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## Tax and Social Context: Legal Fictions and Tax

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# SAVANNAH LAW REVIEW

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## TAX AND SOCIAL CONTEXT: LEGAL FICTIONS WITHIN TAX

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*Tessa Davis\**

There is a widely-held and oft-disputed concept of tax exceptionalism—that tax is an area of law apart. The idea may be expressed in the view that tax administrative law is not bound by the same restraints as administrative law more broadly<sup>1</sup> or simply in a vague sense that the study and practice of tax are categorically different than other “traditional” areas of law such as criminal law or contract law. If accepted, this view might suggest that tax law and policy is a poor fit for a symposium on American Legal Fictions. Legal fictions are most often theorized in areas of judicially driven law. Statutory law, by contrast, dominates tax. Perhaps, then, tax law is an area in which legal fictions are less frequent and less relevant.

This Essay advances a different view. Specifically, I consider whether tax scholarship could benefit from a deliberate effort to identify legal fictions, as well as develop a theory of the role legal fictions serve within tax law. The success of this project, I contend, depends on embracing a broader view of legal fictions than is accepted by some. After a brief discussion of traditional legal fictions in tax, I consider two rules—one judicial and one statutory—that may be understood as legal fictions under a broader definition of legal fiction, as well as lay out the insights for tax law and policy that may follow from adopting a broader definition.

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\*Assistant Professor of Law, University of South Carolina School of Law. This Essay developed from a presentation given at Savannah Law School’s symposium on American Legal Fictions. The author would like to thank Caprice Roberts and *Savannah Law Review* for the invitation to be a part of the symposium, as well as her fellow speakers and attendees.

<sup>1</sup> See e.g., Richard Murphy, *Pragmatic Administrative Law and Tax Exceptionalism*, 64 DUKE L.J. ONLINE 21, 21 (2014). “‘Tax exceptionalism’ holds that, like the animals of an island long cut off from a continent, the administrative law of tax has evolved into different forms than those found in general administrative law.”

Despite his focus on common law rather than the statutory and regulatory law that comprises so much of tax law, Lon Fuller's classic discussion of legal fictions bears repeating. A legal fiction is, Fuller states in his essential work, *Legal Fictions*, "either (1) a statement propounded with a complete or partial consciousness of its falsity, or (2) a false statement recognized as having utility."<sup>2</sup> This definition has been expanded and critiqued in the intervening years but remains an influential articulation of the concept. Even with its common law origins, Fuller's concept of legal fictions arises in tax law and doctrine. A few examples will help clarify the types of traditional legal fictions that arise in tax.

To the extent scholars have focused on legal fictions and tax, a frequent point of focus has been the impact of the legal fiction of the "corporation as entity."<sup>3</sup> Long before *Citizens United*, the Internal Revenue Code (the "Code") accepted the view that a corporation is more than simply the aggregation of its shareholders and is, instead, a separate entity. A corporation files its own tax return, calculates its taxable income, and determines its tax liability under its own rate schedule.<sup>4</sup> A corporation may engage in taxable transactions with its shareholders.<sup>5</sup> Accepting the idea that a corporation is an entity separate from its shareholders gives rise to an aspect of tax policy that is both heralded and much-maligned: the double taxation of corporations. If a corporation were instead treated as is a partnership—as a mere aggregate of its owners—double taxation of the corporation, and the complex tax-planning strategies that arise to mitigate its effects, might be reduced.<sup>6</sup> Despite the complexity it creates, the fiction of the corporation as entity may serve other policy ends that justify its existence, such as acting as a regulatory check on corporate behavior.<sup>7</sup>

Other examples arise outside of corporate taxation. Professor Nancy Knauer identifies 26 U.S.C. § 7872 as an example of a traditional but statutory legal

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<sup>2</sup> LON L. FULLER, *LEGAL FICTIONS* 9 (1967).

