Loyola of Los Angeles Law Review

Volume 16 | Number 3 Article 5

6-1-1983

United States v. Vogel Fertilizer Co.: Supreme Court Paves the Way for Avoidance of Brother-Sister Controlled Group Status

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UNITED STATES v. VOGEL FERTILIZER CO.: SUPREME COURT PAVES THE WAY FOR AVOIDANCE OF BROTHER-SISTER CONTROLLED GROUP STATUS

I. INTRODUCTION

The primary federal income tax advantages of operating in the multicorporate form are the availability of multiple surtax exemptions[1] and multiple accumulated earnings credits.[2] The large enterprise able to structure its corporate form so as to operate numerous corporations without constituting a "controlled group" may divide its total income among its various corporate entities and thereby lower its effective tax rate.[3]

The device known as the "controlled group" has been the primary weapon employed by Congress in its attempts to limit the availability of unintended tax benefits to multicorporate entities.[4] Section 1561(a)

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1. *See* Revenue Act of 1950, ch. 994, § 121(a), 64 Stat. 915 (repealed 1978) (formerly codified at I.R.C. § 11(c) (1976)).

Congress repealed the surtax and surtax exemption in 1978 and instituted the graduated rate structure presently in effect. *See infra* note 34.

2. *See* I.R.C. § 535(c) (1981). A corporation that unreasonably accumulates earnings and profits in order to avoid the dividend tax on its shareholders is subject to a penalty tax on the amount of income unreasonably accumulated. A corporation is presently entitled to accumulate $250,000 without being subject to accumulated earnings tax.

3. I.R.C. § 1561(a)(1) (1981) limits members of a controlled group of corporations to a single benefit under the graduated rate brackets contained in § 11(b).

Under the tax rates effective for 1983, the use of multiple corporations will produce an annual tax savings of $20,250 for each additional corporation with taxable income of at least $100,000. (For example, a group of five related corporations that fail to constitute a "controlled group" can achieve an annual tax savings of up to $81,000. Under the tax rates effective for 1983, a corporation with taxable income in excess of $100,000 pays tax on the excess at the rate of 46%. However, the corporation pays tax on the first $100,000 at graduated rates that result in an effective rate of 25.75%, thereby accounting for the savings of $20,250 for each additional corporation that is not in a controlled group.)

4. *See infra* text accompanying notes 34-54, setting forth the origin of the controlled group legislation. The issue addressed in *Vogel* relates only to the definition of a brother-sister controlled group.

A parent-subsidiary controlled group is defined as one or more chains of corporations connected through stock ownership with a common parent corporation if one or more corporations owns at least 80% of each corporation (except the parent), and the common parent corporation owns at least 80% of at least one of the other corporations in the group. I.R.C. § 1563(a)(1) (1976).

of the Internal Revenue Code[5] was enacted in 1964[6] to limit a "controlled group of corporations" to a single corporate surtax exemption[7] and a single accumulated earnings credit.[8] Thus, two or more corporations found to be a "controlled group" will be taxed as a single entity.

The definition of a "brother-sister controlled group" formulated under the Tax Reform Act of 1969[9] gave rise to a prolonged controversy which was resolved when the United States Supreme Court rendered its decision in *United States v. Vogel Fertilizer Co.*[10] That definition, contained in section 1563(a)(2), sets forth a two-pronged control test:

> Brother-sister controlled group—Two or more corporations if *5 or fewer persons* . . . own . . . stock possessing—
> (A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and
> (B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock of each such person only to the extent such stock ownership is identical with respect to each such corporation.[11]

The Commissioner of Internal Revenue interpreted the term "brother-sister controlled group" to mean two or more corporations if the same five or fewer persons own *"singly or in combination"* the two prescribed percentages of voting power or value.[12]

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5. Hereinafter referred to as "the Code" or by section number. All references herein are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

6. Pub. L. No. 88-272, § 235(a), 78 Stat. 19, 116-25 (1964).

7. I.R.C. § 1561(a)(1) (1981).

8. *Id.* at § 1561(a)(2) (1981).

9. Pub. L. No. 91-172, 83 Stat. 487 (1969).

10. 455 U.S. 16 (1982).

