2014

Who's Afraid of the Big Bad Tax-Free Liquidating Distribution? Ideological Debates on Taxation and the Repeal of General Utilities

Martin Edwards

WHO'S AFRAID OF THE BIG BAD TAX-FREE LIQUIDATING DISTRIBUTION? IDEOLOGICAL DEBATES ON TAXATION AND THE REPEAL OF *GENERAL UTILITIES*

MARTIN EDWARDS*

I
INTRODUCTION

The *General Utilities* doctrine, named for the 1935 Supreme Court decision[1] allowing a corporation to distribute appreciated assets to shareholders without reporting a taxable gain, was once known as one of seven fundamental principles of American corporate taxation.[2] The doctrine's popularity reached its peak in 1954, when Congress formally incorporated it into the Internal Revenue Code.[3] Despite this esteemed position among tax-law doctrines, *General Utilities* was routinely criticized because, among other things, it allowed a situational (and arbitrary) reprieve from "double taxation" of corporate income.[4] Corporate income[5] is functionally taxed twice in the sense that the corporation owes tax on the profits earned by its operations and the shareholders owe individual income taxes on the leftover, after-tax profits the corporation distributes to shareholders. The *General Utilities* doctrine reflects a tension that has existed throughout tax law history—that is, whether double

This article is also available at http://lcp.law.duke.edu/.

* J.D., 2013, Duke University School of Law; B. Accy., 2010, University of Mississippi. Managing Editor of *Law and Contemporary Problems* Volume 76. I would like to thank Professor Lawrence Zelenak for advice in defining the contours of this note, Professor Jeremy Mullem for edits, advice, criticism, and many conversations, and my wife Annie for all of her editing, proofreading, endless readings of this note, and, of course, for love and support.

1. General Utils. & Operating Co. v. Helvering, 296 U.S. 200 (1935).

2. Robert C. Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 YALE L.J. 90, 130 (1977).

3. *See* Cheryl D. Block, *Liquidations Before and After Repeal of* General Utilities, 21 HARV. J. ON LEGIS. 307, 313 n.33 (1984) (arguing that Congress clearly intended to codify *General Utilities* in the 1954 revision of the Internal Revenue Code).

4. Lily Kahng, *Resurrecting the* General Utilities *Doctrine*, 39 B.C. L. REV. 1087, 1088 (1998).

5. "Corporate" and "corporation" primarily refer to corporations organized under Subchapter C or S of the Internal Revenue Code. Subchapter-C corporations will be referred to as "C-corporations." These are types of entities that are incorporated and actually exist apart from their owners. Clarifications regarding the nature of incorporated entities vis-à-vis non–incorporated entities will be noted as necessary.

taxation of corporate income is good policy.[6]

Over the years, many scholars and tax experts have expressed the view that two-level taxation of certain corporate entities is appropriate, while businesses and their tax counsel have routinely lobbied for and devised ways around this now-enduring feature of corporate taxation. This tension between a true two-tax regime and an "integrated" system in which only shareholders are taxed was one of the issues at the heart of the debate surrounding repeal of *General Utilities*.[7] Proponents of separating corporate and shareholder income see *General Utilities* as arbitrary and unreasonably advantageous for corporations. Those who believe that the fictional corporate person should not be taxable view *General Utilities* as a framework to integrate corporate income. *General Utilities*, then, was a blessing to tax attorneys and a predicament for the tax collector.

Both Congress and the Court attempted to balance this longstanding tension by formulating, reformulating, and grafting complex exceptions onto the doctrine.[8] As the doctrine got more complicated, many in the academy became convinced that *General Utilities* was a purely dogmatic convention with no logical justification.[9] However, those who believed that corporate double taxation was not sound policy in every respect saw *General Utilities* as far from unfairly advantageous for corporations.[10] There is no explanation in the *General Utilities* case, the Treasury regulations that might be considered the doctrine's origin, or any subsequent act of the Court or Congress why a transaction that resembles a sale of an appreciated asset would not trigger tax liability for the realized appreciation. On the other hand, the shareholders, and not the corporation, were the taxpayers who were formally and literally selling the shares. And, moreover, dividends in kind were not traditionally considered taxable events for the corporation.[11] Nonetheless, by the mid-1980s, the clamor for reform or repeal of *General Utilities* had reached a fever pitch, and in 1986 Congress entombed the formerly glorious precept of American tax law, thus extending the principle of double taxation[12] and also simplifying the tax treatment of distributions of corporate assets.

6. *See generally* Steven A. Bank, *The Rise and Fall of Post–World War II Corporate Tax Reform*, 73 LAW & CONTEMP. PROBS. 207 (Winter 2010) (describing the double taxation of corporate income through the lens of post–World War II tax-reform efforts, culminating with the dividend provisions in the Bush Tax Cuts in 2003).

7. Block, *supra* note 3, at 333.

8. *Id.* at 324.

9. Bernard Wolfman, *Corporate Distributions of Appreciated Property: The Case for Repeal of the* General Utilities *Doctrine*, 22 SAN DIEGO L. REV. 81, 81 (1985).

10. *See* Richard C.E. Beck, *Distributions In Kind in Corporate Liquidations: A Defense of* General Utilities, 38 TAX LAW. 663, 670 (1985) (arguing that the *General Utilities* doctrine was not necessarily an unfair advantage for corporations).

11. *Id.*

12. David Shores, *Repeal of* General Utilities *and the Triple Taxation of Corporate Income*, 46 TAX L. 177, 177 (1992).

It has been over twenty-five years since *General Utilities* met its end. At the time, its repeal was considered, for better or worse, a "sea change" in American tax law.[13] No longer could liquidating corporations[14] distribute assets to shareholders and transfer them tax free. In addition, managing tax liabilities on various types of assets became simpler: all were taxed.[15] In the intervening years, most who were originally in favor of the doctrine's repeal were likely untroubled by its absence. A smaller group of scholars and a few tax professionals, though, were not so sure.[16] Some of the ill effects supposedly vanquished by the doctrine's repeal were replaced with others. It is possible that Congress will undertake a major tax reform again in the near future. If it does, double taxation of corporate income might well be a significant point of debate. At a comfortable distance of a quarter century, a thorough examination of the history surrounding *General Utilities*, the debates at the time of repeal, and the policy tensions that underpinned those debates will show that *General Utilities*' repeal was a major turning point in American tax law history and may provide some new insights as policymakers once again consider taking up the mantle of tax reform.

II
GENERAL UTILITIES' PLACE IN TAX-LAW HISTORY

A. The History of Double Taxation of Corporate Income

One of the more controversial features of the U.S. federal income tax is that certain income is taxed at both the corporate level and the shareholder level.[17] For example, suppose a corporation earns a profit of $1,000,000 from its operations. As a corporation, a legal entity apart from its owners, it would then pay tax on that income, say $300,000.[18] This leaves $700,000 in the corporate treasury, some of which, say $400,000, it will distribute to its owners as dividends. Those dividends, then, are income of the owners who receive them. Because the owners are individuals who also pay tax on their income, the

13. ROBERT W. WOOD, GENERAL UTILITIES REDUX? M&A TAX REPORT 8 (2009), *available at* http://woodporter.com/Publications/Articles/pdf/General_Utilities_Redux.pdf.