<sup>3</sup> See H. David Rosenbloom, *Banes of an Income Tax: Legal Fictions, Elections, Hypothetical Determinations, Related Party Debt*, 26 SYDNEY L. REV. 17 (2004) (arguing that the corporation-as-entity fiction is one of three factors that has created the morass of code provisions and regulations that govern related-party debt, and the attendant tax avoidance techniques); Nancy Knauer, *Legal Fictions and Juristic Truth*, 23 ST. THOMAS L. REV. 70, 79 (2010).

<sup>4</sup> 26 U.S.C. § 11 (setting out the rates schedule that applies to corporations).

<sup>5</sup> For example, when a corporation pays dividends to its shareholders, the shareholders have taxable income. 26 U.S.C. § 301 (setting out the tax consequences of distributions of property by a corporation to its shareholders "with respect to" the stock of the corporation held by those shareholders). Section 316 defines when a distribution constitutes a dividend. 26 U.S.C. § 316.

<sup>6</sup> Theories regarding the optimal taxation of corporations abound and corporate integration is a hot topic in both political and academic circles. For a sampling of scholarship on the topic, see, e.g., Ed D. Kleinbard, *The Trojan Horse of Corporate Integration*, 152 TAX NOTES 957 (2016); Michael Graetz & Alvin Warren, *Integration of Corporate and Shareholder Taxes*, NAT'L TAXJ. (forthcoming).

<sup>7</sup> Professor Reuven Avi-Yonah, a supporter of corporate tax reform, advances this view. See, e.g., *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193 (2004).

fiction.<sup>8</sup> That section deems a transfer of interest payments from a debtor to a creditor within the context of qualifying below market loans. Just as the property owner is deemed to invite a trespassing child onto his property when an attractive nuisance is present, section 7872 deems transfers of money to occur which the parties, the Service, and, if the dispute continues, the court know did not, in fact, occur.

Yet while some examples of traditional legal fictions arise in tax, the literature on legal fictions in tax is relatively scant. Were Fuller able to offer an explanation as to why, it might simply be that tax law is composed more of “legal facts” and “legal relations”—legal rules that bear no relationship to non-legal facts or extra-legal facts—than laws that construct scenarios that can be proven to be objectively false.<sup>9</sup> Much of tax law may be akin to the legal concept of title. Title, in Fuller’s view, should not be understood as a legal fiction, as title is merely “a means of grouping together certain rather complex legal results in a convenient formula.”<sup>10</sup> Any statements made regarding title, then, should not be taken as fictions but rather as “an attempt to describe . . . a complex legal situation.”<sup>11</sup> Professor Knauer takes this view in her argument that legal fictions, while present in tax law, should not be understood so broadly as to encompass, for example, the concept of income itself.<sup>12</sup> The Code, Professor Knauer writes, is simply “a regime spun out of whole cloth as a fair and equitable method to apportion the burdens of citizenship.”<sup>13</sup> The Code’s concept of income cannot then be a fiction because income is, quite simply, whatever we as a society say it is.

Many scholars do not accept such limitations on the concept of legal fictions, however. Writing outside of tax, Professor Peter Smith argues that rules that expressly prohibit expert testimony on the reliability of eyewitness testimony should, for example, be viewed as examples of “new legal fictions.”<sup>14</sup>

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<sup>8</sup> Knauer, *supra* note 3, at 87 (“In my Taxation class, I patiently explain the virtues of legal fictions to still skeptical students. By far my favorite example is Section 7872 of the Internal Revenue Code, which stands out for its complex and multi-layered deeming principles. It establishes a statutory definition of ‘foregone interest’ as the amount of interest that would have been charged on a loan had the loan borne interest in accordance with the prevailing applicable federal rate. Of course, this is a mere fiction and no interest is actually charged. Under section 7872, this statutorily created ‘foregone interest’ is deemed transferred from the lender to the borrower and then retransferred from the borrower to the lender as interest. Again, given that this is a fiction, no money actually changes hands. Magically, however, this fictive interest can produce a hefty tax bill. Depending upon the context of the underlying transaction, this ‘foregone interest’ can be subject to income tax twice—once in the hands of the lender and then again in the hands of the borrower. And, so is the power of the fiction.”)

<sup>9</sup> FULLER, *supra* note 2, at 30–33; John A. Miller, *Liars Should Have Good Memories: Legal Fictions and the Tax Code*, 64 U. COLO. L. REV. 1, 22–25 (1993).

