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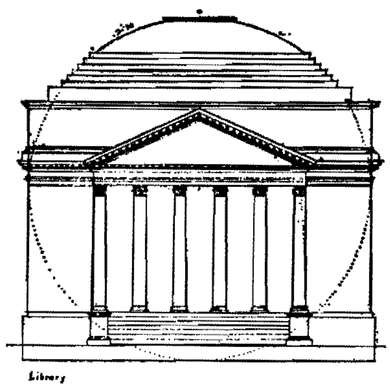

The Legal Authority of the Department of the Treasury to Promulgate a Regulation Providing for Indexation of Capital Gains

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I. Introduction and Summary

One of the recurring recent debates in the field of tax policy involves the question of whether the determination of taxable gain from the sale or exchange of a capital asset should be "indexed" to reflect the effect of inflation on the taxpayer's investment. Until recently, this debate has focused almost exclusively on the economic and political wisdom of amending the Internal Revenue Code ("the Code") to provide for such indexation. In recent months, however, a subsidiary issue has been at times the subject of vigorous debate: Is a statutory amendment necessary for such an indexation scheme to be implemented? Although this latter issue has political overtones, it is, at bottom, a legal question, implicating the permissible bounds of interpreting and applying current Code provisions and the deference to which any such reinterpretation would be entitled in a court challenge.

In this Article, we examine whether the Department of the Treasury ("the Treasury") would have a solid legal foundation for promulgating a regulation under the Code providing for the indexation of capital gains. Although this question is a close and difficult one, involving complex questions of modern administrative law and more than 70 years of legislative history underlying the development of the capital gains provisions of the Code, we conclude that the legal basis for such a regulation is sound and would amply support its conscientious adoption by the Treasury. Indeed, although the arguments against such a reinterpretation are substantial, we believe that the better view is that a regulation indexing capital gains for inflation should and would be upheld judicially as a valid exercise of the Treasury's interpretative discretion under the Code.

At the outset, we emphasize that our analysis of this question depends heavily on the standard of judicial review that would apply to such a regulation if it were to be challenged. The question is not whether a court, were it reviewing the relevant provisions of the Code de novo, would conclude that indexation of capital gains is *required* under the statute. Rather, as discussed in detail below,[1] the question is whether a court, reviewing a Treasury regulation indexing capital gains, would conclude that the agency's regulation was based upon a "permissible" reading of the statute. Obviously, an agency's statutory construction is not permissible if Congress has directly and unambiguously addressed the precise question at issue in a manner that forecloses the agency's interpretation. Apart from this obvious constraint on an administrative agency's interpretive discretion, however, a court must defer to the agency's reading of a statute that it administers if the reading is "plausible" and "reasonable," even if the court's own de novo construction of the statute would differ from the agency's.

At the heart of the inquiry is the statutory meaning of the word "cost" in the capital gains provisions of the Code. The Treasury has consistently interpreted the "cost" of a capital asset to mean the asset's original purchase price and has measured the gain on the asset's sale as the difference (with certain adjustments not relevant here) between its purchase price and its selling price. The question is whether this definition of "cost" is *required* by the Code. If it is not, the question becomes whether an administrative interpretation of "cost" to account for the effects of inflation is "plausible."

For the reasons discussed at length in this Article, we believe that the Treasury has administrative discretion to reinterpret "cost" to take account of the economic reality that a "gain" attributable solely to inflation adds nothing to the taxpayer's *real* wealth or purchasing power.[2] The term "cost" is subject to more than one

[1] See infra notes 22-51 and accompanying text.

[2] It must be noted that other commentators have reached a contrary conclusion. See, e.g., Lawrence Zelenak, Does Treasury Have Authority to Index Basis for Inflation, 55 Tax Notes 841 (May 11, 1992); Tax Section, New York State Bar Association, Memorandum in

reasonable interpretation and is readily amenable to a construction that takes account of inflation. While the Treasury has never construed the language or the legislative history of the Code to allow the term "cost" to include the adverse effects of changes in the general price level, in neither the language nor the legislative history has Congress clearly and directly addressed the "precise issue" of the meaning of "cost" or otherwise evidenced an intent to limit its meaning, for all purposes, to original purchase price. Nor does the legislative history of the Code contain persuasive evidence that Congress intended to deny the Treasury any interpretative discretion to take account of economic considerations other than original purchase price in calculating "cost" for purposes of determining capital gains. To the contrary, the legislative and regulatory history of the Code's capital gains provisions affirmatively demonstrates that the Treasury has exercised, without objection from Congress, regulatory discretion in applying the concept of "cost." The regulations promulgated by the Treasury — especially under the Revenue Act of 1918, the statute which first incorporated the term "cost" in the capital gains provisions — demonstrate that the Treasury did not view itself as confined to a definition of cost limited to original purchase price if use of such a definition would not truly and accurately measure the income of the taxpayer.

In recent years, Congress has on several occasions attempted to amend the Code to provide for the indexation of capital gains. It may be argued from the failure of these recent attempts that Congress has "acquiesced" in the Treasury's current interpretation of "cost" and that therefore the Treasury is foreclosed from reinterpreting that term. Although this point has some force, we believe it represents a fundamental misconception of the nature of the legislative process and its interaction with the administrative state. Moreover, the legislative history of Congress' consideration of such indexation proposals reveals, if anything, that Congress *favors* the concept of indexing capital gains. Indeed, indexation measures

Opposition to Proposal to Index Capital Gains for Inflation by Indexation (Feb. 13, 1992) [hereinafter "NYSBA I"]; Tax Section, New York State Bar Association, Memorandum Re: Capital Gains Indexation by Regulation (Sept. 1, 1992) [hereinafter "NYSBA II"]. See also Linda Galler, Chevron and the Administrative Regulation of Indexation: Challenging the Cooper Memorandum, 56 Tax Notes 1791 (Sept. 28, 1992).

have passed at different times in recent sessions of both the Senate and the House.

Finally, the case law relating to the Treasury's interpretative discretion in the capital gains and analogous contexts supports the conclusions that the concept of "cost" is ambiguous and that the Treasury has administrative discretion to reinterpret "cost" in a manner that better reflects economic reality and accords with the principles underlying the taxation of income. Even though it would constitute a change from the agency's long-standing view, such an administrative reinterpretation would be entitled to substantial judicial deference because it would clearly be both "reasonable" and supported by a "reasoned analysis."

In Part II of this Article we discuss the inequities of the current system of capital gains taxation, in which increases in "value" arising solely from inflation and having no connection to actual, real increases in wealth are nonetheless taxed as income. In Part III we first discuss the modern judicial framework for reviewing administrative interpretations of statutes under general administrative law principles and under more specific principles applying to interpretations of the Code. Such Code interpretations are entitled to substantial deference. We then apply these principles of deference to a Treasury reinterpretation of "cost" that accounts for the effects of inflation on capital gains. In so doing, we review the possible meanings of "cost," and examine in depth the legislative and regulatory history of relevant capital gains legislation, particularly the Revenue Act of 1918. We turn next to a discussion of relevant case law regarding the capital gains provisions of the Code and the Treasury's interpretive discretion. Part III also addresses whether an attempt by the Treasury now to provide for indexation by regulation is foreclosed by Congress' numerous reenactments of the Code over the years, or by Congress' failure to enact indexation legislation on its own. We examine in Part IV whether any such Treasury reinterpretation of the Code would be supported by a reasoned analysis of the law and of tax policy. Part V presents our conclusions as well as some observations regarding potential practical problems that are beyond the scope of this Article.

This Article had its genesis in a comprehensive legal memorandum on this subject prepared by the authors. In early 1992, commentators and columnists suggested that President Bush had within his constitutional authority the power to provide a stimulus to the then-stagnant economy by ordering the Treasury to provide for the administrative indexation of capital gains.[3] Treasury Department attorneys apparently concluded that the Treasury lacked authority under current provisions of the Code to index the basis of capital assets. In the summer of 1992, the National Chamber Foundation, an affiliate of the United States Chamber of Commerce, asked the authors to examine independently the legal authority issue. After conducting an analysis of the Code and its legislative history, as well as of the relevant general principles of administrative law, we concluded in August 1992, that the Treasury would have the authority to index capital gains without an amendment to the Code. The National Chamber Foundation forwarded the authors' legal memorandum to high-ranking officials in the Treasury, the Department of Justice, and the White House. In September, the Justice Department's Office of Legal Counsel prepared an opinion concluding that the Code precludes administrative indexation.[4] President Bush decided against ordering administrative indexation shortly thereafter.[5]

II. Background — the Current System and its Inequities

The Sixteenth Amendment granted Congress "power to lay and collect taxes on incomes, from whatever source derived . . . ."[6] In *Eisner v. Macomber*, the Supreme Court defined the term "income" as " 'the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets . . . ."[7] In the context of a sale of a capital asset, the Court described income as "a gain, a profit, something of exchangeable value, proceeding from the property . . . and . . . received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal."[8]

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[3] See, e.g., Presidential Indexation, Wall St. J., Jan. 28, 1992, at A14.

[4] Memorandum for Jeanne S. Archibald Re: Legal Authority of the Department of the Treasury to Issue Regulations Indexing Capital Gains for Inflation, 16 Op. Off. Legal Counsel 145 (1992) [hereinafter the "OLC Opinion"]. The OLC Opinion was made public in January 1993. (See Appendix).

[5] Steven Mufson and Ruth Marcus, Indexation of Capital Gains Nixed, Wash. Post, Sept. 4, 1992, at F1.

[6] U.S. Const. amend. XVI.

[7] 252 U.S. 189, 207 (1919).

[8] Id. (emphasis omitted). In a later decision upholding the constitutionality of the taxa-

The Code provides that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis."[9] The "amount realized from the sale or other disposition of property" generally is equal to "the sum of any money received plus the fair market value of any property (other than money) received."[10] The "basis" of property is defined generally as "the cost of such property."[11] The Code provides for a number of adjustments to basis for items such as depletion, depreciation, amortization, and certain expenses.[12] This basic structure for the determination of gain or loss on the sale of property has not changed since 1918.

Congress has never defined the term "cost" in the Code, and the regulations issued under the Code ("Treasury Regulations") did not define it until 1957. The Treasury Regulations issued in 1957 defined cost as "the amount paid for . . . property in cash or other property."[13] This regulatory definition of cost remains in place today.

Until 1986 Congress had consistently accorded some form of tax preference to capital gains. For example, from 1922 until 1934, capital gains were fully included in taxable income, but were taxed at a preferential rate. From 1934 until 1986, the preference took the form of a partial exclusion of capital gains from taxable income. Throughout this period, the amount of the capital gains exclusion and the length of time an asset had to be held in order to qualify for exclusion was statutorily adjusted from time to time, but the tax preference for capital gains was always substantial. With the passage of the Tax Reform Act of 1986,[14] the capital gains preference was virtually eliminated. Capital gains are now

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tion of capital gains, the Supreme Court did not consider the question of whether a gain attributable solely to inflation comports with the constitutional meaning of "income" and is thus taxable under the Sixteenth Amendment. Merchants' Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921). But see Hellermann v. Commissioner, 77 T.C. 1361 (1981) (rejecting taxpayer's argument that "gain" caused by inflation is not "income" under the Sixteenth Amendment). The constitutionality of the present scheme of capital gains taxation is beyond the scope of this Article.

[9] I.R.C. § 1001(a).

[10] I.R.C. § 1001(b).

[11] I.R.C. § 1012.

[12] See, e.g., I.R.C. § 1016.

[13] Treas. Reg. § 1.1012-1(a).

[14] Pub. L. No. 99-514, 100 Stat. 2085 (1986).

fully includible in taxable income, and they are taxed at substantially the same rates as ordinary income.

One of the express congressional justifications for the preferential treatment of capital gains has been the adverse effect of inflation on the calculation of capital gains. During periods of high or even moderate inflation, nominal gains realized upon the sale of property may not reflect a true increase in the value of the property at all. Thus, the taxpayer is taxed on the sale even though, in real terms, he has not received any income in the sense of an increase in wealth or purchasing power.

Consider the example of a taxpayer who bought a capital asset for $100,000 in 1982. In 1992, he sells the asset for $200,000. Under the current regime, the taxpayer will be taxed on his "gain" of $100,000. If, however, inflation has caused the general price level to double between 1982 and 1992, the taxpayer has not realized any increase in wealth — that is, an increase in the value of the asset. The $200,000 that he has in 1992 represents the same purchasing power that the $100,000 represented in 1982. The value of the asset has not increased; it has merely kept pace with inflation. In fact, the taxpayer is now worse off than if he had never bought the asset at all, because the tax on the sale of the asset will eat into the nominal gain he received. It is even possible that inflation will have the effect of creating a tax liability for what is in truth a loss. If, for example, the taxpayer had sold the asset in 1992 for $180,000, in real terms he has suffered a ten percent *loss* in purchasing power. It is thus difficult to view the $80,000 increase as "a profit, something of exchangeable value, proceeding from the property . . . and . . . received or drawn by . . . (the taxpayer) for his separate use, benefit and disposal."[15] Yet, the taxpayer will nevertheless be taxed on $80,000 of "gain."

This capital gain taxing scheme not only artificially inflates the profit or "income" being taxed, it also leads to differential taxation of similarly situated taxpayers. According to Nobel Prize winning economist James M. Buchanan, "[o]ne of the most widely accepted principles or norms for the distribution of taxes among individuals states that individuals in similar situations should be treated similarly, or in other words, equals should be treated equally."[16] Rich-

[15] *Eisner*, 252 U.S. at 207.

[16] James M. Buchanan, The Public Finances 165 (1960).

ard and Peggy Musgrave, two of the most widely recognized experts on taxation and public finance, define in practical terms precisely what it means to "treat equals equally:" "The requirement of equal taxes for people in equal positions is also referred to as 'horizontal' equity. Taxpayers are said to be treated equally if their tax payments involve an equal sacrifice or loss of welfare."[17]

Taxing inflationary capital gains clearly violates this basic principle. If, for example, a taxpayer bought $1,000 of stock invested in the Standard and Poor's 500 index in 1970, that stock would have sold for $3,677 in late 1990. This would have resulted in a taxable capital gain of $2,677. At the current 28 percent tax rate, the taxpayer would have paid $750 in tax. However, inflation since 1970 has been over 218 percent. This means the taxpayer's real gain was only $257. The taxpayer was taxed $750 on a real gain of $257 for a tax rate of 292 percent. In short, the taxpayer sacrificed almost three times his real gain or purchasing power to the government in taxes. Another individual who purchased $1,000 of stock in 1989 and sold it one year later for $1,268 also would have realized a real gain of $257 since inflation, as measured by the Gross Domestic Product price deflator, was 4.1 percent in 1990. At the current 28 percent tax rate, this taxpayer would have paid $75 in taxes. The first taxpayer, who realized an identical increase in his income, sacrificed in taxes 10 times the purchasing power compared to the second taxpayer, a clear violation of the principle of horizontal equity.

The most direct way to counter the impact of inflation is to index capital gains.[18] The indexation of capital gains would involve adjustment of the basis of the asset to reflect changes in the general price level due to inflation (or deflation).[19] To use the first example discussed above, when the 1982 purchaser sold his asset in 1992 for $200,000, his basis in the asset, which was $100,000, would

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[17] Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice 216 (2d ed. 1976).

[18] Section 1012 of the Code supplies a basis rule for all property, not just capital assets. The indexation of basis in § 1012 could therefore affect the determination of gain or loss for some types of ordinary income, such as gain on the sale of real estate lots held by a real estate developer. Unlike most types of ordinary income, such as salaries and wages, inflation affects this type of income in exactly the same way as it affects capital gains.

[19] We have not examined the merits of various indexing schemes. Past proposals have suggested the use of the Consumer Price Index or a GNP deflator.

be adjusted to reflect the cumulative rate of inflation over the previous ten years (i.e., 100%). Thus, his new basis would be $200,000, and he would have no gain for federal income tax purposes because he would have no real increase in wealth. If he had sold the asset for $250,000, he would have recognized a $50,000 capital gain.

The Code currently provides for the indexation of tax brackets for individuals as well as for the indexation of the standard deduction and personal exemptions for individual taxpayers.[20] In recent years, there have been several proposals in Congress to provide for the indexation of capital gains. While such proposals have passed at different times in both the House and Senate, none have been enacted.[21]

III. The Legal Authority of the Treasury to Index Capital Gains

In general terms, the Treasury's legal authority to index capital gains turns on the scope of its administrative discretion under the Code. As previously noted, the Code's measurement of capital gains revolves around the concept of "basis," which is in turn defined as "cost." The Treasury has interpreted "cost" to refer to historical or original cost only — i.e., the actual amount paid for the asset. The issue is not whether this interpretation of "cost" for measuring capital gains is a permissible exercise of the Treasury's regulatory discretion. It is undoubtedly so. The issue, rather, is whether the Treasury's "purchase price" understanding of "cost" is required — that is, whether it is the *only* permissible means of measuring capital gains income consistent with the Code. If it is not, the question becomes whether there is a "reasoned and lawful basis" for reinterpreting cost to reflect the effect of inflation.

Over the last 20 years, the Supreme Court has made clear that an agency is afforded wide latitude in interpreting and construing the provisions of a statute the agency administers. There is also ample precedent for the proposition that an agency interpretation is entitled to strong deference even when it represents a change from a previous interpretation. Indeed, numerous judicial decisions have upheld Treasury regulations that have reinterpreted Code

[20] See, e.g., I.R.C. § 1(f)-(g).
[21] See discussion infra notes 151-171 and accompanying text.

provisions in circumstances analogous to those present here. The framework for analyzing the issue under study is provided by the Supreme Court's landmark *Chevron* decision.

A. The Standard for Reviewing Administrative Interpretations — The Chevron *Doctrine*

In *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*,[22] the Supreme Court announced a rule of judicial deference to agency constructions of statutes. The *Chevron* analysis involves a two-step inquiry:

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. 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, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[23]

The *Chevron* doctrine is premised on the simple and unremarkable proposition that the agency, rather than a court, is the appropriate body to "'fill any gap left, implicitly or explicitly, by Congress.'"[24] The agency has the congressionally delegated responsibility to administer the terms of the statute based upon the agency's technical and policy expertise. The *Chevron* doctrine allows the agency to administer its organic statute in the manner that best fulfills its statutory mandate and the policies reflected in the law. Whether a reviewing court, were it examining the issue de novo, would agree with the agency's interpretation is not the issue. "The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[25] Rather, the

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[22] 467 U.S. 837 (1984).

[23] Id. at 842-43.

[24] Id. at 843 (quoting Morton v. Ruiz, 415 U.S. 199, 231 (1974)).

[25] Id. at 843 n.11. See also Pauley v. BethEnergy Mines, Inc., 111 S. Ct. 2524, 2534 (1991)

agency's construction "may not be disturbed as an abuse of discretion if it reflects a plausible construction of the plain language of the statute and does not otherwise conflict with Congress' expressed intent."[26] In short, then, the Treasury's construction of ambiguous Code terms is entitled to "substantial deference."[27]

The Supreme Court's recent decision in *Rust v. Sullivan* makes clear that even though indexing capital gains represents a change in the Treasury's long-standing interpretation of the Code, this change does not eliminate the deference due to the agency's new construction.[28] In that case, the Court upheld regulations of the Department of Health and Human Services ("HHS") which limited the ability of fund recipients to engage in abortion-related activities. The petitioners argued "that the regulations are entitled to little or no deference because they 'reverse a longstanding agency policy . . .' and thus represent a sharp break from the Secretary's prior construction of the statute."[29] The Court rejected this argument, holding that the agency's interpretation was entitled to judicial deference under *Chevron* despite its "sharp break" with prior interpretations of the statute.[30]

Chevron itself involved a change in an agency interpretation. In *Chevron*, a new presidential administration took office and initiated the change in the interpretation of the statutory term ("stationary source") at issue.[31] Nevertheless, the Supreme Court accorded the new interpretation deference:

> The fact that the agency has from time to time changed its interpretation of the term "source" does not, as respondents argue, lead us to conclude that no deference should be accorded the agency's interpretation of the statute. An initial agency interpretation is not instantly carved in stone. *On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations*

("When Congress, through express delegation or the introduction of an interpretive gap in the statutory structure, has delegated policymaking authority to an administrative agency, the extent of judicial review of the agency's policy determinations is limited.").

[26] Rust v. Sullivan, 111 S. Ct. 1759, 1767 (1991).

[27] Id.

[28] Id.

[29] Id. at 1768.

[30] Id. at 1769. See also Cross-Sound Ferry Serv., Inc. v. ICC, 873 F.2d 395, 398 (D.C. Cir. 1989) (agency "has great latitude in determining the scope of [statutory term] and in modifying it from time to time as the [agency] sees fit").

[31] 467 U.S. at 857-58.

and the wisdom of its policy on a continuing basis.[32]

A central premise of the Court's decision in *Chevron* is that the popularly elected executive (or his designate) may adopt and implement reasonable policy choices within the discretion the statute entrusts to him, and that changes in such policy choices are the natural and predictable outgrowth of the political process. The judiciary is not to interfere with such legitimate policy choices:

> Judges are not experts in the field, and are not part of either political branch of the Government. Courts must, in some cases, reconcile competing political interests, but not on the basis of judges' personal policy preferences. In contrast, an agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments. While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices — resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities. When a challenge to an agency construction of the statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail. In such a case, federal judges — who have no constituency — have a duty to respect legitimate policy choices made by those who do.[33]

Of course, the fact that the agency interpretation represents a change from a previous interpretation is not irrelevant. The agency must provide a "reasoned analysis" of the change in policy or interpretation.[34] But so long as the agency's new policy is supported by a "reasoned analysis," it is entitled to no less judicial deference than the policy it replaces.[35]

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[32] Id. at 863-64 (emphasis added).

[33] Id. at 865-66. See also Michigan Citizens for an Indep. Press v. Thornburgh, 868 F.2d 1285, 1293 (D.C. Cir. 1989), aff'd without opinion by equally divided Court, 493 U.S. 38 (1989).

[34] *Rust*, 111 S. Ct. at 1769 (quoting Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 42 (1983)). See also Black Citizens for a Fair Media v. FCC, 719 F.2d 407, 417 n.25 (D.C. Cir. 1983), cert. denied, 467 U.S. 1255 (1984).

[35] The Supreme Court has not been entirely consistent on this issue. For example, in *Pauley* the Court stated in dictum that "[a]s a general matter, of course, the case for judi-

The Supreme Court has stated in dictum that the *Chevron* deference rule applies only in cases of the application of law to fact and not to "pure" questions of law.[36] Regardless of the validity of this dictum, which has been criticized,[37] the question of the application of "cost" to property whose value has been affected by inflation is probably not a pure question of law.

The Court has not expressly addressed whether the *Chevron* doctrine applies to Treasury interpretations of the Code. Several lower courts, as well as the Tax Court, recently applied *Chevron* to Treasury regulations.[38] It is unsurprising that many courts have not felt the need to explicitly decide *Chevron's* application, because, as will be discussed in the next section, courts already operate under decades-old precedent that independently compels deference to Treasury interpretations.[39] In any event, there is no

cial deference is less compelling with respect to agency positions that are inconsistent with previously held views." 111 S. Ct. at 2535. The fact that this dictum was announced within a month of the contrary holding in *Rust* does not make the analysis of this issue any simpler. The cryptic *Pauley* dictum does not require, however, that there be no deference or less deference accorded to changes in agency interpretations; the statement that the case for deference in such situations is "less compelling" may be read to mean that the agency has a burden to explain the reasons for its change, but once explained, the interpretation is entitled to deference under *Chevron*. See *State Farm*, 463 U.S. at 42.

[36] INS v. Cardoza-Fonseca, 480 U.S. 421, 446 (1957). See Union of Concerned Scientists v. NRC, 824 F.2d 108, 113 (D.C. Cir. 1987) (same). But see Central States Motor Freight Bureau, Inc. v. ICC, 924 F.2d 1099, 1102 (D.C. Cir.), cert. denied, 112 S. Ct. 87 (1991) (rejecting argument that *Chevron* deference is inappropriate for "purely legal" issues). See also Timothy B. Dyk & David Schenck, Exceptions to Chevron, 18 Admin. L. News, No. 2 at 1 (1993) ("While *Cardoza-Fonseca* has not been overruled, its broad implications have been ignored in numerous cases where the Court has applied the deferential *Chevron* approach to purely legal questions."). The OLC Opinion relies on the *Cardoza-Fonseca* dictum. See OLC Opinion, supra note 4, at 149 n.6, 151.

[37] *Cardoza-Fonseca*, 480 U.S. at 454-55 (Scalia, J., concurring).

[38] See, e.g., RJR Nabisco v. United States, 955 F.2d 1457, 1464 (11th Cir. 1992); Peoples Fed. Sav. & Loan Ass'n v. Commissioner, 948 F.2d 289, 299-300 (6th Cir. 1991); Georgia Fed. Bank, F.S.B. v. Commissioner, 98 T.C. 105, 107-08 (1992).

In a very recent case, Justice Souter, in a dissent joined by three other justices, cited *Chevron* for the proposition that Treasury interpretations of the Code are entitled to deference. Newark Morning Ledger Co. v. United States, 113 S.Ct. 1670, 1686 (1993) (Souter, J., dissenting). The majority opinion in *Newark Morning Ledger* assumed the validity of the Treasury regulation at issue and thus had no opportunity to address the applicability of *Chevron*. The majority did not express disagreement with the dissent's citation of *Chevron*.

[39] See Pacific First Fed. Sav. Bank v. Commissioner, 961 F.2d 800, 803 (9th Cir. 1992) ("We need not decide whether *Chevron* applies to the regulations in this case, however, because the traditional rule of deference to Treasury regulations supports our decision to uphold the challenged regulation.").

logical reason why Treasury regulations interpreting Code provisions would be entitled to less deference than would the interpretations by other administrative agencies of their organic statutes.[40]

B. Treasury Interpretations of the Code Are Entitled to Judicial Deference

Section 7805(a) of the Code provides a general delegation of rulemaking authority to the Secretary of the Treasury:

> Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.[41]

It is clear that deference is to be accorded to regulations promulgated by the Treasury pursuant to section 7805(a). The courts, however, have not consistently expounded the extent and scope of this deference. There is authority to the effect that interpretive regulations promulgated pursuant to section 7805(a) are entitled to less deference than "legislative" regulations promulgated pursuant to a specific grant of rulemaking authority.[42] Other cases, however, have not distinguished between legislative and interpretive rules with respect to this issue.[43] Of course, *Chevron* itself announced a rule of strong deference to agency regulations *interpreting* a statute.[44]

Regardless of the amount of deference accorded to legislative regulations, it is clear that considerable deference is due interpretive regulations. In *Cottage Savings Association v. Commissioner*,

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[40] See *RJR Nabisco*, 955 F.2d at 1464 ("The Supreme Court has been particularly deferential in the area of tax laws," especially in light of the delegation of rulemaking authority found at IRC § 7805(a).). See also OLC Opinion, supra note 4, at 147 n.4 ("*Chevron* provides the framework for analyzing this issue . . . .").

[41] I.R.C. § 7805(a).

[42] See Rowan Cos. v. United States, 452 U.S. 247, 253 (1981); United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 (1982); Water Quality Ass'n Employees' Benefit Corp. v. United States, 795 F.2d 1303, 1305 (7th Cir. 1986).

[43] See 4 Borris I. Bittker and Lawrence Lokken, Federal Taxation of Income, Estates and Gifts § 110.4.2, at 110-38 (2d ed. 1992) ("[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.") (citations omitted).