11. I.R.C. § 1563(a)(2) (1976) (emphasis added).

12. In Treas. Reg. § 1.1563-1(a)(3), T.D. 7181, 1972-1 C.B. 291, 300-01, the Commissioner interpreted § 1563(a)(2) as follows:

> (3) *Brother-sister controlled group*—(i) The term "brother-sister controlled group" means two or more corporations if the same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of the rules contained in paragraph (b) of § 1.1563-3), singly or in combination, stock possessing—
> *(a)* At least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each corporation; and
> *(b)* More than 50 percent of the total combined voting power of all classes of

The proper application of the eighty percent test ultimately became an issue which divided the circuits and provoked controversy among legal commentators.[13] The issue addressed by the Court in *Vo-*

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stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

(ii) The principles of this subparagraph may be illustrated by the following examples:

Example (1). The outstanding stock of corporations P, Q, R, S, and T, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Individuals	Corporations					Identical Ownership
	P	Q	R	S	T	
A....	60%	60%	60%	60%	100%	60%
B....	40%	—	—	—	—	—
C....	—	40%	—	—	—	—
D....	—	—	40%	—	—	—
E....	—	—	—	40%	—	—
Total	100%	100%	100%	100%	100%	60%

Corporations P, Q, R, S, and T are members of a brother-sister controlled group.

Example (2). The outstanding stock of corporations U and V, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Individuals	Corporations		Identical Ownership
	U	V	
F.....	5%	-	-
G.....	10%	-	-
H.....	10%	-	-
I.....	20%	-	-
J.....	55%	55%	55%
K.....	-	10%	-
L.....	-	10%	-
M.....	-	10%	-
N.....	-	10%	-
O.....	-	5%	-
Total	100%	100%	55%

Corporations U and V are not members of a brother-sister controlled group because at least 80 percent of the stock of each corporation is not owned by the same 5 or fewer persons.

13. *See* Bonovitz, *Brother-Sister Controlled Groups Under Section 1563: The 80 Percent Ownership Test*, 28 TAX LAWYER 511 (1975); Kringel, *Multiple corporation Proposed Regulations raise more questions than they answer*, 36 J. TAX'N 358 (1972); Libin and Abramowitz, *Multiple Corporations: A surprising interpretation of Sec. 1563(a)(2) in temporary regulations*, 3 TAX ADVISER 326 (1971); Thomas, *Brother-Sister Multiple Corporations—The Tax Reform Act of 1969 Reformed by Regulation*, 28 TAX L. REV. 65 (1972); Note, *Disallowance of Surtax Exemption to Brother-Sister Corporation Stock Ownership Test under Sections 1551 and 1563*,

gel was whether the statutory definition is satisfied if the "5 or fewer persons" own the stock "singly or in combination" as contended by the Commissioner pursuant to the governing Treasury regulations, or whether each person whose stock is to be taken into account must own stock in each corporation of the group.

The Court adopted the position advocated by numerous taxpayers and consistently applied by the Tax Court,[14] holding that the eighty percent test of section 1563(a)(2) excludes the stockholdings of a person who does not own an interest in each of the corporations in the alleged controlled group.[15] The United States Court of Appeals for the Fifth Circuit[16] and the United States Court of Claims[17] in the decision below had also adopted this position. By so holding, the *Vogel* Court rejected the Commissioner's position that the eighty percent test does not impose a common ownership requirement. This position had been upheld by the United States Court of Appeals for the Second,[18] Fourth[19]

1976 B.Y.U. L. REV. 1000, 1017 (1976); Note, *Brother-Sister Controlled Groups Basic Eighty Percent Stock Ownership Test as Control* 58 TEX. L. REV. 1161 (1980); Note, *The Brother-Sister Controlled Group Under I.R.C. § 1563(a)(2)*, 67 VA. L. REV. 751 (1981). *But see* White, *The Tax Reform Act of 1969: Demise of Multiple Surtax Exemptions—When Too Much of a Good Thing Proved Its Own Undoing*, 16 WAYNE L. REV. 1353 (1970).

14. The Tax Court first invalidated Treas. Reg. § 1563-1(a)(3) in a decision reviewed by the full court with four judges dissenting. Fairfax Auto Parts, Inc. v. Commissioner, 65 T.C. 798 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977). The Tax Court followed its *Fairfax* decision in T.L. Hunt, Inc. v. Commissioner, 45 T.C.M. (P-H) 952 (1976), *rev'd*, 562 F.2d 532 (8th Cir. 1977); Charles Baloian Co. v. Commissioner, 68 T.C. 620 (1977), *aff'd mem.*, (9th Cir. 1982); Delta Metalforming Co. v. Commissioner, 47 T.C.M. (P-H) 1473 (1978), *aff'd*, 632 F.2d 442 (5th Cir. 1980), *cert. denied*, 455 U.S. 906 (1982); Allen Oil Co. v. Commissioner, 48 T.C.M. (P-H) 348 (1979), *rev'd*, 614 F.2d 336 (2d Cir. 1980); Davidson Chevrolet Co. v. Commissioner, 48 T.C.M. (P-H) 1598 (1979).