<sup>10</sup> FULLER, *supra* note 2, at 28.

<sup>11</sup> *Id.* at 29.

<sup>12</sup> Knauer, *supra* note 3, at 75 n.33.

<sup>13</sup> *Id.* at 109.

<sup>14</sup> Peter J. Smith, *New Legal Fictions*, 95 GEO. L.J. 1435, 1441–42 (2007) (“A court deploys a new legal fiction when (1) the court offers an ostensibly factual supposition as a

Such a rule is a legal fiction, Smith writes, “because (1) it is offered as a factual, rather than a normative, supposition, and (2) social science research demonstrates persuasively that it is false.”<sup>15</sup> Writing specifically on tax, Professor John Miller argues for a similar though distinct expansion of the concept of legal fiction. Miller pushes back against Fuller’s premise that legal relations should not be viewed as legal fictions, writing “[i]n my view, Fuller overstates the case for rejecting legal relations as a form of legal fiction because legal relations can have a social context as well as a legal context.”<sup>16</sup> Legal fictions are not, then, limited to such obvious falsities as the idea that a property owner invites a child to trespass, but may encompass legal rules that depend upon an underlying assertion that is empirically or socially false.<sup>17</sup>

Embracing a broader concept of legal fictions may prove a useful tool in analyzing and critiquing the Code. A fiction, presumably, serves some policy end and considering whether a rule is a fiction pushes us to deliberately consider that end.<sup>18</sup> Returning to the imputed interest of 26 U.S.C. § 7872, Miller writes:

When a statute contradicts reality, we want to know why the statute contradicts reality. In a case such as section 7872, we may have difficulty in comprehending the underlying economic theory, but at least our recognition of the statute’s falsity has set us upon the path toward understanding. Taking note of the fiction is the first step toward understanding its purpose or attacking its utility.<sup>19</sup>

To be sure, many scholars have and continue to take on the work of ensuring that the Code is deliberate and consistent in advancing its policy goals.<sup>20</sup> But the goals of the Code—raising revenue, advancing social and

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ground for creating a legal rule or modifying, or refusing to modify, an existing legal rule; and (2) the factual supposition is descriptively inaccurate. In most cases, the premise is false because empirical research has demonstrated that it is false, although occasionally the factual supposition so conflicts with general knowledge and conventional wisdom that it can be characterized as a new legal fiction even without reference to empirical research. To be a new legal fiction, the court must offer the factual supposition as a (or the) basis supporting the court’s normative choice among competing possible legal rules.”).

<sup>15</sup> *Id.* at 1441.

<sup>16</sup> Miller, *supra* note 9, at 21–22.

<sup>17</sup> Miller is careful not to expand the concept of a legal fiction beyond utility. For example, Miller argues that we must avoid categorizing as fictions rules that may only sometimes be false. To be a legal fiction, a rule must (1) “involve[ ] the implied or express assertion of a fact that one standing outside the legal system would regard as clearly false, such as the assertion that a daughter owns her mother’s stock or the claim that a person flying off on vacation has this week’s pay in hand when in fact the paycheck is still lying on his desk at work”; and (2) must not simply “state a generalization that in some cases may be false. Instead legal fictions deliberately overstate a comparative statement and are *always* false.” *Id.* at 8.

<sup>18</sup> FULLER, *supra* note 2, at 71; Miller, *supra* note 9, at 28; Smith, *supra* note 14, at 1477–78.

<sup>19</sup> Miller, *supra* note 9, at 18.

<sup>20</sup> Critical tax scholars have, for example, explored the definitions of family and concepts of marriage found in the Code, assessing their utility, their basis in lived experience and implications for economic and social policy. *See, e.g.*, Tessa R. Davis,

economic policy—and its metrics of success—fairness, administrability and efficiency—are many and often conflicting. Embracing a broader concept of legal fictions—one in which a rule is a fiction when it relies upon an empirically or socially invalid analogy—may expose as fictions heretofore undertheorized rules. And because identifying a fiction begs analysis of its utility, a deliberate effort to identify fictions in tax creates the opportunity for rooting out tax laws that may no longer serve their intended purpose, or that serve purposes no longer intended.

