillsboro* but dissented from the result in *Bliss*.¹⁰¹ The benefits received by the shareholders in both cases, Justice Stevens argued, should not result in income to the corporate taxpayer.¹⁰² Justice Stevens initially disagreed with the Court's formulation of the purpose of the tax benefit rule. As he construed the rule, the determinative factor is whether the taxpayer's wealth has been enhanced by the later event, not whether earlier deductions were proper when viewed in the light of later events.¹⁰³ Relying on the two earlier Supreme Court cases construing the rule,¹⁰⁴ Justice Stevens concluded that application of the tax benefit rule requires a recovery.¹⁰⁵ He further stated that an inconsistent event was not, of itself, sufficient to invoke the operation of the rule.¹⁰⁶ Justice Stevens viewed the majority's formulation of the rule as a rejection of the earlier decision in *Nash v. United States*.¹⁰⁷ Contending that *Nash* requires a recovery, Justice Stevens stated that the Court had established a new hybrid rule falling somewhere between the inconsistent event theory and the recovery theory.¹⁰⁸ The result, he claimed, was an uncertain and inconsistent interpretation of the Code that would only complicate the tax system and increase litigation.¹⁰⁹ Justice Stevens argued that the proper approach to such a change would be through congressional modification of the Internal Revenue

96. I.R.C. § 337 (West 1978 & Supp. 1983).

97. *Id.* § 336 (West Supp. 1983). The Court concluded that § 337 was enacted to create the same consequences as § 336, that is, to allow a corporation nonrecognition of gain or loss in a distribution in liquidation. 103 S. Ct. at 1153, 75 L. Ed. 2d at 157 (citing *Midland-Ross Corp. v. United States*, 485 F.2d 110 (6th Cir. 1973); S. REP. NO. 1622, *supra* note 91, at 258).

98. 103 S. Ct. at 1153, 75 L. Ed. 2d at 157. Among numerous authorities, the Court cited *Conerry v. United States*, 460 F.2d 1130 (3d Cir. 1972), and *Commissioner v. Anders*, 414 F.2d 1283 (10th Cir.), *cert. denied*, 396 U.S. 958 (1969).

99. 103 S. Ct. at 1153, 75 L. Ed. 2d at 157. The Court noted that Congress has made changes in the liquidation provisions but has not changed the application of the tax benefit rule to § 337 liquidations. *Id.*

100. *Id.* at 1154, 75 L. Ed. 2d at 158. The Court remanded for a determination of the amount to be included in income. *Id.*

101. *Id.* at 1163, 75 L. Ed. 2d at 170.

102. *Id.* at 1154, 75 L. Ed. 2d at 158.

103. *Id.*, 75 L. Ed. 2d at 159.

104. *Nash v. United States*, 398 U.S. 1 (1970); *Dobson v. Commissioner*, 320 U.S. 489 (1943).

105. 103 S. Ct. at 1156-58, 75 L. Ed. 2d at 161-63.

106. *Id.* at 1156, 75 L. Ed. 2d at 161.

107. 398 U.S. 1 (1970); *see supra* note 19 and accompanying text.

108. 103 S. Ct. at 1161, 75 L. Ed. 2d at 167.

109. *Id.*, 75 L. Ed. 2d at 166.

Code.¹¹⁰ Finally, Justice Stevens concluded that under his view of the recovery theory, the taxpayers in both *Hillsboro* and *Bliss* would not be required to include the benefits received by the shareholders in income.¹¹¹

Justice Blackmun dissented from the conclusions reached by the Court in both *Hillsboro* and *Bliss*.¹¹² In *Hillsboro* Justice Blackmun examined the legislative history of section 164(e) and reached a different conclusion than the majority. The focus of Congress in enacting section 164(e), according to Justice Blackmun, was on the payment of a legitimate tax rather than on the mere act of payment, as the majority had concluded.¹¹³ If a deduction is taken for tax payments and later events prove that no tax is required, Justice Blackmun stated that a court must apply the tax benefit rule.¹¹⁴ Justice Blackmun's procedure for rectifying the undeserved tax benefit, however, requires correction of the deduction in the year in which it was claimed.¹¹⁵ Since in *Bliss* and *Hillsboro* the later events occurred within two days and two months, respectively, of the beginning of the following tax year,¹¹⁶ Justice Blackmun urged that the most precise and accurate adjustment would be to file an amended return for the year of the original deduction.¹¹⁷ Because an amended return is the easiest and most accurate way to adjust income, Justice Blackmun argued that the tax benefit rule was never intended to be applied "in simple situations of the kind presented in these successive-tax-year cases."¹¹⁸

The fourth opinion, written by Justice Brennan, concurred with the majority in *Bliss* but dissented in *Hillsboro*.¹¹⁹ Although agreeing with the majority's formulation of the tax benefit rule, Justice Brennan took issue with the application of the rule in *Hillsboro*. Justice Brennan agreed with Justice Blackmun's interpretation of congressional intent in enacting section 164(e).¹²⁰ He concluded, therefore, that an adjustment was necessary

110. *Id.* at 1163, 75 L. Ed. 2d at 169.