In *Delta Metalforming* Judge Drennen stated that until the Supreme Court resolved the issue, the Tax Court would continue to maintain the position it established in *Fairfax*, despite reversals of that decision by the Fourth and Eighth Circuits. 47 T.C.M. (P-H) 1473, 1477 (1978). The Tax Court continued to maintain that the regulation was invalid; however, where bound by the rule established in Golsen v. Commissioner, it was forced to follow the precedent established by the Court of Appeals in the Circuit to which a case would be appealed. Golsen v. Commissioner, 54 T.C. 742 (1970). *See, e.g.*, Dixie Realty Co., 49 T.C.M. (P-H) 1321 (1980). (Tax Court maintained that regulation was invalid but followed Eighth Circuit decision in *T.L. Hunt* holding to the contrary because the case was appealable to that circuit under *Golsen*.)

15. 455 U.S. 16 (1982).

16. Delta Metalforming Co. v. Commissioner, 632 F.2d 442 (5th Cir. 1980).

17. Vogel Fertilizer Co. v. United States, 634 F.2d 497 (Ct. Cl. 1980), *cert. granted*, 450 U.S. 994 (1981). The Court of Claims was restructured in 1982 and is now the United States Claims Court. Pub. L. 97-164, § 105(a), 96 Stat. 27 (1982). *See infra* note 72.

18. Allen Oil Co. v. Commissioner, 614 F.2d 336 (2d Cir. 1980).

19. Fairfax Auto Parts, Inc. v. Commissioner, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977).

and Eighth[20] Circuits.

The *Vogel* Court concluded that any ambiguity in the language of section 1563(a)(2) was resolved by the legislative history, making it plain that the Commissioner's regulation was "not a reasonable statutory interpretation."[21] This note will consider whether the legislative history relied on by the Court does in fact neatly resolve the statutory ambiguity and plainly render the regulation an unreasonable statutory interpretation. In addition, this note will consider whether the Court's decision is supported by the legislative history when the results of the decision are viewed in light of Congress' intent to broaden the definition of a brother-sister controlled group when it enacted the Tax Reform Act of 1969. This note will also examine the effects of the decision upon other areas of the tax law beyond the specific issue of the multiple surtax exemption addressed by the Court in *Vogel*.[22] Finally, this note will conclude that the *Vogel* Court relied primarily upon ambiguous statutory language and legislative history, which led the Court to reach a result not entirely consistent with the aims Congress sought to achieve through enactment of section 1563(a)(2) in 1969. Inasmuch as the regulation is neither unreasonable nor plainly inconsistent with the statute, the Court should have deferred to the judgment of the Commissioner and upheld the validity of the regulation.[23]

II. STATEMENT OF THE CASE

Arthur Vogel owned 77.49% of the outstanding stock of the tax-

20. T.L. Hunt, Inc. v. Commissioner, 562 F.2d 532 (8th Cir. 1977); Yaffe Iron & Metal Corp. v. United States, 593 F.2d 832 (8th Cir. 1979) (per curiam), *cert. denied*, 444 U.S. 843 (1979).

21. 455 U.S. at 26.

22. The issue of controlled group status is relevant in a host of other provisions of the Internal Revenue Code: *See, e.g.*, §§ 804(a)(3) (1976) and 809(d)(10) (1976) (limitation on small business deduction of life insurance companies); §§ 404(a)(1)(c) (1976) and 414(b) (1981) (deductions by employers for contributions to stock bonus, revision, profit-sharing or annuity plans); § 58(b) (1981) (apportionment of exemption from minimum tax); § 179(d)(7) (1981) (limitation on expensing of depreciable property); § 48(c)(2)(C) (1981) (cost of used property eligible for investment credit); and § 465(c)(4)(C) (1981) (at-risk limitations).

The Service has also taken the position that employees of controlled corporations who perform substantial services for all of the corporations will be considered employees of *each* of the corporations for purposes of FICA, FUTA and federal income tax withholding, even if the employee is compensated by only *one* of the corporations. *See* Rev. Rul. 73-162, 1973-1 C.B. 417, *amplified by* Rev. Rul. 74-390, 1974-2 C.B. 331.