Let us turn now to an example to explore the potential value of applying a broader concept of legal fictions to the study of tax law and policy. Consider a common concept frequently introduced in an introductory Income Tax course: the tax treatment of nonrecourse debt. Before identifying the legal fiction in the treatment of such debt, however, it is necessary to have a working knowledge of the foundational tax treatment of debt.

While the Code and Treasury Regulations provide a partial definition of income,<sup>21</sup> tax law relies upon the courts to fully flesh-out this all-important concept. The 1955 Supreme Court decision in *Commissioner v. Glenshaw Glass Co.* provides the oft-cited judicial definition of income, identifying as income “undeniable accessions to wealth, clearly realized, and over which the taxpayer[] has complete dominion.”<sup>22</sup> With this definition in mind, let us begin by considering how debt fits into the concept of income.

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*Mapping the Families of the Internal Revenue Code*, 22 VA. J. SOC. POL'Y & L. 179 (2015); Anthony C. Infanti, *Decentralizing Family: An Inclusive Proposal for Individual Filing in the United States*, 2010 UTAH L. REV. 605, 609, 648 (2010); Marjorie E. Kornhauser, *Love, Money and the IRS: Family, Income Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63, 104, 109 (1993); James E. Maule, *Tax and Marriage: Unhitching the Horse and the Carriage*, 67 TAX NOTES 539 (1995). For a discussion of how the tax code differentially treated unmarried and same sex couples pre-*Windsor*, see, for example, Patricia A. Cain, *Taxing Families Fairly*, 48 SANTA CLARA L. REV. 805 (2008); Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code*, 34 U.S.F. L. REV. 465 (2000); Lily Kahng, *One Is the Loneliest Number: The Single Taxpayer in the Joint Return World*, 61 HASTINGS L.J. 651 (2010); Nancy J. Knauer, *Heteronormativity and Federal Tax Policy*, 101 W. VA. L. REV. 129 (1998); Theodore P. Seto, *The Unintended Tax Advantages of Gay Marriage*, 65 WASH. & LEE L. REV. 1529 (2008); Lawrence Zelenak, *Doing Something About Marriage Penalties: A Guide for the Perplexed*, 54 TAX L. REV. 1 (2000).

<sup>21</sup> 26 U.S.C. § 61, mirroring the Sixteenth Amendment, defines gross income as “income from whatever source derived.” It then lists a representative but expressly not exhaustive list of items of income, including the obvious, such as wages or gains from property sales, and the perhaps less obvious, such as “income from cancellation of indebtedness.” 26 U.S.C.A. § 61(a). The Sixteenth Amendment states that “Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.”

<sup>22</sup> *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). The opinion addressed two separate cases, *Glenshaw Glass Co. v. C. I. R.*, 18 T.C. 860 (1952) and *William Goldman Theatres v. Comm’r*, 19 T.C. 637 (1953), both of which originated in the Tax Court. Taxpayers in both cases argued that potential items of income—fraud and treble damages, and solely treble damages, respectively—were not income, relying heavily upon the 1920 Supreme Court decision in *Eisner v. Macomber*, 252 U.S. 189 (1920). In

Imagine a taxpayer, Atticus, takes out a \$20,000 private loan to help finance his engineering degree. When the loan proceeds are disbursed, Atticus will see his bank account swell by \$20,000. Should Atticus add this \$20,000 to his gross income total at tax time? The tax answer to that question is, and has been, no. The rationale is fairly straightforward: though Atticus has received a gain of a sort, that gain came at a price, namely the obligation to repay the amount borrowed.<sup>23</sup> Put in the language of *Glenshaw Glass*, the taxpayer who borrows has no accession to wealth because any ostensible gain comes with an equal and offsetting obligation to repay.<sup>24</sup> When that equal and offsetting obligation to pay has teeth—when the creditor can garnish wages or possess assets if the debtor defaults—the rationale for excluding loan proceeds from income seems sound. But the strength of the rationale weakens when the creditors right to full repayment is curtailed as in the case of nonrecourse debt.