[44] 467 U.S. at 842-43.

a recent case reviewing Treasury regulations interpreting the realization requirements of the Code with regard to gains and losses on dispositions of property, the Supreme Court deferred to interpretive IRS regulations issued under section 7805(a).[45] In upholding the regulation, the Court observed:

> Because Congress has delegated to the Commissioner the power to promulgate "all needful rules and regulations for the enforcement of [the Internal Revenue Code]," 26 U.S.C. § 7805(a), we must defer to his regulatory interpretations of the Code so long as they are *reasonable*.[46]

This statement is merely the latest in a long line of judicial pronouncements according deference to interpretive regulations promulgated under section 7805(a). In *Bob Jones University v. United States*, the Court noted that "ever since the inception of the [Code], Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws . . . . This Court has long recognized the primary authority of the IRS and its predecessors in construing the Internal Revenue Code."[47] The Court characterized the agency's rulemaking authority under section 7805(a) as "essential to efficient and fair administration of the tax laws."[48]

This principle was perhaps most forcefully stated in *United States v. Correl*.[49] In *Correl* the Supreme Court upheld a longstanding Treasury rule requiring that in order to deduct the cost of meals, a taxpayer traveling on business must stop for sleep or rest during his trip. In upholding this rule, the Court expressed the

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[45] 111 S. Ct. 1503, 1508 (1991). These regulations defined a statutory term — "disposition" of property — to include a requirement that the property be exchanged for cash or for "materially different" property. This requirement was recognized in neither the language nor the legislative history of the statutory term.

[46] Id. (emphasis added).

[47] 461 U.S. 574, 596 (1983).

[48] Id. See also Bingler v. Johnson, 394 U.S. 741, 750 (1969) (Treasury regulations " 'must be sustained unless unreasonable and plainly inconsistent with the revenue statutes,' and 'should not be overruled except for weighty reasons.' ") (quoting Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948)); Lykes v. United States, 343 U.S. 118, 127 (1952) (Treasury regulation "entitled to substantial weight"); Brewster v. Gage, 280 U.S. 327, 336 (1930) ("It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons.").

[49] 389 U.S. 299 (1967).

principles of deference governing its review in language remarkably similar to that used by the *Chevron* Court seventeen years later:

> Alternatives to the Commissioner's sleep or rest rule are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts to make the appropriate adjustments." *Commissioner v. Stidger*, 386 U.S. 287, 296 . . . . The rule [sic] of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.[50]

Thus, it is well established that interpretive regulations promulgated pursuant to section 7805(a) are entitled to substantial judicial deference.[51]

C. *The Treasury Has Discretion to Index Capital Gains for Inflation*

In applying the foregoing principles to the proposed indexation regulation, the initial inquiry is whether the Treasury has express or implied interpretive discretion regarding the statutory terms at issue. In terms of the *Chevron* doctrine, the question is whether

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[50] Id. at 306-07.

[51] There have been cases refusing to accord deference, or according less deference, to Treasury regulations interpreting statutory provisions for which the Code provides a *detailed* definition of the term. See, e.g., *Vogel Fertilizer*, 455 U.S. at 24; Thomas Int'l Ltd. v. United States, 773 F.2d 300, 303 (Fed. Cir. 1985), cert. denied, 475 U.S. 1045 (1986). This principle has little application here since "cost" is not defined in the Code and "basis" is defined only by reference to cost. See supra note 11 and accompanying text. There have also been a number of cases refusing to defer to statutory constructions that are unreasonable or impermissible. See, e.g., Commissioner v. Engle, 64 U.S. 206 (1984); United States v. Cartwright, 411 U.S. 546, 550 (1973) (The deference "principle is to set the framework for judicial analysis; it does not displace it. We find that the contested regulation is unrealistic and unreasonable."); City of Tucson v. Commissioner, 820 F.2d 1283, 1290 (D.C. Cir. 1987); *Water Quality Ass'n*, 795 F.2d at 1309, 1313. To be sure, neither the *Chevron* principle nor the *Correl* line of cases according deference to interpretive regulations under § 7805(a) can be entirely successful in divorcing the predilections of judges from the standard of review. Nonetheless, these deference principles are designed to ensure that such occurrences are the exception and not the norm.

Congress has explicitly (by express delegation) or implicitly (by failing to speak directly and clearly to the precise question at issue) delegated authority to the Treasury to interpret the statute.[52]

1. The Term "Cost" Is Ambiguous and Amenable to a Construction that Accounts for Inflation

There are several points in the *Chevron* analysis that are elastic enough to allow judicial maneuvering. One of these is the question of statutory ambiguity. The Supreme Court has not conclusively clarified just how ambiguous a statute must be in order for the agency construction to be entitled to deference. At times, members of the Court have indicated that an agency construction should prevail if the statute is "arguably ambiguous."[53] At other times, the Court has seemed to require a higher standard of ambiguity.[54] One commentator has opined that the mere fact that a plausible alternative view of the meaning of a term is available is not enough to trigger *Chevron* deference.[55] The Court, however, has deferred to an agency construction when the statutory term is capable of being interpreted in a plausible alternative manner.[56] Whatever the precise standard, there are cases according deference to Treasury interpretations of Code terms that are no more ambiguous than the terms at issue here.[57] We believe that, although the question is close, the Treasury has interpretive discretion in this case.

"Adjusted basis" is the most immediately operative term in the computation of gains from the disposition of property. Section 1001(a) of the Code provides that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011." Section 1011(a) provides the general rule for determining the ad-

[52] *Chevron*, 467 U.S. at 843-44.

[53] K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 293 n.4 (1988) (opinion of Kennedy, J.).

[54] *Cardoza-Fonseca*, 480 U.S. at 448 (rejecting agency interpretation of "well-founded fear").

[55] Cass R. Sunstein, Law and Administration After Chevron, 90 Colum. L. Rev. 2071, 2091-93 (1990).

[56] National R.R. Passenger Corp. v. Boston and Maine Corp., 112 S. Ct. 1394, 1401-02 (1992) ("required").

[57] See, e.g., *Cottage Savings*, 111 S. Ct. at 1507-08 ("disposition of property"); Helvering v. Reynolds, 313 U.S. 428, 433 (1941) ("acquisition"). See also Drummond Coal Co. v. Hodel, 796 F.2d 503, 505 (D.C. Cir. 1986), cert. denied, 480 U.S. 941 (1987) ("coal produced"). See discussion, infra notes 194-99 and accompanying text.

justed basis of property:

> The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under Section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.[58]

Section 1012, in turn, equates "basis" with the "cost of such property."[59] While "cost" also appears in numerous places throughout the Code, the term, unlike "basis," is nowhere in the Code separately defined. Accordingly, the basic question under *Chevron* is whether the term "cost" is amenable to a construction that takes account of inflation.

We believe that the meaning of "cost" is sufficiently ambiguous to permit the exercise of administrative discretion and that interpreting this term to refer to the true economic consequences of the taxpayer's investment — that is, the taxpayer's gain or loss of *real* income or spending power — is at least as "plausible" and "reasonable" as interpreting it to refer only to the *nominal* dollars expended to purchase the asset.[60] Indeed, the only difference between these two definitions is that the former measures "cost" at the time the capital asset is sold, while the latter measures it at the time the asset was purchased.

The Random House Dictionary defines cost as follows: "1) the price paid to acquire, produce, accomplish, or maintain anything . . . 2) an outlay or expenditure of money, time, labor, trouble, etc.: What will the cost be to me?, 3) a sacrifice, loss or penalty: to work at the cost of one's health."[61] Accordingly, under a standard definition of "cost," the Code directs that capital gains are to be measured by determining the difference between the taxpayer's "loss," "sacrifice," or "expenditure" represented by the asset and the money he has realized through its sale. Any such

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[58] I.R.C. § 1011(a).

[59] I.R.C. § 1012.

[60] See Edgar K. Browning and Jacquelene M. Browning, Microeconomic Theory and Application 195 (2d ed. 1986) (cost refers not just to expenditures of money, but also to "sacrificed alternatives").

[61] Random House Dictionary of the English Language 457 (2d ed. 1987).

"loss," "sacrifice," or "expenditure" needs to be ascribed a monetary value in order to determine the gain realized. The issue, then, is whether Congress specifically intended that a taxpayer's cost be measured solely by the nominal dollars expended at the time of purchase or, rather, whether the monetary value of the expenditure represented by the asset may be assessed at the time the asset is sold and the taxable event occurs. We can discern nothing in the standard definition of "cost," or in any language of the Code, suggesting that the historical "purchase price" measurement of monetary value must be used instead of a measurement that coincides with the sale of the asset.[62] Both methods of measurement are straightforward assessments of the taxpayer's "cost," differing only in the time at which such "cost" is measured. The language of the statute provides no indication that one method must be used rather than the other.[63]

We can discern no reason why a historical measurement of cost is more appropriate or reasonable than measuring cost at the time the asset is sold. To be sure, measuring the monetary value of cost at the time of purchase is a more convenient and readily discernible basis for assessing cost since it looks to the actual purchase price. Aside from administrative convenience, however, the Treasury's approach has little to commend it. This simple and convenient measurement of cost has the significant drawback of failing to

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[62] The OLC Opinion seizes upon this observation to argue that measuring "cost" at the time of sale would create an inconsistency with other provisions of the Code, such as the provision governing the depreciation deduction, that depend upon the "cost" of the asset. See OLC Opinion, supra note 4, at 159-60. According to the OLC Opinion: "If Treasury reinterpreted cost to require that cost be measured at the time of the asset's sale, . . . the taxpayer (and Treasury) would have no basis on which to calculate the proper deduction." Id. at 160. Under our analysis the Treasury has authority to measure "cost" at the time of any relevant event for tax purposes. This Article focuses on the measurement of gain or loss from the sale of an asset; for such purposes, we submit that the Treasury would be well within its discretion to measure "cost" at the time of the sale. This is not in the least inconsistent, however, with the measurement of "cost" at different times for different tax purposes. For example, in figuring the basis of an asset for purposes of the depreciation deduction, the "cost" of the asset would be measured at the time of the deduction, allowing "cost" to reflect changes in the price level between the time of purchase and the time the deduction is taken.

[63] The OLC Opinion asserts that the presence of these alternative definitions do not create a "*relevant* ambiguity" because none defines "cost" as "purchase price adjusted for inflation." OLC Opinion, supra note 4, at 155 (emphasis in original). This superficial analysis ignores that the concepts of "loss" or "sacrifice" are themselves broad enough to comprehend a real versus a nominal measure of cost.

accurately assess the taxpayer's true cost and the real income or "gain" realized by the sale of the capital asset. Focusing on the nominal dollars expended as the measurement of cost, rather than on what the dollars would purchase at the time the capital gains are measured, falsely understates the genuine cost to the taxpayer and falsely inflates the "gain" being taxed.

Under standard economic analysis, the assessment of financial "sacrifice," "loss," or "cost" is the extent to which the taxpayer's purchasing power has been diminished.[64] Returning to our prior hypothetical, a buyer of a $100,000 capital asset in 1982 has expended his purchasing power by $100,000 in 1982 terms. But ten years later, the purchasing power represented by that same capital asset (assuming 100% cumulative inflation over ten years) is now $200,000. The financial "cost" to the purchaser in 1982 has doubled by 1992, and a sale of the asset increases the taxpayer's purchasing power only if, and to the extent, he realizes more than $200,000 in return for it. Equating cost with purchase price ignores this economic reality, and yields capital "gains" that are wholly fictional — that do not truly represent, in the Supreme Court's words, "a profit, something of exchangeable value."[65] Obviously, measuring the cost of an asset at the time of sale more accurately assesses the taxpayer's true income or gain. Moreover, this more accurate measurement of cost eliminates differential taxation of short-term and long-term holders of capital assets, which results from treating a sum expended in 1982 for a capital asset as if it were no less valuable than the same sum expended in 1992.

By way of another example, consider a taxpayer who purchased in 1982 1,000 shares in an oil exploration company at $10 per share. In 1992, he sells the stock for $20,000 and is taxed on his "gain" of $10,000. If, however, inflation has caused the general price level to double during the decade, the taxpayer has not realized any increase in wealth at all — $20,000 in 1992 represents the same purchasing power that $10,000 represented in 1982. In fact, the taxpayer is worse off than if he had not bought the stock, since the tax on its sale will eat into his nominal "gain." If the taxpayer had sold the stock for less than $20,000 — say $18,000 — in real

[64] See, e.g., John Eatwell, et al., The New Palgrave - A Dictionary of Economics 343-45 (1987).

[65] *Eisner*, 252 U.S. at 207.

terms he would have suffered a 10 percent *loss* in purchasing power, yet he would be taxed on an $8,000 "gain." Equating "cost" with purchase price thus ignores economic reality, yielding capital "gains" that are in truth losses and imposing "income" taxes that are in truth capital levies.[66]

Nor does a "purchase price" definition of "cost" square with common sense and tax fairness. Suppose that six months ago a second taxpayer also purchased 1,000 shares in the oil exploration company at $10 per share. If the company struck oil last month, and both taxpayers sold their stock for $20,000 today, would the "cost" of their investments be the same? The first taxpayer, who held his stock ten years longer, would certainly not think so. Would taxing them the same be fair?

The Office of Legal Counsel believes that when people ordinarily use the term "cost," they are referring exclusively to purchase price or original price. According to OLC:

> If one were asked "How much did your car cost?," a response simply that "the car cost $10,000" would be considered truthful only if that amount were at least a close approximation of the actual price paid at the time of purchase. In contrast, a response based on some specialized meaning of the term "cost" (such as cost expressed in inflation-adjusted dollars or net of trade-in value) would be perceived as not responsive to the question. Indeed, such a response would be viewed as truthful only if the respondent were careful to point out that he was using the term in other than its normal and plain meaning.[67]

To be sure, people do not normally express themselves in "infla-

[66] The OLC Opinion criticizes our reliance on economic concepts in demonstrating the ambiguity inherent in the Code's "cost" provision, arguing that the ordinary, lay meaning of "cost," and not some "specialized, technical" meaning, controls. OLC Opinion, supra note 4, at 149. See id. at 156 ("[T]he meaning to be given 'cost' must be the 'common and ordinary' meaning of that word — not its purported meaning in the jargon of economists."). Whatever the merits of the view that specialized economic "jargon" does not control interpretation of the Code, the economic analysis presented above cannot seriously be characterized as "specialized, technical" "jargon." Understandings of "cost" ranging far beyond historical price can be found in lay dictionaries. See supra note 61 and accompanying text. Perhaps more importantly, it is the rare lay person who does not understand the effects of inflation on his purchasing power, and how inflation can be a "cost" of holding onto an asset. While economic analysis confirms this understanding of "cost," this does not remove that understanding from the realm of common sense.

[67] See OLC Opinion, supra note 4, at 154.

tion-adjusted dollars" when discussing "cost" or any other economic concept. But they plainly do find ways, in everyday language, to account for inflation when inflation is relevant to the discussion.

In everyday parlance, the cost of an item is typically expressed by referring to the real value of the economic sacrifice needed to obtain the item. The true cost of an item may thus have only marginal connection to the item's purchase price. In such cases, the description of the "cost" of the item usually includes a temporal reference to emphasize the economic effect of the passage of time. For example, asking a homeowner "How much did your house cost?" will invariably elicit not only the purchase price but also when the house was bought. The naked statement "my house cost $50,000" would not be considered responsive if the house were located in a neighborhood in which similar homes were selling at $200,000, and would doubtless evoke the question "When did you buy it?" Returning to the question posited in the OLC Opinion, "How much did your car cost?," it seems clear that "a response simply that 'the car cost $10,000' " would be meaningful only if the questioner was already in possession of relevant information, such as the car's make and model and, most critically, when it was purchased. If the questioner does not know this information, he will undoubtedly ask for it in order to make the purchase price response suggested in the OLC Opinion intelligible. If the questioner already knows the car's make and model and when it was purchased, a response identifying only the car's purchase price may be sufficient. The questioner can then call upon his everyday experience in assessing the value of the car when it was purchased and the effect of the passage of time on the car's current value. In these ways, our language reflects economic reality and common sense.

In short, it is fully consistent with the normal understanding of the term "cost" to measure the asset in terms of the purchasing power it represents in real dollars at the time of the sale rather than in nominal dollars at the time of the purchase. Moreover, measuring costs and gain at the same time can be argued to better serve the general purposes of the Code by more accurately assessing real income and by furthering the principle of horizontal equity.[68] Accordingly, the language and structure of the Code support

[68] See supra notes 16-17 and accompanying text. See also I.R.C. § 446(b) (accounting

a measurement of capital gains that takes account of the effect of inflation on historical purchase price and the extent to which that inflation overstates the true "income" realized from a capital asset sale.

This conclusion is reinforced by the fact that "cost" or similar terms in other statutes have been construed to permit, or even require, accounting for inflationary effects. For example, in *Mercy Community Hosp. v. Heckler*,[69] the Eleventh Circuit Court of Appeals applied a cost provision in such a way as to require the agency to take account of inflation in the Medicare context. Under the Medicare regime, health care providers are reimbursed their "reasonable costs" incurred in providing covered services to Medicare beneficiaries, including depreciation of hospital land and buildings.[70] In *Mercy*, the provider sold the hospital's assets for an amount greater than their net book value, which reflected the depreciation expense reimbursed by HHS. Pursuant to its regulations, HHS argued that, because the provider recognized a gain over the net book value, it must necessarily have incurred fewer costs than it had calculated, and that it had therefore received excessive reimbursement. The Eleventh Circuit rejected HHS' view, stating:

> The subsequent sale of the unconsumed remainder of the depreciable assets at a price in excess of the depreciated book value does not necessarily imply, as the Secretary seems to argue, that the provider did not actually incur some portion of the cost it was reimbursed with the consumption of the asset before it was sold.
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> * * *
>
> *The monetary value of depreciable assets may also increase as the assets are being consumed simply because of the effect on market values of inflation.*[71]

Whatever the validity of the *Mercy* court's holding that the statute *required* the agency to take account of a factor such as inflation,[72]

methods must clearly reflect income).

[69] 781 F.2d 1552 (11th Cir. 1986).

[70] Id. at 1553-54.

[71] Id. at 1557 (emphasis added).

[72] A number of other cases have held that HHS did not act unreasonably in applying the recapture rules struck down in *Mercy*. See, e.g., Creighton Omaha Regional Healthcare v. Sullivan, 950 F.2d 563, 565 (8th Cir. 1991), and cases cited therein. Of course, these cases cannot be read to hold that the agency would have acted unreasonably if it had taken infla-

the court's analysis certainly supports the view that the term "cost" *may* be so construed by the relevant enforcement agency.[73]

Similarly, the Seventh Circuit upheld the Copyright Royalty Tribunal's creation of an automatic inflation adjustment mechanism for jukebox royalty rates pursuant to the Tribunal's statutory authority to establish "reasonable" rates.[74] The court upheld this adjustment, reciting that "a cost of living or other inflation adjustment designed to maintain the real value of the fee set by the Tribunal is not prohibited but is instead affirmatively supported by the language of the Act."[75] The court came to this conclusion even though other portions of the copyright law covering different industries, such as cable television, specifically required adjustments for inflation and no such express requirement is contained in the part of the Act covering jukebox royalties.[76]

Our analysis of the ambiguity of the Code's "cost" provision closely parallels the analysis of the Supreme Court in one of its most recent cases applying *Chevron*. In *National Railroad Passenger Corp. v. Boston and Maine Corp.*, the Court deferred to an agency definition of a statutory term — "required" — that is no more ambiguous than "cost." The Court stated initially that if statutory text is "open to interpretation in some respects," it is ambiguous.[77] In reaching its conclusion, the court emphasized that a dictionary definition of "required" supported the agency's inter-

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tion into account.

[73] The OLC Opinion dismisses the *Mercy* case as "largely irrelevant to understanding the intent of Congress in enacting the Internal Revenue Code." See OLC Opinion, supra note 4, at 164 (referring to two cases in the NCF memorandum). The OLC Opinion's recognition that the term "cost" may have various meanings in different statutes seems inconsistent with its dictionary-driven position that a court is bound to adopt the term's "common and ordinary meaning, that is, price paid in nominal dollars not adjusted for inflation." Id. at 168.

[74] Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal, 676 F.2d 1144 (7th Cir.), cert. denied, 459 U.S. 907 (1982).

[75] Id. at 1155.

[76] See id. at 1146-49. See also National Cable Television Ass'n v. Copyright Royalty Tribunal, 724 F.2d 176 (D.C. Cir. 1982). Moreover, monetary damages awards, which are obviously designed to compensate for the financial worth of the victim's injuries, routinely take account of the effect of inflation when calculating lost future earnings. See, e.g., Jones & Laughlin Steel Corp. v. Pfeifer, 462 U.S. 523 (1983). This is so even though such calculations must prospectively speculate about the rate of future inflation — an administrative difficulty not present in the capital gains context.

[77] *Boston and Maine*, 112 S.Ct. at 1401-02. See also id. at 1401 ("If the agency interpretation is not in conflict with the plain language of the statute, deference is due.").

pretation: "The existence of alternative dictionary definitions of the word 'required,' each making some sense under the statute, itself indicates that the statute is open to interpretation."[78]

The OLC Opinion almost completely ignores the *Boston and Maine* application of the *Chevron* doctrine, relegating the decision to a brief discussion in a footnote.[79] Instead, the government's attorneys rely on the fact that dictionaries use purchase price as the primary definition of "cost," and accord secondary status to other, broader definitions of the term.[80] According to the OLC Opinion, because the first definition of "cost" listed in dictionaries is purchase price, it follows that purchase price is the "ordinary, contemporary, common meaning" of the term.[81] Thus, courts must construe "cost" to mean purchase price under the plain meaning doctrine.

To apply literally OLC's formalistic rule would, of course, vitiate the *Chevron* doctrine. A reviewing court could ignore all but the first definition of a term listed in the dictionary, conclude that the term was unambiguous notwithstanding "[t]he existence of alternative dictionary definitions of the [term], each making some sense under the statute,"[82] and refuse to defer to the agency's differing construction. Notably, the Court in *Boston and Maine* did not engage in an inquiry regarding the order or ranking of dictionary definitions of the term "required"; nor did it ascertain where the agency's proffered definition of the term fell within that ranking. Rather, the existence of multiple plausible dictionary definitions was itself sufficient to trigger deference.[83]

Indeed, the Court deferred to an agency interpretation of "required" — "useful or appropriate" — which constitutes a less "common" meaning of that term than the alternative interpretation the court adopted below — "indispensable or necessary."[84]

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[78] Id. at 1402, citing Sullivan v. Everhart, 494 U.S. 83, 88 (1990).

[79] OLC Opinion, supra note 4, at 149-50 n.6.

[80] Id. at 154 (relying on fact that, "as reflected in each of the dictionary definitions of 'cost' set forth above, the first and most common meaning of the term is the price paid").

[81] Id. at 151 (quoting Perrin v. United States, 444 U.S. 37, 42 (1979)).

[82] *Boston and Maine*, 112 S. Ct. at 1402.

[83] Id.

[84] Id. Even the dissenters in *Boston and Maine* had no quarrel with application of *Chevron* deference in the circumstances presented. Rather, the dissent was based on the argument that the agency developed its interpretation during litigation (at the Supreme Court level), and the interpretation was merely a *post hoc* rationalization of counsel not entitled to

The scope of OLC's error in dismissing *Boston and Maine* is underscored by comparing the language of the OLC Opinion with that of *Boston and Maine*.[85]

Boston and Maine and *Rust v. Sullivan*[86] represent the Court's most up-to-date thinking concerning the *Chevron* doctrine. These cases amply support a reinterpretation of "cost," regardless of whether the reinterpretation mirrors the most "common" or "natural" reading of the term.

It is interesting that though the OLC Opinion agrees that the *Chevron* doctrine applies to the indexation issue, the Opinion relies to a large extent, particularly with respect to its discussion of the "plain meaning" doctrine, on cases that do *not* implicate either *Chevron* or its underlying policy considerations. Rather, the OLC Opinion cites to a large number of cases that do not involve agency interpretations of statutes, and thus, cases in which there is no agency interpretation entitled to deference.[87] The analysis of the plain meaning doctrine in these decisions is relevant under the first prong of *Chevron* in determining whether Congress has expressed its intent in unambiguous terms. These cases, however, are not responsive to the concerns implicated when an agency entrusted with the administration of a complex statutory scheme interprets a term used in that scheme.[88]

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deference. Id. at 1405-07 (White, J., dissenting).

[85] Compare *Boston and Maine*, 112 S. Ct. at 1402 ("The existence of alternative dictionary definitions of the word 'required,' each making some sense under the statute, itself indicates that the statute is open to interpretation."), with OLC Opinion, supra note 4, at 150 n.6 ("Clearly, however, the mere existence of alternative dictionary definitions will not establish 'ambiguity.' ").

[86] 111 S. Ct. at 1767 (agency "construction . . . may not be disturbed as an abuse of discretion if it reflects a *plausible* construction of the plain language of the statute and does not otherwise conflict with Congress' expressed intent") (emphasis added).

[87] See, e.g., Molzof v. United States, 112 S. Ct. 711 (1992); Mallard v. United States Dist. Court, 490 U.S. 296 (1989); United States v. Ron Pair Enters., 489 U.S. 235 (1989); United States v. James, 478 U.S. 597 (1986); United States v. Rodgers, 466 U.S. 475 (1984); *Perrin*, 444 U.S. at 37.

[88] This point was made clearly in another case on which the OLC Opinion relied, and which addressed the tension between deference principles and other standards of construction:

> The controlling principle in this case is the basic and unexceptional rule that courts must give effect to the clear meaning of statutes as written. The principle can at times come into some tension with another fundamental principle of our law, one requiring judicial deference to a reasonable statutory interpretation by an administering agency. *Chevron* . . . ; . . . *Boston and Maine* . . . . Of course, a reviewing court

In any event, the OLC Opinion's dictionary-driven analysis does not even fully support the OLC's conclusions. The Opinion quotes several dictionaries to establish that the primary definition of "cost" is purchase price.[89] For example, the OLC Opinion relies on the following definition of "cost" supplied in a 1914 edition of the *Bouvier Law Dictionary*: "The cost of an article purchased for exportation is the price paid, with all incidental charges paid at the place of exportation. Cost price is that actually paid for the

> should not defer to an agency position which is contrary to an intent of Congress expressed in unambiguous terms. In any event, we need not resolve any tension of that sort here, because [the relevant agencies] have altered their position regarding the best interpretation of [the statutory term]. The [agency] appears as a respondent before us, arguing in favor of the Court of Appeals' statutory interpretation, and contrary to [its] previous position. If the [agency] asked us to defer to [its] *new* statutory interpretation, this case might present a difficult question regarding whether and under what circumstances deference is due to an interpretation formulated during litigation. The agency does not ask this, however. Instead, the federal respondent argues that the Court of Appeals was correct in saying the language [of the statutory term] is plain and cannot support the interpretation given it by the Board. Because we agree with the federal respondent and the Court of Appeals, and because Cowart concedes that the position of the BRB is not entitled to any special deference, we need not resolve the difficult issues regarding deference which would be lurking in other circumstances.

Estate of Cowart v. Nicklos Drilling Co., 112 S. Ct. 2589, 2594-95 (1992) (emphasis in original) (citations omitted).