23. Legislation was introduced in the Ninety-seventh Congress to amend § 1563(a)(2) so that the 80% test would continue to limit the control group to five shareholders, but would not impose a common ownership requirement. This legislation was not enacted. H.R. 6725, 97th Cong., 2d Sess. (1982). *See infra* note 135 and acompanying text.

payer, Vogel Fertilizer Company, an Iowa corporation engaged in the business of selling farm fertilizer products at retail to local customers. An unrelated shareholder, Richard Crain, owned the remaining 22.51% of the company's outstanding stock. Vogel also held 87.5% of the voting power, and between 90.66% and 93.42% of the value of the stock of Vogel Popcorn Company, an Iowa corporation engaged in the business of selling popcorn in the wholesale and retail markets. Crain owned no stock in Vogel Popcorn Company.[24]

Vogel's interest in each company clearly satisfied the fifty percent test of section 1563(a)(2)(B).[25] However, his holdings in Vogel Fertilizer fell below the eighty percent requirement contained in part A of the statute. Under section 1.1563-1(a)(3) of the regulations, Vogel Fertilizer and Vogel Popcorn constituted a controlled group since Crain's stock could be counted toward the eighty percent test, despite the fact that Crain owned no stock in Vogel Popcorn. Vogel Fertilizer treated itself and Vogel Popcorn as members of a brother-sister controlled group for the tax years 1973 through 1975 under the belief that the regulations required such treatment.[26] However, following a 1976 Tax Court decision invalidating the controversial regulation,[27] the taxpayer changed its position and filed timely claims for refund.[28] When the Internal Revenue Service disallowed the claims, the taxpayer sued for a refund in the United States Court of Claims.[29] The court held that Vogel Fertilizer and Vogel Popcorn did not constitute a brother-sister

24. 455 U.S. at 19-21. The remainder of the Vogel Popcorn Company stock was voting preferred stock owned by Vogel as trustee of the Alex Vogel Family Trust. Vogel is not deemed to own this stock for tax purposes under the attribution rules of § 1563(d)(2) and (e). *Id.* at 21 & n.4.

25. The application of the 50% test contained in subparagraph (B) of § 1563(a)(2) is straightforward. The 50% test takes into account a shareholder's ownership only to the extent that the shareholder's ownership is identical in each corporation tested. If X owns 30% of ABC Corporation and has no ownership interest in XYZ Corporation, X's identical ownership is zero. If, however, X owns 70% of ABC Corporation and 40% of XYZ Corporation, and Y owns 20% of each corporation, the 50% test is satisfied. In this example, the identical ownership of individual X is 40%, and that of individual Y is 20%, for a total identical ownership in excess of 50%.

26. 455 U.S. at 21 & n.5. For 1973 and 1974 Vogel Fertilizer and Vogel Popcorn elected the option of claiming separate surtax exemptions and paying the multiple surtax penalty imposed by § 1562(b). This option was phased out with the enactment of § 1564 in 1969. Vogel Fertilizer elected to allocate the single surtax exemption to Vogel Popcorn for 1975 under § 1561(a)(2).

27. Fairfax Auto Parts, Inc. v. Commissioner, 65 T.C. 798 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977). *See infra* notes 58-64 and accompanying text.

28. 455 U.S. at 21.

29. *Id.*

controlled group and that the taxpayer was entitled to a full surtax exemption and a refund for overpayment of taxes for the years in question.[30] Although noting that the regulation at issue was not "wholly unreasonable" as a construction of the statute, the Court of Claims invalidated the regulation to the extent that it considered, for purposes of the eighty percent test, stock held by a shareholder owning stock in only one corporation of an alleged controlled group.[31]

Upon petition by the Commissioner, the Supreme Court granted certiorari.[32] In a seven-two decision the Court affirmed the decision of the Court of Claims in favor of the taxpayer.[33]

III. BACKGROUND OF THE CONFLICT

A. The Legislative Origin of Section 1563

Of the numerous income tax advantages available to related corporations that do not constitute a controlled group, the most significant is that which was at issue in *Vogel*—the availability of multiple surtax exemptions. For taxable years ending after 1974 and before 1979, a corporation was entitled to a $50,000 surtax exemption.[34] The surtax rate of twenty-six percent applied only upon corporate taxable income in excess of $50,000.[35] Thus, where total corporate taxable income exceeded $50,000, a significant tax savings could be achieved by employ-

30. 634 F.2d 497 (Ct. Cl. 1980).

31. *Id.*

32. 450 U.S. 994 (1981).

33. 455 U.S. at 35. Justice Brennan wrote the opinion for the Court. He was joined by Chief Justice Burger and Justices Marshall, Powell, Rehnquist, Stevens, and O'Connor. Justice Blackmun, joined by Justice White, dissented.

34. Section 11(d) (1975).

For tax years ending before 1975, the first $25,000 of corporate earnings was exempted from the federal surtax on corporate income. I.R.C. § 11(d) (1970).

Although the Revenue Act of 1978 replaced the surtax exemption with a graduated five-step rate structure for years ending after 1978 for the first $100,000 of corporate taxable income, the progressive system of taxation has continued to provide incentive for abuse. *See supra* note 3.