The proper tax treatment of debt depends, in theory, on who bears the economic burden of that debt.<sup>25</sup> Stated differently, who, when everything goes belly-up, is most exposed to risk of economic loss? Consider the example of a nonrecourse car loan. If an individual purchases a \$15,000 car with \$5,000 cash and \$10,000 loan, the creditor is exposed to potential loss from the decline in value of the car. Assume that the purchaser makes two payments of \$175 (\$150 interest and \$25 principal) on the car before defaulting. Also assume that the purchaser got in a small accident in the vehicle before defaulting, resulting in the

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*Macomber*, the Court upheld the view that income is “the gain derived from capital, from labor, or from both combined.” *Macomber*, 252 U.S. at 207 (citing *Doyle Case*, 247 U.S. 183, 185 (1918)). Accordingly, the taxpayers in *Glenshaw Glass* and *Goldman Theatres* argued that, because their respective damages were neither the fruits of their labor, nor returns to capital, the damages were not taxable as income. The Court in *Glenshaw Glass* did not overrule *Macomber* but instead recast it as a correct but limited decision. *Glenshaw Glass Co.*, 348 U.S. at 431 (“In that context—distinguishing gain from capital—the definition served a useful purpose. But it was not meant to provide a touchstone to all future gross income questions.”).

<sup>23</sup> See *United States v. Rochelle*, 384 F.2d 748, 751 (5th Cir. 1967) (“A loan does not in itself constitute income to the borrower, because whatever temporary economic benefit he derives from the use of the funds is offset by the corresponding obligation to repay them.”).

<sup>24</sup> For an introductory discussion to the tax treatment of loans, see, e.g., J. MARTIN BURKE & MICHAEL K. FRIEL, *TAXATION OF INDIVIDUAL INCOME* Ch. 3 (11th ed. 2015).

<sup>25</sup> See, e.g., 26 C.F.R. §§ 1.752-2, 1.752-3. The bane of students studying partnership tax and a source of significant complexity in tax practice, these and other regulations help determine each partner’s share of a partnership’s debt, setting up the corollary impacts of that determination. Treasury Regulation §1.752-2(a) states the general rule that “[a] partner’s share of a recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss.” Bearing the risk of loss is defined as being “obligated to make a payment” in the event the debts of the partnership came due. § 1.752-2(b). As true economic risk of loss is limited when the debt is nonrecourse, determining the share of such liabilities is, necessarily, more complex. Overwriting the specifics, the regulations use share of profits rather than risk of loss as the relevant metric. § 1.752-3. See also 26 C.F.R. § 1.704-2 (governing allocations attributable to nonrecourse liabilities.).

car declining in value by \$7000 to \$8,000. Because the loan is nonrecourse, the creditor's only means of recouping the debt is by repossessing the car. At the time of repossession the debt outstanding is \$9,950 (\$10,000 less two \$25 principal payments) while the value of the car is only \$8,000. Without the right to possess other assets, the creditor will simply not recover the remaining \$1,950 owed. If the debt were instead recourse, the creditor would not be exposed to the same risk from decline in value of the asset, because she could simply find value elsewhere by garnishing wages, possessing other assets, et cetera.

One area in which this important distinction between recourse and nonrecourse debt looms large is in the concept of basis. The Code defines basis and a multitude of provisions exist to manage basis in different areas of tax.<sup>26</sup> Stepping back from doctrine, however, the concept is relatively easily grasped. Consider the following hypothetical: Abby purchases a home with \$200,000 cash. A few years after purchasing the home, she sells it for \$250,000. Abby's proper taxable gain from the sale is only \$50,000.<sup>27</sup> To say that Abby has a \$250,000 gain upon the sale would ignore the fact that Abby had already invested \$200,000 cash into acquiring the home. Upon the sale she simply turned \$200,000 worth of the value of the home back into cash, leaving \$50,000 as the new, taxable accession to wealth.<sup>28</sup> Basis is simply the means by which we track a taxpayer's ongoing investment in an asset. Per the language of the Code, Abby held the home with a \$200,000 § 1012 cost basis.