14. Liquidation is functionally the only circumstance in which a corporation could avail itself of *General Utilities* by the time it was repealed. *See* I.R.C. § 336 (1984) (allowing nonrecognition of gain in complete liquidation).

15. However, given the number of relief provisions and other rules for mitigating the troubles caused by repeal, some have argued that this issue has become more complicated. *See* Beck, *supra* note 10, at 663 (describing various relief provisions proposed prior to repeal).

16. *See, e.g.*, Kahng, *supra* note 4, at 1087; Louis F. Lobenhofer, *The Repeal of* General Utilities *for Corporate Liquidations — The Consequences of Incomplete and Unexpected Tax Reform*, 4 AKRON TAX J. 153 (1987).

17. This feature of U.S. tax law is considerably different from other tax systems around the world. Bank, *supra* note 6, at 207.

18. This figure is for illustrative purposes only and does not necessarily reflect what a corporation with $1,000,000 of taxable income might currently pay in taxes.

money they receive as a dividend must also be taxed.[19] Therefore, of the same $400,000 in distributed corporate profits, the Internal Revenue Service collects a share at the corporation level as a percentage of the corporation's reported income and at the individual level as a percentage of that shareholder's personal income. Hence, what is essentially the same income, in the sense that it was really only earned or created once, is taxed two times.

A tax on income is relatively young in the United States. Congress enacted the first permanent tax on corporate and individual income[20] in 1894, but the scheme was promptly declared unconstitutional.[21] Roughly fifteen years later, Congress decided to institute an excise tax for doing business as a corporation, the size of that excise being a function of the corporation's income.[22] Like the difference between selling an asset directly and distributing it to shareholders who then subsequently sell it, it is quite difficult to distinguish between an excise tax for doing business as a corporation based on income and a corporate income tax.[23] Nonetheless, the Supreme Court decided that such an excise was constitutional.[24] Although the excise tax was the basis for taxing corporations, there was no income tax on individuals in 1909. If there is only one tax on corporate income, two-level taxation does not exist unless one corporation receives dividends from owning stock in another. Congress was apparently cognizant of the problem with this outcome, so it allowed a deduction of other corporations' dividends from the relevant corporation's excise calculation to ensure that a corporation's income would not be taxed twice.[25] In 1913, Congress passed and the states ratified the Sixteenth Amendment, which overrode the Supreme Court's declaration that an income tax was unconstitutional. Since then, Congress has had constitutional authority to tax the incomes of both corporations and individuals.[26]

At first, both corporate income-tax rates and individual rates were 1% on all income under $20,000.[27] Individuals, and *not* corporations, whose income

---

19. Currently, dividend income is treated separately from ordinary wage income, but that has not always been the case. Prior to 2003, dividend income was ordinary income and will be again if the Bush Tax Cuts are not extended. *See* Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, §§ 302–303, 117 Stat. 752, 760–64 (2003) (codified as amended in scattered sections of 26 U.S.C.).

20. During the Civil War, Congress authorized an income tax to fund war efforts but allowed it to expire in 1872. *See* Gary Giroux, *Financing the American Civil War: Developing New Tax Sources*, 17 ACCT. HISTORY 83 (2012).

21. Pollock v. Farmers' Loan and Trust Co., 158 U.S. 601 (1895); Shores, *supra* note 12, at 186.

22. Shores, *supra* note 12, at 187–88.

23. *Id.* at 188.

24. Flint v. Stone Tracy Co., 220 U.S. 107 (1911).

25. Shores, *supra* note 12, at 188.

26. U.S. Const. amend. XVI.

27. Revenue Act of 1913, Pub. L. No. 63-16, §2A(1) 38 Stat. 114, 166 (1913). This is roughly $450,000 in 2010 dollars, using the Consumer Price Index as the rate of inflation. *See CPI Inflation Calculator*, BUREAU LAB. STATISTICS, http://www.bls.gov/data/inflation_calculator.htm (last visited Jan. 25, 2014) (enter 20000 in "$" field; then select 1913 as the base year and 2010 as the equivalent year).

exceeded $20,000 were required to pay a graduated tax of 2%–6% on any income above $20,000.[28] And, just like it had prevented double taxation for corporations who received the dividends of other corporations, Congress exempted dividend income from the net-income calculation.[29] There was one exception: Those individuals whose total incomes were subject to the graduated tax were required to pay taxes on those dividends that exceeded $20,000.[30] The reason for this was simple: an individual whose business activities would earn in excess of $20,000 could incorporate him or herself as a C-corporation, pay 1% of the corporation's income in taxes and take all of the remaining income in tax-free dividends. Thus, the double tax on corporate income was designed to deter taxpayers from opportunistically and arbitrarily avoiding substantial tax solely by choosing to operate as a corporation.[31]

Nonetheless, many prominent tax scholars have described the *General Utilities* doctrine, a reprieve from double taxation, as dogmatic.[32] They argue that it makes no sense in light of the "classical, double tax" on corporate income.[33] As the twentieth century marched on, scholars and others began to accept the double tax as a permanent feature of the tax code, despite the fact that the early Congresses who confronted double taxation seemed to disfavor it.[34] The justification for the double tax was relatively simple: Because corporations are legally "people,"[35] they are taxed separately from actual people.[36] Viewed this way, it appears that a tax on all income without regard to source could provide for double, triple, or even further multiplied taxation.[37]

28. *Id.* at 166–67.

29. *Id.*

30. *Id.*

31. *Id.*

32. *See, e.g.*, Wolfman, *supra* note 9, at 81 (describing the *General Utilities* doctrine as "theological[] . . . like creation, it was there.").

33. *Id.* at 86; *see also* Shores, *supra* note 12, at 186 n.34 (citing ALI FEDERAL INCOME TAX PROJECT, SUBCHAPTER C, REPORTER'S STUDY OF THE TAXATION OF CORPORATE DISTRIBUTIONS 327 (1982)).

34. *See* Shores, *supra* note 12, at 177 n.60 (citing ALI FEDERAL INCOME TAX PROJECT, *supra* note 33, at 327 (describing and defending the contemporary understanding of double taxation)).

35. The notion of corporate personhood dates back to the mid-1800s. The Supreme Court ruled in an obscure case, *Santa Clara County v. Southern Pac. R., Co.*, 118 U.S. 394 (1886), that corporations were individuals for certain purposes. It arose out of a tax dispute between a California county and a railroad corporation. Individuals were allowed a certain tax deduction by the county, while corporations were not. The Supreme Court sided with the railroad corporation, deciding that for these purposes, corporations had the same rights as individuals. The Court's controversial 2010 decision in *Citizens' United v. Federal Election Commission* seemed to firmly cement corporate personhood as the Court decided that corporations have First Amendment rights to free speech. 558 U.S. 310 (2010).