[89] See OLC Opinion, supra note 4, at 152-53. The OLC Opinion omits alternative definitions of "cost" provided in some of the cited dictionaries. This is not surprising, for the omitted portions of the definitions demonstrate, in a manner very similar to the definition supplied in text, see supra note 61 and accompanying text, that "cost" has a broader meaning than purchase price. See, e.g., Samuel Johnson, A Dictionary of the English Language (Times Books London ed. 1979) ("Sumptuousness; luxury; . . . Charge; expense; . . . Loss; fine; detriment . . ."); 2 A New English Dictionary on Historical Principles 1034 (James A.H. Murray Ed., Oxford, Clarendon Press, 1893) ("Outlay, expenditure, expense . . . Expenditure of time, labour, etc. . . .") [hereinafter A New English Dictionary]; American Heritage Dictionary of the English Language 301 (1976) ("A loss or penalty; detriment"); Webster's New Int'l Dictionary of the English Language 509 (1917) (". . . charge; expense; hence, whatever, as labor, self-denial, suffering, etc., is requisite to secure benefit . . . Loss of any kind; detriment; deprivation; suffering . . . Expenditure; outlay, as of money, time, labor, etc. . . ."). The latter dictionary also included a definition of cost relevant to the field of economics. This definition was similar to some of the "lay" definitions. See id. at 509-10 ("That which is sacrificed to obtain anything. . . . The cost of a thing as reckoned in terms of the amount of labor, or effort, and abstinence required to produce it is often called the real, or subjective, cost."). But see id. at 510 ("Since the price for which anything is ordinarily sold is essentially what is paid for it in money, *cost* is often used in the sense of *price*."). While the OLC's omission is perhaps understandable given its theory regarding "primary" definitions, it misleads in that it implies that the "primary" definition of "cost" is the *only* definition.

goods."[90] Far from conclusively supporting the "plain" meaning of "cost" as purchase price, this definition actually supports a broader understanding of the term. First, the dictionary does not purport to define "cost" for all purposes; it appears to define a term of art for articles "purchased for exportation." Second, and more important, on its own terms the definition indicates that "cost" connotes something more than original price paid, as it expressly includes "incidental charges." Indeed, the only definition that is limited to the price "actually paid" relates *not* to "cost," but to "cost price," a term which is facially narrower than "cost."

Similarly, the OLC Opinion relies on the definition of "cost" in *Black's Law Dictionary*: "Expense; price. The sum or equivalent expended, paid, or charged for something."[91] Here, the "primary" definition is not "price" but "expense," a term with a broader meaning.[92] Again, the OLC Opinion's supporting authority actually cuts against its analysis.[93]

In short, the relevant issue under *Chevron* is not whether the agency's interpretation of a term is listed first among alternative definitions in the dictionary, but whether it is plausible, i.e., whether "it makes some sense under the statute."[94] If so, a reviewing court is bound to accept it. And a definition of "cost" that accounts for changes in the general price level is plainly plausible.

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[90] 1 Bouvier Law Dictionary 689 (8th ed. 1914) (citation omitted).

[91] Black's Law Dictionary 345 (6th ed. 1990).

[92] Black's defines "expense" as "[t]hat which is expended, laid out or consumed. An outlay; charge; cost; price. The expenditure of money, time, labor, resources, and thought. That which is expended in order to secure benefit or bring about a result." Id. at 577. It defines "price" as:

> The cost at which something is obtained. Something which one ordinarily accepts voluntarily in exchange for something else. The consideration given for the purchase of a thing. Amount which a prospective seller indicates as the sum for which he is willing to sell; market value. The amount of money given or set as the amount to be given as a consideration for the sale of a specified thing. The term *may* be synonymous with cost, and with value, as well as with consideration, though price is not always identical either with consideration.

Id. at 1188-89 (emphasis added).

[93] Similarly, the OLC Opinion relies on a secondary definition of "cost" in another dictionary to which it cites. One of the definitions of "cost" in A New English Dictionary is: "That which must be given or surrendered in order to acquire, purchase, accomplish, or maintain something; the price paid for a thing." A New English Dictionary, supra note 89 at 1034. The first and "primary" part of the definition, which the OLC Opinion chooses to ignore, arguably extends beyond original price paid.

[94] *Boston and Maine*, 112 S. Ct at 1402.

We believe, therefore, that there is sufficient room within the concept of "cost" to allow a reinterpretation of the term to account for inflation. Our view is strengthened by the fact that, as discussed in the next section, the Treasury has historically taken a flexible view toward its own interpretation of basis and cost, even if these interpretations have primarily been tied to the concept of historical cost. Given the Treasury's undoubted power to interpret Code provisions and the wide ambit accorded agencies in interpreting their organic statutes under the *Chevron* doctrine, a Treasury interpretation of these provisions accounting for the effects of inflation would likely be entitled to judicial deference. We turn next to an examination of whether the legislative and/or regulatory history of the relevant Code provisions precludes such a course.

2. The Legislative and Regulatory History of the Capital Gains Provisions of the Code Does Not Preclude an Interpretation of "Cost" that Accounts for Inflation

It is generally not sufficient under the *Chevron* analysis to simply find a statutory ambiguity and then resolve it with an agency interpretation. The deference given agency interpretations does not foreclose or obviate the need to review the legislative history of the statute being interpreted in order to determine whether Congress has spoken directly and clearly to the issue at hand. In *Chevron* itself the Court noted that, under the first prong of the deference analysis, "[i]f a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect."[95]

To recognize the relevance of legislative history, however, is not to accord it substantial or controlling weight. In fact, at least one Justice of the Supreme Court has at times expressed great antipa-

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[95] 467 U.S. at 843 n.9. See also National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (examining legislative history of provision in determining whether the "regulation harmonizes with the plain language of the statute, its origin, and its purpose"); *Central States*, 924 F.2d at 1104 (holding that "traditional tools of statutory construction" include relevant legislative history); Galler, supra note 2, at 1793.

On some occasions the Supreme Court has not utilized legislative history in the *Chevron* analysis at all, or has used it only under the second prong of the analysis. See, e.g., *Boston and Maine*, 112 S. Ct. at 1400-1404; Young v. Community Nutrition Inst., 476 U.S. 974 (1986).

thy to reliance on legislative history in interpreting statutes.[96] Courts, including the Supreme Court, have not consistently applied the *Chevron* analysis when resolving the proper scope and significance of legislative history. One commentator has suggested that at least two approaches have developed regarding this and other issues under *Chevron*.[97] An "activist" approach allows courts to closely examine legislative history to determine Congress' intent. A "deferential" approach focuses on the statutory language and the agency's construction of it and places less reliance on ambiguous or imprecise statements in the legislative history.[98] Even when not explicitly recognized, this difference in approaches has led different courts to vary in the precision they require in a statute's legislative history before they refuse to defer to an agency interpretation.[99]

While the Court does not appear to be on the verge of abandoning resort to legislative history altogether, when it has applied the *Chevron* analysis in recent cases, it has demanded a great amount of specificity before it will find that the legislative history supersedes and controls an arguably inconsistent agency interpretation. For example, in *Rust v. Sullivan*, the Court noted that

> While the petitioners' interpretation of the legislative history may be a permissible one, it is by no means the only one, and it is certainly not the one found by the [agency]. *It is well established that legislative history which does not demonstrate a clear and certain congressional intent cannot form the basis for enjoining the regulations.*[100]

Similarly, in *Chevron* itself, the Court noted references in the leg-

[96] See Green v. Bock Laundry Mach. Co., 109 S. Ct. 1981, 1994 (1989) (Scalia, J., concurring in the judgment).

[97] Gregory G. Garre, CERCLA, National Resource Damage Assessments, and the D.C. Circuit's Review of Agency Statutory Interpretations Under *Chevron*, 58 Geo. Wash. L. Rev. 932, 951 (1990).

[98] Id. Compare *K Mart*, 486 U.S. at 293 n.4, with *Cardoza-Fonseca*, 480 U.S. at 432 n.12.

[99] Compare Japan Whaling Ass'n v. American Cetacean Soc'y, 478 U.S. 221 (1986) (deferring to agency interpretation that it had discretion under statute to refuse to certify nations for violation of international whaling quotas even though legislative history contained statements from agency officials recognizing that agency had no such discretion), with Ohio v. U.S. Dep't of the Interior, 880 F.2d 432 (D.C. Cir. 1989) (examining broad statements of congressional purpose and history relating to different sections of statute in refusing to defer to agency interpretation).

[100] 111 S. Ct. at 1770 (emphasis added).

islative history that arguably were inconsistent with the agency's interpretation of the statute, but refused to accord the legislative history controlling significance because it did not speak to the "precise issue" before the Court.[101] The "general remarks" in the legislative history were entitled to little weight because they were not made "with this narrow issue in mind and they cannot be said to demonstrate a Congressional desire."[102] Thus, there is a rather high threshold for specificity before legislative history will be treated as superseding the agency's interpretation.

With these principles in mind, we have closely examined the legislative history of the capital gains provisions of the Code dating back to 1913. We have given special attention to early revenue Acts, particularly the Revenue Acts of 1918 and 1921, for it was in these acts that Congress first set forth the "cost" definition of basis and first established a preferential tax status for capital gains. We have also paid careful attention to the last 15 years of legislation in the income tax area, because in these years capital gains, and specifically, capital gains indexation, has been a recurring issue in Congress. Although there are some indirect indications in this legislative history that can be argued to foreclose an interpretation of "cost" to account for the effects of inflation, there are other indications that support the opposite conclusion. Nothing in this legislative history, however, forecloses the Treasury's authority to index capital gains. That is, the legislative history does not

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[101] 467 U.S. at 862. The analysis of whether Congress has, through legislative history or otherwise, spoken to the "precise question at issue" is another facet of the *Chevron* analysis that is subject to manipulation. By defining the "precise question at issue" either narrowly or broadly, a reviewing court may influence its decision as to whether Congress has addressed the question; Congress is more likely to have addressed broad issues than narrow ones. See Garre, supra note 97, at 948 n.112. Of course, the formulation of the inquiry — has Congress spoken to the "precise" question at issue — suggests that the question should be defined narrowly. As lower courts have recognized, see *Ohio*, 880 F.2d at 443 n.6, *Chevron* itself defined the precise question quite narrowly. Rather than ask whether Congress had defined "stationary source," the Court asked whether Congress had an expressed intent regarding the applicability of the concept espoused in the agency interpretation to the statutory program at issue. *Chevron*, 467 U.S. at 845. See also *Ohio*, 880 F.2d at 443 (asking whether Congress had addressed whether the agency was entitled to formulate specific definition at issue regarding measurement of damages rather than whether Congress had addressed the measurement of damages generally); *Central States*, 924 F.2d at 1104 ("precise question at issue" is "to be interpreted tightly").

[102] Id. (quoting Jewell Ridge Coal Corp. v. Mine Workers, 325 U.S. 161, 168-69 (1945)). See also *Drummond*, 796 F.2d at 507.

speak directly and clearly to this "precise issue."

a. *1913-1920.* The Sixteenth Amendment, authorizing the taxation of incomes, became effective on March 1, 1913. The first income tax law passed under this statute was enacted on October 3, 1913.[103] The most relevant guide to Congress' understanding of "cost," however, is the Revenue Act of 1918 ("1918 Act"), for neither the Income Tax Act of 1913 ("1913 Act") nor the Revenue Act of 1916 ("1916 Act") addressed how to measure capital gains for property acquired after March 1, 1913.[104]

Section 202 of the 1918 Act provided that "for the purpose of ascertaining the gain derived or losses sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be . . ., [i]n the case of property acquired on or after [March 1, 1913] . . . the cost thereof."[105] This definition of basis is derived from the Treasury Regulations under the 1916 Act.[106]

No Treasury Regulation prior to 1918 defined "cost," although several "Treasury Decisions" indicated that cost was equivalent to the original price paid for the property.[107] An argument could be

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[103] Income Tax Law of 1913, Pub. L. No. 63-16, 38 Stat. 114 (1913).

[104] The language and legislative history of the 1913 Act neither differentiated between ordinary income and capital gains nor set up a mechanism for determination of the gains. Section 2(c) of the 1916 Act provided that:

> [F]or the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

Revenue Act of 1916, Pub. L. No. 64-271, 39 Stat. 756, 758 (1916).

This provision apparently was inserted to avoid the constitutional problems that might arise if the government attempted to tax gains that accrued prior to the effectiveness of the Sixteenth Amendment. The Act itself, however, provided no basis rule for property acquired after the effective date of the Sixteenth Amendment.

[105] Revenue Act of 1918, Pub. L. No. 65-254, 40 Stat. 1058, 1060 (1919).

[106] Treas. Reg. No. 33, art. 90 (capital gain is "the difference between the price at which disposed of and the cost"). See also id. art. 101, 116.

[107] See T.D. 2005, 16 Treas. Dec. Int. Rev. 111 (1914); T.D. 2077, 16 Treas. Dec. Int. Rev. 245 (1914); T.D. 2090, 16 Treas. Dec. Int. Rev. 259 (1914). While relevant, these Treasury Decisions are not dispositive of the meaning of "cost" as used in the 1918 Act. First, these Treasury Decisions cannot be read as interpreting Congress' use of "cost," for "cost" was not used in the Code until the 1918 Act. Equally important, these Decisions do not represent a unitary or exclusive definition of "cost" for purposes of measuring gain. In fact, only T.D. 2090 is itself concerned with the measurement of gain; T.D. 2005 deals with business losses and T.D. 2077 deals with assets acquired before January 1, 1909. Moreover, T.D. 2077 continues to use "purchase price" rather than "cost." Furthermore, these Treasury Decisions also reflect that "cost" entailed something more than the original price for which

made that the 1918 Act incorporated these administrative interpretations of cost. Such an argument is not wholly persuasive, however, since Treasury Decisions do not have the interpretive significance of Treasury Regulations. Moreover, the Decisions themselves are ambiguous, and there is nothing in the legislative history of the 1918 Act indicating that they were being adopted.[108]

Furthermore, the intent of the Treasury Regulations prior to 1918 is unclear. While the 1916 regulations measured capital gain in terms of "cost," the predecessor regulations for the 1913 Act more narrowly defined capital gains as "the difference between the selling price and the buying price."[109] The regulations' shift from the narrower measurement of "buying price" to the broader term "cost" seems to reflect a more flexible administrative approach to measuring capital gains, one which does not strictly equate "cost" with purchase price. In all events, this variation in the pre-1918 regulations seems to refute any implication that the 1918 Act incorporated a prior administrative definition that equated "cost" exclusively with the purchase price or original cost of the asset.

More importantly, the regulations issued under the authority of the 1918 Act demonstrate that the Treasury considered itself to continue to have flexibility in determining the basis of property under the "cost" rule. Throughout the regulations, the Treasury provided for adjustments to basis and to cost that differed from original cost, in order to more accurately represent the taxpayer's income. Most notable is the 1918 regulations' treatment of property acquired by gift or bequest. The original 1918 regulations pro-

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the asset was purchased. For example, both T.D. 2005 and T.D. 2090 adjusted original cost for subsequent improvements made to the asset. Finally, the Treasury also adjusted basis for depreciation and depletion under the early revenue acts. See discussion infra at notes 117-19 and notes 130-32 and accompanying text. Even if there were substantial evidence, which there is not, that Congress meant in 1918 to adopt the Treasury's definition of "cost" as reflected in these Treasury Decisions, the exact contours of this definition remain ambiguous.

[108] But see Galler, supra note 2, at 1793 (noting that Treasury Decisions are relevant as evidence of Congress' state of mind, although recognizing that because the legislative history does not refer to the Decisions, "a court would have to draw its own conclusions regarding [their] weight or importance"); OLC Opinion, supra note 4, at 157 (concluding that Congress did intend to adopt these Treasury Decisions).

[109] Treas. Reg. No. 33, Act of October 3, 1913 (January 5, 1914) art. 109. This regulation dealt with capital gains on assets acquired by corporations after January 1, 1909. The 1909 date is apparently significant because it refers to the effective date of a corporation tax law that was enacted prior to the effective date of the Sixteenth Amendment.

vided that "[i]n the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition . . . ."[110] A later version of the 1918 regulations made clear that this basis rule was tied to the Treasury's conception of the meaning of cost: "[T]he cost of . . . property [acquired by gift or bequest] to the person making the sale or other disposition thereof is the fair market value of the property at the date of acquisition . . . ."[111]

By equating "cost" with the fair market value of the property as of the date it was acquired by gift or bequest, the 1918 regulations expounded an idea of "cost" completely divorced from concepts of historical or original cost. By no measure could the taxpayer's "cost" as defined in these regulations be seen as representing the amount that the taxpayer had paid for the property — the taxpayer himself paid nothing for the gift or bequest. If the proper focus is on the donor or the testator, the regulation still was not tied to any concept of historical or original cost. Fair market value at the time of the gift or bequest is in no way related to the amount paid by the donor or testator for the property. Indeed, the 1921 Revenue Act (and subsequent Acts) rejected the fair market value rule for measuring capital gains on sales of property acquired by gift, adopting instead a rule that defined basis as the amount paid by the donor.[112] The Treasury in 1918 thus did not uniformly

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[110] Treas. Reg. No. 45, art. 1562 (1919).

[111] Id. art. 1562 (as amended July 28, 1921).

[112] The 1921 Act provided that in the case of property acquired by gift after December 31, 1920, the basis was to be the same as it was in the hands of the donor. Revenue Act of 1921, ch. 136, § 202(a)(2), 42 Stat. 227 (1921). The congressional reports discussing these provisions noted that the Treasury's regulation was subject to abuse because a taxpayer could get a substantial step-up in his basis by giving the property to a spouse or close relative, who could then sell the property immediately and effectively avoid taxation.

The 1918 regulation was cross-referenced to a provision in the 1918 Act providing that the value of property acquired by gift, bequest, devise or descent was not to be included in gross income. Treas. Reg. No. 45 art. 1562. While at least one commentator has relied on this fact to discount the importance of this regulation, see NYSBA II, supra note 2, at 3, it should not alter the analysis. The regulation was promulgated solely under the authority of section 202 of the 1918 Act, which defined the basis of property acquired after February 28, 1913, solely with regard to "cost." Further, the 1918 regulation tied the fair market value rule explicitly to the concept of "cost." Moreover, the congressional reports supporting the 1921 Act's changes to the basis of gift property noted that under the 1918 Act,

> no explicit rule is found in the present statute for determining gain or loss resulting from the sale of such property, but the Treasury Department has held that the proper basis for such determination is the fair market price or value of such property

equate the statutory term "cost" with the original purchase price of the asset.

Similarly, the 1918 regulations provided that

> [W]hen a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him . . . of his interest in the partnership, *including in such cost . . . the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid.*[113]

Thus the regulations explicitly contemplated that "cost" would include not only the original cost of the partner's share in the partnership, but also his share in undistributed taxed partnership net income. Other provisions in the Treasury's 1918 regulations promulgated under section 202 reflected similar variations in the agency's definition of "cost." For example, the regulations provided that the original cost of property had to be adjusted downward for any depreciation or depletion taken on the property by the taxpayer prior to its sale.[114]

These regulatory departures from equating "cost" with original purchase price as the measure of capital gains made sound economic sense and helped harmonize the capital gains tax with other provisions of the Code. Indeed, many of these regulations were congressionally adopted in the Code as expressly authorized ad-

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at the time of its acquisition by the donee.

S. Rep. No. 275, 67th Cong., 1st Sess. 10 (1921). See also H.R. Rep. No. 350, 67th Cong., 1st Sess. 9 (1921).

Thus, not only did Congress recognize the Treasury's administrative discretion to interpret the "cost" basis rule of section 202 of the 1918 Act, it did not believe that the Treasury's interpretation of the gift basis rule was necessary in order to be consistent with any other provision of the 1918 Act. Significantly, Congress changed the rule with respect to gift property without changing at all the gross income provisions referenced above. The 1921 Act continued to provide that gross income did not include the value of property acquired by gift or by inheritance. The 1921 Act did not change the fair market value basis rule for property acquired by bequest, devise or descent; in fact, it codified these rules.

[113] Treasury Regulations under the Revenue Act of 1918 art. 1570 (1919) (emphasis added).

[114] Id. art. 1561. Similarly, the regulations provided that in the case of an exchange of stock for other stock of greater par value, the gain taxed would be either the excess of the fair market value of the new stock over the cost of the old stock *or* the excess of the par value of the new stock over the par value of the old stock. Furthermore, for purposes of later transactions, the "cost" of the new stock would be considered to be the cost of the old stock "plus the profit taxed on the exchange." Id. art. 1569.

justments to basis for assessing gain. The relevant point, however, is that these adjustments to basis were not expressly authorized by the *1918* Act. The only relevant measure of basis in that Act was "cost."[115]

The Treasury thus defined the statutory term "cost" as not limited to the original purchase price; other measures of "cost" could be used if justified by sound economic and tax considerations. This result obtained even when using a measure other than original cost, such as the measurement of basis in property acquired by gift, was not necessary to harmonize the capital gains rule with other Code provisions. This contemporaneous administrative interpretation of the initial Code provision equating basis with "cost" is powerful evidence that "cost" was not intended by Congress to be a static concept relating only to the original purchase price of property. Rather, it was understood to authorize administrative adjustments that are consistent with economic reality and tax fairness.

The history of the basis rules for gift and inheritance property is in relevant respects similar to the history of other specialized basis rules. The Code currently contains twenty-four enumerated adjustments to basis. Some commentators have argued that the specificity of these statutory basis adjustments establishes that Congress has "preempted" the field in a way that forecloses basis adjustments originated administratively.[116] However, this analysis overlooks the fact that several of the statutory basis adjustments had their origin in Treasury practice during the years following the passage of the Sixteenth Amendment, and not in legislative action. Thus the Treasury provided for the adjustment of an asset's purchase price for depreciation long before there was an explicit statutory provision for such an adjustment.[117] Furthermore, from at least 1914 on, the Treasury provided that the "cost" of property included later improvements added to the property. It was not until 1924 that Congress explicitly provided that an adjustment be

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[115] The 1918 Act did provide a separate mechanism for the determination of the basis of inventory, but none of the regulations discussed in text were promulgated under this provision.

[116] See, e.g., NYSBA I, supra note 2, at 9; NYSBA II, supra note 2, at 3. See also OLC Opinion, supra note 4, at 160.

[117] This practice was approved by the Supreme Court in United States v. Ludey, 274 U.S. 295 (1927). See infra notes 176-83 and accompanying text.

made for items "properly chargeable to capital account."[118] Like the Treasury's practice with respect to gift and inheritance property, therefore, these basis adjustments confirm the Treasury's longstanding exercise of discretion with respect to the interpretation of these Code provisions.[119]

Returning to the 1918 Act, its legislative history points in different directions and is, in all events, not directly on point. Nowhere in the Committee Reports accompanying the Act did Congress define or explain "basis" or "cost." The legislative history of the 1918 Act nonetheless arguably supports an inference that Congress did not intend to limit "cost" to historical or original cost. The 1918 Act also included an "Excess or War Profits Tax" title. This tax utilized a concept known as "invested capital" to measure an excess profit. Section 326(a)(3) of the House bill defined "invested

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[118] Revenue Act of 1924, Pub. L. No. 68-176 § 202(b) (1924) [hereinafter 1924 Act]. The House report on this provision recognized the prior Treasury practice:

> *There is no provision in the existing law which corresponds to subdivision (b) [of Section 202], but the rule laid down therein is substantially the same as the construction placed upon existing law by the Treasury Department.* It provides that in computing gain or loss from the sale or other disposition of property the cost or other basis of the property . . . shall be increased by the amount of items properly chargeable to capital account and decreased by the depreciation and similar deductions allowed with respect to the property. Under this provision capital charges, such as improvements, betterments, and carrying charges . . . are to be added to the cost of the property in determining the gain or loss from a subsequent sale, and items such as depreciation and obsolescence previously allowed with respect to the property are to be subtracted from the cost of the property in determining the gain or loss from its subsequent sale.

H.R. Rep. No. 179, 68th Cong., 1st Sess. 12 (1924) (emphasis added).

[119] For this reason, the OLC Opinion's reliance on the doctrine of expressio unius est exclusio alterius ("the expression of one thing is the exclusion of another") is not particularly persuasive. OLC Opinion, supra note 4, at 161. With respect to many of these adjustments, Congress acted to codify a prior Treasury interpretation rooted in the term "cost." To use the expressio unius canon to defeat indexation is to freeze the ability of Treasury to continue to exercise interpretive discretion over that term. In any event, the OLC Opinion ignores recent authority for the proposition that the expressio unius doctrine has less force in the context of modern administrative law and should not be allowed to "trump" principles of judicial deference to agency interpretations. See Texas Rural Legal Aid, Inc. v. Legal Servs. Corp., 940 F.2d 685, 694 (D.C. Cir. 1991) ("Under *Chevron*, we normally withhold deference from an agency's interpretation of a statute only when Congress has 'directly spoken to the precise question at issue,' and the expressio unius canon is simply too thin a reed to support the conclusion that Congress has clearly resolved this issue.") (citation omitted); Cheney R.R. v. ICC, 902 F.2d 66, 68-69 (D.C. Cir. 1990) (stating that the expressio unius canon is "an especially feeble helper in an administrative setting where Congress is presumed to have left to reasonable agency discretion questions that it has not directly resolved").

capital" to mean "paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the taxable year, *and not including the increase in the value of any asset above the original cost until such increase is actually realized by sale*."[120] The use of the term "original cost" in section 326(a)(3), when juxtaposed with the use of the term "cost" in the basis provision of the same bill, appears to demonstrate a consciously flexible understanding of the term "cost."[121]

Confusing the situation further is a portion of the House debate on what became section 202. One member of the House, Representative Hardy, objected to certain aspects of the basis rules which he felt were inequitable. His main objection to the provision was the fact that it would allow taxation on increases in value that accrued prior to the taxable year in question. In his extended colloquy with other members, Mr. Hardy raised the possible effects of inflation on capital gains as another problem with the provision, and indicated that he understood the provision to require the subtraction of purchase price from the amount realized on sale of the asset. The debate is worth quoting at length:

> Mr. Hardy: Mr. Chairman, I move to strike out section 201 [the precursor to § 202], which makes income out of the difference between what a man sells his property for and what it was worth in March 1913, if he bought it before then, or what he paid for it if he bought after that date. I do so because section 201 is absolutely inequitable . . . . In simple principle and policy, a piece of property bought in 1913, if its exchange value today is to be equal to its exchange value when it was bought, must bring in dollars and cents something like two times what it cost . . . . If you comply with section 201 you will have to keep a schedule of every sale of personal, real, or mixed property that you make, because your income is by section 201 declared to be the difference between what you paid and what you sell it for if you bought it since March 1913, or a difference between what it was worth in March 1913, and what you sell it for if you bought it before that, and that takes every sale that a man makes. If complied with, section 201 will require that

[120] H.R. Rep. No. 12863, 65th Cong., 1st Sess. (1918) (emphasis added).

[121] The Senate Bill deleted the clause of section 326(a)(3) underscored above. The Senate Finance Committee considered the clause unnecessary because it considered the remaining definition of invested capital to recognize that only the original cost was to be used in the computation. S. Rep. No. 617, 65th Cong., 1st Sess. 11 (1918).

> every seller of personal or other property should keep a schedule of what he paid for that property if he bought it after 1913, or an estimate of what it was worth in 1913 if he bought it before that . . . . I am appealing to the committee not to adopt the principle of this section now, because it will cause a stagnation in all trade and there will be infinite difficulty in the enforcement of it . . . .
>
> Mr. Garner: This is merely enacting into law the rules and regulations now enforced under the present statute.
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> Mr. Hardy: So far as the present rules and regulations are concerned, they have not cut the figure that this will. You take a man who has done a great deal of trading, who bought his property years ago and now is in the habit of making trades, whether it be in the buying and selling of ships or the buying and selling of land, that man today makes a sale of a tract of land which he bought in 1913 at the prices then prevailing, and he sold it today at 100 percent of apparent profit and reinvested the money he could not obtain any more property now than he could have obtained in 1913 with the money then paid for the same land.
>
> And yet he is taxed under this bill for alleged profits accruing from his sale . . . .
>
> Mr. Garner: If a man bought a piece of land in 1915 for $10,000 and sold it 1918 for $20,000, then I understand the gentlemen to argue that he has made no profit because $20,000 now is not worth as much $10,000, then.
>
> Mr. Hardy: That is one proposition, one ground of my objection to this tax.[122]

Rep. Hardy later made clear that his real objection to this statute was that it taxed a seller of property for the gain that had accrued throughout the time he held the property instead of just for the gain accruing during the taxable year in question. He thus withdrew his proposed amendment to strike the section entirely, and replaced it with an amendment that would define the basis of the property as the property's fair market value at the beginning of the taxable year in which it was sold.[123] The amendment was rejected.[124] This discussion is notable for a number of reasons. It demonstrates that at least certain members of Congress were aware of the effects of inflation on capital gains. It also can be argued to reflect Congress' understanding that a property's basis

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[122] 56 Cong. Rec. 10349-50 (1918).