Where basis starts to get more interesting is where debt becomes part of the means of acquisition. Returning to our car purchaser, three potential basis values emerge: (1) the \$5,000 cash paid; (2) the full \$15,000, representing her \$5,000 cash plus the \$10,000 debt assumed; or (3) \$5,000 basis increasing with the amount of principal in each payment. Were her debt recourse, option 2 would be correct. Though she only invested \$5,000 of her own cash she will, either through payment of the loan or surrendering the car and any the assets required to satisfy the debt, be on the hook for its full value. Stated differently, the assumption of the debt is a real cost. The same logic need not hold, however, when the debt is nonrecourse, because, as discussed above, the purchaser may not ever actually have to pay the debt. In that case, option 3 might be the most accurate means of tracking basis.<sup>29</sup> Herein is where the tax treatment of debt and the concept of legal fictions merge.

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<sup>26</sup> See, e.g., 26 U.S.C. § 1015 (governing basis of gift property in the hands of the donee).

<sup>27</sup> 26 U.S.C. § 1001 dictates this result. It defines gain as the excess of amount realized over the taxpayer's adjusted basis. Amount realized is the amount of cash or fair market value of property received (herein, \$250,000) less Abby's \$200,000 basis. Section 1016 sets out a number of adjustments to basis while § 1012 defines the starting point of cost basis.

<sup>28</sup> Though beyond the scope of this paper, Abby's gain on the home may not be taxable if she qualifies for an exclusion from income of the gain from the sale of a primary residence. See § 121. Further, Abby's gain may be characterized as capital gain per § 1221, rather than ordinary gain, meaning it would be subject to the more favorable, lower rates of § 1(h) (currently 0%, 15%, or 20%).

<sup>29</sup> *Comm'r v. Tufts*, 461 U.S. 300, 317 (1983) (O'Connor, J., concurring).



In *Crane v. Comm'r*<sup>30</sup> and *Comm'r v. Tufts*, the Supreme Court established the principal that nonrecourse debt should be respected as true debt. In *Crane*, the Court reasoned that nonrecourse debt assumed increases the basis of the debtor.<sup>31</sup> And when that same debtor was relieved of debt, she realized a true benefit akin to having received cash in the amount of the outstanding debt.<sup>32</sup> The Court opined, however, in now famous footnote 37, that nonrecourse debt might not always be respected as true debt, writing:

Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot.<sup>33</sup>

The facts of footnote 37 were then tested in *Tufts*. In that case, the Court modified the logic of *Crane* but upheld its key tenet: nonrecourse debt is true debt.<sup>34</sup> Herein emerges a potential legal fiction.

*Crane* and *Tufts* present an interesting test of the concept of legal fictions within tax. Under a narrow view of legal fictions, the assertion that nonrecourse debt is true debt may not constitute a legal fiction. The concept of debt may not have a sufficiently extra- or non-legal meaning as to assert that treating nonrecourse debt as true debt is plainly false. Yet the Court seems to acknowledge a fictive element to its holding. In his opinion, Justice Blackmun writes that it is “economic interest,” rather than a true personal obligation for the full value of the debt, that justifies treating nonrecourse debt as true debt:

Because the value of the property in that case exceeded the amount of the mortgage, it was in Crane’s economic interest to treat the mortgage as a personal obligation; only by so doing could she realize upon sale the appreciation in her equity represented by the \$2,500 boot. The purchaser’s assumption of the liability thus resulted in a taxable economic benefit to her, just as if she had been given, in addition to the boot, a sum of cash sufficient to satisfy the mortgage.<sup>35</sup>

But arguing that it makes sense to pay down a debt because one is building equity in a property is, as Blackmun acknowledges, substantively different than being truly liable for the full value of said debt.

To be clear, neither the Court nor the parties contested the validity of the debt instruments at hand. When the Court upheld the view that nonrecourse

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<sup>30</sup> *Crane v. Comm'r*, 331 U.S. 1 (1947).

<sup>31</sup> *Id.* at 7–14.

<sup>32</sup> *Id.* at 14.