36. *See* Shores, *supra* note 12, at 185–86 (describing the entity theory of corporate law).

37. *Cf. id.* To illustrate the multiple-tax principle, imagine a corporation, call it Bitterman. Bitterman owns stock in another corporation, Acme. Acme distributes some of its income as dividends to shareholders, including Bitterman. Bitterman earns income, including the dividends from Acme, and then distributes dividends of its own. Acme is taxed on income it earns, then Bitterman is taxed on the dividends it earned from Acme stock, and Bitterman shareholders are taxed on dividends distributed by Bitterman. Therefore, part of the income has been taxed at three levels, unless Congress provides that dividends are deductible at some level.

Furthermore, many corporations are large and have vast numbers of individual and institutional shareholders, making the corporation seem even more distinct from the random and varied individuals who own it. Certainly, from a revenue-collection standpoint, the more opportunities (or entities) from which taxes may be extracted, the more potential revenue fills the nation's coffers. Only lawmakers, then, could decide whether and at what levels dividends could be exempted from taxation, and therefore how many levels at which certain earnings are taxed. The first Congress faced with the prospect of double taxation apparently felt that this was not appropriate and exempted dividends from other income earned by taxpayers. Further, just six years after the constitutional birth of the income tax, Treasury regulations were promulgated making the distribution of dividends and dividends in kind non–taxable events.[38] Surely, those regulations were on the Court's mind when it decided *General Utilities*.

B. *General Utilities Co. v. Helvering*

More than fifteen years prior to the Supreme Court's decision in *General Utilities*, but only six years after the birth of the income tax, the Treasury introduced regulations that essentially declared that various dividend transactions would not be taxable.[39] The treatment of dividend transactions has always been a struggle for policymakers because there is no easy way to classify dividends for tax purposes. They are not expenses paid that might be deducted from income, nor are they expenses on debts owed to creditors. They are simply an internal transaction in which a corporation releases capital directly into the hands of shareholders rather than holding it for use within the operations of the corporation. Either way, the shareholders are still ultimately entitled to the capital.

General Utilities is a beguilingly simple case. At the time of the events that gave rise to the case, the General Utilities Corporation owned half of the outstanding stock of Islands Edison, which it had acquired for the paltry sum of approximately $2000.[40] By the time a buyer approached General Utilities about purchasing its share of Islands Edison, the market value of the stock had appreciated to more than $1.2 million.[41] From an economic perspective, General Utilities and the buyer interested in Island Edison could have arranged this transaction in any number of ways and achieved the ultimate result of the buyer taking control of Islands Edison by purchasing its stock. But taxes are always and forever part of any transaction's economic picture. If General Utilities had simply sold the stock to the buyer, it would have faced a massive capital-gains tax liability[42] for the appreciation of the Islands Edison stock from $2000 to $1.2

38. *See, e.g.*, 26 C.F.R. § 39.22 (a)–20 (1953).

39. *Id.*

40. General Utils. & Operating Co. v. Helvering, 296 U.S. 200, 201 (1935).

41. *Id.* at 202.

42. Capital gains refers to the recognition of income from the dispostion of certain types of assets

million.

Thus, General Utilities arranged the transaction by distributing the stock as a dividend in kind.[43] In doing so, General Utilities shareholders would owe individual income taxes on the value they received from the corporation as a dividend, which was the market value of their portion of the distributed stock at the time of the distribution. A fundamental principle of both tax and accounting is that whenever any entity acquires an asset, the asset must be recorded at the price paid or fair market value. This value is called its "basis" for tax purposes. In the case of a dividend in kind, the basis of the property distributed as a dividend is "stepped up" to fair market value at the time of the distribution. Therefore, the stepped-up basis of the Islands Edison stock resulting from the dividend distribution eliminated the massive taxable capital gain that would have been attributed to General Utilities.[44] Given the way this transaction was structured, General Utilities had avoided taxation on the capital gain allocable to the Islands' Edison stock, though the shareholders still had to pay taxes on the stock they received. However, they did not pay tax on the subsequent sale. If General Utilities had sold the stock, it would have owed taxes on the gain. Then, if it distributed any of the cash from the sale, the shareholders would owe taxes on whatever they received as well.

Following the transaction, the commissioner of the Internal Revenue Service brought an action in tax court against General Utilities to recover the tax that would have been owed on the appreciation of the Islands Edison stock.[45] The commissioner's only argument in the tax court was that distributions in kind are taxable as gains to the distributing corporation.[46] The Treasury itself disfavored this view, at least in the context of liquidation.[47] However, General Utilities was not liquidating at the time it divested itself of Islands Edison. The commissioner failed to make the argument that would serve as a centerpiece to the arguments for repeal and that would later be accepted by the Court in another case:[48] that an arranged, postdistribution sale of an appreciated asset by a corporation's shareholders is functionally a sale by the corporation, on which the corporation should pay taxes.[49] Indeed, the court of appeals sided with the commissioner against *General Utilities* on this very

---

that is treated differently from the recognition of general income under § 61 of the Internal Revenue Code.

43. "In kind" simply means that the dividend is paid in some form other than cash. In this case, the dividend was in the form of Islands Edison stock certificates. Distribution of dividends in kind in liquidation was not considered a taxable event. Therefore any appreciation on the property distributed was not taxable.

44. *General Utilities*, 296 U.S. at 202.

45. *Id.* at 200.

46. *Id.*

47. *See* Wolfman, supra note 9, at 82 n.3 (describing the early Treasury regulations that set forth the nontaxability of in-kind dividends).

48. Comm'r of Internal Revenue v. Court Holding Co., 324 U.S. 331 (1945); *see infra* Part II.C.

49. *General Utilities*, 296 U.S. at 206.

ground.[50] However, the Supreme Court did not reach the issue because of the commissioner's failure to raise it below.[51] Although many repeal advocates could forgive the Supreme Court for allowing a corporation to avoid taxes in circumstances in which it simply distributed the property to shareholders as dividends without directing them to immediately sell the property, they could see no justification for the Court's decision to allow General Utilities to avoid a tax simply by distributing the asset first and then selling it.[52]

As will become clear, *General Utilities* itself was not actually an application of the doctrine that existed at the time of its repeal in 1986. General Utilities was not liquidating. Rather, it was simply ridding itself of a single asset.[53] Only liquidating corporations were ultimately allowed to avail themselves of tax-free distribution-then-sale of appreciated assets.[54]

C. The Supreme Court's Subsequent Refinement of *General Utilities*

In what would seem like an about-face, the Supreme Court decided *Commissioner v. Court Holding Co.*[55] a mere ten years after *General Utilities*. Similar to the circumstances in *General Utilities*, Court Holding owned an appreciated asset that it wished to sell.[56] The corporation, though, began negotiations and agreed in principle to a sale of the asset.[57] At the eleventh hour, the corporation's attorney advised its manager–shareholders that the corporation would incur a significant capital-gains tax liability if the sale went forward as planned.[58] As a result, the corporation immediately distributed the asset to its two shareholders in kind, who made the sale on practically identical terms.[59] The Supreme Court found that the corporation obviously contracted to make the sale, despite the midnight formalism that the shareholders carried out to avoid the tax liability on the appreciation of the asset.[60] The head- and chin-scratching began anew since it seemed as though *General Utilities* and *Court Holding* were practically identical fact situations but had widely divergent outcomes. In fact, the Court even announced a test for this very situation: The determination of whether a corporation should be taxed should be decided based upon "substance" of the transaction.[61] At the time *Court Holding* was

50. Helvering v. Gen. Utils. & Operating Co., 74 F.2d 972, 976 (4th Cir. 1935).

51. *General Utilities*, 296 U.S. at 206.