I.R.C. § 11(b) (1981) provides:

> The amount of the tax imposed by subsection (a) shall be the sum of—
> (1) 15 percent (16 percent for taxable years beginning in 1982) of so much of the taxable income as does not exceed $25,000;
> (2) 18 percent (19 percent for taxable years beginning in 1982) of so much of the taxable income as exceeds $25,000 but does not exceed $50,000;
> (3) 30 percent of so much of the taxable income as exceeds $50,000 but does not exceed $75,000;
> (4) 40 percent of so much of the taxable income as exceeds $75,000 but does not exceed $100,000; plus
> (5) 46 percent of so much of the taxable income as exceeds $100,000.

35. Section 11(d) (1975).

ing multiple corporations.[36]

The surtax exemption was originally enacted in 1950 to reduce the tax burden on small businesses.[37] Soon thereafter, taxpayers began to structure ownership of business entities to take advantage of the tax reductions produced by operating in the multicorporate form.[38] Prior to 1964, the Commissioner's attack on such abuse was limited in that the sole available remedy was a subjective case-by-case approach provided by sections 269, 482 and 1551.[39] Of these, only section 1551 was

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36. Under the $50,000 surtax exemption, the tax savings amounted to $13,500 for each additional surtax exemption obtained through the use of multiple corporations.

37. *See* H.R. REP. No. 2319, 81st Cong., 2d Sess. 26-27 (1950).

38. The House Ways and Means Committee Report that addressed the problem in 1969 noted that

> large organizations have been able to obtain substantial benefits . . . by dividing the organization's income among a number of related corporations. Your committee does not believe that large organizations which operate through multiple corporations should be allowed to receive the substantial and unintended tax benefits resulting from the multiple use of the surtax exemption and the other provisions of present law.

H.R. REP. No. 413, 91st Cong., 1st Sess. pt. 1, 98, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 1746-47. *See also* S. REP. No. 552, 91st Cong., 1st Sess. 134, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2027, 2166.

39. H.R. REP. No. 749, 88th Cong., 2d Sess. 117, *reprinted in* 1964 U.S. CODE CONG. & AD. NEWS 1313, 1636.

Section 269 authorizes the Secretary to disallow a tax deduction, credit or other allowance when an acquisition is made solely to avoid or evade federal income tax. *See* Slappey Drive Industrial Park v. United States, 561 F.2d 572 (5th Cir. 1977) (additional surtax exemptions denied multiple real estate corporations selling adjoining vacant lands because tax avoidance motive outweighed all other motives); Atlas Storage Co. v. United States, 437 F.2d 1319 (4th Cir. 1971) (multiple surtax exemptions denied storage corporations that were owned by one stockholder and operated as a single entity; multiple corporations were formed for the principal purpose of avoiding surtax by keeping net income of each corporation under $25,000); Bobsee Corp. v. United States, 411 F.2d 231 (5th Cir. 1969) (multiple surtax exemption denied for separately incorporated citrus groves that were essentially a single enterprise and formed for principal purpose of tax avoidance); Kessmar Constr. Co. v. Commissioner, 336 F.2d 865 (9th Cir. 1964) (multiple surtax exemptions denied where principal purpose of shareholders in forming 16 corporations instead of one was evasion or avoidance of income tax through securing of tax benefits which the stockholders otherwise would not have enjoyed).

Section 482 authorizes the Secretary to reallocate income, deductions, credits or allowances between or among taxpayers if such an allocation is necessary to prevent evasion of taxes or clearly reflect income of taxpayers. Although § 482 may not be employed directly to disallow surtax exemptions (*see* Challenger, Inc., 33 T.C.M. (P-H) 2315 (1964)), a reallocation under § 482 may have the same effect as a disallowance of the surtax exemption. (Assuming all of the income of two commonly controlled corporations is allocated under § 482 to the first corporation, the second corporation will have no taxable income from which to derive the benefit of the surtax exemption.) *See* Shaw Constr. Co. v. Commissioner, 323 F.2d 316 (9th Cir. 1963) (income and expenses of 88 corporations formed by

specifically aimed at multiple surtax exemptions.[40] Each of these sections requires a showing of an improper tax motive on the part of the taxpayer in its use of multiple corporations.[41] Since taxpayers frequently met the burden of showing valid nontax reasons for the use of multiple corporations, these sections were virtually without effect.[42]

Seeking to halt the proliferation of multiple corporations, the Treasury Department persuaded Congress to limit the use of multiple surtax exemptions by related corporations.[43] A mechanical test of control and ownership under which motive was irrelevant was enacted as a part of the Revenue Act of 1964, thus subrogating the subjective approach of sections 269, 482 and 1551.[44] In sections 1561-1563 Congress defined a "controlled group" of corporations and limited such groups to a single surtax exemption.[45] The exemption was to be allocated among the members of the controlled group unless the group elected to pay a six percent penalty per corporation for the privilege of claiming the multiple surtax exemption.[46] The statutory definition included two

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shareholders of construction company allocated to the construction company because the corporations did not serve a business purpose and were thus regarded as shams).