<sup>33</sup> *Id.* at 14 n.37.

<sup>34</sup> *Tufts*, 461 U.S. at 307 (“We are disinclined to overrule *Crane*, and we conclude that the same rule applies when the unpaid amount of the nonrecourse mortgage exceeds the value of the property transferred. *Crane* ultimately does not rest on its limited theory of economic benefit; instead, we read *Crane* to have approved the Commissioner’s decision to treat a nonrecourse mortgage in this context as a true loan.”).

<sup>35</sup> *Id.* at 306.

debt should be respected as true debt it was not simply stating the obvious (and non-fictitious) assertion that a party bound by a legal debt is obligated to pay that debt whether it is recourse or nonrecourse. Rather, the Court was analyzing whether nonrecourse debt assumed should be respected as a true cost, and relief of that debt recognized as an economic benefit. Doing so required considering who bore the burden of economic loss. Despite the fact that it may be the creditor who bears that burden when the debt is nonrecourse, the Court felt compelled to treat nonrecourse debt as true debt, even as it seemed to understand the falsity of that assertion.

Even if a more narrow view of legal fictions might reject the doctrine of *Crane* and *Tufts* as rising to the level of legal fiction, I believe to do so may be error. A broader view of legal fictions could embrace the doctrine as fiction and push us to explore the second defining aspect of a legal fiction: the utility it supposedly serves. The answer to that question in the context of nonrecourse debt is, at least in part, administrability.<sup>36</sup>

By embracing the fiction that nonrecourse debt is equivalent to recourse debt, the Court advanced the goal of ease of administering a multitude of Code provisions. Returning to our example of the car purchaser will help clarify this point. If the Court did not accept the fiction, our purchaser would determine her basis under the third approach: \$5,000 basis increasing with the amount of principal in each payment. Notably, it was the Service and not the taxpayer that

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<sup>36</sup> Under these provisions, if the mortgagor's equity were the [§] 113(a) basis, it would also be the original basis from which depreciation allowances are deducted. If it is, and if the amount of the annual allowances were to be computed on that value, as would then seem to be required, they will represent only a fraction of the cost of the corresponding physical exhaustion, and any recoupment by the mortgagor of the remainder of that cost can be effected only by the reduction of his taxable gain in the year of sale. If, however, the amount of the annual allowances were to be computed on the value of the property, and then deducted from an equity basis, we would in some instances have to accept deductions from a minus basis or deny deductions altogether. The Commissioner also argues that taking the mortgagor's equity as the [§] 113(a) basis would require the basis to be changed with each payment on the mortgage, and that the attendant problem of repeatedly recomputing basis and annual allowances would be a tremendous accounting burden on both the Commissioner and the taxpayer. Moreover, the mortgagor would acquire control over the timing of his depreciation allowances.

Thus it appears that the applicable provisions of the Act expressly preclude an equity basis, and the use of it is contrary to certain implicit principles of income tax depreciation, and entails very great administrative difficulties. It may be added that the Treasury has never furnished a guide through the maze of problems that arise in connection with depreciating an equity basis, but, on the contrary, has consistently permitted the amount of depreciation allowances to be computed on the full value of the property, and subtracted from it as a basis. Surely, Congress' long-continued acceptance of this situation gives it full legislative endorsement.

*Crane*, 331 U.S. at 9-11.

advanced the argument that such computation would be too burdensome. The Court simply agreed. Understanding the treatment of nonrecourse debt as a legal fiction (1) pushes us to articulate the rationale for the fiction and (2) sets us on a path to assess whether the utility justifies the fiction, or if perhaps another approach would better serve the goals of the relevant law and policy. Respecting nonrecourse debt as true debt may be right as a matter of policy, but it is no less a fiction because it is a useful one, and acknowledging its status as a fiction pushes us to test the justifications for a doctrine that frequently leads to a great deal of complexity.<sup>37</sup>