52. *See* Wolfman, *supra* note 9, at 82 (describing the grounds that were ultimately upheld in *Court Holding* as "out-of-bounds" and criticizing that result).

53. *General Utilities*, 296 U.S. at 202.

54. *See infra* Part II.D; *supra* note 35.

55. Commissioner of Internal Revenue v. Court Holding Co., 324 U.S. 331, 331 (1945).

56. *Id.* at 333.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 334.

61. *Id.*

decided, this test seemed at least generally reasonable[62] and balanced the concerns many had about allowing these distribution-then-sales to occur to avoid corporate-level tax. It might be that the Court was already turning against *General Utilities*, or it could simply have been that the Court in *General Utilities* did not reach the question of whether the structured distribution-then-sale of appreciated assets would be taxable to the corporation.

Five years after *Court Holding*, the Supreme Court decided *Commissioner v. Cumberland Public Service Co.*,[63] whose facts were somewhat different than the prior cases. The Cumberland Public Service Company was liquidating itself[64] and wanted to sell various assets to a competitor.[65] The competitor apparently refused to purchase the assets directly from the company. Therefore, as a part of winding up its operations, it distributed the assets to its shareholders as dividends in kind.[66] The shareholders then sold the assets to the competitor.[67] The facts of *Cumberland* would seem to place it right in the ambiguity that reigned after *Court Holding*. The Supreme Court, applying the *Court Holding* test, decided that when the corporation could not have made the sale at all, the distribution-and-sale of the assets would not be taxable to the corporation.[68] After *Cumberland*, there was no obvious conclusion as to exactly how various corporate distributions should be treated for tax purposes. Under *General Utilities*, it seemed that a distribution-then-sale would be tax free, but under *Court Holding*, such a transaction would be taxed.[69] And, of course, the economic-substance-of-the-transaction test seemingly announced in *Court Holding* added little clarification. *Cumberland*'s reasoning was straightforward, but the situation seemed very specific: The corporation would only be allowed to effect a distribution-then-sale tax free when it simply could not sell the assets on its own.[70] Further, *Cumberland* created even more tension in the doctrine by raising the question of whether the Supreme Court in *Cumberland* was blessing *General Utilities* in the liquidation context but not in other contexts or whether it had simply applied the test it announced in *Court Holding*.[71] It was not until almost ten years later that Congress acted to sort out how it wanted to tax

62. Indeed, one commentator argued that focusing on the *Court Holding* test would be preferable to repealing the doctrine altogether. Beck, *supra* note 10, at 670.

63. Comm'r of Internal Revenue v. Cumberland Pub. Serv. Co., 338 U.S. 451 (1950).

64. Essentially, Cumberland was selling all of its assets and ceasing to operate as a corporation. This is the context in which Congress ultimately decided that *General Utilities* was most useful to businesses. I.R.C. § 336 (1954).

65. *Cumberland*, 338 U.S. at 452–53.

66. *Id.* at 453.

67. *Id.*

68. *Id.* at 453–54.

69. Commissioner of Internal Revenue v. Court Holding Co., 324 U.S. 331, 331 (1945); General Utils. & Operating Co. v. Helvering, 296 U.S. 200, 200 (1935).

70. *Cumberland*, 338 U.S. at 451.

71. *See* Kahng, *supra* note 4, at 1089 (describing the disparate holdings of *Cumberland* and *Court Holding* as a tension in the doctrine).

corporate distributions of appreciated assets.[72]

D. Codification and Limitation of the Doctrine by Congress

In 1954, Congress sought to clear up the confusion about the tax effects of various types of corporate distributions.[73] As scholars have noted, most believed that Congress would do away with *General Utilities* or codify it.[74] In codifying the doctrine, though, Congress apparently decided that the scope of *General Utilities* should be even greater than the Court found in *Court Holding*. The sale of any appreciated assets, not just those distributed and then sold, to any party within a year of a company's complete liquidation would avoid taxation at the corporate level.[75] In essence, the holding of *Cumberland* was extended to include all situations in which a company was liquidated, not just situations in which the buyer would not accept sale from the liquidating corporation.[76] The end result of Congress's codification was to allow corporations to avoid taxation on an asset's appreciation via a distribution to and sale by shareholders or simply any sale within a year in this liquidation context.[77]

Nonetheless, Congress apparently did not intend for corporations who were *not* winding down their operations to take advantage of the *General Utilities* doctrine.[78] Such was the basis of the tension that one early commentator called the "central distortion" of tax law.[79] Congress apparently believed that in the context of liquidation—when a company distributed all remaining cash including cash resulting from the sale of appreciated assets—there would always be a receiving shareholder to tax.[80] Indeed, in every circumstance of corporate distribution of assets, there was always a shareholder who was taxed on the increase in wealth resulting from the distribution, whether in-kind or in cash. Further, Congress apparently perceived a certain wisdom to allowing corporations to structure liquidations this way.[81] Indeed, liquidation is an "extraordinary" event in the life of a corporation.[82] It is the point at which the distinction between the corporation and its owners is least visible. At the very moment the corporation ceases to exist, all remaining cash from the sales of its assets is distributed to the corporation's owners. Nonetheless, many scholars and politicians persistently believed that double taxation was necessary.

---

72. *See* Shores, *supra* note 12, at 179 (describing Congress's decision to codify *General Utilities* in 1954).

73. *Id.*

74. Wolfman, *supra* note 9, at 82.

75. I.R.C. § 336 (1954).

76. *Id.*

77. *Id.*

78. The codification only allowed the *General Utilities*–style distribution-and-sale or any sale to be affected tax free as a part of a plan for "full liquidation" of the company. *Id.*

79. Wolfman, *supra* note 9, at 82.

80. *See* Shores, *supra* note 12, at 179 n.16 (explaining that if the company is in liquidation, the distributed assets will "become subject to a shareholder-level tax").

