SUPREME COURT OF THE UNITED STATES

No. 99–1295

DAVID A. GITLITZ, ET UX., ET AL., PETITIONERS *v.* COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

[January 9, 2001]

JUSTICE BREYER, dissenting.

I agree with the majority's reasoning with the exception of footnotes 6 and 10. The basic statutory provision before us is 26 U. S. C. §108– the provision that excludes from the "gross income" of any "insolvent" taxpayer, income that cancellation of a debt (COD) would otherwise generate. As the majority acknowledges, however, *ante*, at 7, n. 6, §108 contains a subsection that sets forth a special exception. The exception, entitled "Special rules for S corporation," says:

> "(A) Certain provisions to be applied at corporate level.
>
> "In the case of an S corporation, subsections (a), (b), (c), and (g) shall be applied at the corporate level." 26 U. S. C. §108(d)(7)(A).

If one reads this language literally as exclusive, both the COD exclusion (§108(a)) and the tax attribute reduction (§108(b)) would apply only "at the corporate level." Hence the COD income would not flow through to S corporation shareholders. Consequently, the insolvent S corporation's COD income would not increase the shareholder's basis and would not help the shareholder take otherwise unavailable deductions for suspended losses.

The Commissioner argues that we should read the

language in this way as preventing the flow-through of the corporation's COD income. Brief for United States 27. He points to the language of a House Committee, which apparently thought, when Congress passed an amendment to §108, that the Commissioner's reading is correct. H. R. Rep. No. 103–111, pp. 624–625 (1993) ("[T]he exclusion and basis reduction are both made at the S corporation level (sec. 108(d)(7)). The shareholders' basis in their stock is not adjusted by the amount of debt discharge income that is excluded at the corporate level"). At least one commentator believes the same. See Loebl, Does the Excluded COD Income of an Insolvent S Corporation Increase the Basis of the Shareholders' Stock?, 52 U. Fla. L. Rev. 957, 981–988 (2000). But see Lockhart & Duffy, Tax Court Rules in *Nelson* that S Corporation Excluded COD Income Does Not Increase Shareholder Stock Basis, 25 Wm. Mitchell L. Rev. 287 (1999).

The Commissioner finds support for his literal, exclusive reading of §108(d)(7)(A)'s language in the fact that his reading would close a significant tax loophole. That loophole– preserved by the majority– would grant a *solvent* shareholder of an insolvent S corporation a tax benefit in the form of permission to take an otherwise unavailable deduction, thereby sheltering other, unrelated income from tax. See *Witzel* v. *Commissioner*, 200 F. 3d 496, 497 (CA7 2000) (Posner, C. J.) ("It is hard to understand the rationale for using a tax exemption to avoid taxation not only on the income covered by the exemption but also on unrelated income that is not tax exempt"). Moreover, the benefit often would increase in value as the amount of COD income increases, a result inconsistent with congressional intent to impose a "price" (attribute reduction), see Lipton, Different Courts Adopt Different Approaches to the Impact of COD Income on S Corporations, 92 J. Tax. 207 (2000), on excluded COD. Further, this deduction-related tax benefit would have very different tax conse-

quences for identically situated taxpayers, depending only upon whether a single debt can be split into segments, each of which is canceled in a different year. For example, under the majority's interpretation, a $1 million debt canceled in one year would permit Taxpayer A to deduct $1 million of suspended losses in that year, thereby permitting A to shelter $1 million of unrelated income in that year. But because §108 reduces tax attributes after the first year, five annual cancellations of $200,000 will not create a $1 million shelter. Timing is all important.

The majority acknowledges some of these policy concerns and confesses ignorance of any "other instance in which §108 directly benefits a solvent entity," but claims that its reading is mandated by the plain text of §108(d)(7)(A) and therefore that the Court may disregard the policy consequences. *Ante*, at 13, and n. 10. It is difficult, however, to see why we should interpret that language as treating different solvent shareholders differently, given that the words "at the corporate level" were added "[i]n order to treat all shareholders in the same manner." H. R. Rep. No. 98–432, pt. 2, p. 1640 (1984). And it is more difficult to see why, given the fact that the "plain language" admits either interpretation, we should ignore the policy consequences. See *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U. S. 130, 134–135 (1960) (abandoning literal meaning of 26 U. S. C. §1221 (1958 ed.) for a reading more consistent with congressional intent). Accord, *Commissioner* v. *P. G. Lake, Inc.*, 356 U. S. 260, 264–267 (1958); *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 51–52 (1955); *Hort* v. *Commissioner*, 313 U. S. 28, 30–31 (1941).

The arguments from plain text on both sides here produce ambiguity, not certainty. And other things being equal, we should read ambiguous statutes as closing, not maintaining, tax loopholes. Such is an appropriate understanding of Congress's likely intent. Here, other things are

equal, for, as far as I am aware, the Commissioner's literal interpretation of §108(d)(7)(A) as exclusive would neither cause any tax-related harm nor create any statutory anomaly. Petitioners argue that it would create a linguistic inconsistency, for they point to a Treasury Regulation that says that the Commissioner will apply hobby loss limitations under §183 "at the corporate level in determining" allowable deductions, while, presumably, nonetheless permitting the deduction so limited to flow through to the shareholder. Treas. Reg. §1.183–1(f), 26 CFR §1.183–1(f) (2000). But we are concerned here with the *"application"* of an exclusion, not with *"determining"* the amount of a deduction. Regardless, the regulation's use of the words "at the corporate level," like the three other appearances of the formulation "applied" or "determined" "at the corporate level" in the Code, occur in contexts that are so very different from this one that nothing we say here need affect their interpretation. See 26 U. S. C. §49(a)(1)(E)(ii)(I) (determining whether financing is recourse financing); 26 U. S. C. §264(f)(5)(B) (1994 ed., Supp. IV) (determining how to allocate interest expense to portions of insurance policies); 26 U. S. C. §302(e)(1)(A) (determining whether a stock distribution shall be treated as a partial liquidation). If there are other arguments militating in favor of the majority's interpretation, I have not found them.

The majority, in footnote 6, says that the words "at the corporate level" in §108(d)(7)(A) apply to the exclusion of COD income from corporate income and to "tax attribute reduction" but do not "suspen[d] the operation of . . . ordinary pass-through rules" because §108(d)(7)(A) "does not state or imply that the debt discharge provisions shall apply *only* 'at the corporate level.'" It is the majority, however, that should explain why it reads the provision as nonexclusive (where, as here, its interpretation of the Code results in the "practical equivalent of [a] double deduc-

tion," *Charles Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, 68 (1934)). See *United States* v. *Skelly Oil Co.,* 394 U. S. 678, 684 (1969) (requiring "clear declaration of intent by Congress" in such circumstances). I do not contend that §108(d)(7)(A) *must* be read as having exclusive effect, only that, given the alternative, this interpretation provides the best reading of §108 as a whole. And I can find no "clear declaration of intent by Congress" to support the majority's contrary conclusion regarding §108(d)(7)(A)'s effect. It is that conclusion from which, for the reasons stated, I respectfully dissent.