If legal relations and legal fictions exist on a spectrum, perhaps the doctrine of nonrecourse debt is close enough to a legal fiction so as not to raise many objections if it is pulled into the legal fiction category. Considering a more controversial example, however, may further clarify my argument that embracing a broader notion of legal fictions can reveal heretofore unseen or under theorized problems in tax law. Though some may conceive of the definition of a resident alien as simply a legal relation, under a broader concept of legal fictions 26 U.S.C. § 7701(b)(1)(A) can be understood as a legal fiction.<sup>38</sup>

The tax concept of resident alien works to define who is subject to U.S. taxation. In so doing, it pulls resident noncitizens into the same system of taxation as governs U.S. citizens.<sup>39</sup> The analogy underlying this categorization is that resident noncitizens are more like U.S. citizens<sup>40</sup> than they are like

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<sup>37</sup> Estate of Franklin v. Comm’r, 544 F.2d 1045 (9th Cir. 1976).

<sup>38</sup> In another article, I analyze the role the concept of resident alien plays in defining citizenship and the implications of that role for tax policy. See Tessa Davis, *The Tax-Immigration Nexus*, 94 DENV. L. REV. 195 (2017).

<sup>39</sup> I introduce the concept of tax citizen to highlight the role tax law plays in defining and policing the boundaries of substantive citizenship. Davis, *supra* note 38, at 197, 228–31.

<sup>40</sup> Many would qualify the statement to say resident noncitizens are more like *resident* U.S. citizens than they are like noncitizens or nonresident U.S. citizens. For scholarship criticizing and praising the U.S. system of worldwide taxation on the basis of citizenship, see, e.g., Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT’L 389 (2010); Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT’L L. 705 (2008); Allison Christians, *Drawing the Boundaries of Tax Justice*, in THE QUEST FOR TAX REFORM CONTINUES: THE ROYAL COMMISSION ON TAXATION FIFTY YEARS LATER, 53 (Kim Brooks ed., 2013); Mark S. Hoose, *Trading One Danger for Another: Creating U.S. Tax Residency While Fleeing Violence at Home*, 12 FLA. TAX REV. 827 (2012); Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice* 16 FLA. TAX REV. 117 (2014); Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443 (2007); Francine J. Lipman, *The Taxation of Undocumented Immigrants: Separate, Unequal, and Without Representation*, 9 HARV. LATINO L. REV. 1 (2006); Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169 (2016); Philip F. Postelwaite & Gregory E. Stern, *Innocents Abroad? The 1978 Foreign Earned Income Tax Act and The Case For Its Repeal*, 65 VA. L. REV. 1093 (1979); Renée Judith Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101 (1985); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011); Almaz Zelleke,

noncitizens. Accordingly, they should be taxed in a similar fashion. Fuller and adherents to a narrow view of legal fictions might argue that the concept of citizenship or residence is akin to title—a concept that exists only in law with no non- or extra-legal truth. The narrow view may, however, miss the mark. Citizenship, as I discuss in *The Tax-Immigration Nexus*, is both a legal and a social phenomenon. If we accept that a rule may be a legal fiction when it conflicts with the underlying social understanding of a given concept, the tax definition of resident alien may emerge as a statutory fiction. The value of analyzing § 7701(b)(1)(A) as a legal fiction comes from being forced to consider the socially or culturally-contingent nature of concepts that claim a degree of objectivity or descriptive rather than normative goals. The definition of resident alien may be a fiction meant both to delineate taxable persons and part of a regime meant to discipline would-be citizens. The second insight comes from taking a critical eye to how the rule relates to lived reality; stated differently, whether the rule is a legal fiction. Working with a narrower view of legal fictions may lead to bypassing this analysis and, perhaps, a less critical acceptance of a potentially imperfect or problematic rule.

Tax law seems a ripe area in which to explore the extent and purpose of legal fictions. While such work may help refine the concept of legal fictions itself, of greater interest to me is the value of a broader, though still limited definition of legal fictions to critical tax scholarship. By embracing a concept of legal fictions that encompasses rules that conflict with empirical data or social facts, tax scholars gain a useful tool for rooting out the potentially undertheorized justifications for existing rules and doctrine.

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*Basic Income in the United States: Redefining Citizenship in the Liberal State*, 63 REV. SOC. ECON. 633 (2005).