[123] Id. at 10351.

[124] Id. at 10354.

referred to the acquisition cost of the property.

This legislative history, however, should not foreclose the Treasury's authority to promulgate a different interpretation of the term "cost." As an initial matter, the floor statements of opponents of statutory provisions are notoriously weak indications of congressional intent.[125] Thus, Rep. Hardy's criticisms of what became section 202 do not carry substantial weight in the legislative history analysis. Second, Rep. Hardy's proposals went far beyond merely accounting for inflation in the calculation of capital gains. His initial proposal, to delete entirely the provision taxing gains on sales of property, would have eliminated taxation of all gains, not just those attributable solely to inflation. His second, more limited, proposal was even less suited to deal with the problem of taxing inflationary gains. It eliminated taxation entirely on all gains, inflationary or not, accruing on property before the taxable year of the sale, while taxing the entire gain, whether or not inflationary, accruing during the taxable year of the sale. In short, rejection of these proposals cannot be definitively construed as reflecting a congressional determination that gains attributable solely to inflation should be taxed.

Some of the comments made in opposition to Rep. Hardy's proposal, however, echoed Rep. Hardy's comment that taxable gain is measured by simply subtracting the asset's purchase price from its sales price. For example, to emphasize his point that an increase in value cannot be measured until the property is actually sold, Rep. Kitchin, chairman of the House Ways and Means Committee, stated: "If you bought a ship in 1916 for $100,000 and sell it in 1918 at $200,000 or if you bought Bethlehem stock . . . in 1915, your income is the difference between the purchase and selling price and that is the only rule under which you can administer the law."[126]

Similarly, another opponent of Hardy's proposal, Rep. Fordney, argued that the value of an investment "is what you paid for it, and when you sell it this year the difference between what you paid for it and what you get for it is profit, and on that you pay an income tax. That is the law. I cannot make it any plainer than

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[125] See 2A Norman Singer, Sutherland Statutory Construction § 48.13 (5th ed. 1992).
[126] 56 Cong. Rec. 10350-51 (1918).

that."[127]

These statements are unequivocal, and if the legislative history of the 1918 Act ended here, they would indeed provide a firm basis for inferring that at least some members of the House understood and intended cost to mean purchase price, plain and simple. But if one reads on, the debate gets more sophisticated. Both Reps. Fordney and Kitchin acknowledged that in measuring taxable gain on the sale of property, costs in addition to purchase price are included. For example, Rep. Fordney stated:

> If you bought a piece of property five years ago for $100,000, and you sell it today for $25,000 more than you paid for it, your profit over and above the purchase price is $25,000 and you have a profit of $25,000. Now, you may charge up against the $25,000 profit the taxes which you have paid on that property at the time you purchased it until the time you sold it, or you may charge up any other expenses which you have been put to in maintaining or looking after that property, and the net profit is the difference between all those *costs* and the price you obtained for it.[128]

Later in the debate, Rep. Fordney added the interest paid on a mortgage to the list of costs of the capital asset.[129]

Equally illuminating are Rep. Kitchin's comments concerning a proposed amendment requiring that the cost of improvements to property, among other things, be included in determining the property's cost basis. The proposed amendment was rejected, but not because of disagreement on the treatment of improvements. To the contrary, opponents of the amendment acknowledged that the Treasury had always, and quite properly, included the cost of improvements in determining an asset's cost basis, despite the absence of any statutory provision authorizing such an adjustment.[130]

Indeed, Rep. Kitchin cited his own experience in selling a farm, noting that "the permanent improvements that I had put on were added to the purchase price of my farm" in determining its cost for capital gains purposes.[131] To punctuate his point, he produced the relevant Treasury tax form, which specifically provided that an as-

[127] Id. at 10352.
[128] Id. (emphasis added).
[129] Id. at 10355.
[130] Id. (statements of Rep. Kitchin).
[131] Id.

set's cost basis be adjusted for both improvements and depreciation.[132]

The legislative history of the 1918 capital gains provision, when read as a whole, is significant for two reasons. First, despite isolated statements implying that cost is limited to purchase price, the full debate shows that the legislators understood that the cost of a capital asset included items other than the asset's purchase price.

Second, the floor debate reflects a congressional recognition that prior to 1918, the Treasury interpreted the concept of cost to include items other than purchase price, such as improvements and depreciation. No one, least of all the Treasury, believed that the Treasury's discretion to interpret the concept of cost had been extinguished by passage of the 1918 Act.

We believe that rejection of Rep. Hardy's proposals should not be construed as a congressional determination to deny the Treasury any interpretative discretion over the term "cost." The legislative history of the 1918 Act, including the colloquy on the House floor concerning the issue of taxing inflationary gains, simply did not address the precise question that is relevant here, *i.e.*, the definition of "cost" for all circumstances and the Treasury's authority to interpret that term to comport with economic realities, changing conditions, and/or shifting policy imperatives. While Congress did not *require* the Treasury to adjust basis for inflation in taxing capital gains, neither did it deny, either expressly or implicitly, the Treasury discretion to implement the capital gains provisions in a manner that takes account of inflation. Congress did not, for example, statutorily limit the meaning of the term "cost" to original purchase price. Thus, Congress arguably did not foreclose the Treasury's discretion to take account of cost considerations other than original purchase price when warranted by economic reality or tax fairness. As discussed previously, the Treasury did not hesitate to exercise this discretion in its 1918 regulations concerning depreciation, basis of gift property, and similar matters. Congress' failure to address in the statute cost-related considerations such as depreciation, gifts, *and inflation* did not foreclose the Treasury's ability to do so.

In sum, the legislative history of the 1918 Act in our view does

[132] Id. at 10356.

not speak directly and clearly to the "precise question at issue."[133] Since "legislative history which does not demonstrate a clear and certain congressional intent cannot form the basis for enjoining the [agency's] regulations,"[134] there seems little doubt that a Treasury Regulation promulgated under the 1918 Act and providing for indexation of capital gains would have been upheld as a reasonable statutory interpretation under the principles of judicial deference announced in *Chevron*.[135] The question thus becomes whether, subsequent to passage of the 1918 Act, Congress clearly manifested an intent to deprive the agency of its interpretive discretion.[136]

b. *The 1921 Act*. The Revenue Act of 1921[137] made no relevant changes in the definitions of basis or cost, and the legislative history does not illuminate the meaning of these terms. This Act is significant, however, because it represents the first revenue act in which a preference was given to capital gains income. The final version of the statute taxed capital gains at a preferential rate of 12.5 percent. This preferential rate was applicable only to gains on assets held for more than two years.[138] The House and Senate Reports justified the newly-enacted preference on two grounds. First was so-called "bunching" — taxing in the year of sale all of the gain that accrued over the time that the asset is held. Under a progressive rate system, this "bunching" could have the effect of placing the taxpayer into a higher bracket than if he had been taxed each year on the gain accruing during that year. Bunching

[133] *Chevron*, 467 U.S. at 843 n.9. Furthermore, statements made during the debate to the effect that this provision merely codified the law as it was applied under the 1913 and 1916 Acts should not be read to imply that these Acts foreclosed a definition of basis that took inflation into account. As discussed, the 1913 and 1916 Acts themselves did not define basis. To the extent that basis was defined in the regulations, the Treasury moved away from a more specific definition of basis that would not allow inflation to be taken into account ("buying price") to a broader definition that arguably could be read to take inflation into account ("cost"). Finally, that Congress might not have felt the need to act affirmatively to counter the effects of inflation does not mean that it did not provide the Treasury with the authority to take such action if it should find it necessary.

[134] *Rust*, 111 S. Ct. at 1770.

[135] See generally *Chevron*, 467 U.S. 837. See also Galler, supra note 2, at 1793-94 ("a lack of specificity in the committee reports also contributes to an argument that legislative intent is equivocal, and, therefore, that the court should proceed to step 2 of *Chevron* analysis").

[136] But see Galler, supra note 2, at 1793 (post-enactment legislative history is irrelevant).

[137] Revenue Act of 1921, Pub. L. No. 67-98, 42 Stat. 227 (1921) [hereinafter the 1921 Act].

[138] The 1921 Act § 206.

was considered to discourage taxpayers from selling their capital assets, and thus was also tied to the second rationale for the preference — encouraging the sale of assets.[139]

These concerns were expressed in both the Senate and the House hearings through the testimony of the same witness, a lawyer named Frederick R. Kellog.[140] Mr. Kellog criticized the capital gains tax provision on the grounds that it had a "lock-in" effect. The perceived high rate of tax on capital gains "kills transactions which would be made if the taxation were reasonable."[141] Mr. Kellog also referred to another perceived problem with the manner in which the capital gains tax was administered — the adverse effect of inflation on capital gains.[142] Thus, a concern with inflation played a role, albeit minor, in the establishment of the first capital gains tax preference.

c. *1924-1977.* During this period, many new revenue measures

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[139] See H.R. Rep. No. 350, 67th Cong., 1st Sess. (1921); S. Rep. No. 275, 67th Cong., 1st Sess. (1921).

[140] Internal Revenue Hearings: Hearings Before Senate Finance Committee, 67th Cong., 1st. Sess. 534 (1921) (statement of Frederick R. Kellog, Attorney at Law) [hereinafter Senate Hearings]. See also Hearings Before House Ways and Means Committee, Internal Revenue Revision, 67th Cong., 1st Sess. 405 (1921) (statement of Frederick R. Kellog, Attorney at Law) [hereinafter House Hearings].

[141] Senate Hearings, supra note 140, at 540 (statement of Frederick R. Kellog, Attorney at Law).

[142] In the House hearings, Mr. Kellog described the experience of an acquaintance who was forced to sell his house when he needed to relocate for occupational reasons. Mr. Kellog stated that his friend:

> [T]hen became very keenly alive to the fact that the purchasing power of a dollar had lessened so much that a supposed profit was largely stage money. It did not amount to anything, but the government, nevertheless, under the present law had no alternative but to require him to pay a tax on that amount.

House Hearings, supra note 140, at 129.

This problem was discussed even more explicitly in the Senate hearings:

> Senator McCumber: Suppose property was purchased in 1914 and held until 1921 and it has increased in value 100 percent. A dollar has decreased 50 percent. The property has increased mainly because of the inflation and the cheaper dollar rather than from any more income that you could get out of it. Is it not unjust to say that a person, because he sells it for the same number of dollars that he purchases it for in the general market, has got to pay the Government some money?
>
> Mr. Kellog: I think you have touched the most vital point in the whole matter.
>
> Senator McCumber: The fact is that he has not made a cent if those figures are correct.
>
> Mr. Kellog: I believe that is one of the strongest reasons. I am very sorry that I did not think of it myself. But it is absolutely sound, as it appeals to me now.

Senate Hearings, supra note 140, at 545.

were enacted, and the tax laws were codified two different times (in 1939 and 1954). But, while the structure of the Code changed, the essential provisions at issue did not. Basis continued to be defined in terms of "cost," and "cost" was not itself defined.[143]

The legislative history of some of the provisions enacted during this period provides indirect references to how "cost" was understood. In discussing different aspects of the capital gains provisions, the legislative history often used examples that contemplated the use of historical cost. For example, the House Report on the Revenue Bill of 1932 explained the principles behind provisions relating to the carryover of basis by using examples which equated original cost with basis.[144] The use of such examples, however, merely reflects the practice of the time, and cannot be read as expressing Congress' intent to foreclose a different interpretation of basis. The same is true of scattered references in the reports characterizing basis as the "original capital investment in the property."[145] None of these isolated references speak to the precise question at issue, i.e., the limits of the meaning of "cost" or the interpretive discretion of the Treasury over a term not defined in the statute. While the references reflect congressional awareness of the Treasury's general practice, to read into the references an intent to extinguish any interpretive discretion Treasury might have had with respect to "cost" is to read far too much into these statements.

The one feature of the capital gains provisions that did change during this time was the exact nature of the capital gains preference. From 1924 through 1933, long-term capital gains were taxed at a preferential 12.5% rate. Beginning in 1934, the nature of the preference changed. A portion of capital gain was excluded from income entirely, depending upon the holding period of the asset.[146]

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[143] Not until 1957 was "cost" explicitly defined in the Regulations to mean purchase price. See T.D. 6265, 1957-2 C.B. 463.

[144] H.R. Rep. No. 708, 72d Cong., 1st Sess. 18 (1932). At various points during hearings on the Revenue Act of 1932, Congressmen or witnesses described capital gains as the difference between the price "paid" for an asset and the price received upon its disposition. See, e.g., Revenue Revision, 1932: Hearings Before the Ways and Means Committee, 72d Cong., 1st Sess. 325-26 (1932). These discussions did not take place in the context of a discussion of the meaning of "cost."

[145] H.R. Rep. No. 708, supra note 144, at 19.

[146] See Revenue Act of 1934, Pub. L. No. 73-216, § 117(a), 48 Stat. 680, 714 (1934) [hereinafter 1934 Act].

While the percentage of gain excludable from income, the number of holding periods used, and the length of the holding periods varied from Act to Act,[147] capital gains received preferential tax treatment until 1986.

Throughout this time, one of the criticisms of the capital gains tax, and one of the rationales for the preference accorded to capital gains, was the effect of inflation on capital gains. For example, the Joint Committee on Internal Revenue Taxation prepared a Supplemental Report on Capital Gains and Losses pursuant to Section 1203(b)(6) of the Revenue Act of 1926. This Report recognized that "a large part of our tax on capital gains is derived from the taxation of appreciation in money value as distinct from actual value. In other words, a large tax is derived from these provisions merely because of the reduced purchasing power of the dollar."[148] This realization was also expressed during hearings on the Revenue Act of 1934.[149]

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[147] For example, under the 1934 Act, five different holding periods were specified. The longer the holding period, the greater amount of capital gain excluded from taxable income. The use of the holding period in this and other acts can be seen as a recognition that gains are more adversely affected by inflation for assets held for longer periods. In 1938, the number of exclusion ratios was reduced from five to three. The Revenue Bill of 1942 simplified the distinction between short-term capital gains and long-term capital gains, specifying a six-month holding period. Gains on assets held more than six months were allowed a 50% exclusion from income. In 1969, the effective maximum capital gains rate was increased although it remained below the rates for ordinary income.

[148] Report to the Joint Committee on Internal Revenue Taxation: Supplemental Report on Capital Gains and Losses, 71st Cong., 1st Sess. 2 (1929). See also The Revenue Bill of 1934, H.R. Rep. No. 704, 73d Cong., 2d Sess. 10 (1934) (justifying preferential treatment and addition of holding periods for capital gains in part because the "tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.").

[149] During hearings before the Senate Finance Committee, the following colloquy took place between a Senator and a Treasury witness:

> Senator Reed: . . . Have you taken into account at all the fact that we have changed the value of the currency of America so that there is a nominal profit which is really non-existent? Assuming a man gets back his cost in gold equivalent, there is a nominal profit in so-called dollars, whereas we all know that there is no profit as expressed in gold. There has been no account taken of that?
>
> Dr. Magill: No provision directly directed to that proposition. This provision with respect to capital gains and losses, you will observe, gives some relief with respect to property which is sold at a profit, and conceivably you could regard what is done with respect to capital gains and losses as being a provision to take care of the things you have in mind.

Revenue Act of 1934: Hearings Before the Senate Finance Committee, 73d Cong., 2d Sess. (1934).

These references, at a minimum, do reflect that Congress was aware that inflationary gains were taxed under the Treasury's interpretation of the basis provisions. It is a leap of logic, however, to infer from these statements that Congress intended to foreclose any other interpretation of such provisions, or to extinguish any interpretive discretion the Treasury might have had with respect thereto.[150]

In fact, it is arguable that one of the reasons that neither the Treasury nor the Congress specifically accounted for inflation in the determination of "cost" is that the general capital gains tax preference ameliorated the adverse effect of inflation. This is particularly true since the longer a taxpayer held a capital asset — and thus the more likely it was that inflation would create an inflated gain from the asset's sale — the larger the preference. While the preference was at best a blunt tool to counter inflation, it was nonetheless recognized as a tool. It obviated the need and impetus, from 1921 until 1986, to establish a more accurate counter for inflation, such as indexation.

d. *1978 to Present.* Over the last 15 years, there has been much legislative action in the area of capital gains. During this time, the capital gains preference was initially expanded and then virtually eliminated. Furthermore, over this period at least six different measures were proposed to provide for indexation of capital gains through an amendment to the Code. Although indexation legislation has passed at different times in both the House and Senate, none of these measures were enacted.

The Revenue Act of 1978 ("1978 Act") increased the exclusion for capital gains to 60 percent. One of the reasons given for the increased preference was the desire to "offset the effect of inflation by reducing the amount of gain which is subject to tax."[151]

More interesting is the course of Congress' deliberations regarding the indexation of capital gains as it considered the 1978 Act. The House actually passed legislation indexing capital gains. Under the House bill, the adjusted basis of certain capital assets,

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[150] In this regard, Congress' consideration in 1926 and 1934 of the issue of taxing inflationary gains is no more revealing than its later consideration of the issue in 1978, 1982, 1986, 1989, and 1992. For a discussion of the significance of these events, see infra notes 151-71 and notes 232-43 and accompanying text.

[151] General Explanation of the Revenue Act of 1978, Joint Committee on Taxation, 95th Cong., 2d. Sess. 252 (1979).

such as common stock, tangible personal property, and real property, would be indexed to the Consumer Price Index.[152] The Senate bill, however, did not include an indexing provision, and the Senate version was adopted in conference. The Senate Report indicated that the Finance Committee believed that an increased capital gains deduction would be sufficient to offset the effect of inflation. The Senate Report stated:

> [A]n increased capital gains deduction will tend to offset the effect of inflation by reducing the amount of gain which is subject to tax. Thus, by increasing the deduction, taxable gain should be reconciled more closely with real, rather than merely inflationary gain. However, since the deduction is constant, unlike the automatic adjustments generally provided for in various indexation proposals, it should not tend to exacerbate inflationary increases.[153]

One commentator viewed this passage from the Senate Report as "decisive" evidence of a congressional intent to preclude administrative indexation of capital gains: "Congress has indicated, in authoritative Committee Reports, that special capital gains rates are appropriate because (among other reasons) the law does not permit basis adjustments to reflect inflation."[154] We believe that this reading probably overstates the significance of this legislative history. The quoted passage reflects only that the Code did not require "basis adjustments to reflect inflation" and that the Senate Finance Committee, unlike the House, did not believe that the Code should have been amended to require such adjustments. Nowhere in the Senate Report, or elsewhere in the legislative history of the 1978 Act, is there any indication that Congress considered the term "cost" to have a clear and unambiguous meaning or that Congress intended to preclude the Treasury from exercising any interpretative discretion possessed over the term. In other words, if there were any "gaps" left by Congress in the statutory meaning of "cost" prior to enactment of the 1978 Act, they were not closed when Congress failed to amend the statute. By failing to fill in one of the "gaps" in the meaning of "cost," Congress did not a fortiori forbid the Treasury from doing so,[155] and nothing in the legislative

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[152] See Revenue Act of 1978, H.R. Rep. No. 1445, 95th Cong., 2d Sess. 125-32 (1978).

[153] Revenue Act of 1978, S. Rep. No. 1263, 95th Cong., 2d Sess. 192 (1978).

[154] Zelenak, supra note 2, at 844 (emphasis added).

[155] The OLC Opinion simply misses this crucial point. For example, the Opinion argues

history of the 1978 Act evidences such a congressional intent.[156]

In 1982, the Senate approved a capital gains indexation provision. During consideration of the Tax Equity and Fiscal Responsibility Act of 1982, Senator Armstrong proposed an amendment calling for the prospective indexing of the basis of capital assets for capital gains purposes.[157] The Senate approved the amendment by a vote of 64 to 32, but a conference committee did not retain the provision.

The watershed Tax Reform Act of 1986 ("1986 Act") enacted dramatic changes in the taxation of capital gains and in the process provided new impetus for those seeking indexation. The complex history of the 1986 Act includes some items that are relevant to the indexation analysis.

In November, 1984, the Treasury Department issued a report to the President outlining and discussing tax reform proposals.[158] This report recommended the repeal of the capital gains exclusion and indexation of capital gains.[159]

In May, 1985, the President submitted his tax proposals to the

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that "[i]t appears . . . that Congress has consistently made a deliberate policy choice not to index asset basis for inflation." OLC Opinion, supra note 4, at 162 n.21. Leaving aside the question of how "deliberate" Congress' choice was, this point is largely irrelevant. Undisputedly, Congress has always had the discretion to amend the Code to require indexation of capital gains, and it has not done so. The fact that Congress has not exercised this discretion in no way signifies that the agency charged with the implementation of the statutory scheme that Congress *has* enacted may not exercise any preexisting authority it may have to interpret current provisions of the statute. This latter question is one of agency authority, not of de novo statutory construction. To illustrate, suppose that the Code had long contained a provision expressly granting the Treasury authority to promulgate a regulation indexing capital gains for inflation and that the Treasury had refrained from exercising this discretion. Surely no one would argue that the Treasury's express statutory authority to require indexation was repealed when Congress failed to enact a legislative proposal to require indexation. Similarly, a congressional failure to enact legislation indexing capital gains for inflation, standing alone, could not reasonably be interpreted as extinguishing any preexisting discretion that the Treasury may have had under *Chevron* to define "cost" to account for the effects of inflation.

[156] If anything, the legislative history of the 1978 Act, including the Senate Report quoted above, clearly reflects a congressional recognition of the difference between "real" and "merely inflationary" gains and the desirability of making some effort to reconcile taxable gain with real gain.

[157] See 128 Cong. Rec. S8903 (July 22, 1982).

[158] Tax Reform for Fairness, Simplicity, and Economic Growth, The Treasury Department Report to the President (Nov. 1984) ("Treasury I").

[159] Id., Vol. 2 at 178-88. The Report also proposed the indexation of inventories, interest on indebtedness, and depreciable assets.

Congress.[160] These proposals differed significantly from the Treasury I proposals. With respect to capital gains, the Treasury II proposals did not recommend the repeal of the capital gains preference but merely reduced its amount. The indexation proposal was virtually eliminated. Treasury II included a proposal that would allow an individual taxpayer to choose, beginning in 1991, either to use the capital gains exclusion preference or to index the basis of capital assets for inflation occurring after January 1, 1991.[161]

The 1986 Act as enacted included the Treasury I proposal to eliminate the capital gains preference and followed Treasury II by not including a general capital gains indexation provision. Congress in effect believed that the elimination of the preference without a compensating provision for indexation was justified by the substantial reductions in tax rates effected by the 1986 Act.[162] However, the effective tax rate on capital gains was actually increased. In addition, Congress felt that eliminating the capital gains preference would extinguish a range of tax shelters in which taxpayers sought to convert ordinary income into capital gain.[163]

The elimination of the capital gains preference also counteracted the reduction in tax rates because the elimination of the preference had the effect of increasing taxes paid on gains arising from inflation. The apparent similarity of treatment of ordinary income and capital gains income effected by the 1986 Act[164] is in this respect

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[160] The President's Tax Proposals to the Congress for Fairness, Growth and Simplicity (May 1985) ("Treasury II").

[161] See *Id.* at 168-69. Treasury II included some other limited indexation proposals, including a proposal to index inventories under the FIFO method of inventory accounting.

[162] As stated in the Senate Report, "the Committee believes that as a result of the large reductions in tax rates, it is no longer necessary to provide a lower rate for capital gains." S. Rep. No. 313, 99th Cong., 2d Sess. 169 (1986). See also Joint Committee on Taxation, General Explanation of The Tax Reform Act of 1986 at 178.

[163] Id.

[164] It is technically inaccurate to say that by eliminating the partial exclusion of capital gains from taxable income Congress intended to treat ordinary income and capital gains income exactly the same. The effect of the elimination of the exclusion was to tax capital gains at the same rate as ordinary income (with a maximum rate of 28%). However, the 1986 Act did not collapse the tax rates into one rate. Instead, the 1986 Act provided a cap of 28% for capital gains rates. This meant that the two types of income were taxed at the same rate, but the cap protected against later attempts to increase ordinary income tax rates. This is exactly what happened in 1990 with the Omnibus Budget Reconciliation Act. That Act slightly increased ordinary income tax rates for both individuals and corporations. The cap ensured that capital gains remain taxable at 28%, and capital gains currently enjoy a slight preference.

superficial. Most types of ordinary income are not affected by inflation from previous years because they are earned during the taxable year. Capital gains, on the other hand, may be adversely affected by inflation for the entire holding period of the asset, which could be many years.[165]

While concern about inflation did not play nearly as great a role in 1986 as it did in Congress' consideration of the 1978 Act, inflation and indexing were discussed at various points during the consideration of the 1986 Act and in both the Treasury I and Treasury II proposals. The subject of indexation was raised, for example, at congressional hearings on the 1986 Act.[166]

Indexation again became a topic of congressional consideration in 1988 during consideration of the Senate Budget Resolution. Senator Armstrong, who had introduced the indexation amendment passed by the Senate in 1982, offered an amendment to the Budget Resolution that would have reduced the revenue base and certain funding levels. He proposed this measure in order to allow, under the terms of Congress' Budget Agreement with President Reagan, proposal of an amendment to the Code that would provide for the indexing of capital gains. Several Senators were opposed,[167] and the Senate tabled the Armstrong amendment by a vote of 66 to 29.

During consideration of the Omnibus Budget Reconciliation Act

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[165] This point was recognized in the Senate debate on the Act. Senator Gordon discussed the merits of indexation on the floor of the Senate. He noted that the tax bill effectively taxed capital gains more than it taxed ordinary income, because long-term capital gains include inflationary "gain" that ordinary income does not. 132 Cong. Rec. S7663-64 (1986).

[166] See, e.g., Tax Reform Act of 1986, Part IV (Deficit Reduction and Capital Formation): Hearings Before the Senate Finance Committee at 61 (February 5 and 6, 1986). While the House debated and rejected a Republican alternative proposal that included a provision for limited indexing of capital gains, the House debate did not address this feature of the Republican alternative.

[167] Senator Bradley indicated that the indexation of capital assets was a logical concept, but that he believed that capital gains should not be indexed alone. Rather, in order to be fair and to have a neutral system, he suggested that depreciation and interest payments also would need to be indexed. Senator Bradley also opposed the spending reductions suggested by Senator Armstrong. 134 Cong. Rec. S3954 (1988). Senator Bentsen opposed the amendment, although he characterized himself as a "strong supporter of a low capital gains rate." Id. at S3955. He did not think that the Budget Resolution was the proper place to consider revisions to the Code, and also was concerned with the potential for instability in the Code, expressing the opinion that it was too soon after the 1986 Act to be tinkering with the Code. Id. Senator Packwood opposed the amendment on similar grounds, as did Senators DeConcini and Chiles.

of 1989,[168] the House again passed a provision indexing capital gains. Under the House bill, certain assets (including corporate stock, tangible capital assets, and property used in a trade or business) acquired after December 31, 1991, would be subject to indexation tied to the Consumer Price Index for purposes of determining gain (but not loss).[169] The Senate bill did not include an indexing provision, and the House indexing provision was dropped in conference.[170]

The most recent congressional consideration of indexing proposals occurred in the 1992 session. The House passed tax legislation that provided for the prospective indexation of capital assets. The Senate version included a capital gains exclusion preference. The Conference version of the bill as approved by the House and the Senate contained a modified version of the Senate's progressive exclusion. The bill imposed a capital gain marginal tax rate of 0, 14, 21, or 28 percent, depending on the individual's taxable income.[171] President Bush vetoed this bill.