81. WOOD, *supra* note 13, at 8.

82. Shores, *supra* note 12, at 208.

A brief example can illustrate how the postcodification doctrine functioned. Suppose a corporation, Enterprise, Inc., purchased 100 shares of Consolidated, Inc. in 2002 for $10,000. The CEO perused Consolidated's financial statements, but did not do that much work in assessing the risk. The board of directors did not pay attention because it was a small sum of money and because the board generally deferred to management. In the financial crisis of 2008, Consolidated made a fortune by buying credit default swaps and its stock has been on the rise ever since. Its market price is now $1,000,000. The CEO wants to sell the stock, but realizes that Enterprise would realize a $990,000 gain on the sale of the asset. Under the codified *General Utilities* doctrine, it would not matter whether the CEO sold the stock on the open market or distributed the stock to the shareholders with arrangements for them to sell it instead. Enterprise would owe taxes on the gain. However, if Enterprise found itself in liquidation, it could sell the stock (with all kinds of assets) within one year and avoid the taxes on the $990,000 increase over the value it paid.

With this in mind, it seems arbitrary to tax in one circumstance while not taxing in another. The same stock with the same appreciation in value is taxed twice if Enterprise remains a going concern but is only taxed once if it liquidates. On the other hand, at the point when the corporation is liquidating and the shareholders are set to receive whatever cash is left over after all the assets are sold and creditors are paid, the tax the corporation must pay with its last breath is really paid by the stockholders, not the now-dissolved corporation.

III
THE DEBATE SURROUNDING REPEAL

A. The Rest of the Tax Reform Act of 1986

The Tax Reform Act of 1986[83] was the most recent major overhaul of the American system of income taxation. Despite significant complexity, the Act was primarily concerned with reducing individual income-tax rates, broadening the income-tax base, and eliminating some of the more peculiar (and sometimes nonsensical) tax contraptions of the twentieth century.[84] To many scholars and tax reformers, *General Utilities* fell into this third category.[85] Congress wanted to remove many of these provisions because they created unnecessary complexity in the Code and because they led to arbitrarily constructed and tax-driven transactions that resulted in special advantages for sophisticated businesses with

83. Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of the U.S. Code).

84. For example, throughout the 1900s, individual income taxes were as high as ninety-one percent on the highest income earners. With such incredibly high marginal rates, taxpayer unrest was always assuaged with numerous loopholes, deductions, and various methods for avoiding some of the Code's highest historical rates.

85. *See* Wolfman, *supra* note 9, at 86 (describing one of the driving forces behind repeal, the ALI FEDERAL INCOME TAX PROJECT, *supra* note 33, as a "simplifying and elegant reform" that would bring "coherence" to the tax code).

expensive tax counsel.[86] Given this landscape, it was not surprising that *General Utilities* found its way to the chopping block. Scholars[87] and politicians[88] lined up to express their displeasure with *General Utilties*' contribution to the Code's complexity and to its seemingly arbitrary reprieve from the "classical"[89] double-tax system. Furthermore, *General Utilities* was decidedly on the wrong side of the goal of broadening the tax base.[90]

There was one peculiarity to the Tax Reform Act of 1986 with respect to corporate taxation: The reduction in personal income taxes resulted in, for the first time in history, lower personal income-tax rates than corporate income-tax rates.[91] For all those who saw *General Utilities* as an affront against the traditional system of double taxation, a corporate tax rate higher than the individual rate would make no difference: they believed both individuals and corporations should be taxed either way.[92] Strangely, given the historical justification of the double tax, a corporate rate higher than the personal one would eliminate that justification.[93] There was no longer a distinct tax advantage to operating as a C-corporation vis-a-vis operating as a proprietorship, partnership, or some other type of pass-through corporate entity.[94]

B. Double Taxation or Integration?

As previously discussed, the double-tax system had clearly taken root in American corporate tax law during the twentieth century. However, over time there were always a few who thought that corporations should not be taxed at all.[95] At the time of the tax reform in 1986, these people were known as "integrationists."[96] President Reagan himself seemed to be an integrationist,

86. Lobenhofer, *supra* note 16, at 168.

87. *See, e.g.*, Wolfman, *supra* note 9, at 81 (questioning why the doctrine existed).

88. *See* Lobenhofer, *supra* note 16, at 169 (summarizing some of the legislative history surrounding repeal).

89. Wolfman, *supra* note 9, at 86.

90. Block, *supra* note 3, at 308.

91. Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of the U.S. Code).

92. *See* Wolfman, *supra* note 9, at 86 (describing the double taxation of corporate income as "classical").

93. Shores, *supra* note 12, at 190.

94. Small and medium-sized businesses that do not plan to seek capital investment through access to public capital markets may organize as entities that have the same limited liability as corporations but are relieved of the double tax by "passing income through" the entity to its shareholders, usually limited to a certain number.

95. *See* Anthony Polito, *Constructive Dividend Doctrine from an Integrationist Perspective*, 27 AKRON TAX J. 1, 2 (2012) (describing the term integrationist and the "Integrationist Norm," which is that corporate income should only be taxed once).

96. This is because they believed that the tax framework for individual people should be "integrated" with the tax framework for corporations. Corporations are nothing but a group of people operating in a different form, so the integrationists believed that practically all corporations should be pass-through entities.

stating that he saw little justification for any tax on corporations and that taxes for corporate income should simply fall to the shareholders when they received income from their ownership stake.[97] Nonetheless, scholars suggested that even integrationists should agree that the system under *General Utilities* represented a partially integrated system, and that those who could benefit from the partial integration was simply the result of how well their counsel could splice together *General Utilities* with other doctrines to avoid tax.[98]

C. Academic Criticism of *General Utilities*

The primary academic criticism of *General Utilities* is that it seems to be an arbitrary and dogmatic tax break for corporations.[99] After all, an ordinary distribution of an appreciated asset would be required to be reported as a gain, while the same gain would not be reported in liquidation.[100] Beyond this superficial complaint that the doctrine was arbitrary, the doctrine troubled scholars because it was a way for corporations to avoid double taxation, which had come to be accepted as a permanent feature of income taxation, and because it led to what many saw as an above-optimal level of acquisitions.[101]

Tax scholars of the 1980s no longer saw double taxation as a proposition to prevent opportunistic taxpayers from paying a lower tax simply by virtue of operating as a corporation. They saw double taxation as the "classical" system for taxation of corporations and their shareholders.[102] In effect, repealing *General Utilities* was, to these scholars, the choice to operate a double-tax system between corporations and shareholders, rather than one of single tax. Simply put, they found it unfair that a corporation in liquidation could escape paying taxes on sales and distributions of appreciated property while corporations continuing to operate could not.[103]

Another major academic complaint about *General Utilities* was the economic effects of allowing liquidating corporations to avoid payment of taxes on distributions of assets while disallowing going concerns the same opportunity.[104] As has been noted, there are a number of ways that a corporation wishing to buy another may effect such a transaction.[105] For the sake of simplicity, the acquiring corporation may simply buy the stock of the target corporation and exert control over the assets that way, or it may arrange the transaction so that the target corporation liquidates itself and then sells all

---

97. *See* Block, *supra* note 3, at 308, n.8 (citing *Corporate Tax Upsets Reagan*, N.Y. TIMES, Jan. 27, 1982, at D1, col. 3) (describing Reagan's criticism of the tax system).