111. *Id.* at 1154, 75 L. Ed. 2d at 158. Justice Stevens argued that since neither corporate taxpayer recovered its earlier expenditure, neither case involved a recovery giving rise to taxable income. *Id.*

112. *Id.* at 1164, 75 L. Ed. 2d at 170.

113. *Id.*

114. *Id.*

115. *Id.* at 1165, 75 L. Ed. 2d at 172. This method, however, would contradict both well-settled judicial policy and congressional enactments. See generally *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 363 (1931) (a recovery on judgment is required to be included in income in taxable year in which received); *Lexmont Corp. v. Commissioner*, 20 T.C. 185, 191 (1953) (refund of taxes deducted in prior years is includable in income in year refunded); *South Dakota Concrete Prods. Co. v. Commissioner*, 26 B.T.A. 1429, 1432 (1932) (recovery of embezzled amounts charged to expense in previous years is taxable income in year of recovery); I.R.C. § 111 (1976 & Supp. V 1981) (providing for exclusion of portions of recoveries received during taxable year and implying nonexcluded portion is included in income in year recovered).

116. In *Bliss* the dairy adopted a liquidation plan on July 2, 1973, two days after the end of the tax year in which the deduction was taken. In *Hillsboro* the Supreme Court decision resulting in the tax refund was rendered in February 1973, only two months after the end of the 1972 tax year in which the deduction was taken.

117. 103 S. Ct. at 1166, 75 L. Ed. 2d at 173.

118. *Id.*

119. *Id.* at 1154, 75 L. Ed. 2d at 158.

120. *Id.*

to the income of the bank in *Hillsboro*.¹²¹

The Court's holding in *Hillsboro National Bank* and *Bliss Dairy* follows the decisions in the Sixth and Seventh Circuit Courts of Appeals in rejecting an actual recovery requirement for application of the tax benefit rule. The majority did not, however, expressly follow the inconsistent event theory enunciated by those courts. The rule used by the majority does not appear to differ from the formulation of the rule adopted by the Sixth Circuit, but the Court refused to declare a blanket tax benefit rule to be applied in all situations.¹²² Each court should apply the rule only after determining the purpose of the provision granting the original deduction.¹²³ The *Hillsboro* cases formulate the required analysis that must be followed in determining a proper application of the rule.

The Court also clearly indicated in the *Hillsboro* cases that the tax benefit rule will not always override a nonrecognition provision in the Code.¹²⁴ The *Bliss* decision concludes that the rule overrides section 336, but makes no conclusion as to other nonrecognition provisions in the Code.¹²⁵ An analysis similar to that used by the majority is required to determine whether the rule or the nonrecognition provision prevails when another nonrecognition provision is at issue.¹²⁶

The decision in these cases settles the disputes between the circuits as to the proper formulation of the tax benefit rule and the application of the rule in a section 336 liquidation. The Court's opinion in *Hillsboro* and *Bliss* advocating a case-by-case analysis leaves open the possibility, however, that varying decisions will be reached by the different courts. In addition, when cases involving nonrecognition provisions other than sections 336 and 337 arise in different circuit courts, the opportunity for differing results is enhanced.

III. CONCLUSION

In *Hillsboro National Bank v. Commissioner* the United States Supreme Court determined that the tax benefit rule is properly invoked when events occur that are fundamentally inconsistent with an earlier deduction. In applying the rule, the Court emphasized that a determination must be made of the legislative purpose in enacting the particular Code provision giving rise to the taxpayer's original deduction. The Court held that the tax benefit rule overrides the nonrecognition provisions of section 336, based on the Court's interpretation of the underlying legislative intent. In deciding whether the nonrecognition provision or the tax benefit rule prevailed, the Court also relied on the desire for parity of treatment with sec-

121. *Id.*

122. *Id.* at 1144, 75 L. Ed. 2d at 147.

123. *Id.*

124. *Id.* at 1145, 75 L. Ed. 2d at 147.

125. *Id.* at 1153, 75 L. Ed. 2d at 157.

126. The Court expressly stated that the decision in *Bliss* does not determine the outcome in other cases, such as depreciation recapture under I.R.C. §§ 1245, 1250 (1976 & Supp. V. 1981). 103 S. Ct. at 1145 n.20, 75 L. Ed. 2d at 147 n.20; see O'Hare, *supra* note 20, at 216-18.

tion 337, which is overridden by the tax benefit rule. The effect of the *Hillsboro* decisions is not to establish a broad general rule to be applied in all situations, but rather to demonstrate the appropriate analysis to be followed in future applications of the tax benefit rule.

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