* * *

At the risk of over-simplification, the following can be gleaned from the legislative history discussed in the foregoing pages: since 1918, Congress has defined basis as "cost." Nowhere in the legislative history of the Code's capital gains provisions has Congress "directly addressed the precise question" either of the meaning of the term "cost" or of the Treasury's interpretive discretion over that term. From the early days the Treasury has adopted a flexible approach to interpreting "basis" and "cost" and provided for the regulatory adjustment of these items in ways not explicitly sanctioned in the corresponding provisions of the revenue acts. At various times during the legislative evolution of the Code, isolated congressional discussions of the capital gains provisions evidenced a general assumption that the capital gains computation entails the subtraction of original cost from the amount realized on the sale or disposition of an asset. From early on, and with greater force in recent years, Congress has recognized the adverse impact of infla-

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[168] Pub. L. No. 101-239, 103 Stat. 2106 (1989).

[169] See H.R. Rep. 247, 101st. Cong., 1st Sess. 1476-77 (1989).

[170] H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 664 (1989).

[171] See Tax Fairness and Economic Growth Act of 1992, H.R. Conf. Rep. No. 461, 102d Cong., 2d Sess. 356-64 (1992).

tion on capital gains. For most of the history of the Code, Congress has attempted to ameliorate this effect through the provision of a general capital gains tax preference and an additional preference for long-term holders of assets. Congress recently failed on several occasions to enact provisions for the indexation of capital gains, though both the House and the Senate have individually passed such measures.

Some of these points can support a construction of the Code forbidding an administratively mandated capital gains indexing system. We address the most forceful of these arguments below.[172] We believe, however, that none of these arguments subverts our conclusion that the Code does not foreclose the administrative indexing of basis. Congress, in our view, has not spoken clearly and directly to the "precise issue" involved in making such a determination. In neither the language nor the legislative history of the Code has Congress definitively and explicitly defined the term "cost" or otherwise evidenced an unambiguous intent to limit its meaning to original purchase price. Nor does the legislative history contain persuasive evidence that Congress intended to deny the Treasury interpretive discretion to account for economic considerations other than original purchase price in calculating "cost" for purposes of determining capital gains. To the contrary, the legislative and regulatory history of the Code's capital gains provisions demonstrates that the Treasury has exercised, without objection from the Congress, regulatory discretion in applying the concept of cost. The regulations promulgated by the Treasury — especially under the Revenue Act of 1918, the statute which first codified the "cost" definition of basis — demonstrate that the Treasury did not confine itself to a definition of cost limited to original or historical cost if use of such a basis would not truly and accurately measure the taxpayer's income.

The Treasury promulgated its 1918 regulations implementing the concept of "cost" contemporaneously with Congress' initial enactment of that term. These regulations are therefore especially illuminating indications of both Congress' and the Treasury's intent concerning the flexibility inherent in the term — in our view, far more illuminating than arguably inconsistent references in the legislative deliberations of later Congresses. Indeed, the Supreme

[172] See infra notes 221-43 and accompanying text.

Court has recognized the unreliability, if not irrelevance, of statements in the legislative history of later statutes purporting to interpret the intent of Congress in enacting an earlier statute.[173]

In short, while the question is a close one, we believe that the legislative history should not be read to foreclose a reinterpretation by the Treasury of "cost" that better comports with economic reality and the principles underlying the taxation of income. This is particularly true in light of the Supreme Court's recent pronouncements requiring very clear indications of a contrary congressional intent before it will invalidate an agency interpretation of a statute.[174] As the Court of Appeals for the District of Columbia Circuit put it in an analogous context: "By leaving the operative statutory terms undefined and delegating broad rulemaking authority to the [Treasury], . . . Congress has left a gap in the regulatory regime for the agency to fill."[175]

3. Case Law Under the Code Supports the Treasury's Discretion to Interpret "Cost" to Account for Inflation

We next examine relevant judicial precedent. In our view, nothing in the case law interpreting the capital gains provisions of the Code contradicts our conclusion concerning the Treasury's inter-

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[173] While the Supreme Court has been of two minds regarding the significance of subsequent legislative history, in Pierce v. Underwood, 487 U.S. 552, 566-67 (1988), the Court stated that such legislative history is not to be given effect. The question in *Pierce* was whether a committee report setting forth a very definite view of a 1980 statute at the time the statute was reenacted in 1985 without change to its language could influence the reading of the statutory language. The Court stated:

> If this [committee report] language is to be controlling upon us, it must be either (1) an authoritative interpretation of what the 1980 statute meant, or (2) an authoritative expression of what the 1985 Congress intended. It cannot, of course, be the former, since it is the function of the courts and not the Legislature, much less a Committee of one House of the Legislature, to say what an enacted statute means. Nor can it reasonably be thought to be the latter — because it is not an explanation of any language that the 1985 Committee drafted, because on its face it accepts the 1980 meaning of the terms as subsisting, and because there is no indication whatever in the text or even the legislative history of the 1985 reenactment that Congress thought it was doing anything insofar as the present issue is concerned except reenacting and making permanent the 1980 legislation.

Id.

[174] See *Rust*, 111 S. Ct. at 1770 ("It is well established that legislative history which does not demonstrate a clear and certain congressional intent cannot form the basis for enjoining the regulations.").

[175] *Drummond*, 796 F.2d at 507.

pretive discretion. To the contrary, an early Supreme Court decision, *United States v. Ludey*,[176] upheld the Treasury's discretion to fill in gaps that Congress left in the Code's capital gains provisions, specifically with respect to the concept of "cost."[177] The issue in *Ludey* concerned the tax owing on the sale of oil mining property and equipment that the taxpayer owned and operated for several years.[178] Because the taxpayer sold the properties for less than he had paid for them, he contended that he had suffered a loss on the sale and thus owed no taxes.[179] The Treasury, however, deducted from the taxpayer's purchase price certain amounts for depletion and depreciation "[f]or the purpose of determining the cost of the properties sold."[180] After reducing the taxpayer's basis in the property, the IRS calculated that the taxpayer actually had a taxable gain on the sale.

The Court, in an opinion by Justice Brandeis, upheld the Treasury's authority to require the deductions despite the fact that at the time of the sale "none of the Revenue Acts provided in terms that, in computing the gain from a sale of any property, a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation."[181] The *Ludey* Court agreed with the Treasury's view that the real "cost" of the taxpayer's asset for purposes of determining gain or loss on its sale was less than its "original cost" by an amount equal to the sum of the annual deductions from taxable income permitted for depreciation (and depletion). As the Court explained:

> The theory underlying this allowance for depreciation is that by

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[176] 274 U.S. 295 (1927).

[177] The OLC Opinion takes issue with this characterization of the *Ludey* decision, arguing that "*Ludey* is not a decision that upholds agency discretion, but a decision in which the Court construed the statute for itself." OLC Opinion, supra note 4, at 172-73. Whether one views the *Ludey* decision as upholding the Treasury's discretion to interpret the term "cost" or as merely agreeing with the Treasury's interpretation of the term, it nonetheless remains that the Court upheld the Treasury's authority to require a deduction for depreciation in calculating capital gains despite the fact that, as the Supreme Court recognized, "none of the revenue acts provided in terms that . . . a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation." *Ludley*, 274 U.S. at 297 (footnote omitted). The *Ludey* decision refutes the OLC Opinion's conclusion that the term "cost" can only be defined to mean purchase price.

[178] *Ludley*, 274 U.S. at 296.

[179] Id. at 296-97.

[180] Id. at 297.

[181] Id. (footnote omitted).

> using up the [asset] a gradual sale is made of it. The depreciation charged is the measure of the cost of the part which has been sold. When the [asset] is disposed of after years of use, the thing then sold is not the whole thing originally acquired. The amount of the depreciation must be deducted from the *original cost* of the whole in order to determine the *cost* of that disposed of in the final sale of properties.[182]

Thus, the Supreme Court agreed with the Treasury that Congress had not intended to blind the agency to economic reality by confining the calculation of capital gains to items of cost expressly stated in the Code.[183]

But the Court has made equally clear that the Treasury's discretion to "fill in the gaps" in the capital gains provisions is *limited* by economic reality as well.[184] At issue in *Koshland v. Helvering*[185] was a sale of preferred stock on which dividends had been paid in the form of common stock rather than cash. In calculating the taxpayer's gain, the Treasury allocated to the common stock a proportionate amount of the preferred stock's cost, decreasing the basis of the preferred stock and increasing the gain on its sale.[186] The Court rejected the Treasury's analysis.[187]

The Court reasoned that the common stock dividend was in real-

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[182] Id. at 301 (emphasis added).

[183] See also Even Realty Co., 1 B.T.A. 355, 358 (1925) (Under the Revenue Act of 1913, basis was merely the "*starting point* or *primary figure* in the computation of gain or loss," and Congress "expected the computation to include all adjustments necessary to a logical ascertainment of gain or loss.").

[184] In Goodrich v. Edwards, 255 U.S. 527 (1921), the Court even ignored plain statutory language that could not be harmonized with economic reality. The taxpayer had purchased corporate stock in 1912 for $291,600 and had sold it at a loss four years later for approximately $269,000. Id. at 534. The relevant capital gains provisions of the Code at the time of the sale, however, provided that the basis of property acquired before March 1, 1913 "shall be" the fair market value of the property as of that date. Id. at 535. As of March 1, 1913, the taxpayer's stock had a fair market value of approximately $149,000, and he was accordingly taxed the difference between that amount and the amount realized from the sale. Id. at 534. Notwithstanding the specificity of the applicable statutory language, the Court concluded that Congress intended to tax the sale of property "to the extent only that *gains* are derived therefrom." Id. at 535. Since the taxpayer had realized no real "gain" from the sale of the stock, no tax could be assessed against him. The Court's approach to basis for assets acquired prior to March 1, 1913 became a part of statutory law soon after the decision in *Goodrich*. See Revenue Act of 1921, ch. 136, § 202(b), 42 Stat. 227, 229-30 (1921).

[185] 298 U.S. 441 (1936).

[186] Id. at 443.

[187] Id. at 447.

ity taxable income to the taxpayer: "[W]here a stock dividend gives the stockholder an interest different from that which his former stock holdings represented he receives income."[188] In contrast, a stock dividend does not constitute income if it "work[s] no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character."[189] Because in *Koshland* the stock dividends constituted taxable income to the taxpayer, rather than simply an increase in the number of preferred shares representing the taxpayer's unchanged proportionate interest in the corporation, allocating a portion of the preferred stock's basis to the common stock dividends would "in effect . . . convert[ ] an income tax into a capital levy" on the preferred stock.[190] Accordingly, despite the agency's long-standing administrative construction, "the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce [its] cost."[191]

The *Koshland* Court thus refused to allow a concept unrelated to cost to influence the determination of capital gain. As we have discussed previously, however, inflation is clearly and directly related to the cost of a capital asset. Indeed, taxing gains attributable solely to inflation, like the regulatory policy invalidated in *Koshland*, "in effect . . . converts an income tax into a capital levy."[192] While it cannot be said that *Koshland* requires the Treasury to bring its regulatory interpretation of "cost" into harmony with the economic realities of inflation, it indirectly supports the Treasury's regulatory discretion to do so.[193]

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[188] Id. at 446.
[189] Id. at 445.
[190] Id. at 445-46.
[191] Id. at 447.
[192] Id. at 445.
[193] In a number of Tax Court cases, a taxpayer argued that the Code *requires* the Treasury to account for the effects of inflation. See, e.g., Ruben v. Commissioner, 53 T.C.M. (CCH) 992 (1987); Silba v. Commissioner, 68 T.C. 422 (1977), aff'd, 611 F.2d 1260 (9th Cir. 1980); Gajewski v. Commissioner, 67 T.C. 181, 193-95 (1976), aff'd, 578 F.2d 1383 (8th Cir. 1978); Crossland v. Commissioner, 35 T.C.M. (CCH) 262 (1976). These courts refused, in the absence of clear statutory provisions to the contrary, to accept the taxpayer's construction of the Code over the Treasury's contrary construction. None of these cases, however, addressed the issue of whether the Treasury could itself interpret the Code to allow for the consideration of inflation. In other words, the fact that courts have had little trouble rejecting taxpayer claims that conflict with the Treasury's administration of the tax laws does

Cases recognizing similar discretion with respect to terms in other provisions of the Code no more ambiguous than "cost" provide additional support for the Treasury's interpretive discretion concerning that concept. For example, in *Helvering v. Reynolds*,[194] the Supreme Court rejected the taxpayer's contention that the term "acquisition," as it related to property received by bequest, is unambiguous, noting that its meaning could not be resolved "by reference to explicit statements of Congressional purpose."[195] Because the meaning of "acquisition," "[h]owever unambiguous that word might be as respects other transactions," was unclear in the context of bequests, the Treasury had regulatory discretion to define the term so long as its interpretation was "not a strained or artificial one."[196]

Similarly, in *Bob Jones University*, the Supreme Court upheld the Treasury's construction of the term "charitable" in section 501(c)(3) of the Code, which exempts from taxation organizations operated for "religious, charitable . . . or educational purposes."[197] The Treasury regulation at issue in the case interpreted "charitable" to include a requirement that the exempt organization operate in a manner consistent with federal "public policy," specifically the policy against racial discrimination.[198] The Treasury applied this requirement not only to "charitable" organizations, but also to organizations qualifying as "religious" and "educational" under section 501(c)(3). Thus, the Treasury's interpretation of the provision read the disjunctive "or" to mean the conjunctive "and." The Su-

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not mean that a change in agency interpretation must similarly be rejected. Taxpayer interpretations of the Code are not entitled to deference, but Treasury interpretations are. The OLC Opinion misses this point entirely. According to the OLC Opinion, we contend "that income from the sale of a capital asset can be determined . . . *only* by taking inflation into account," a view "similar to the legion of 'tax protester claims' that has so often been rejected by the courts." OLC Opinion, supra note 4, at 156 n.15 (emphasis added). But nowhere have we argued that indexation is the "only" way to determine gain under the Code; to the contrary, we have not questioned that the Treasury's administration of the Code's capital gains provisions represents a reasonable construction of the statute. Again, the relevant question under *Chevron* is not whether the Code *requires* indexation, but whether an agency construction allowing indexation is *permissible* under the statutory scheme. See Part III A-B, supra notes 22-51 and accompanying text.

[194] 313 U.S. at 428.

[195] Id. at 432.

[196] Id. at 433.

[197] 461 U.S. at 599.

[198] Id. at 579.

preme Court nonetheless upheld the Treasury's interpretive regulation, noting that "ever since the inception of the Tax Code, Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws."[199]

Notably, both of these latter cases, particularly *Bob Jones University*, strongly support the Treasury's discretion to change a long-standing statutory interpretation. The Treasury, prior to 1970, had consistently interpreted section 501(c)(3) and its predecessors to allow bona fide educational institutions to qualify for tax exempt status without regard to whether they conformed in all respects to federal "public policy."[200] The Treasury "abruptly" changed course in 1970 and read a public policy requirement into its construction of the Code provision.[201] In upholding the Treasury's reinterpretation, the Supreme Court noted: "In an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems."[202] The Court recognized that "the need for continuing interpretation of [the Code] is unavoidable."[203]

Similarly, *Reynolds* upheld the Treasury's revised view of the statutory term "acquisition" even though that view reversed prior administrative interpretation.[204]

In *Dickman v. Commissioner*,[205] the Supreme Court upheld an agency construction of the Code which changed the agency's interpretation of the gift tax "transfer" provisions. The Court noted:

> [I]t is well established that the Commissioner may change an earlier interpretation of the law, even if such a change is made retroactive in effect . . . . This rule applies even though a taxpayer may have relied to his detriment upon the Commissioner's prior position . . . . The Commissioner is under no duty to assert a particular position as soon as the statute authorizes such an interpretation.[206]

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[199] Id. at 596.

[200] Id. at 619 (Rehnquist, J., dissenting).

[201] Id. at 619-20 (Rehnquist, J., dissenting).

[202] Id. at 596.

[203] Id. at 597.

[204] 313 U.S. at 432-33.

[205] 465 U.S. 330 (1984).

[206] Id. at 343 (citations omitted). See also Davis v. United States, 110 S. Ct. 2014, 2022 (1990) (noting in dicta that the Service "may retain some flexibility to adopt other interpretations [of a statutory term] in the future"); Morrissey v. Commissioner, 296 U.S. 344, 354-

Thus, there is ample precedent both for Treasury's discretion to change its interpretation of the Code and for the judicial validation, under principles of deference, of such changes.[207]

We turn last to three cases in which lower federal courts have indicated that the "cost" of property for tax basis purposes is the amount paid for the property.[208] At first blush, these cases can be argued to foreclose any reinterpretation of "cost" ranging beyond original purchase price. While some commentators have taken that position,[209] upon closer inspection the cases are unremarkable. At bottom, these cases reflect the Treasury's contemporaneous interpretation of "cost." The relevant issue now is whether the Treasury retains discretion to *reinterpret* "cost" to account for inflation. None of these cases addresses this issue, let alone decides it in such a manner as to foreclose the Treasury's interpretive discretion over the term "cost," either with respect to inflation or in other respects.

In fact, at least one of these cases *reaffirms* the Treasury's authority to interpret cost so as to range beyond the purchase price of an asset. In *Hawke v. Commissioner*, the taxpayer purchased stock of his employer pursuant to a contract that allowed the tax-

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55 (1935) (Treasury rulemaking authority is not "so restricted that the regulations, once issued, could not later be clarified or enlarged so as to meet administrative exigencies or conform to judicial decision."); Cohen v. Commissioner, 910 F.2d 422, 427 (7th Cir. 1990) (upholding Treasury interpretation changing construction of gift tax measurement law); Yarbro v. Commissioner, 737 F.2d 479, 483 (5th Cir. 1984) (relying on *Dickman* to uphold interpretation of the Code provision regarding sales or exchanges of capital asset "by abandonment").

[207] This support is not undercut by cases according judicial deference to Treasury regulations that represent a "contemporaneous" construction of the Code provision at issue. See, e.g., *National Muffler Dealers*; Fulman v. United States, 434 U.S. 528, 533 (1978); Fawcus Mach. Co. v. United States, 282 U.S. 375, 378 (1931); *Bingler*, 394 U.S. at 749-50. While some courts have suggested that Treasury interpretations that are not "contemporaneous" are entitled to less deference than contemporaneous interpretations, see, e.g., *City of Tucson*, 820 F.2d at 1287 n.26, the Supreme Court noted in *National Muffler Dealers* that, "[C]ontemporaneity . . . is only one of many considerations that counsel courts to defer to the administrative interpretation of a statute. It need not control here . . . . We would be reluctant to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience." 440 U.S. at 477.

[208] See Vandenberge v. Commissioner, 147 F.2d 167, 168 (5th Cir. 1945), cert. denied, 325 U.S. 875 (1945); Hawke v. Commissioner, 35 B.T.A. 784, 789 (1937), rev'd, 109 F.2d 946 (9th Cir.), cert. denied, 311 U.S. 657 (1940); Silverstein v. United States, 349 F. Supp. 527, 530 (E.D. La. 1972).

[209] See, e.g., NYSBA I, supra note 2, at 6-7; NYSBA II, supra note 2, at 2; OLC Opinion, supra note 4, at 158-59.

payer to purchase the stock at a price less than its fair market value.[210] When the taxpayer later sold the stock, he claimed his basis for purposes of computing gain or loss was the fair market value of the stock at the time purchased rather than the amount he paid for it.[211] The Tax Court upheld the Commissioner's determination that the amount paid for the stock was the proper basis.[212] Significantly, however, the Tax Court considered the relevance of a Treasury regulation providing that where an employer sells stock to an employee for an amount less than its fair market value, the employee should include in his gross income "the difference between the amount paid for the property and the amount of its fair market value."[213] The regulation further stated that "in computing the gain or loss from the subsequent sale of such property its *cost* shall be deemed to be its fair market value at the date of acquisition . . . ."[214] The Tax Court did not find that this regulation, which deviated from the "amount paid" definition of "cost," was an invalid exercise of the Treasury's interpretive discretion. Rather, the Tax Court interpreted the regulation to allow for the fair market value determination of "cost" only when the difference between fair market value and the amount paid was included by the taxpayer in his gross income in the year of acquisition.[215] Since the taxpayer had not done so in this case, the regulation was inapplicable.[216] Thus, the Tax Court's decision demonstrates an acceptance of the Treasury's discretion with respect to the definition of "cost."

More significant is the fact that the Tax Court's ruling against the taxpayer was reversed by the Court of Appeals for the Ninth Circuit.[217] The Ninth Circuit rejected the Commissioner's argument that the regulation quoted above applied only when the taxpayer was taxed on the difference between the fair market value and the amount paid:

> If in fact a taxpayer paid a portion of the purchase price of the

[210] 35 B.T.A. at 784.
[211] Id. at 788.
[212] Id. at 792-93.
[213] Id. at 791 (quoting Treas. Reg. No. 74, Revenue Act of 1928, Art. 51).
[214] Id. (emphasis added).
[215] Id.
[216] Id.
[217] *Hawke*, 109 F.2d at 946.

> stock with his own services, we do not agree to the conclusion of the Commissioner. The treasury regulation is merely a recognition of the principle that a broad rather than restricted meaning must be given the word "cost", and a taxpayer should not be deprived of its provisions merely because he was not taxed during the year of acquisition.[218]

Because the bargain price offered to the taxpayer was part of his compensation, the court of appeals concluded that the regulation applied and that "the taxpayer is entitled to use as his *cost* basis in determining the profit from the sale [of the stock], the fair market value at the time of acquisition."[219] Thus, the *Hawke* case cannot be considered a dispositive rejection of all measures of "cost" other than the original amount paid for an asset.[220]

In sum, the case law relating to the Treasury's interpretive discretion in the capital gains and analogous contexts supports the conclusions that the concept of "cost" is ambiguous and that the Treasury has regulatory discretion to define and apply it in a manner that accords with economic reality and the principles underlying the taxation of income. Indeed, the cases, particularly *Ludey*, tend to support the conclusion that if the Treasury had initially defined the term "cost" in the 1918 Code to account for inflation, the agency's statutory construction would have received substantial deference and been upheld.

The agency did not initially define "cost" to account for inflation, and a decision to do so now would constitute a clear change in its long-standing practice. The inquiry into the validity of such a change must therefore address whether Congress has in some way

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[218] Id. at 949.

[219] Id. at 952 (emphasis added).

[220] Similarly, neither *Vandenberge* nor *Silverstein* can fairly be read to foreclose the Treasury's interpretive discretion over the term "cost." Both cases represent a rather straightforward application of the principle that in determining the cost basis of property, the Treasury may properly take account of economic realities. In *Vandenberge*, the court decided that the cancellation and return to the seller of unsecured notes recognized to be "utterly valueless" should not be considered part of the buyer's purchase price for the property. *Vandenberge*, 147 F.2d at 168. Similarly, in *Silverstein*, the court merely decided that an exchange designed solely to increase the stockholders' basis in their interest in an S corporation and thus to make the corporation's losses deductible to the shareholder was a sham transaction to be disregarded for tax purposes. *Silverstein*, 349 F. Supp. 527. In the words of the court, "[i]n tax matters artifice must not be exalted above reality." Id. at 531. Neither case forecloses a reinterpretation of "cost" that is itself designed to take account of the economic reality of changes in the general price level.

adopted the Treasury's construction of "cost" and has thus precluded any regulatory change. In the absence of congressional *action* amending the Code to incorporate expressly the Treasury's definition of "cost," the question becomes whether Congress has effectively adopted the Treasury's definition through *inaction*, either by reenacting the Code without specifically changing the Treasury's definition or by failing to enact legislative proposals designed to change the agency's definition. For the reasons discussed below, we do not believe that either argument based on congressional inaction should or would likely be sustained in a challenge to administrative indexation.

D. Adoption by the Treasury of Capital Gains Indexing Is Not Foreclosed by Congress' Prior Reenactments of the Code or by Its Failure To Enact Its Own Indexing Measure

Prior to the 1939 Code, Congress generally enacted entirely new revenue acts every two years or so. During this time, a doctrine developed giving Treasury regulations substantially more force if Congress reenacted the revenue laws while the regulations were in effect without changing the provisions interpreted by the regulations. The classic statement of this "reenactment doctrine" can be found in *Helvering v. Winmill*: "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."[221] The doctrine has even earlier antecedents, however.[222]

Although revenue acts are no longer generally reenacted every two years, the reenactment doctrine retains some vitality today. In the *Cottage Savings* case, announced in 1991, the Supreme Court upheld the Treasury interpretation at issue, relying in part on the fact that the agency's interpretation had remained consistent since 1934.[223] Quoting *Winmill*, the Court noted that such a long-standing administrative interpretation, applying to a substantially reenacted statute, was "deemed to have received congressional approval and have the effect of law."[224]

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[221] 305 U.S. 79, 83 (1938).
[222] See, e.g., *Morrissey*, 296 U.S. at 355; *Brewster*, 280 U.S. at 336-37.
[223] 111 S. Ct. at 1508.
[224] Id. See also *Davis*, 110 S. Ct. at 2021 ("Congress' reenactment of the statute in 1954,

With respect to indexing capital gains, it could be argued, with some force, that under the reenactment doctrine a new Treasury interpretation of "cost" has been congressionally precluded. In light of the Treasury's consistent and long-standing interpretation of "cost" to mean original cost, the reenactment of the Code arguably gives the agency's interpretation the force of law. We believe, however, that the reenactment doctrine is not designed and cannot be utilized to support such an argument.

The reenactment doctrine has generally been invoked as a shield to *taxpayer* challenges to long-standing agency interpretations. The doctrine should not be available to a taxpayer as a sword with which to invalidate a new interpretation promulgated by the Treasury. Were it otherwise, the doctrine would eviscerate the agency's well-recognized authority to revise its interpretations in light of experience, shifting policy imperatives, and/or changed circumstances.

This point was made clear in *Helvering v. Wilshire Oil Co.*[225] The taxpayer in that case argued that Congress' reenactment of the revenue laws after the Treasury had interpreted a certain Code provision prevented the Treasury from later changing its interpretation. Noting that "[t]ax statutes and tax regulations never have been static,"[226] the Court rejected the taxpayer's argument. The Court's discussion is worth quoting at length:

> The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change . . . covers the situation where the validity of administrative action standing by itself may be dubious or where ambiguities in a statute or rules are resolved by reference to administrative practice prior to reenactment of a statute; and where it does not appear that the rule or practice has been changed by the administrative agency through exercise of its continuing rule-making power. *It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely*

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using the same language, indicates its apparent satisfaction with the prevailing interpretation of the statute."); *Bob Jones University*, 461 U.S. at 599 ("Congress' awareness of the [Service interpretation at issue] when enacting other and related legislation make out an unusually strong case of legislative acquiescence in and ratification by implication of the 1970 and 1971 rulings.").

[225] 308 U.S. 90 (1939).

[226] Id. at 97.

> *by reenactment of that provision, so that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers* . . . . The contrary conclusion would not only drastically curtail the scope and materially impair the flexibility of administrative action; it would produce a most awkward situation. Outstanding regulations which had survived one Act could be changed only after a pre-view by the Congress. In preparation for a new revenue Act the Commissioner would have to prepare in advance new regulations covering old provisions. Their effectiveness would have to await Congressional approval of the new Act. The effect of such procedures, so far as time is concerned, would be precisely the same as if these new regulations were submitted to the Congress for approval. Such dilution of administrative powers would deprive the administrative process of some of its most valuable qualities — ease of adjustment to change, flexibility in light of experience, swiftness in meeting new or emergency situations. It would make the administrative process under these circumstances cumbersome and slow. Known inequities in existing regulations would have to await the advent of a new revenue act. Paralysis in effort to keep abreast of changes in business practices and new conditions would redound at times to the detriment of the revenue; at times to the disadvantage of the taxpayer. Likewise, the result would be to read into the grant of express administrative powers an implied condition that they were not to be exercised unless, in effect, the Congress had consented. We do not believe that such impairment of the administrative process is consistent with the statutory scheme which the Congress has designed.[227]

Two years later, in *Helvering v. Reynolds*, the Court again made clear that the reenactment doctrine:

> [I]s no more than an aid in statutory construction. While it is useful at times in resolving statutory ambiguities, it does not mean that the prior construction has become so embedded in the law that only Congress can effect a change . . . . It gives way before changes in the prior rule or practice through exercise by the administrative agency of its continuing rule-making power.[228]

This understanding of the reenactment doctrine has been recog-

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[227] Id. at 100-01 (emphasis added). Thus, the Court's analysis in *Wilshire* rejected, although it did not explicitly overrule, the Supreme Court's earlier dicta in the case of Helvering v. R.J. Reynolds Tobacco Co., 306 U.S. 110 (1939). See Bittker and Lokken, supra note 43, ¶ 110.4.3.