98. Wolfman, *supra* note 9, at 85–86.

99. *Id.*

100. I.R.C. § 336 (2006).

101. *See* Kahng, supra note 4, at 1087 (explaining the concern among many about how much acquisition activity was occurring in the 1980s).

102. *See, e.g.*,Wolfman, *supra* note 9, at 86.

103. *Id.* at 85.

104. *Id.*

105. *See supra* Part II.B.

the assets to the acquiring corporation. Under the *General Utilities* doctrine, an acquiring corporation who purchased control of the target corporation via purchasing stock would now own the appreciated assets.[106] If, however, the acquiring corporation used the second option, it could effect a step up of the asset basis to its fair market value much more simply.[107] If an asset was stepped up every time it moved out of one corporation and into another, no corporation would ever have to pay taxes on the gain. This ultimately made appreciated assets more valuable to an acquirer than they were to the going concern that was currently operating them, thus increasing merger and takeover activity.[108] More disconcerting to the academic proponents of *General Utilities*' repeal was that the second scenario could occur perpetually as long as the doctrine held sway.[109] Every time an asset was stepped up, the government lost the opportunity to tax the accumulated gain at the corporate level.[110] In addition to a general belief that *General Utilities* was dissonant with double taxation of corporate income, the perception that *General Utilities* was contributing to an abnormally high level of takeovers led many to believe *General Utilities* repeal should be a piece of tax reform in 1986.[111]

D. Congressional Reports

The legislative history of the Tax Reform Act of 1986 tracks the academic arguments in favor of repeal rather closely. The staff of the Senate Finance Committee generated a report that concluded that corporations are getting an unreasonably favorable deal by being able to perpetually step up asset values under *General Utilities* and that the general goals of the corporate income tax were not being served by allowing *General Utilities* nonrecognition.[112]

The report of the House Ways and Means Committee on the proposed legislation also echoed the academy's concerns about the apparently perverse incentive for acquiring corporations to liquidate target corporations to avoid tax

---

106. Under another doctrine, known as the *Kimbell-Diamond* doctrine, acquiring companies could step up the assets to fair market value regardless of whether they purchased the stock or the assets directly. However, if the assets were purchased directly, the *seller* would owe taxes on the built in gain unless it could avail itself of *General Utilities*. If it purchased the stock, the stock would reflect the increased value of the assets and therefore would result in higher taxes for shareholders. Scholars did not particularly like this doctrine either, but its combination with *General Utilities* was especially deplorable because it allowed corporations to effectively avoid ever paying taxes on asset appreciations. *See* Wolfman, *supra* note 9, at 84.

107. In essence, the price of the stock of the target corporation would be more expensive if tax was required on the appreciation. This led to an incentive to liquidate with *General Utilities* rather than simply buy the stock and use the step up provided under *Kimbell-Diamond*.

108. Kahng, *supra* note 4, at 1092.

109. *See* Wolfman, *supra* note 9, at 86 (explaining that "dead" corporations have effectively avoided tax for their entire lives).

110. *Id.* Furthermore, when you factor in *Kimbell-Diamond* step ups, an asset may go through its life without ever being taxed. *See* Wolfman, *supra* note 9, at 85 (discussing how corporations can avoid tax when assets are at a stepped-up basis).

111. Kahng, *supra* note 4, at 1093.

112. *See* Beck, *supra* note 10, at 678–79 (describing the report of the Senate Finance Committee).

through *General Utilities*.[113] The committee thought it was important "that the Code should not artificially encourage corporate liquidations and acquisitions" and that "repeal of . . . *General Utilities* . . . is a major step" towards slowing down the merger activity of the 1980s.[114] Like many scholars, the Ways and Means Committee was concerned that *General Utilities* "undermine[d] the corporate income tax."[115] The Committee noted the same concern that corporations could step up the basis of acquired assets through a *General Utilities* sale and perpetually avoid recognition of accumulated gains on various assets.[116] Notably absent from the committee report is an explicit declaration that *General Utilities* is a natural enemy of the double tax. Though limiting takeover activity was apparently a normative goal for Congress and it appeared to believe that the perpetual step up in gain was an improper gratuity to corporations, it did not explain its rationale for the latter conclusion.[117] Despite Congress's conclusive stance and the practically unanimous academic chorus of repeal,[118] some voices in the wilderness urged Congress to think twice.

E. In Defense of *General Utilities*

Most of the defenses of *General Utilities* around the time of its repeal were rooted in path dependence.[119] Repealing *General Utilities* would result in a "shock wave," noted one commentator.[120] By 1984, two things were clear to most defenders of *General Utilities*: first, it probably would be repealed and second, there would need to be a number of relief provisions and other various workarounds to mitigate some of the repeal's negative consequences.[121]

Both the Senate Finance Committee in 1984 and the House Ways and Means Committee in 1985 had apparently decided that repeal of *General Utilities* was a favorable and proper course of action. However, the underlying rationale for their recommendations seemed shaky at best and theoretically untenable at worst.[122] Although many arguments in favor of retaining *General Utilities* acknowledged Congress's queasiness with respect to acquisitions as an underlying reason for repeal,[123] they generally suggest that the cure would be worse than the disease.[124]

---

113. H.R. Rep. No. 99-426, at 281–82 (1985).

114. *Id.* at 282.

115. *Id.*

116. *Id.*

117. *Id.*

118. Beck, *supra* note 10, at 667.

119. *See* Block, *supra* note 3, at 308 (explaining that given the many years that *General Utilities* has been a major fixture in the corporate tax landscape, there would be some "discomfort" among the tax bar with its repeal).

120. *Id.* at 309.

121. *Id.*

122. *See* Beck, supra note 10, at 663 (stating that the proposals for repeal would create more problems).