The § 1561 regulations note that the provisions of part II (§ 1561 and following), subchapter B, chapter 6 of the Code, do not "delimit or abrogate any principal [sic] of law established by judicial decision, or any existing provisions of the Code, such as sections 269, 482 and 1551, which have the effect of preventing the avoidance or evasion of income taxes." Treas. Reg. § 1.1561-1(b).

40. Revenue Act of 1951, ch. 521, § 121(f), 65 Stat. 452, 468-69, *as amended*, I.R.C. § 1551 (1981).

Prior to 1964, § 1551 disallowed the surtax exemption and the accumulated earnings credit to any corporation that transferred property (other than money) to another corporation created to receive the property, or not actively engaged in business at the time of the transfer, if the corporations were under common control. The control test under this section required that the transferor corporation (or its shareholders) own at least 80% of the voting power or total value of the transferee corporation. This section was effective *only* if the transferor corporation could not establish by a preponderance of the evidence that a major purpose of the transfer was not to obtain the exemption or credit. *See* Thomas, *supra* note 13, at 66-67.

41. *See* Thomas, *supra* note 13, at 66-67; White, *supra* note 13, at 1355-56 & n.14-16.

42. *Id.*

43. *See Hearings on the President's 1963 Tax Message Before the House Committee on Ways and Means*, 88th Cong., 1st Sess. 159-61 (1963). In a 1963 tax message, President Kennedy urged Congress to limit related groups to a single surtax exemption. The Treasury adopted the President's suggestion in its proposal. *Id.* at 36, 76-82, 158-83.

44. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19, 116-25 (current version at I.R.C. § 1563(a)). *See infra* text accompanying note 48; *supra* note 39.

45. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19, 116-25.

46. *Id.* (formerly codified at I.R.C. § 1562 (1964)). The stated purpose of the additional tax was to decrease the incentive to use multiple surtax exemptions. *See* H.R. REP. NO. 749, 88th Cong., 2d Sess. 117, *reprinted in* 1964 U.S. CODE CONG. & AD. NEWS 1313, 1617. Section 1562 was repealed by § 401(a)(2) of the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, 600.

types of controlled groups—parent-subsidiary and brother-sister.[47] As originally enacted, section 1563 defined a brother-sister controlled group as:

> [t]wo or more corporations if stock possessing at least eighty percent of the total combined voting power of all classes of stock entitled to vote or at least eighty percent of the total value of shares of all classes of stock of each of the corporations is owned . . . by one person who is an individual, estate, or trust.[48]

The 1964 legislation failed to curb the abuse of multiple corporations. The Treasury reported that although the 1964 legislation had reduced the tax benefits available through the use of multiple corporations, the abuse had not been eliminated.[49] The eighty percent ownership test was easily avoided by insuring that no single shareholder's ownership interest was greater than or equal to eighty percent of more than one corporation.[50] In addition, the six percent elective penalty tax had the unintended effect of encouraging corporations to claim multiple surtax exemptions.[51] In response to a Treasury proposal aimed at the growing problem of abuse of the multicorporate device, Congress adopted the present two-part test codified in section 1563(a)(2) as a part of the Tax Reform Act of 1969.[52]

Section 1563 as amended increased the number of shareholders who may be considered for purposes of determining controlled group

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47. *See supra* note 4.

48. Revenue Act of 1964, Pub. L. No. 88-272, § 235(a), 78 Stat. 19, 120 (1964) (amended 1969) (current version at I.R.C. § 1563(a)(2) (1981)).

Congress amended § 1551 concurrently to extend to indirect transfers of property to a controlled corporation and to transfers made by "five or fewer individuals who are in control of a corporation." H.R. REP. No. 749, 88th Cong., 1st Sess. 116-23, 187-213, *reprinted in* 1964 U.S. CODE CONG. & AD. NEWS 1313, 1636; S. REP. No. 830, 88th Cong., 2d Sess. 148-55, *reprinted in* 1964 U.S. CODE CONG. & AD. NEWS 1673, 1829. The definition of control under § 1551 is identical to that adopted by Congress in 1969 when it amended § 1563. *Hearings on the Subject of Tax Reform Before the House Committee on Ways and Means*, 91st Cong., 1st Sess. pt. 14, at 5168 (1969) (Technical Explanation of Treasury Tax Reform Proposals) [hereinafter cited as Technical Explanation]. *See generally* Thomas, *supra* note 13.