[228] 313 U.S. at 432.

nized in many cases since *Wilshire* and *Reynolds*.[229]

Indeed, the *Wilshire-Reynolds* discussion of the reenactment doctrine can be seen as a precursor to the vision of modern administrative law and the role of agencies recognized in cases like *Chevron* and *Rust*. These cases recognize that in order for an agency to fulfill its statutory mandate, it must have the flexibility to vary, within reasonable limits, its interpretations of governing statutes in accordance with experience and changes in policy perspectives and circumstances. A contrary rule, allowing an agency only one shot at interpreting a statutory provision, would drain all meaning from statutory delegations of interpretive discretion and would eliminate the very flexibility that is often the raison d'etre for the administrative scheme.[230]

Thus, the Treasury would have, in our view, a very strong argument against allowing the reenactment doctrine to "carve in stone" its current interpretation of "cost." We believe that a reviewing court would consider the doctrine merely a rule of construction designed to assist in determining whether a new administrative interpretation of "cost" is reasonable under general standards of deference given agency interpretations of statutes.[231]

A similar issue is raised by Congress' failure to enact capital

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[229] See, e.g., American Chicle Co. v. United States, 316 U.S. 450, 454-55 (1942); Campbell v. Brown, 245 F.2d 662 (5th Cir. 1957); Phillips Petroleum Co. v. Jones, 176 F.2d 737, 739 (10th Cir. 1949), cert. denied, 339 U.S. 904 (1950). See also Schuster v. Commissioner, 800 F.2d 672, 676 (7th Cir. 1986) (upholding change in Treasury construction of Code provision despite argument that prior construction had been adopted by Congress through reenactment of the Code); Peoples Fed. Sav. & Loan Ass'n v. Commissioner, 948 F.2d 289, 302-03 (6th Cir. 1991) (same); Galler, supra note 2, at 1794 ("Because it is merely a tool of statutory construction, the legislative reenactment doctrine cannot prevent an agency from altering a long-standing position.").

[230] Moreover, to give controlling effect to an administrative interpretation of the statute once that statute has been reenacted is effectively to transform an executive agency into a legislature. A prior administrative construction of the statute cannot permanently modify the meaning of the underlying legislation because an administrative construction does not meet the requirements in Article I for the passage of binding legislation. See INS v. Chadha, 462 U.S. 919 (1983). See also *State Farm*, 463 U.S. at 45 (Congress' "ratification of an agency construction for failure to change the underlying statute does not incorporate agency construction into statute.").

[231] See also Fribourg Nav. Co. v. Commissioner, 383 U.S. 272, 283-86 (1966); United States v. Leslie Salt Co., 350 U.S. 383, 396-97 (1956). Each of these cases, which rejected a Treasury interpretation of the Code, can be read as applying the reenactment doctrine merely as a rule of construction, rather than as automatically invalidating a later administrative interpretation.

gains indexation legislation, which has been proposed at least five times over the last fifteen years. This question implicates the doctrine of "legislative acquiescence." The theory underlying the doctrine is that Congress' failure to enact a proposed amendment to an existing statute signifies a congressional determination that the law cannot be interpreted in accordance with the proposed amendment.[232]

Some commentators have relied on this doctrine in concluding that the Treasury is foreclosed from reinterpreting "cost."[233] As a theory of statutory construction, however, the legislative acquiescence doctrine suffers from most of the same flaws discussed above with respect to the reenactment doctrine. Most important, the doctrine is virtually blind to the simple truth that legislative proposals are rejected for an infinite variety of reasons, many having nothing to do with Congress' views concerning their merits. Allowing Congress' failure to enact a measure to have controlling interpretive significance over the enactments of a previous Congress not only ignores the realities of the legislative process, but comes perilously close to transferring Congress' exclusive constitutional lawmaking power to executive agencies. As Professor Tribe has noted, "justifying an interpretation of a prior enactment by pointing to what a *subsequent* Congress did *not* enact seems incompatible with our constitutional structure."[234]

The Supreme Court has recognized these problems and has thus generally eschewed reliance on legislative acquiescence principles in this context.[235] The Court has repeatedly warned that " 'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.' "[236]

[232] See Lawrence Tribe, Toward a Syntax of the Unsaid: Construing the Sounds of Congressional and Constitutional Silence, 57 Ind. L.J. 515 (1982).

[233] See, e.g., NYSBA I, supra note 2, at 11; NYSBA II, supra note 2, at 5.

[234] Tribe, supra note 232, at 530 (emphasis in original); see also Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 501 (1988) ("[u]nenacted approvals, beliefs, and desires are not laws"). Interestingly, although the OLC Opinion agrees with this general point, it contradicts itself by arguing that the failure of Congress to enact indexation on its own somehow "ratified" Treasury's interpretation of the Code. Compare OLC Opinion, supra note 4, at 171 with id. at 169.

[235] See, e.g., Aaron v. SEC, 446 U.S. 680, 694 n.11 (1980).

[236] Consumer Product Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 118 (1980) (quoting United States v. Price, 361 U.S. 304, 313 (1960)); see supra note 173. See also Patterson v. McLean Credit Union, 109 S. Ct. 2363, 2371 n.1 (1989) ("Congressional inaction cannot amend a duly enacted statute."); Cleveland v. United States, 329 U.S. 14, 22 n.4

In rare cases, however, the Court has found interpretive significance in congressional inaction.[237] In fact, in *Bob Jones University* the Court relied on such a legislative acquiescence theory in upholding a controversial 1970 Treasury Regulation requiring that tax exempt organizations conform to federal "public policy," although it recognized that "[o]rdinarily, and quite appropriately, courts are slow to attribute significance to the failure of Congress to act on particular legislation."[238] Still, the Court found the particular circumstances surrounding Congress' nonaction in that case to have interpretive significance:

> Nonaction by Congress is not often a useful guide, but the nonaction here is significant. During the past 12 years their have been no fewer than 13 bills introduced to overturn the IRS interpretation of section 501(c)(3). Not one of these bills has emerged from any committee, although Congress has enacted numerous other amendments to section 501 during this same period, including an amendment to section 501(c)(3) itself . . . . In view of its prolonged and acute awareness of so important an issue, Congress' failure to act on the bills proposed on this subject provides added support for concluding that Congress acquiesced in the IRS rulings of 1970 and 1971.[239]

In contrast to the circumstances presented in *Bob Jones University*, Congress' failure to enact capital gains indexation legislation presents a rather weak claim of legislative acquiescence. First, while Congress has not actually enacted a capital gains indexing proposal, the legislative history of Congress' consideration of such proposals reveals, if anything, that Congress *favors* the concept of indexing capital gains. Indeed, as previously discussed,[240] indexa-

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(1946) (Rutledge, J., concurring) ("[I]n view of the specific . . . constitutional procedures required for the enactment of legislation," an "action or *nonaction* not taken in accordance with the prescribed procedures" should be given no "legislative effect.") (emphasis added); Girouard v. United States, 328 U.S. 61, 69 (1946) ("It is at best treacherous to find in Congressional silence alone the adoption of a controlling rule of law."); *Texas Rural Legal Aid*, 940 F.2d at 695; Tribe, supra note 232, at 516-19.

[237] See, e.g., Pacific Gas and Elec. Co. v. State Energy Resources Conservation and Dev. Comm'n, 461 U.S. 190, 220 (1983) ("While we are correctly reluctant to draw inferences from the failure of Congress to act, it would, in this case, appear improper for us to give a reading to the Act that Congress considered and rejected.").

[238] 461 U.S. at 600.

[239] Id. at 600-01.

[240] See supra notes 151-71 and accompanying text.

tion measures have *passed* in recent sessions of both the Senate and the House.

These facts contrast starkly with the history of Congress' consideration of proposals to overturn the Treasury's "public policy" interpretation of section 501(c)(3), where none of the proposals, as the *Bob Jones University* Court emphasized, even got out of committee. Far from indicating its acquiescence in the existing administrative interpretation of "cost," Congress' deliberations on the issue to date suggest that a majority of both Houses would welcome a Treasury reinterpretation of "cost" to take account of inflation.[241]

More important than the stark factual distinctions between *Bob Jones University* and this case is the equally stark distinction in the postures in which the claims of legislative acquiescence arise. The Supreme Court in *Bob Jones University* invoked legislative acquiescence to *uphold* the Treasury's 1970 change in its prior long-standing interpretation of the Code, against taxpayers' claim that the agency's reinterpretation was not authorized under the statute. Thus, the doctrine of legislative acquiescence buttressed and reinforced the principle of judicial deference to the administrative agency's construction of its statute. Here, in contrast, legislative acquiescence would be invoked as a sword to *invalidate* the Treasury's reinterpretation of "cost" to account for inflation.

We are aware of no Supreme Court case that has applied the doctrine of legislative acquiescence to void an otherwise valid administrative regulation construing the agency's own statute.[242] Nor

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[241] Contrary to the assertion in the OLC Opinion, we do not rely on this fact as somehow affirmatively demonstrating that Congress has legislatively *approved* the indexation of capital gains. See OLC Opinion, supra note 4, at 168-69. Rather, the point is that it is simplistic and dangerous to blindly infer from the failure of Congress to enact legislation that Congress has legislatively *foreclosed* certain action.

[242] The Supreme Court has invoked legislative acquiescence principles against the government in the context of de novo judicial review of the statutory issue in dispute. In these cases, however, the Court rejected the government's litigating position rather than a regulation presenting a formal agency construction of statutory language that the agency was charged with administering. See, e.g., *Pacific Gas and Elec.*, 461 U.S. at 220; Federal Trade Comm'n v. Ruberoid Co., 343 U.S. 470, 478-79 (1952). Thus, the Court in these cases was not confronted with an agency position entitled to *Chevron*-type judicial deference.

In Andrus v. Shell Oil Co., 446 U.S. 657 (1980), the Supreme Court relied in part on legislative acquiescence principles in rejecting the Department of the Interior's changed interpretation of a statutory term. The agency did not argue, however, that its new interpretation was a permissible change in interpretation entitled to deference. Instead, the agency is it difficult to understand why the doctrine has not been applied by the Court as a sword, for invalidating an agency's statutory interpretation on the strength of a claim of legislative acquiescence would raise all the problems recognized, in the passage from *Helvering v. Wilshire Oil Co.* quoted earlier,[243] with respect to the reenactment doctrine. Moreover, such a theory of legislative acquiescence logically could make the validity of agency changes in regulatory policy turn on the timing of judicial review of the agency's action. For example, if a Treasury reinterpretation of "cost" to account for inflation was challenged after a failed congressional attempt to overturn it, the doctrine of legislative acquiescence could be asserted in *support* of the agency's reinterpretation rather than in opposition to it. Finally, application of the doctrine as a sword against regulatory changes would be inconsistent with the principles of judicial deference enunciated in *Chevron* and analogous cases.

A Treasury Regulation indexing capital gains for inflation, therefore, should not succumb to challenges based upon the reenactment doctrine or the doctrine of legislative acquiescence. This brings us finally to the question whether such a Treasury Regulation would be supported by a "reasoned analysis."

IV. A Treasury Regulation Indexing Capital Gains Would be Supported by a "Reasoned Analysis"

The Treasury, in our view, would clearly have reasoned support for reinterpreting the term "cost" to permit the indexing of capital gains. As discussed at length earlier in this article, the indexation of capital gains not only furthers the purposes underlying the Code, it better accords with economic reality than does the Treasury's current approach. The theory of taxation of incomes is to tax a person on an increase in his wealth — on "a gain, a profit, something of exchangeable value . . . received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal."[244]

argued that its prior interpretation was "plainly erroneous" and that its new interpretation was required to correct the error. Id. at 662. The Court examined the legislative history of the original statute and concluded that the agency's prior interpretation was the correct one. Id. at 663-66. This conclusion was "confirmed" by the Court's review of later congressional action. Id. at 666.

[243] See supra 225-27 and accompanying text.

[244] *Eisner*, 252 U.S. at 207.

To the extent that a tax is imposed on a gain attributable to inflation, it is a tax on an illusory "gain" that may in fact be a loss in the taxpayer's purchasing power, his true wealth. Moreover, taxation of capital gains on an unindexed basis disadvantages those taxpayers who have made long term investments in capital assets. The indexation of capital gains would, by more accurately assessing real income — that is, the true increase in a person's wealth or purchasing power — eliminate these effects and run truer to the principles underlying federal income taxation.

These same considerations support administrative indexation even though it represents a change from the Treasury's current and long-standing practice. In 1986 Congress virtually eliminated the preferential tax treatment historically accorded to capital gains. As previously discussed, this preferential treatment was expressly justified in part by the adverse effect of inflation on capital gains. The preferential tax treatment historically accorded to capital gains renders the Treasury's pre-1986 inaction on the subject of capital gains indexation unremarkable, and the virtual elimination of the preference by Congress supports current administrative action with respect to the issue.[245] In short, the capital gains taxation regime has not remained consistent, and only an unyielding preference for "foolish consistency" would justify an insistence that the administrative scheme for the measurement of capital gains remain unchanged. Similarly, indexation of capital gains is consistent with Congress' general purpose in 1986 of providing equal treatment to

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[245] Many economists support the policy, reflected in the 1986 Act, of eliminating any kind of preferential tax treatment for capital gains, which they see as producing undesirable economic distortions. As Richard and Peggy Musgrave have noted: "With regard to realized gains, most students of taxation hold that there is no good justification on equity grounds for preferential treatment . . . . There seems little doubt, on equity grounds, that realized capital gains should be treated as ordinary income." Musgrave and Musgrave, supra note 17, at 245. Musgrave and Musgrave also recognize, however, that inflation must be accounted for:

> The equity case for full taxation of capital gains is tempered, however, by the impact of inflation. If capital gains are a reflection of an inflationary increase in nominal values only, they should not be taxed. To produce a meaningful index of taxable capacity, it is evident that income should be defined in real terms, i.e., that changes in the price level should be allowed for in determining taxable income. This is of special importance with regard to changes in asset value. A rise in the money value of an asset which is matched by an increase in price level is an illusory capital gain and should not be considered income.

Id. at 246.

capital gains and personal income, since the detrimental effects of inflation largely do not adversely affect personal income, particularly given indexation of tax brackets.[246]

V. Conclusion

The foregoing analysis does not attempt to address a host of subsidiary issues, both legal and policy, that would confront the Treasury were it to promulgate a regulation providing for indexation of capital gains. Some of these issues may present formidable practical or political obstacles to any decision to provide for indexation without an amendment to the Code, and, for that reason, they should be considered before any indexation proposal is put into effect.[247] Our analysis in this article has been confined to the purely legal question whether the Treasury would have a sound legal basis for adopting a regulation indexing capital gains for inflation. For the foregoing reasons, we believe that it would, and that therefore the decision whether to index capital gains administratively should hinge not upon the views of lawyers, but upon the views of the President concerning the national interest.

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[246] See also Galler, supra note 2, at 1796 ("Because agency interpretation is largely a matter of discretionary policy making, and there are plausible arguments in support of reasonableness, it is likely that the proposed contruction of 'cost' would be upheld, if a challenge were to reach the reasonableness aspect of *Chevron's* step 2".).

[247] One such issue involves the implications outside the capital gains context of a reinterpretation of "cost" to account for inflation. The "cost" provision of Code § 1012 applies to items other than capital gains and losses. A reinterpretation of "cost" would affect these other items, unless the new interpretation was somehow limited to the capital gains context. Such a limitation may be accomplished more easily through a statutory amendment than through selective interpretation of existing statutory terms. See NYSBA I, supra note 2, at 2-5; NYSBA II, supra note 2, at 6-8. Other practical issues involve the effects of indexation on the federal budget, and the budgetary and administrative implications of making administrative indexation retroactive or of purely prospective effect. These issues belong more properly in the domain of economists, politicians, and policymakers than they do in the legal realm. Finally, there may be a significant question regarding whether any taxpayer would have legal standing to challenge administrative indexation in court. In an inflationary era, there are substantial doubts whether any taxpayer would be injured by a rule taking into account the effects of changes in the general price level. See Zelenak, supra note 2, at 841-42. We have not examined this standing issue because, in our view, it should play no role in the decision whether the Treasury has legal authority to reinterpret "cost." This issue of legal authority should instead be decided on its merits. No conscientious policymaker should order administrative indexation of capital gains, no matter how clear it might be that such a regulation would be immune from judicial challenge, if he is not persuaded that there is a sound legal basis for administrative indexation.

APPENDIX: MEMORANDUM FOR JEANNE S. ARCHIBALD RE: LEGAL AUTHORITY OF THE TREASURY TO ISSUE REGULATIONS INDEXING CAPITAL GAINS FOR INFLATION 16 Op. Off. Legal Counsel 145 (1992) (OLC Opinion)

General Counsel, Department of the Treasury*

[145] You have asked for our opinion whether the Department of the Treasury (Treasury) has legal authority to amend its regulations to index capital gains for inflation. In connection with that request, you have provided us with your legal opinion concluding that Treasury does not have such authority. Opinion of the General Counsel (Aug. 28, 1992) (Treasury Memorandum) (copy attached). In reaching that conclusion, you consider in detail, and specifically reject, arguments presented by the National Chamber Foundation in the form of a legal memorandum prepared by its private counsel, which concludes that Treasury has such legal authority. See Memorandum for Dr. Lawrence A. Hunter, Executive Vice President, National Chamber Foundation, by Charles J. Cooper, et. al. (Aug. 17, 1992) (NCF Memorandum).

We have carefully reviewed the arguments set forth in the Treasury Memorandum and the NCF Memorandum. As a result of that review, and of our own research and analysis, we are compelled to agree with Treasury's legal conclusion that Treasury does not have legal authority to index capital gains for inflation by means of regulation.[1]

I.

Section 1001(a) of the Internal Revenue Code (Code) provides that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the [146] adjusted basis provided in section 1011." The general rule of section

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Ed. note - the typeface conventions of this memorandum were modified to conform to Virginia Tax Review standards. In addition, original pagination is indicated in brackets.

[1] Were we to disagree with your conclusion, and were Treasury to adopt a regulation of the sort proposed by the NCF Memorandum, we expect that the regulation would be challenged in court. Accordingly, we have consulted with the Department of Justice's Tax Division, the litigating division that would be responsible for defending any such indexing regulation. That division concurs fully in the conclusions set forth herein.

1011(a) is that a property's adjusted basis is its "basis (determined under section 1012 . . .), adjusted as provided in section 1016." Section 1012 defines the basis of property as generally "the cost of such property." Although the term "cost" is not further defined in the Code, since the inception of the federal income tax system following ratification of the Sixteenth Amendment in 1913, Treasury has consistently interpreted the statutory term "cost" to mean price paid. Compare, e.g. T.D. 2090, 16 Treas. Dec. Int. Rev. 257, 273 (1914) ("The cost of property purchased . . . will be the actual price paid for it. . . .") with 26 C.F.R. § 1.1012-1(a) (1992) ("The cost [of property] is the amount paid for such property in cash or other property."). The current regulation dates from 1957. See T.D. 6265, 22 Fed. Reg. 8935, 8938 (1957).

The sole issue presented by your request is whether Treasury may, by amending its regulations, reinterpret the statutory term "cost" to mean the price paid as adjusted for inflation. The NCF Memorandum argues that Treasury may do so. In making that argument, the Memorandum relies heavily on analysis of the Supreme Court's decision in *Chevron U.S.A. Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).[2] *Chevron* announced a two-step rule for courts to follow when reviewing an agency's construction of a statute that it administers. The court must always first examine "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Id. at 842-43. If, however, "the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." Id. at 843. As the Court noted in *Chevron*, " '[t]he power of an administrative agency to administer a congressionally created program necessarily requires the formulation of policy and

[2] See NCF Memorandum at 1 ("We must stress at the outset that our analysis of this question depends heavily on the standard of judicial review that would apply to such a regulation [under *Chevron*]."); id. at 12 ("The framework for analyzing the issue under study is provided by the Supreme Court's landmark *Chevron* decision."); id. at 21 ("In terms of the *Chevron* doctrine, the question is whether Congress has . . . delegated authority to the Treasury to interpret the statute."); id. at 23 ("Accordingly, the basic question under *Chevron* is whether the term 'cost' is amenable to a construction that takes account of inflation.").

the making of rules to fill any gap left, implicitly or explicitly, by Congress.' " Id. (quoting *Morton v. Ruiz*, 415 U.S. 199, 231 (1974)). But any such "gap" must be created by Congress: [147] "assertions of ambiguity do not transform a clear statute into an ambiguous provision." *United States v. James*, 478 U.S. 597, 605 (1986).[3]

The NCF Memorandum's central argument rests on the proposition that "cost" is an ambiguous term. In essence, the Memorandum argues that Congress, in using that word, left a "gap" in the statutory scheme to be filled by Treasury in the exercise of its rulemaking power under the Code. Specifically, the NCF Memorandum asserts that the "meaning of 'cost' is sufficiently ambiguous to permit the exercise of administrative discretion" to interpret cost in a manner that takes account of inflation, id. at 23, and consequently that in light of *Chevron*, "a regulation indexing capital gains for inflation should and would be upheld judicially as a valid exercise of the Treasury's interpretive discretion under the [Code]," id. at 1.[4] [148] *Chevron* is a profound expression of princi-

[3] Two members of the Supreme Court have suggested that an agency construction should prevail if the statute is merely "arguably ambiguous." See K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 293 n.4 (1988) (opinion of Kennedy, J., joined by White, J.). The NCF Memorandum's characterization of the "arguably ambiguous" standard as the view of "the Court" in that case, id. at 22 n.11, however, is plainly mistaken. Only two Justices embraced that view, and they expressly took issue with the refusal of four other members of the Court to recognize the alleged ambiguity. See 486 U.S. at 293 n.4.

[4] Although we agree with the conclusion of the NCF Memorandum that *Chevron* provides the framework for analyzing this issue, we note that there remains some confusion in the case law on this point. In Cottage Savings Association v. Commissioner, 111 S. Ct. 1503 (1991), the Supreme Court considered a challenge to a Treasury regulation interpreting a provision of the Code. The Court noted that Congress had given Treasury the broad power "to promulgate 'all needful rules and regulations for enforcement of the Internal Revenue Code.' " Id. at 1508 (quoting I.R.C. § 7805(a)). Based on that grant of authority, the Court held that it "must defer to [Treasury's] regulatory interpretations of the Code so long as they are reasonable." Id. (citing National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 476-77 (1979)). The Court made no reference to *Chevron* or its progeny.

Whatever the significance of the Court's failure in *Cottage Savings* to cite *Chevron*, we have found no case that has expressly rejected application of *Chevron* to regulations interpreting the Internal Revenue Code. Some lower court cases apply the *National Muffler* standard without considering *Chevron*, see, e.g., Davis v. United States, No. 91-1840, 1992 U.S. App. Lexis 19628 (7th Cir. Aug. 25, 1992), while others cite both cases without resolving any supposed inconsistency between them, see, e.g., American Medical Ass'n v. United States, 887 F.2d 760, 770 (7th Cir. 1989). Two courts of appeals, however, expressly applied *Chevron* to interpretative regulations under the Internal Revenue Code. See RJR Nabisco, Inc. v. United States, 955 F.2d 1457, 1464 (11th Cir. 1992); Peoples Federal Sav. & Loan Ass'n v. Commissioner, 948 F.2d 289, 299 (6th Cir. 1991). A third court of appeals noted the two different standards but declined to choose between them, because on the facts of the ples that flow from the doctrine of separation of powers. The decision recognizes the appropriate roles of each of the three branches of government. Congress writes laws; the Executive Branch interprets and enforces them. Congress may, however, leave greater or lesser scope for Executive action. Thus, Congress often leaves to the Executive Branch the task of filling in the [149] gaps in the statutory scheme through interpretation, and courts must then defer to the Executive's reasonable interpretations. As the *Chevron* Court explained:

> While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices — resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.

467 U.S. at 865-66.

Chevron is thus a powerful analytical tool for the smooth administration of complex statutes and for the defense of agency actions under such statutes. It is not, however, unlimited. *Chevron* also teaches that when Congress writes legislation in specific terms, if it

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case, either standard would have compelled the same result. Pacific First Fed. Sav. Bank v. Commissioner, 961 F.2d 800, 803 (9th Cir. 1992) (noting, however, that much of the reasoning in *Peoples Federal* was persuasive), Petition for cert. filed, 61 U.S.L.W. 3150 (U.S. Aug. 12, 1992) (No. 92-270). Cf. Georgia Fed. Bank v. Commissioner, 98 T.C. 105, 107-08, 118 (1992) (rejecting Sixth Circuit's conclusions in *Peoples Federal*, but applying *Chevron* principles).

Even if we assume that application of the *National Muffler* test rather than the *Chevron* test can produce different results in some cases, as applied here *National Muffler* would not alter our conclusion. The *National Muffler* standard requires that a regulation "harmoniz[e] with the plain language of the statute, its origin, and its purpose." 440 U.S. at 477. This permits not a plenary review by the court, but rather a determination whether the regulation is a "reasonable" interpretation of the statute. Id. at 476. Because the interpretation advanced in the NCF Memorandum is contrary to the plain language of the statute, it would fail the *National Muffler* test as well as the *Chevron* test.

In addition, we note that the Treasury Memorandum cites several decisions in which the courts of appeals have continued to apply — in the wake of *Chevron* — the traditional distinction between "legislative" and "interpretive" regulations in determining how much deference is due Treasury's interpretation of the Code. Treasury Memorandum at 41-42. Under this regime, "legislative" regulations generally are accorded greater deference than are "interpretive" regulations. We need not address the issue of *Chevron*'s impact upon this traditional distinction here, because in either case the plain meaning of the statute will control. We note, however, that the Supreme Court has not conclusively resolved this issue.

does not leave policy choices to be resolved by an administrative agency, then Congress' decision binds both the Executive Branch and the Judiciary. To repeat: "If the intent of Congress is clear, that is the end of the matter." Id. at 842. In particular, *Chevron* does not furnish blanket authority for the regulatory rewriting of statutes whenever a dictionary gives more than a single definition for a statutory term or whenever some arguably relevant discipline assigns a specialized, technical meaning to such a term. Such a reading of *Chevron* would eviscerate the well-established rule of construction that statutes must be accorded their plain and commonly understood meaning.[5] Indeed, it would lead to a legal regime in which many statutory terms with widely understood meanings would be deemed "ambiguous." In this regard, we fully concur in your conclusion that "[i]f the plain meaning doctrine could be applied only to words that have only one conceivable meaning, it would have precious little utility as a principle to resolve conflicting interpretations of statutes." Treasury Memorandum at 7-8.[6]

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[5] This rule of construction, like *Chevron* itself, sounds in the separation of powers under the Constitution and thus is an important limitation on judicial power. See In re Sinclair, 870 F.2d 1340, 1344 (7th Cir. 1989) (Easterbrook, J.).