123. Block, *supra* note 3, at 324.

124. Beck, *supra* note 10, at 663–64.

In the first place, arguing that *General Utilities* was unfairly generous to corporations necessarily implies that a tax on a corporation's shareholders exclusively, rather than a tax on both, is fundamentally "overgenerous."[125] However, there is very little traditional justification for a true double tax.[126] The early Treasury regulations did not consider in-kind distributions as realization events, and ample legislative and other administrative history shows that, as a general proposition, simply moving assets in and out of the corporate form is not something that the income tax is supposed to touch.[127] In essence, it appears that the academic arguments for repeal flowed only from a value judgment that taxing practically every transaction involving a corporation twice is appropriate. Furthermore, history tends to fall on the side of taxation at only one level.[128] Double taxation is a later tax innovation that was grafted upon a system never built to handle it.[129]

As a practical matter, repealing *General Utilities* seems even more problematic. The crux of the arguments against repeal was the nature of circumstances[130] in which assets moved in and out of the corporate form.[131] The scholars were clearly contemplating situations in which new ownership was using *General Utilities* to circumvent taxes on gains that occurred under old ownership of any given set of assets.[132] However, many occurrences involve assets moving in and out of various corporate forms by the same owners.[133] In those circumstances, a person simply moving an asset out of the corporate form will have to pay a tax on any appreciation that occurs while the asset lived under a corporate form rather than a pass-through form. Such a "toll" for moving your own asset in and out of a corporation is problematic.[134] The fundamental basis of any economic argument for *General Utilities* was that it did not let the Tax Code get in the way of the goal of lining up assets with their most efficient uses. If there are awkward tax barriers between various forms, this goal is harmed.[135] Surely, those making this argument were making an implied or subconscious distinction between the different types of enterprises

125. *Id.* at 669.

126. *See* Shores, *supra* note 12, at 177 (stating that the Tax Reform Act of 1986 eliminated the justification for double taxation).

127. Beck, *supra* note 10, at 672–73 (1985).

128. *See supra* Part III.B (discussing the integrationists and proponents of double tax).

129. *See* Shores, *supra* note 12, at 189–90 (explaining that the double tax was not originally intended to be as broad as it is currently).

130. These circumstances did not always include transactions, which are considered bargained-for agreements for transfer of property between two unrelated parties. These situations are usually thought of as taxable circumstances since there are two unrelated parties. However, oftentimes the same owners would be changing their holdings from assets themselves to stock in a corporation that held those assets, and vice versa.

131. Beck, *supra* note 10, at 672–73.

132. *See* Wolfman, *supra* note 9, at 84 (discussing "purchasers" who used *General Utilities* to avoid tax on later sales of the same assets to other parties).

133. Beck, *supra* note 10, at 673.

134. *Id.* at 674.

135. *Id.* at 673.

that operated as separately-taxable C-corporations. Some corporations are large, have operations throughout the world, employ thousands of people, and have thousands of diverse shareholders who are truly disconnected from the operation of the business. This is the circumstance where the fictional corporate person seems the most real or separately alive. However, there were many C-corporations that were owned by one, two, or twenty people, many of whom were involved in or close to the operation of the corporation. In this case, the fictional corporate form seems much less distinct from these owners. These people tended to move assets in and out of the corporate form or even change operating form altogether. The justification for taxing both the corporate body and the shareholders that represent its backbone is much weaker for these closely held C-corporations.

The liquidation context, in particular, is one in which the double tax can sting all the more painfully. The earlier example of Enterprise, Inc. can serve to illustrate this. Enterprise has shareholders who own rights to the corporation's assets through stock. Say the CEO has haphazardly managed the company and run it into the ground. The company will have to liquidate and will cease to exist in the corporate form. Nonetheless, it has valuable assets, such as its stock in Consolidated, Inc. Under a non–*General Utilities* regime, the corporation would have to pay taxes on all the gains that occurred while the assets existed in corporate form, right before the corporation ceased to exist. Functionally, though, the tax that the corporation owed would ultimately be borne by the shareholders, generally by a lower amount of distribution to them after the liquidation.[136] This is not just a double tax, one on the corporation and one on the shareholders, but rather a double tax on the shareholders by themselves. The corporation that technically held the assets while they appreciated is no longer alive. Yet, without *General Utilities*, it is forced to pay taxes. Of course, one prominent scholar would respond to these voices in the wilderness by imploring you not to pity the poor, dead corporation, because it probably spent its life . . . avoiding taxes.[137]

IV

IMMEDIATE EFFECTS OF REPEAL AND CALLS FOR REINSTATEMENT

A. Effects on Taxpayers

Although by now most taxpayers have adjusted their strategies to account for the repeal of *General Utilities*, the short term was more difficult. As argued prior to repeal, those hardest hit were small businesses whose owners placed

136. *See* Beck, *supra* note 10, at 674 ("As soon as the tax is measured, it will fall upon the shareholders either as a reduction of their liquidation proceeds or as their direct obligation.").

137. *See* Wolfman, *supra* note 9, at 86 ("[T]he decedent corporation is one that managed quite successfully to maneuver through its corporate existence without paying tax on real income that accrued during its ownership of the appreciating assets.").

their assets in the corporate form for many years prior to liquidation.[138] In addition to making liquidation more costly, and thereby deterring those who scholars might have wished to prevent from availing themselves of *General Utilities*, the repeal also caught many small businesses in the process.[139] Even more telling is that big, sophisticated corporations were not the ones most acutely affected.[140] Large corporations are rarely in liquidation and they can avoid gains during acquisitions using other tools and tax provisions aside from *General Utilities.*[141] Smaller corporations, though, are less immune to changing business cycles and other social problems.[142] Owners of small corporations are more likely to be very few in number and to move their assets in and out of the corporate form from time to time. Given the new tax on moving assets around in this way, it would follow logically that smaller corporations would be disproportionately hit.[143] Furthermore, for those who had the misfortune of being a C-corporation before *General Utilities* repeal and who later wished to re-form as a different type of entity, they would owe taxes on long-term appreciation of their assets, while an enterprise re-forming itself from one type of noncorporation to another will not.[144] This tends to "trap" assets in corporate forms where they may not be as efficiently used or leave the owner with a tax burden in trying to change the form of her small business. It is more difficult to pity the thousands of disparate shareholders of a corporate giant, who are probably diversified and may not even notice the last-gasp tax they will have to pay. However, in a small corporation, the backbone shareholders will surely notice. Again, the corporate form does not seem as separate from shareholders in the context of a small corporation as it does in the context of a giant like Wal-Mart. Of course, immediately following repeal of *General Utilities*, there was a marked increase in small businesses formed and re-formed as pass-through entities because of the built-in tax advantages and the ease with which assets can move in and out of those forms.[145] The C-corporation is now the province of only the largest operations and a few others who have other tax strategies.[146]

Aside from repeal's apparent mistreatment of small business owners, it created new problems in the market for corporate control.[147] Even though *General Utilities* repeal had ushered in a new era of tax neutrality with respect

138. Lobenhofer, *supra* note 16, at 174.

139. *Id.*

140. *Id.* at 175–76.

141. *Id.*

142. *See id.* (explaining the classic case of the "family business" when the business splits up because of family pressures, related or unrelated to the operation of the business).

143. *Id.* One cannot imagine Wal-Mart distributing all its assets to shareholders and then trying to operate as a pass-through entity such as a partnership.

144. Beck, *supra* note 10, at 673.

145. WOOD, *supra* note 13, at 8.

146. Other tax issues may include avoiding the alternative minimum tax, another historical tax contraption, or those who simply pay themselves salaries as managers rather than distributing dividends to themselves as owners.