49. The Treasury Department reported that the number of corporations claiming multiple surtax exemptions increased from 104,000 to 126,000 from 1964 to 1966. *Hearings on the Subject of Tax Reform Before the House Committee on Ways and Means*, 91st Cong., 1st Sess. pt. 14, at 5387-88 (General Explanation of Treasury Tax Reform Proposals) [hereinafter cited as General Explanation].

50. General Explanation, *supra* note 49, at 5396.

51. *See supra* notes 46 and 49 and accompanying text.

52. *See supra* text accompanying note 11. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 401(c), 83 Stat. 602.

status from one (as provided in the 1964 version of the statute) to "5 or fewer."[53] Thus, it is apparent that Congress was attempting to broaden the reach of the statute in order to make it more difficult to evade the control limitation.[54]

B. Judicial Application of the Eighty Percent Test

The proper application of the eighty percent test in section 1563(a)(2)(A) was the key question addressed by the *Vogel* Court. The question raised by the statutory ambiguity is whether a person's stockholdings are to be taken into account for purposes of the eighty percent test only if each individual owns an interest in *each* of the corporations making up an alleged controlled group. The Treasury's interpretation of the statute is that " 'brother-sister controlled group' means two or more corporations if the same five or fewer persons . . . own . . . *singly or in combination*" stock that represents the two described percentages of voting power or total value.[55]

The focal point in *Vogel* was the Treasury's addition of the words "singly or in combination,"[56] an addition which had become the subject of exhaustive commentary and debate. Many critics considered the regulation an improper expansion of the statute which was unsupported by the legislation itself or by legislative intent.[57]

The validity of the regulation first came before the courts in *Fairfax Auto Parts, Inc. v. Commissioner*.[58] In *Fairfax*, the Tax Court invalidated the regulation after examining the language, legislative history and purpose of the statute and concluding that the regulation was

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53. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 401(c), 83 Stat. 602. *See supra* note 48 and accompanying text.

54. *See* General Explanation, *supra* note 49, at 5394, 5396.

> Expanding the 80-percent ownership test from one person to five will close the present opportunity for easy avoidance of that 80-percent test. However, adding the 50-percent identical ownership test will insure that the new expanded definition is limited to cases where the brother-sister corporations are, in fact, controlled by the group of shareholders as one economic enterprise.

Id. at 5396.

55. Treas. Reg. § 1.1563-1(a)(3) (1975) (emphasis added). *See supra* note 12 and accompanying text.

The Treasury Department issued temporary regulations in 1971. Temp. Treas. Reg. § 13.16-1(a), T.D. 7101, 1971-1 C.B. 269. Although commentators attacked these regulations (*see* Kringel, *supra* note 13; Libin and Abramowitz, *supra* note 13), the wording remained unchanged in the proposed and final regulations. Prop. Treas. Reg. § 1.1563-1(a)(3), 36 Fed. Reg. 17, 869 (1971); Treas. Reg. § 1.1563-1(a)(3) (1972).

56. Treas. Reg. § 1.1563-1(a)(3) (1972).

57. *See* Libin and Abramowitz, *supra* note 13, at 328.

58. 65 T.C. 798 (1976), *rev'd per curiam*, 548 F.2d 501 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977).

"an unreasonable interpretation of the statutory language."[59] Reasoning that the function of the eighty percent test is to measure the financial interest of those individuals who satisfy the fifty percent control test, the Tax Court majority argued that the regulation rendered the eighty percent test meaningless.[60] The effect of the *Fairfax* decision was to impose a common ownership requirement for purposes of the eighty percent test.

In contrast, the *Fairfax* dissent concluded that the two tests were independent. The dissent based its argument in support of the regulation on the identical language relied on by the majority to invalidate the regulation.[61] Judge Simpson's dissent criticized the majority for overlooking the "obvious meaning" of the statutory language,[62] and for its attempt to define the application of the statute without authorization in the language of the statute or legislative history.[63] Judge Simpson concluded:

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59. 65 T.C. at 802.

60. *Id.* at 805-06. The court stated:

> [T]he 50-percent test is one of control, drawn to insure that the members of the controlled group could be organized and operated as one corporation (citations omitted). The 50-percent test being the control test, it is apparent that the 80-percent test is one of financial interest. Together, the tests assure that the sanctions imposed by section 1561 are applied only in those instances where the evil sought to be remedied rears its head, i.e., where those in control of two or more corporations are utilizing the multicorporate form to obtain an unwarranted financial benefit. To allow the 80-percent ownership test to be satisfied with stock of a person owning stock in only one corporation, i.e., a person not within the control group, would simply ignore the basic function of the 80-percent test.