[6] Accordingly, courts have generally been reluctant to treat the meaning of a single word or a short phrase as other than a "pure question of statutory construction" on which courts will not defer to agencies. INS v. Cardoza-Fonseca, 480 U.S. 421, 446 (1987). Courts have rejected agency interpretations of such words or terms in favor of the courts' own reading of the statutory language. See, e.g., Conecuh-Monroe Community Action Agency v. Bowen, 852 F.2d 581, 588-89 (D.C. Cir. 1988) (meaning of "terminate"); Telecommunications Research & Action Ctr. v. FCC, 836 F.2d 1349, 1357-58 (D.C. Cir. 1988) (meaning of "system of random selection"); Santa Fe Pac. R.R. v. Secretary of Interior, 830 F.2d 1168, 1174-80 & n.91 (D.C. Cir. 1987) (meaning of "lieu selection . . . right").

Surprisingly, the NCF Memorandum nowhere discusses the plain meaning rule, despite its obvious importance to the legal analysis. The omission is significant, because the methodology adopted by the NCF Memorandum would undermine the rule. Of course, the availability of two clearly inconsistent and equally plausible alternative dictionary definitions can in some circumstances "indicate[ ] that the statute is open to interpretation," National R.R. Passenger Corp. v. Boston & Me. Corp., 112 S. Ct. 1394, 1402 (1992), particularly if the overall statutory context of the provision at issue provides evidence that the agency's proffered interpretation is a reasonable one, id. Clearly, however, the mere existence of alternative dictionary definitions will not establish "ambiguity." Were that so, the dictionary would become an irresistible engine for destroying the plain meaning rule. In practice, of course, the courts rely on dictionary definitions to *establish*, rather than obscure, plain meaning. E.g., United States v. Rodgers, 466 U.S. 475, 479-80 (1984) (rejecting "alternative definition" of term "jurisdiction" provided by dictionary in favor of "[t]he most natural, nontechnical reading" provided by same source). See also Mallard v. United States District Court, 490 U.S. 296 (1989), discussed infra. As we shall demonstrate, there is no ambiguity in the term "cost" in its statutory context.

[150] *Chevron* teaches that the inquiry into the meaning of a statutory term — including whether that meaning is ambiguous — [151] is to be conducted by "employing traditional tools of statutory construction." 467 U.S. at 843 n.9. See also *INS v. Cardoza-Fonseca*, 480 U.S. 421, 449 (1987) (using "ordinary canons of statutory construction" to ascertain the meaning of statutory terms). These tools and canons include examination of "the plain language of the Act, its symmetry with [other relevant legal materials], and its legislative history." Id. Additionally, "[i]n ascertaining the plain meaning of the statute, the court must look to . . . the language and design of the statute as a whole." *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988). In reaching its ultimate conclusion that Treasury lacks the legal authority to index capital gains for inflation, your opinion considers and rejects the NCF Memorandum's arguments that the term "cost" is ambiguous. It concludes that "[t]he statute itself has a plain meaning which is clear and unambiguous: cost means the 'actual price paid' or 'purchase price.'" Treasury Memorandum at 1. See also, e.g., id. at 4-8. As set forth below, we also conclude that "cost" is not ambiguous in the context of determining gain or loss from the disposition of property.

II.

A.

We must begin with what the Supreme Court has called a "fundamental canon of statutory construction" that "unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). This fundamental canon, of course, applies with full force to the tax laws. See, e.g., *Crane v. Commissioner*, 331 U.S. 1,

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The courts recognize that an "ambiguity" can properly be found only if there is a genuinely *reasonable* and *relevant* alternative reading of a term, not a merely *possible* or *arguable* alternative reading. Only this past Term, for instance, the Supreme Court found the meaning of the statutory phrase "person entitled to compensation" to be "plain," Estate of Cowart v. Nicklos Drilling Co., 112 S. Ct. 2589, 2596 (1992), despite the dissenting Justices' argument that it could bear two distinct interpretations, id. at 2607. (Blackmun, J., dissenting). See also United States v. James, 478 U.S. 597 (1986) (holding that the provision of the Flood Control Act creating immunity for "damage" was not ambiguous even though that term might arguably refer only to damage to property rather than, as ordinarily understood, to damage to both persons and property).

6 (1947) ("[T]he words of statutes — including revenue acts — should be interpreted where possible in their ordinary, everyday senses."); *Old Colony Trust Co. v. Commissioner*, 301 U.S. 379, 383 (1937) ("The words of the statute are plain and should be accorded their usual significance in the absence of some dominant reason to the contrary."); *Helvering v. San Joaquin Fruit & Inv. Co.*, 297 U.S. 496, 499 (1936) ("Language used in tax statutes should be read in the ordinary and natural sense.").[7] Therefore, in order to determine [152] whether "cost is an ambiguous statutory term, we must first attempt to ascertain the "ordinary, contemporary, common meaning" of that term.

"Cost" first appears in the federal tax laws in the capital gains context in the Revenue Act of 1918.[8] The Supreme Court has explained that statutory terms are best understood by reference to meanings common at the time of their adoption. *Shaare Tefila Congregation v. Cobb*, 481 U.S. 615, 617 (1987).[9] Dictionaries that are roughly contemporaneous with the enactment of that Act de-

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[7] In United States v. Leslie Salt Co., 350 U.S. 383 (1956), the Supreme Court unanimously rejected Treasury's "more recent ad hoc contention" as to how the statutory term "debenture" should be construed, in favor of Treasury's "prior longstanding and consistent administrative interpretation." Id. at 396. Treasury's traditional interpretation, the Court held, was more "in accord with *the generally understood meaning* of the term 'debentures.' 'The words of the statute [a stamp tax statute] are to be taken in the sense in which they will be understood *by that public in which they are to take effect*.' " Id. at 397 (citations omitted; emphases added; brackets in original).

[8] The Revenue Act of 1918 was actually enacted into law early in 1919. It provided in part: "That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, . . . the basis shall be . . . the cost thereof." Act of Feb. 24, 1919, ch. 18, § 202(a)(2), 40 Stat. 1057, 1060.

Subsequent revenue acts, see infra note 16, adopted the formulation in effect today: in general, the basis of property is "the cost of such property." In 1939, Congress began the practice of codifying the tax laws. The definition of property's basis as generally "the cost of such property" appears unchanged in all three codifications. See Internal Revenue Code of 1939, ch. 2, § 113(a), 53 Stat. 1, 40; Internal Revenue Code of 1954, ch. 736, § 1012, 68A Stat. 1, 296 (codified at I.R.C. § 1012); Internal Revenue Code of 1986, Pub. L. No. 99-514, § 2, 100 Stat. 2085, 2095 (reenacting in relevant part the Internal Revenue Code of 1954).

[9] See also Molzof v. United States, 112 S. Ct. 711, 715 (1992) (relying upon "[l]egal dictionaries in existence when the [Federal Tort Claims Act] was drafted and enacted" to ascertain the meaning of a term used in that statute). Thus, although the meaning of the term "cost" has not changed in the 74 years since the enactment of the Revenue Act of 1918, we refer to authority contemporaneous with the first appearance of "cost" in this context.

Indeed, the definition of "cost" has remained essentially unchanged since the publication of the first modern English dictionary in 1755. In that year, Dr. Johnson defined "cost" principally as "[t]he price of any thing." 1 Samuel Johnson, A Dictionary of the English Language (1755) (George Olms Verlagsbuchhandlung ed. 1968).

fine "cost" as the price paid for a thing or service. See, [153] e.g., Webster's New International Dictionary of the English Language 509 (1917) ("*The amount or equivalent paid*, or given, or charged, or engaged to be paid or given for anything bought or taken in barter or service rendered . . . .") (emphasis added); 1 Bouvier Law Dictionary 689 (8th ed. 1914) ("The cost of an article purchased for exportation is the price paid, with all incidental charges paid at the place of exportation. Cost price is that actually paid for goods.") (citations omitted); 2 A New English Dictionary on Historical Principles 1034 (James A.H. Murray ed., New York, MacMillan & Co. 1893) ("That which must be given or surrendered in order to acquire, produce, accomplish, or maintain something; *the price paid for a thing*.") (emphasis added). More recent dictionaries give the same definition. See, e.g., American Heritage Dictionary 301 (1976) ("An amount paid or required in payment for a purchase."); Black's Law Dictionary 345 (6th ed. 1990) ("Expense; price. The sum or equivalent expended, paid or charged for something."). Indeed, the only dictionary cited in the NCF Memorandum also gives as the primary meaning of cost "the price paid to acquire, produce, accomplish, or maintain anything." NCF Memorandum at 24 (quoting Random House Dictionary of the English Language 457 (2d ed. 1987)).

The NCF Memorandum's analysis of this dictionary meaning is revealing. The Memorandum first quotes the full definition: "1) the price paid to acquire, produce, accomplish, or maintain anything . . . 2) an outlay or expenditure of money, time, labor, trouble, etc.: What will the cost be to me?, 3) a sacrifice, loss, or penalty: to work at the cost of one's health." It then ignores the primary definition of cost — "price paid" — in favor of the third, obviously figurative, definition of cost as "loss" or "sacrifice."[10] NCF Memorandum at 24. To this, the Memorandum adds "expenditure" generally, rather than "expenditure of money," which is the relevant concept when one is discussing the acquisition of property. The NCF Memorandum thus takes a perfectly clear defi-

[10] Moreover, after describing the third alternative dictionary definition of "cost" as "*a* standard definition," the NCF Memorandum suggests later on the same page that it is "*the*" standard definition, implying that the third definition is the *only* meaning of the term. NCF Memorandum at 24 (emphases added). Thus, the *primary* dictionary definition of "cost" is spirited away.

nition of cost as applied to financial matters — price paid, or outlay or expenditure of money — and, without any discussion or further mention of that clear definition, seeks to obfuscate it.[11]

[154] The NCF Memorandum attempts to mix the figurative and literal meanings of "cost" by asserting that "[a]ny such 'loss,' 'sacrifice,' or 'expenditure' needs to be ascribed a monetary value in order to determine the [taxable] gain realized" on the sale of an asset. NCF Memorandum at 24. The Memorandum further asserts that the monetary value of a loss, sacrifice, or expenditure could be measured at other than the time it is incurred — at either the time of purchase or the time of sale. The Memorandum concludes: "We can discern nothing in the standard definition of 'cost' . . . suggesting that the historical 'purchase price' measurement of monetary value must be used in preference to a measurement that coincides with the sale of the asset." Id. Finally, the Memorandum asserts that when cost to the taxpayer is measured at the time of sale, it is legally appropriate to state cost in inflation-adjusted dollars to reflect the real impact of the purchase and sale on the taxpayer's buying power. Id. at 25.

We disagree with this line of reasoning on several levels. First, as reflected in each of the dictionary definitions of "cost" set forth above, the first and most common meaning of the term is the price paid. "Price paid" obviously *does* suggest an "historical 'purchase price' measurement of monetary value." The primacy of this meaning is easily illustrated. If one were asked "How much did your car cost?" a response simply that "the car cost $10,000" would be considered truthful only if that amount were at least a close approximation of the actual price paid at the time of purchase. In contrast, a response based on some specialized meaning of the term "cost" (such as cost expressed in inflation-adjusted dollars or net

[11] The analysis set forth in the NCF Memorandum stands in marked contrast to the analysis employed by the Supreme Court in similar circumstances. In Mallard v. United States District Court, 490 U.S. 296 (1989), the Court was called on to interpret the word "request." The Court first looked to "closest synonyms" in "everyday speech," namely, "ask," "petition," and "entreat." Id. at 301 (citing Wester's New International Dictionary 1929 (3d ed. 1981) and Black's Law Dictionary 1172 (5th ed. 1979)). Although the Court acknowledged that the dictionary gave other entries — "require" and "demand" — it found "little reason to think that Congress did not intend 'request' to bear its *most* common meaning when it used the word in [the statute]." Id. (emphasis added). Indeed, despite the potential alternate meanings of request, the Court chose to give it "its ordinary and natural signification." Id. Accord *Perrin*, 444 U.S. at 42.

of trade-in value) would be perceived as not responsive to the question. Indeed, such a response would be viewed as truthful only if the respondent were careful to point out that he was using the term in other than its normal and plain meaning. Clearly, then, a specialized use of "cost" is appropriate only with the addition of some qualifying [155] words signaling that the speaker is using the term in a manner not contemplated by normal usage.[12]

Second, even assuming that it is appropriate to look to an alternative, figurative definition to establish the ambiguity of a statutory term, the NCF Memorandum's argument on this point cuts sharply against its conclusion. When monetary values are ascribed to terms such as "sacrifice" and "loss," such values are normally measured when *made* or *expended.* For example, statements such as "I lost $5,000 on the stock market" and "I sacrificed $10,000 to help my neighbor" require the listener to assume that the speaker is talking about historical dollar "loss" or "sacrifice," unless the speaker makes clear that those terms are being used in some way other than their ordinary meaning.[13]

Finally, even if the definitions of the term "cost" could be read to create some ambiguity with respect to that term, the NCF Memorandum fails to demonstrate the existence of any *relevant* ambiguity. That a particular term has two plausible definitions does not support an agency determination that rests on a third, implausible definition. As shown above, none of the dictionary definitions of "cost" refers to "purchase price adjusted for inflation."[14]

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[12] An additional analytical flaw in the NCF Memorandum's treatment of the definition of the term "cost" is its focus on the "cost to the taxpayer" rather than on the statutory phrase "cost of such property" in section 1012 of the Code. The former phrase may be read to include a broader range of costs incurred by the owner in the course of ownership. For example, a statement of the "cost *to X* of owning a car" might include, in addition to the purchase price, costs associated with maintenance of the car, insurance, taxes, etc. The statute however, refers to "cost *of* . . . *property*." This phrase refers more naturally to the original price paid for the property: "What *did* the car cost?"

[13] Other relevant statutory terms also provide support for our rejection of the NCF Memorandum's conclusion that "cost" as used in section 1012 may be read to refer to something other than "historical cost." In ordinary usage, the term "gain" would be thought to describe an increase measured from one point in time to another. Moreover, the term "basis" suggests that gain is measured from some fixed baseline, rather than from a floating indicator of relative value.

[14] A possible alternative argument not advanced in the NCF Memorandum would be that, although the unambiguous meaning of "cost" is the original price paid, that definition is

[156] In addition to its argument based on the Random House Dictionary, the NCF Memorandum argues that "standard economic analysis" should be taken into account in determining the meaning of the term "cost." Id. at 25. To this end, the Memorandum looks to uses of "cost" in economics treatises to establish the term's ambiguity. Id. For purposes of construing section 1012 of the Code, however, the meaning to be given "cost" must be the "common and ordinary" meaning of that word — not its purported meaning in the jargon of economists. For example, the Tax Court has rejected arguments that taxpayers should not be taxed on their nominal capital gain, but on their "economic gain," quoting Learned Hand's statement that " 'the meaning of income is to be gathered from the implicit assumptions of its use in common speech.' Thus, the meaning of income is not to be construed as an economist might, but as a layperson might." *Hellerman v. Commissioner*, 77 T.C. 1361, 1366 (1981) (quoting *United States v. Oregon-Wash. R.R. & Nav. Co.*, 251 F.2d 211, 212 (2d cir. 1918)). In other words, "[t]he income tax laws do not profess to embody perfect economic theory." *Weiss v. Wiener*, 279 U.S. 333, 335 (1929). We must therefore reject the NCF Memorandum's attempt to ascertain the meaning of cost under "standard economic reality" or "principles" of sophisticated economic analysis more generally, see, e.g., id. at 2, 8, 23-27, 68, 87, 88 n.47, in favor of the common and ordinary meaning of that term.[15]

itself ambiguous in that it is not specified whether the price is to be stated in nominal or inflation-adjusted dollars. This argument suffers from several of the same defects noted above with respect to the Memorandum's attempt to discover ambiguity in the word "cost." The common meaning of the term "price" requires that it be stated in nominal dollars unless it is clear that the word is being used in some specialized sense. For example, in everyday speech the question "What was the price of your home when you bought it?" calls for an answer expressed in nominal dollars.

[15] The NCF Memorandum's contention that income from the sale of a capital asset can be determined for purpose of the Code only by taking inflation into account is similar to the legion of "tax protestor" claims that has so often been rejected by the courts. For example, in Stelly v. Commissioner, 804 F.2d 868, 869 (5th Cir. 1986), the taxpayers asserted that they were entitled to a 13 percent downward adjustment in their interest income on the ground that their interest income had been devalued by inflation. The Fifth Circuit ruled that there was "no basis in law or fact" for the inflation adjustment and concluded that Treasury "properly characterized the [taxpayers'] argument as frivolous." Id. at 870.

[157] B.

The drafters of the Revenue Act of 1918 had available, in addition to the common and ordinary dictionary meanings of cost, Treasury's contemporaneous regulatory definition of cost. This definition, embodied in published Treasury Decisions, was "actual price paid." See T.D. 2005, 16 Treas. Dec. Int. Rev. 111, 112 (1914), restated, T.D. 2090, 16 Treas. Dec. Int. Rev. 259, 272-73 (1914). This definition, adopted by Congress in the 1918 Act, certainly also evidences the "ordinary, contemporary, common meaning" of cost.[16]

[158] That "cost" in the Code has this plain meaning has been recognized in several court cases. For example, the Tax Court has

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[16] The assertion in the NCF Memorandum that "there is nothing in the legislative history of the 1918 Act indicating that these Treasury Decisions were being adopted," id. at 36, is incorrect. As discussed more fully below, the available legislative history from 1918 concerning this issue indicates that Congress did adopt Treasury's interpretation when it wrote "cost" into the Revenue Act of 1918. During the floor debate concerning a proposal to amend the 1918 legislation so as to virtually eliminate the effect of inflation on capital gains, it was explained that the capital gains provision of the Act was "merely enacting into law the *rules and regulations* now in force under the present statute." 56 Cong. Rec. 10349 (1918) (statement of Rep. Garner) (emphasis added). See also Treasury Memorandum at 8-13.

Treasury's interpretation of "cost" has not substantially changed since 1914. See 28 C.F.R. § 1.1012-1(a) ("The cost [of property] is the amount paid for such property in cash or other property."). This definition was adopted in T.D. 6265, § 1.1012-1(a), 22 Fed. Reg. 8935, 8938 (1957), and has not been amended. Congress has repeatedly amended and reenacted the tax laws and has never disturbed Treasury's consistent interpretation of cost. See Revenue Act of 1921, ch. 136, § 202(a), 42 Stat. 227, 229; Revenue Act of 1924, ch. 234, § 204(a), 43 Stat. 253, 258; Revenue Act of 1926, ch. 27, § 204(a), 44 Stat. 9, 14; Revenue Act of 1928,, ch. 852, § 113(a), 45 Stat. 791, 818; Revenue Act of 1932, ch. 209, § 113(a), 47 Stat. 169, 198; Revenue Act of 1934, ch. 277, § 113(a), 48 Stat. 680, 706; Revenue Act of 1936, ch. 690 § 113(a), 49 Stat. 1648, 1682; Revenue Act of 1938, ch. 289, § 113(A), 52 Stat. 447, 490; Internal Revenue Code of 1939, ch. 247, § 113(A), 53 Stat. 1, 40; Internal Revenue Code of 1954, ch. 736, § 1012, 68A Stat. 1, 296 (codified at I.R.C. § 1012); Internal Revenue Code of 1986, Pub. L. No. 99-514, § 2, 100 Stat. 2085, 2095 (reenacting in relevant part the Internal Revenue Code of 1954).

A court would likely deem significant Congress' repeated reenactment of the tax laws without disturbing Treasury's interpretation of "cost." Cottage Savings Ass'n v. Commissioner, 111 S. Ct. 1503, 1508 (1991). Accord United States v. Correll, 389 U.S. 299, 305-06 (1967); Helvering v. Winmill, 305 U.S. 79, 83 (1938). A court would also likely attach significance to Congress' repeated consideration of and refusal to enact proposals explicitly to index capital gains for inflation. See, e.g., Bob Jones Univ. v. United States, 461 U.S. 574, 600-01 & n.25 (1983) (finding in Congress' failure to enact any one of 13 bills introduced to overturn the Treasury's interpretation of section 501(c)(3) of the Code additional support for the conclusion that Congress acquiesced in that interpretation). For a recounting of these refusals, see infra note 27.

stated that "there is no statutory provision which allows for an upward adjustment to basis to reflect inflation or loss of the purchasing power of the dollar." *Ruben v. Commissioner*, 53 T.C.M. (CCH) 992, 994-95 (1987). The court also observed that "[s]ections 1011 and 1012 of the Internal Revenue Code provide the general rule that a taxpayer's basis in property shall be its cost. While it is true that [government] reports do provide evidence of inflation, basis in property is not affected by inflation." Id. at 994 n.2.[17]

Similarly, in *Crossland v. Commissioner*, 35 T.C.M. (CCH) 262 (1976), the taxpayers claimed an "inflation loss deduction" of ten percent of their gross income. The court acknowledged that "[i]nflation is a fact" and that it "affects every taxpayer to some extent," but it nonetheless disallowed the deduction: "Our tax structure is not set up to take into account the effects of inflation. Tax liability depends on income figures computed in terms of nominal dollars, without regard for inflation." Id. at 262. In a passage that is especially relevant, the court noted: "The problem of inflation has caused several writers to explore [159] the practicality of indexing; i.e., changing the tax structure to adjust for price level changes in computing taxable income. Although the suggestion might have merit, Congress has not seen fit to consider it . . . ." Id. at 263 (footnote omitted).[18]

Other courts have also interpreted the term "cost" as meaning

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[17] This key case is discussed by the NCF Memorandum only in a footnote, at the end of a string cite, and the Tax Court's quoted conclusion is mischaracterized as the court's "refus[al], in the absence of clear statutory provisions to the contrary, to accept the taxpayer's construction of the [Internal Revenue Code] over the Treasury's contrary construction." NCF Memorandum at 70 n.39. As noted in the text, however, the *Ruben* court's conclusion rested expressly on its observation that there is no applicable "*statutory* provision" permitting an upward adjustment to basis to reflect inflation. The *Ruben* court viewed the taxpayers' argument to the contrary as so "frivolous" that it upheld the assessment of penalties against the taxpayers in the form of additional tax. 53 T.C.M. (CCH) at 996.

[18] The same footnote in the NCF Memorandum that mischaracterizes *Ruben* mischaracterizes *Crossland* in the same way. The footnote also cites two other Tax Court cases. Neither of these cases turns upon "Treasury's . . . construction" of the Code, as the Memorandum asserts. Gajewski v. Commissioner, 67 T.C. 181 (1976), aff'd, 578 F.2d 1383 (8th Cir. 1978), held that the "statutory gold content of the dollar is irrelevant for purposes of computing petitioner's taxable income *under the Code*." Id. at 195 (footnote omitted; emphasis added). Sibla v. Commissioner, 68 T.C. 422 (1977), aff'd, 611 F.2d 1260 (9th Cir. 1980), held that the taxpayer was "not entitled to any adjustment in the gross income he received because of any decline in the value of the dollar with respect to gold or silver." Id. at 431. Nothing in *Sibla* suggests that the holding was based on Treasury's interpretation of the Code, rather than on the court's own interpretation.

nominal purchase price. In *Vandenberge v. Commissioner*, 147 F.2d 167, 168 (5th Cir.), cert. denied, 325 U.S. 875 (1945), the court stated: "Section 113(a) of the Revenue Act of 1938 provides that the unadjusted basis of property shall be the cost of such property. The solution to the question raised is as simple and clear as the language of the pivotal statute. The cost of the property was the price paid to acquire it." See also *Hawke v. Commissioner*, 35 B.T.A. 784, 789 (1937) ("We must assume that Congress used the term 'cost' in its commonly understood meaning as the amount of money which a man pays out in the acquisition of property."), rev'd on other grounds, 109 F.2d 946 (9th Cir.), cert. denied, 311 U.S. 657 (1940).

C.

Another of the traditional tools of statutory construction is an examination of "the language and design of the statute as a whole." *K Mart Corp.*, 486 U.S. at 291. The NCF Memorandum appears to recognize this rule of construction, but asserts flatly that there is nothing "in any other language of the [Code] suggesting that the historical 'purchase price' measurement of monetary value must be used in preference to a measurement that coincides with the sale of the asset." Id. at 24. That assertion is mistaken. Many provisions of the Code that grant itemized deductions to individuals and corporations are intelligible only if "cost" under section 1012 is measured at the time an asset is purchased or at other times beside the time of sale.

[160] To cite an important example, the deduction for depreciation is calculated based on "the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property." I.R.C. § 167(c). Under section 1011, of course, the adjusted basis of an asset is determined by section 1012, which uses the term "cost." Accordingly, the cost of an asset must be known in every year in which the taxpayer would take a depreciation deduction. If Treasury reinterpreted cost to require that cost be measured at the time of the asset's sale, as the NCF Memorandum suggests it could, the taxpayer (and Treasury) would have no basis on which to calculate the proper deduction.

See Treasury Memorandum at 52-53.[19]

Other structural characteristics of the Code strongly support the conclusion that cost unambiguously means historical price paid, in nominal dollars *not* adjusted for inflation. As indicated above, "adjusted basis" is important in interpreting many provisions of the Code. The term appears in more than a hundred sections. By reference to section 1012, section 1011 provides that adjusted basis is generally the cost of property, "adjusted as provided in section 1016." I.R.C. § 1011(a). Section 1016 is entitled "Adjustments to basis," and it contains twenty-five separate items of adjustment.[20] This list of congressionally determined adjustments to cost does not include an inflation adjustment. Yet one would rationally expect that if Congress intended to provide such an adjustment in the Code, the adjustment would appear in section 1016 or in some other section of Part II of Subchapter O, entitled "Basis Rules of General Application." It is, at best, unlikely that Congress would so carefully and precisely lay out the many mandatory and allowable adjustments to cost and at the same time load (or authorize Treasury to load) a very significant adjustment — for inflation — into the word "cost" itself.

[161] Moreover, under the doctrine of expressio unius est exclusio alterius ("the expression of one thing is the exclusion of another"), omissions in such instances are to be deemed to reflect the intent of the legislature. Thus, in *TVA v. Hill*, 437 U.S. 153 (1978), the Court ruled that TVA's Tellico Dam project was subject to Endangered Species Act requirements, reasoning that, while Congress had included several "hardship" exemptions in the Act, none was provided for federal agencies. The Court concluded that "under the maxim expressio unius est exclusio alterius, we must presume that these were the only 'hardship cases' Congress intended to ex-

[19] Many other deductions and credits are also defined in terms of "adjusted basis" and would suffer from the same problem. See I.R.C. §§ 42(d) (low income housing), 165(b) (losses), 166(b) (bad debts), 169(f)(1) (pollution control facilities), 171(b)(2) (bond premiums), and 612 (depletion). If cost for some purposes must be determined at the time of acquisition, or at least at the time the deduction or credit is taken each year, while cost for purposes of calculating capital gains is to be determined at the time that an asset is sold (as proposed by the NCF Memorandum), the Internal Revenue Code would contradict itself. Such a forced contradiction would certainly undercut the reasonableness of any Treasury regulation indexing capital gains for inflation.

[20] Twenty-three of these are found in subsection (a)(1)-(9), (11)-(24), and one each in subsections (c) and (d).

empt." Id. at 188. See also, e.g., *United States v. Monsanto*, 491 U.S. 600, 611 (1989) (inclusion of forfeiture exemption in another chapter of the same legislation "indicates . . . that Congress understood what it was doing in omitting such an exemption" from the chapter at issue); Letter from William H. Rehnquist, Assistant Attorney General, Office of Legal Counsel, to George L. Carneal, General Counsel, Federal Aviation Administration 2 (Oct. 6, 1971); 2A Norman J. Singer, *Sutherland on Statutory Construction* § 47.23, at 216-17 (5th ed. 1992). Because Congress has specified other adjustments to basis but has not included an adjustment for inflation in the computation of capital gains, it follows that Congress did not intend to permit indexing in the capital gains context.