147. *See generally* Kahng, *supra* note 4, at 1087 (questioning whether repeal was wise).

to acquisitions, it brought with it a troubling mismatch in corporate control.[148] Whereas prior to *General Utilities* repeal there had been an incentive to take over companies and operate their assets more efficiently, there was now an incentive to allow underutilized assets to sit on the books of unnecessarily bloated companies.[149] Whatever victory may be claimed from slowing down merger activity following repeal of *General Utilities*,[150] there was now another problem: stagnation. With new taxes complicating the free flow of assets in and out of various corporate forms, firms had a tendency to hold onto entire businesses that would not be as efficient under their control as they would be under someone else's.[151] Even if repeal was the right decision at the time, there are strong arguments for reviving, at the very least, some of the policy underlying *General Utilities*.

B. Did Repeal Achieve Any of its Goals?

The proponents of double taxation pretty clearly achieved their goal of broadening the scope of double taxation. *General Utilities* met its end and almost all gains and losses on distributed assets, with few exceptions, were now considered reportable events. Whether the policy underlying double taxation of corporate income is proper or not, the repeal of *General Utilities* certainly reiterated the preference among many for a double-tax regime. To be sure, the reformers had achieved their goal of reducing the arbitrariness of the tax treatment of corporate distributions.[152] Once again, all were taxed.

There is little evidence that the practical goal of some scholars of reducing merger activity was ever realized.[153] Although merger activity slowed slightly in 1986and 1987 following the repeal of *General Utilities*, it increased to heights above pre-repeal levels in 1988 and 1989.[154] In addition to the little evidence that supports the theory that repeal slowed down or stopped *inefficient* merger activity, there is some evidence that it might have prevented some *efficient* merger activity.[155] According to one commentator, the question never should have been whether the total takeover activity was too great, but rather whether the amount of *inefficient* takeovers were too great.[156] Only after that question is addressed can policy be properly developed to limit the inefficient transactions while not inhibiting efficient ones.

---

148. *Id.*

149. *See id.* at 1097 (explaining that acquisitions are a natural way to punish corporate managers by taking assets away from those who are not efficiently utilizing them).

150. See part IV.B for discussion on how *General Utilities* may not have slowed down merger activity.

151. Kahng, *supra* note 4, at 1097.

152. Shores, *supra* note 12, at 195.

153. *Id.* at 181.

154. *Id.*

155. Kahng, *supra* note 4, at 1110.

156. *See id.* at 1116 (criticizing lawmakers for recognizing only the undesirable aspect of takeover activity).

V
GENERAL UTILITIES AS A TURNING POINT IN TAX LAW HISTORY

Repeal of *General Utilities* was considered one of the "sea changes" in the life of many tax practitioners who practiced in the 1980s.[157] Before *General Utilities*, the landscape of corporate liquidations and the natural flow of assets that went along with them were vastly different. Under the single, shareholder tax regime that existed under the codified *General Utilities* doctrine, assets could move in and out of the corporate form with relative ease, at least from a tax perspective.[158] Shareholders of liquidating corporations were only subject to tax on capital gains once, rather than having to pick up the tab for the dead corporation as well. The law recognized the wisdom of nonrecognition in the context of a company's liquidation. Of course, repeal simplified the Code and broadened the base of corporate taxation.[159] It also further entrenched the concept of double taxation.

Another notable effect of *General Utilities* repeal was a mass migration from subchapter-C to subchapter-S corporations. Since assets moving from subchapter-C or subchapter-S and back faced potential tax liability under a tax code without *General Utilities*, many smaller businesses that might have incorporated under Subchapter C opted instead to be an LLC or LLP. These provisions of the Code probably mitigated some of the harshness of *General Utilities* repeal.

The shift underlying *General Utilities* was more than just a change in the way businesses do business. Despite the evidence of problems that arose from repeal and the thin justification for the double tax, repeal of *General Utilities* was an ebb away from a more integrated regime for corporate taxation. In truth, the fight over *General Utilities* was not so much about economic theory, business decisionmaking, or generating revenue. It was an ideological choice for double taxation. Many believe that even in the context of liquidation, an extraordinary event in the life cycle of a corporation, double taxation is still appropriate.[160] The policy underlying this reprieve from double taxation was based simply on the belief that double taxation itself was a bad idea as much as it was a bad idea in the liquidation context. Even today, the policy of double taxation is still up for debate.[161] Today, like in the early 1980s, tax reform is once again a real possibility.[162] And, again, broadening the tax base, that is, taxing more entities, is one competing goal.[163] On the other hand, limiting the effects of double taxation

157. WOOD, *supra* note 13, at 8.

158. *See* Lobenhofer, *supra* note 16, at 174 (explaining that the repeal of *General Utilities* created more difficulty in moving assets from corporate to noncorporate forms).

159. *See id.* at 155 (explaining that reformers achieved their goal).

160. Wolfman, *supra* note 9, at 86.

161. *See, e.g.*, Polito, *supra* note 95 (arguing for integration, yet admitting that it is likely politically impractical).

162. Robert Pear, *G.O.P. Talks of Limiting Tax Breaks*, N.Y. TIMES, Nov. 7, 2011, at A15.

163. *See* Editorial, *Flat Taxes and Angry Voters*, N.Y. TIMES, Oct. 30, 2011, at A20; *see also* Alan Reynolds, *Tax Rates, Inequality and the 1%*, WALL ST. J., Dec. 6, 2011 at A15 (representing the current

on taxpayers is, as it has always been, a potential driver of new tax policy.[164] Indeed, the last major tax-reform event, the Bush Tax Cuts, involved mitigating the effect of double taxation of corporate income through lowering rates on capital gains and dividends.[165] Whether for the sake of efficiency, fairness to the consumer–investor, administrative simplicity, or even perhaps to encourage repatriation of American tax dollars from cross-border tax havens, some of the policy arguments regarding double taxation that underpinned *General Utilities*' repeal could be considered by policymakers as they navigate the next potential shift in the history of American income taxation.

VI

CONCLUSION

Tax policy, tax scholarship, tax theory, and tax practice all had different ways of analyzing the issue of corporate distributions and sales of appreciated assets. Over time, different value judgments over the efficacy of the double tax, the desirability of various tax avoidance opportunities, and politicians' affinity for modifying taxpayer behavior through the Tax Code gave us a massive code filled with all sorts of divergent provisions. The story of the *General Utilities* doctrine is certainly no exception. It is not just a case of how to treat various types of business activities under the tax law, but perhaps a microcosm for how tax policy and philosophy ebb and flow over time. Beginning with the early regulations from the Treasury to the ultimate repeal of the doctrine in 1986, the life and death of *General Utilities* may be a microcosm for how scholarship, politics, and business approach tax issues differently. Will the future hold a return of *General Utilities*? Though this answer is doubtful, it is abundantly clear that the *General Utilities* doctrine, and the tensions it represents, was a major part of the history of federal income taxation in the United States.

---

themes and tones in tax policy).

164. *See* Polito, *supra* note 95, at 6.

165. *Id.*