The force of this argument is even greater because Congress has, elsewhere in the Code, carefully and precisely set forth a number of adjustments for inflation. Section 1(f), entitled "Adjustments in tax tables so that inflation will not result in tax increases," requires Treasury every calendar year to "increas[e] the minimum and maximum dollar amounts for each tax rate bracket . . . by the cost-of-living adjustment for such calendar year," which adjustment is defined by reference to the Labor Department's published Consumer Price Index for all-urban consumers. I.R.C. § 1(f)(2)(A), (3)-(5). At least eight other dollar amounts specified in the Code are indexed for inflation by reference to section 1(f)(3). Id. §§ 32(i) (earned income credit), 41(e)(5)(C) (research activity credit), 42(h)(6)(G) (low income housing credit), 63(c)(4) (standard deduction), 68(b)(2) (overall limitation on itemized deductions), 135(b)(2)(B) (income from U.S. savings bonds used to pay higher education tuition and fees), 151(d)(4) (personal exemptions), and 513(h)(2)(C) (distribution of low cost articles by tax-exempt organizations). Section 1012, of course, contains no comparable provision. Again, we would expect that if Congress intended that asset costs be indexed for the calculation of capital gains, it would have done so explicitly and in the same manner as these many other indexing provisions.[21]

[21] We note that the NCF Memorandum nowhere discusses the significance of section 1(f) of the Code and the provisions that refer to it, even though it is clearly of legal significance that Congress has provided for inflation-related indexation in some instances, but not in the case of capital gains. The Memorandum attempts to explain away congressional failure to

[162] D.

In an attempt to find some basis in the statute to support its proposed interpretation, the NCF Memorandum relies on the writings of certain tax theorists for the proposition that a general purpose of the tax code is to treat similarly situated taxpayers alike (the principle of "horizontal equity"). Id. at 8, 26. From this general purpose, the Memorandum argues that the term "cost" should be read to mean inflation-adjusted cost in order to avoid the inequity inherent in taxing real and inflationary gains at the same rate.

Although the principle of horizontal equity may be embodied as a general purpose of the Code, that general purpose cannot be taken to provide a statutory basis for indexing of capital gains. The Supreme Court has noted the dangers of attempting to argue [163] from a general statutory purpose to a context-specific interpretation of a particular statutory provision:

> [N]o legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice — and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law.

Rodriguez v. United States, 480 U.S. 522, 525-26 (1987). See also *Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361,

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index asset costs in the same manner as tax brackets and other concepts in part because "the adverse effect of inflation was ameliorated by the general capital gains tax preference" (a lower effective tax rate on capital gains) which "obviated the need and impetus, from 1921 until 1986, to establish a more accurate counter for inflation, such as indexation." Id. at 53.

This argument, in fact, cuts against the NCF Memorandum's conclusions. Accepting the argument on its face, it is obvious that to the extent Congress established a preference for capital gains in order to reduce taxation of gains that resulted merely from inflation, Congress assumed that its tax laws otherwise treated cost as nominal purchase price with no adjustment for inflation. Moreover, as your opinion points out, Congress has consistently recognized that inflation introduces distortions into the calculation of capital gains. Treasury Memorandum at 13-15. It appears, then, that Congress has consistently made a deliberate policy choice not to index asset basis for inflation. As for the decision to repeal the capital gains preference in 1986, it was not taken in ignorance of the special character of investment in capital assets, but with a conscious belief that the reduction in individual income tax rates would eliminate any need to accord preferential treatment to capital gains. Id. at 15. In any event, long-term capital gains now enjoy a slightly preferential rate. See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11101(c), 104 Stat. 1388, 1388-404 to 1388-405 (amending I.R.C. § 1(j)).

373-74 (1986) (rejecting agency's use of the "plain purpose" of legislation to support regulatory definitions not supported by the plain language of the statute).

Even more generally, the NCF Memorandum suggests that the Court has deferred to agency interpretations of other terms that are "no more ambiguous than the terms at issue here." Id. at 22 n.11. This approach to statutory interpretation suffers from a glaring flaw: as the Supreme Court has recognized in determining whether defence is owed, the court "must look to . . . the language and design of the statute as a whole." *K Mart Corp.*, 486 U.S. at 291. Accordingly, even an identical term may be ambiguous in one context and not in another. For example, in *Helvering v. Reynolds*, 313 U.S. 428 (1941) — relied upon in the NCF Memorandum for the proposition that "acquisition" was found ambiguous, see id. at 22 n.11— the Court found the term ambiguous only in the context presented. The Court noted that although the same term might be "unambiguous . . . as respects other transactions," 313 U.S. at 433 (citing *Helvering v. San Joaquin Fruit & Investment Co.*, 297 U.S. 496 (1936)), it was in fact ambiguous in the context of remainder interests passing by bequest, devise, or inheritance, id. In *San Joaquin*, on the other hand, the Court, addressing real property acquired by lease with an option to buy, relied on the "plain import" of the word "acquired," because "acquired" was not a term of art and "[l]anguage used in tax statutes should be read in the ordinary and natural sense." 297 U.S. at 499.

Moreover, the cases relied upon by the NCF Memorandum for this suggestion themselves rely on factors that, when applied to the present case, undercut the Memorandum's ultimate conclusions. The Memorandum's reliance on *Cottage Savings*, for example, appears to ignore the fact that the Court, addressing the reasonableness of the agency's interpretation, discussed at length the fact that the long-standing agency interpretation had been left undisturbed by Congress for many years, and stated that "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional [164] approval and have the effect of law." *Cottage Savings*, 111 S. Ct. at 1508. Here, as the NCF Memorandum recognizes, "Treasury's consistent and long-standing interpretation of "cost" has been "original cost." Id. at 77. See also *INS v. Cardoza-Fonseca*, 480 U.S. at 446 n.30 ("An agency interpretation of a relevant provision which conflicts with an earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view." (quoting *Watt v. Alaska*, 451 U.S. 259, 273 (1981)).[22]

Finally, the NCF Memorandum cites two cases as support for the proposition that " 'cost' or similar terms in *other* statutes have been construed to permit, or even require, taking account of inflationary effects." Id. at 27 (emphasis added). That proposition is, of course, largely irrelevant to understanding the intent of Congress in enacting the Internal Revenue Code. See, e.g., *Prussner v. United States*, 896 F.2d 218, 228 (7th Cir. 1990) (en banc) (pointing out that "[d]ifferent statutes passed by different Congresses often do use the same words to mean different things"). In any event, at least one of the two cited cases simply offers no support for the Memorandum's proposition. *Amusement & Music Operators Ass'n v. Copyright Royalty Tribunal* 676 F.2d 1144 (7th Cir.), cert. denied, 459 U.S. 907 (1982), concerned a statute that required the Copyright Royalty Tribunal to determine "reasonable copyright royalty rates." 17 U.S.C. § 801(b)(1). The court noted that the tribunal had rejected an "individualized, cost-based approach" and instead relied on factors "not related to cost." 676 F.2d at 1148.[23]

[165] Accordingly, we agree with your conclusion that the Internal Revenue Code's plain language and structure demonstrate that "cost" cannot be interpreted to allow an adjustment for inflation.

III.

Under the Supreme Court's jurisprudence, the plain meaning of

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[22] The Court's recent decision in Rust v. Sullivan, 111 S. Ct. 1759 (1991), which noted that an agency interpretation is entitled to some deference even if it represents a break with prior interpretations, id. at 1769, did not alter this rule. Subsequent to *Rust*, the Court again stated the general rule that "the case for judicial deference is less compelling with respect to agency positions that are inconsistent with previously held views." Pauley v. BethEnergy Mines, Inc., 111 S. Ct. 2524, 2535 (1991).

[23] Indeed, the statute specifically *authorized* the Tribunal "to make determinations concerning the *adjustment* of reasonable copyright royalty rates." 17 U.S.C. § 801(b)(1) (emphasis added). Pursuant to that authority, the Tribunal allowed an inflation adjustment in 1987. In *Chevron* terms, the adjustment was "affirmatively supported by the language of the Act." 676 F.2d at 1155. By contrast, in the case of section 1012 of the Internal Revenue Code, Congress has provided only the definition of "basis" in terms of "cost," while *omitting* any general grant of authority to make inflation-linked adjustments to cost basis.

the word "cost" ends the inquiry:

> The task of resolving the dispute over the meaning of [the statute] begins where all such inquiries must begin: with the language of the statute itself. In this case it is also where the inquiry should end, for where, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." The language before us expresses Congress' intent . . . with sufficient precision so that reference to legislative history . . . is hardly necessary.

United States v. Ron Pair Enters., 489 U.S. 235, 241 (1989) (citations omitted). Once it is determined as a textual matter that cost means "actual price paid" in nominal dollars, resort to the legislative history is unnecessary.

As noted above, however, *Chevron* requires that the search for the meaning of a statutory provision be conducted by "employing traditional tools of statutory construction." 467 U.S. at 843 n.9. These tools include the legislative history of the provision. See also *Cardoza-Fonseca*, 480 U.S. at 449. Thus, even if we were to conclude that the plain language and the structure of the Code did not provide a clear meaning for the term "cost" in section 1012, we would be compelled to search the legislative record of the Revenue Act of 1918 to determine if that record could provide such meaning.[24] Based on our review of [166] that record, we agree with your conclusion that "the contemporaneous legislative history of the [Act] indicates that Congress intended the word 'cost' to mean the price paid in nominal dollars not adjusted for inflation." Treasury Memorandum at 8 (capitalization omitted).

As we have noted above, Treasury's pre-1918 regulatory definition of cost was "actual price paid." T.D. 2005, 16 Treas. Dec. Int. Rev. 111, 112 (1914), restated, T.D. 2090, 16 Treas. Dec. Int. Rev.

[24] The NCF Memorandum suggests that the proper scope and significance of legislative history is unclear under *Chevron*. Id. at 31 n.15. To the contrary, we believe its relevance is quite clear. A court undertakes a *Chevron* inquiry employing traditional tools of statutory construction, of which legislative history is generally one. See, e.g., *Chevron*, 467 U.S. at 851-53, 862-64 (analyzing the legislative history of the Clean Air Act); NLRB v. United Food & Commercial Workers Union, 484 U.S. 112, 124-25 (1987) (analyzing the history of the Labor-Management Relations Act). See also Wagner Seed Co. v. Bush, 946 F.2d 918, 920 (D.C. Cir. 1991) (*Chevron* requires deference "when the statute, viewed in light of its legislative history and the traditional tools of statutory construction, is ambiguous."), cert. denied, 112 S. Ct. 1584 (1992).

259, 272-73 (1914). Contrary to the assertion in the NCF Memorandum that "there is nothing in the legislative history of the 1918 Act indicating that these Treasury Decisions were being adopted," id. at 36, the legislative history concerning this issue clearly indicates that Congress adopted Treasury's interpretation when it wrote "cost" into the Revenue Act of 1918. Indeed, it was explained during floor debate concerning an amendment proposed by Representative Hardy, intended in part to eliminate the effects of inflation on capital gains, that the capital gains provision of the Act was "merely *enacting into law the rules and regulations* now in force under the present statute." 56 Cong. Rec. 10349 (1918) (statement of Rep. Garner) (emphasis added).

The NCF Memorandum, after extensively quoting from the debate surrounding Representative Hardy's proposed amendment to the capital gains provision of the Act, concedes that the legislative history "demonstrates that at least certain members of Congress were aware of the effects of inflation on capital gains. It also can be argued to reflect *an understanding of Congress that a property's basis referred to the acquisition cost of the property*." Id. at 44 (emphasis added).

Indeed, Congress must have been extremely well aware of the problems of inflation when it adopted the Act. In 1918, the year prior to the first statutory use of "cost" to define basis in the capital gains context, consumer prices for all urban consumers increased by 18.0%.[25] Economic Indicators Handbook 224 (Darney ed. 1992). In the previous year, inflation was nearly as high, at 17.4%, a dramatic rise from the 1% inflation rates in 1914 and 1915. Id.

In view of this World War I-related inflation, it is not surprising that a proposal intended to eliminate most of the effects of inflation on capital gains was debated at the time. In moving to strike the basis provision out of the Revenue Act entirely, Representative Hardy argued that the tax on gains would be unfair because "a piece of property bought in 1913, if its exchange value to-day is to be equal to its exchange value when it was bought, must bring in dollars and cents something like two [167] times what it cost." 56 Cong. Rec. 10349 (1918).[26] See also id. ("[If a] man to-day makes a

[25] The 1918 Act was adopted in 1919. See supra note 8.

[26] Representative Hardy was half right. Consumer prices had increased slightly more than

sale of a tract of land which he bought in 1913 at the prices then prevailing, and if he sold it today at 100 per cent apparent profit and reinvested the money he could not obtain any more property now than he could have obtained in 1913 with the money then paid for the same land.").

While noting that "the reasoning of [Representative Hardy] would apply to every conceivable source of income," not simply capital gains, id. at 10350 (statement of Rep. Kitchin), opponents of the proposed amendment emphasized that the section dealing with capital gains did not change current law. See id. ("This provision makes absolutely no change in existing law.") (statement of Rep. Kitchin). The opponents also explained how current law operated. Representative Fordney thus stated that if a taxpayer purchased property ten years ago and then sold it, the appropriate measure of the gain would be "the difference between the *price paid for it 10 years ago* and the price you sell it for to-day." Id. at 10351 (emphasis added). Representative Kitchin, the Chairman of the House Ways and Means Committee, further explained that "[i]f you bought a ship in 1916 for $100,000 and sell it in 1918 at $200,000, or if you bought Bethlehem stock or United States Steel Corporation stock in 1915, your income is the difference between the purchase and selling price, and that is the only rule under which you can administer the law." Id. at 10350-51. The hypotheticals posed by Representatives Fordney and Kitchin are particularly revealing since the gains described would, to a large degree, have been attributable to the dramatic wartime inflation described above. No one at the time disputed these characterizations of current law, and the statements were consistent with the earlier Treasury Decisions quoted above. Ultimately, Representative Hardy withdrew his proposal to strike the basis provision and proposed an amendment that would measure capital gain only from the beginning of the year in which the capital asset was sold. Id. at 10351, 10354. Congress was apparently not persuaded to remedy the effects of inflation on income derived from capital gains in this way, and the proposal was rejected. Id.

The NCF Memorandum attempts to deny the force of its own reading of the legislative history by asserting that the 1918 Act's

50% from 1913 to 1918, from an index of 9.9 to an index of 15.1. Economic Indicators Handbook at 224.

legislative history "simply does not speak directly and clearly to the 'precise question at issue.'" Id. at 46-47 (quoting Chevron, 467 U.S. at 843 n.9). For the reasons set forth above and in the Treasury Memorandum, we disagree. In any event, as the NCF Memorandum recognizes, the legislative history is consistent with the ordinary meaning of the term "cost" as [168] meaning historical price paid, id. at 44, and clearly demonstrates that Congress legislated with full knowledge of the effect of current law and of the impact of inflation on capital gains.

For these reasons, we concur in your conclusion that the legislative record evidences a clear congressional intent that "cost" be given its common and ordinary meaning, that is, price paid in nominal dollars not adjusted for inflation. Treasury Memorandum at 8-13.

IV.

The NCF Memorandum argues that Treasury's adoption of a capital gains indexing regulation is not foreclosed by Congress' repeated reenactments of the Internal Revenue Code with knowledge of Treasury's interpretation of "cost" to mean the actual price paid (the "reenactment" doctrine), or by Congress' rejection of statutory indexing proposals (the "acquiescence" doctrine). See NCF Memorandum at 75-87. We have discussed these doctrines only briefly, see supra note 16, because they have application only if Treasury has discretion under the statute to reinterpret "cost" — that is, only if "cost" is ambiguous. In Parts II and III, we have demonstrated that it is not.

In places, however, the NCF Memorandum appears to make an affirmative argument in support of regulatory indexing of capital gains based on recent votes of either the Senate or the House on legislative proposals to index capital gains:

> [W]hile Congress has not actually enacted a capital gains indexing proposal, the legislative history of Congress' consideration of such proposals reveals, if anything, that Congress *favors* the concept of indexing capital gains. Indeed, . . . indexation measures have *passed* in recent sessions of both the Senate and the House . . . . Congress' deliberations on the issue to date suggest that a majority of both Houses would welcome a Treasury reinterpretation of "cost" to take account of inflation.

Id. at 84. See also id. at 3 ("[T]he legislative history of Congress' consideration of such proposals reveals, if anything, that Congress *favors* the concept of indexing capital gains."). This reasoning is substantially flawed for several reasons.

First, as the Treasury Memorandum points out, although Congress has repeatedly considered proposals explicitly to index capital gains for inflation, it has *never* enacted them. Id. at [169] 15-18.[27] It is a strange twist of logic to conclude that because Congress has *rejected* a proposal many times, Congress therefore *favors* that proposal. Second, even assuming that a majority of both Houses would in fact be willing to enact such legislation, it by no means follows that they would welcome *an administrative agency's* decision to bring about a similar outcome by regulatory action alone.

More fundamentally, the attitude of a majority of the members of the current Congress is completely irrelevant to the question whether an agency's interpretation of existing law is or is not correct. Like the courts, the Executive Branch must interpret the law as it finds it, not base its interpretation on conjecture as to how Congress *might* act. Thus, although agencies must follow the "will of Congress" in interpreting statutes, "the 'will of Congress' we look to is not a will evolving from Session to Session, but a will expressed in a particular enactment." West Virginia Univ. Hosps., Inc. v. Casey, 111 S. Ct. 1138, 1148 n.7 (1991). Furthermore, it is an elementary principle of constitutional law that the policy preferences of individual members of Congress, even if they happen to comprise majorities of both Houses, are legally meaningless until they crystallize into "bicameral passage followed by presentment to the President." INS v. Chadha, 462 U.S. 919, 954-55 (1983). See also NCF Memorandum at 80 n.43.

The history of capital gains taxation also shows that Congress was aware of the effects of inflation but chose to deal with them in a manner other than indexation. The Revenue Act of 1918 did not

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[27] On at least four occasions since 1978, indexation legislation has been approved by either the Senate or the House, only to be rejected in conference. See Revenue Act of 1978, H.R. 13511, 95th Cong., 2d Sess. § 404 (1978) (approved by House), *rejected* by H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess. 258 (1978); Tax Equity and Fiscal Responsibility Act of 1982, H.R. 4961, 97th Cong., 2d Sess. § 310A (1982) (approved by Senate), *rejected* by H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 478 (1982); Omnibus Budget Reconciliation Act of 1989, H.R. 3299, 101st Cong., 1st Sess. § 11961 (1989) (approved by House), *rejected* by H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 664 (1989); Tax Fairness and Economic Growth Act of 1992, H.R. 4210, 102d Cong., 2d Sess. § 2101 (1992) (approved by House), *rejected* by H.R. Conf. Rep. No. 461, 102d Cong., 2d Sess. 356, 364 (1992).

distinguish between capital and ordinary income for purposes of tax rates. In 1921, however, Congress enacted the first preference for capital gains income. Compare Revenue Act of 1921, ch. 136, § 206(b), 42 Stat. 227, 233 (taxing capital gains at a maximum of 12.5%) with id., § 211(a)(1), 42 Stat. at 233-35 (taxing ordinary income at rates as high as 65%). Your opinion concludes that "[o]ne of the policy reasons most often [170] cited for this preferential treatment was the desire to mitigate the impact of inflation on the taxation of capital gains." Treasury Memorandum at 13. See also id. n.16 (citing committee hearings on the 1921 Act); NCF Memorandum at 48-49 & n.25 (same).

It is apparent that the draftsmen of the 1921 Act did not intend that "cost" reflect an adjustment for inflation. In reenacting the tax laws, they chose to mitigate the effects of inflation on capital assets by granting preferential treatment to capital gains — *not* by indexing cost. This choice reflects their understanding that without some special treatment, capital gains would be peculiarly subject to the effects of inflation under the tax law. Congress' decision to provide preferential treatment for capital gains assumed that the Treasury's regulatory interpretation of "cost" as "actual price paid" was valid and would remain in effect.[28]

As recently as 1978, Congress was again faced with a choice in dealing with the impact of inflation on the values of capital assets. In the course of enacting the Revenue Act of 1978, the House adopted a provision expressly indexing the basis of such assets. The Senate, on the other hand, rejected this approach, choosing instead to increase the capital gains exclusion from 50 percent to 60 percent. The Finance Committee's explanation for this choice is instructive:

> [A]n increased capital gains deduction will tend to offset the effect of inflation by reducing the amount of gain which is subject to tax. Thus, by increasing the deduction, taxable gain should be reconciled more closely with real, rather than merely inflationary gain. However, since the deduction is constant, unlike the automatic ad-

[28] The capital gains preference continued to be a major feature of the tax laws until 1986. Since the enactment of the 1954 Code, this preference was accomplished in part by allowing individual taxpayers to exclude from gross income a substantial percentage of their capital gain income. See, e.g., 26 U.S.C. § 1202 (1982 ed.) (allowing individuals to deduct 60 percent of their net capital gain from gross income). Section 1202 was repealed in 1986. Pub. L. No. 99-514, § 301(a), 100 Stat. 2085, 2216 (1986).

> justments generally provided for in various indexation proposals, it should not tend to exacerbate inflationary increases.

S. Rep. No. 1263, 95th Cong., 2d Sess. 192 (1978). The bill as finally enacted into law adopted the Senate's version. Pub. L. No. 95-600, § 402(a), 92 Stat. 2763, 2867 (1978).

[171] Whenever Congress has been faced with a choice of different methods for dealing with impact of inflation on capital gains, it has chosen some means other than indexation. Indeed, it has specifically rejected indexation in favor of the capital gains preference. This fact reflects both the understanding that indexation was not allowed under the Code in the first place and the intent of Congress to keep it that way. We believe that Congress' continued affirmation of an inflation-mitigating mechanism other than indexation — specifically, preferential treatment — together with Treasury's consistent interpretation of "cost" as not allowing indexation, makes this a particularly compelling case for concluding that Congress has ratified Treasury's interpretation of the Code.[29]

V.

The NCF Memorandum advances two other arguments, both of which are unavailing. First, the Memorandum attempts to show that "the Treasury has historically taken a flexible view toward its own interpretation of basis and cost." Id. at 29. Yet the supposed instances of this "flexible" view are mischaracterized.

The NCF Memorandum claims that because the 1918 Treasury regulations addressing the capital gains treatment of property acquired by gift equated "cost" with fair market value of the property at the time of the gift, cost was "completely divorced from concepts of historical or original cost." Id. at 38. This is mistaken; cost was clearly tied to the fair market value *at the time the asset was acquired by gift or bequest*. Rather than altering the time at

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[29] There is evidence that when Congress eliminated the capital gains preference in 1986, its decision not to replace the preference with indexation was deliberate. As the NCF Memorandum points out, both the Treasury's public tax proposals in 1984 and the President's proposals to the Congress in 1985 recommended some form of indexation. Id. at 57-58. Moreover, the problem of inflation and the need to index capital gains in the absence of preferential treatment were the subject of congressional hearings. See, e.g., Tax Reform Act of 1986, Part IV: Hearings Before the Senate Comm. on Finance, 99th Cong., 2d Sess. 61 (1986).

which cost is calculated, as the Memorandum argues, the regulations merely substituted an appropriate measure of value where the taxpayer in question had not paid anything for the asset. See *Hartley v. Commissioner*, 295 U.S. 216, 219 (1935) ("The use of the word cost does not preclude the computation and assessment of the taxable gains on the basis of the value of the property [at the time of acquisition] rather than its cost, where there is no purchase by the taxpayer, and thus no cost at the [172] controlling date.").[30] Similarly, although Congress subsequently rejected fair market value at the time of the gift in favor of the donor's original cost, see Revenue Act of 1921, ch. 136, § 202(a)(2), 42 Stat. 227, 229, Congress never deviated from tying the basis to original cost — the only question was *whose* original cost was appropriate.

The NCF Memorandum also cites the treatment of depreciation and depletion in the 1918 regulations as an example of Treasury's flexibility in defining cost. Id. at 40. Those regulations, however, reflected flexibility not in defining "cost" but in determining what "property" the taxpayer owned. When those regulations were challenged in *United States v. Ludey*, 274 U.S. 295 (1927), the Supreme Court observed that the depreciation allowance was based on the theory that "by using up the [property], a gradual sale is made of it," and thus "the depreciation charged is the measure of the cost of the part which has been sold." Id. at 301. See also id. at 302 (depletion charge "represents the reduction in the mineral contents of the reserves from which the product is taken"). The Court never deviated from its treatment of cost as a bearing on the price paid: "[t]he amount of the depreciation must be deducted from the *original cost* of the whole [property] in order to determine the cost of that disposed of in the final sale of properties." Id. at 301 (emphasis added). See also Treasury Memorandum at 30 n.30. The NCF Memorandum concedes as much: "the regulations provided that the *original cost* of property had to be adjusted downward for any depreciation or depletion taken on the property by the taxpayer prior to its sale." Id. at 40 (emphasis added). Nothing in the regulations suggested that the starting point for

[30] In any event, to reason from the treatment of gifts in 1918 that the indexation of capital gains is appropriate, the NCF Memorandum would have to demonstrate the legal propriety of indexing the value of a gift from the date its cost is determined. There is no suggestion that such an adjustment would have been permissible.

this calculation was not original cost in nominal dollars.

Second, the NCF Memorandum reads *Ludey* as upholding "the Treasury's discretion to fill in gaps left by Congress in the [Code's] capital gains provisions, specifically in the concept of 'cost.' " NCF Memorandum at 66. That reading is flawed in several respects. First, the *Ludey* Court did not rely on the Commissioner's regulatory interpretation; it instead held that "the *revenue acts* should be construed as *requiring* deductions for both depreciation and depletion when determining the original cost of oil properties sold." 274 U.S. at 300 (emphases added). By its own terms, therefore, *Ludey* is not a decision that upholds agency discretion, but a decision in which the Court construed [173] the statute for itself. See also id. at 303-04 (rejecting the Commissioner's method for determining the appropriate deduction).

The Treasury regulations in question in *Ludey* did not fill in "gaps" in the statutory term "cost;" rather, they reconciled two potentially contradictory statutory provisions. Treasury's interpretation of "cost" as requiring adjustments for depreciation was necessary to harmonize the statutory provision taxing capital gains with the statutory provision granting annual deductions for depreciation — that is, to prevent taxpayers from receiving tax benefits twice. See id. at 301 ("Any other construction would permit a double deduction for the loss of the same capital assets."). The Court avoided this double deduction based on indications in the statute that no such deduction was intended.[31] For example, the Court noted that Congress intended the allowance for depreciation to reflect a "gradual sale" of the property. Thus, the "depreciation charged is the measure of *the cost of the part which has been sold*." Id. at 301 (emphasis added). Similarly, the Court determined that because depletion allowances were limited by statute to the amount of the capital invested, the deduction was meant "to be regarded as a return of capital, not as a special bonus for enterprise and willingness to assume risks." Id. at 303.

In the case of indexing for purposes of determining capital gain, there is no conflict in statutory provisions that indexing would re-

[31] Cf. United States v. Skelly Oil Co., 394 U.S. 678, 695 (1969) (Stewart, J., dissenting) ("In prior decisions [including *Ludey*] disallowing what truly were 'double deductions,' the Court has relied on evident statutory indications, not just its own view of the equities, that Congress intended to preclude the second deduction.").

solve. Indeed, as explained above, any interpretation that measures cost at the time of sale rather than purchase would create a positive conflict with provisions allowing deductions for depreciation and other items.

VI.

[174] For all the reasons set forth above, we conclude, as did the Treasury Department, that the term "cost" as used in section 1012 is not ambiguous.[32]

Please let us know if we may be of further assistance.

Timothy E. Flanigan
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Office of Legal Counsel

[32] Because we conclude that in using the term "cost," Congress has left no "gap" for Treasury to fill, no further inquiry is appropriate. We need not address under step two of *Chevron* whether a proposed Treasury regulation indexing capital gains for inflation would be a "reasonable" interpretation of section 1012 of the Code. 467 U.S. at 844.