61. *Id.* at 809-10. Both opinions cited the same language of the General Explanation to support their differing positions:

> (2) Brother-sister groups.—A group of corporations in which five or fewer persons own, to a large extent in identical proportions, at least 80 percent of the stock of each of the corporations. . . . However, in order to insure that this expanded definition . . . applies only to those cases where the five or fewer individuals hold their 80 percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of the five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation.

General Explanation, *supra* note 49, at 5394.

The majority construed the terms "to a large extent in identical proportions" and "one economic entity" to indicate that common ownership and control were the *sine qua non* of a brother-sister controlled group. 65 T.C. at 805. The dissent, on the other hand, believed that the same language made it "clear that different persons may be taken into consideration in applying the 80-percent and the 50-percent tests and that the common ownership requirement is only applicable for purposes of the 50-percent test." 65 T.C. at 810. The dissent interpreted the phrase "to a large extent in identical proportions" to "merely indicate that there will be common ownership 'to a large extent' among those persons whose ownership is considered for purposes of the 80-percent test." 65 T.C. at 810.

62. 65 T.C. at 811.

63. *Id.* at 812.

> For my part, I cannot say that those provisions are arbitrary or irrational, and as a court, it seems to me that we should refrain from adopting an interpretation of them which will limit their applicability. If the reach of the statute is too broad, the remedy lies with Congress. Although some of my colleagues may be firmly convinced that the statute should have been written more narrowly, it is not for us to usurp the policymaking responsibilities of the Congress.[64]

The opposing viewpoints set forth in *Fairfax* formed the basis of the controversy which was finally resolved by the Supreme Court in *Vogel*. Although the Tax Court remained firm in its position in subsequent cases in which it addressed the issue,[65] three of the Circuit Courts favored Judge Simpson's dissenting argument and reversed the Tax Court to uphold the Commissioner's interpretation of the regulation.[66] The Fourth Circuit reversed the Tax Court's *Fairfax* decision in a per curiam opinion which adopted Judge Simpson's dissenting opinion and concluded that the dissent's interpretation "accords with the text of the statute and its legislative history."[67] The Eighth and Second Circuits followed suit in *T.L. Hunt, Inc. v. Commissioner*[68] and *Allen Oil Co. v. Commissioner*,[69] respectively. In *T.L. Hunt* the court concluded that "[t]he holding of the Tax Court in this case constitutes an unwarranted addition to the statute of a requirement not reflected in the plain terms and language of the statute."[70] In *Allen Oil* the court upheld the regulation as a reasonable interpretation of the statute and maintained that the Tax Court's interjection of a common ownership requirement rendered the fifty percent test superfluous.[71]

Taxpayer Vogel Fertilizer approached the Court of Claims as an untested forum in the unsettled controversy which continued to loom over the validity of the regulation.[72] The Court of Claims upheld the taxpayer's position and approved the Tax Court's statutory construc-

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64. *Id.* at 813.

65. *See supra* note 14.

66. *See supra* notes 18-20 and accompanying text.

67. 548 F.2d 501, 503 (4th Cir.), *cert. denied*, 434 U.S. 904 (1977).

68. 562 F.2d 532 (8th Cir. 1977).

69. 614 F.2d 336 (2d Cir. 1980).

70. 562 F.2d at 535.

71. 614 F.2d at 339.

72. At the time of the taxpayer's decision to file its action with the Court of Claims, appeals of decisions of that court could be taken only to the United States Supreme Court by writ of certiorari or by certification of questions of law. 28 U.S.C. § 1255 (originally enacted as Act of June 25, 1948, ch. 646, § 1255, 62 Stat. 928), *repealed by* Pub. L. 97-164, § 123, 96 Stat. 36 (1982).

tion in *Fairfax* as "the most careful and best analysis of the statute to date."[73] The court acknowledged, however, the position of the Second, Fourth and Eighth Circuits and admitted that "the different view taken by Treas. Reg. § 1.1563-1(a)(3) is not wholly unreasonable as a construction of the words appearing in section 1563(a)(2)."[74] The majority further acknowledged that the statute has been "fairly criticized" as being open to at least four possible interpretations.[75] Nevertheless, the court found the regulation "clearly inconsistent with the legislative history and unreasonable when the purpose, as well as the bare words, of the statute are considered."[76]

Noting that the legislative history relied on by the majority to invalidate the regulation can just as reasonably be read to support the regulation, the Court of Claims dissent framed the issue succinctly: "[T]he issue is not whether plaintiff's interpretation is *as* reasonable as defendant's . . . [but] whether plaintiff has carried its heavy burden of showing the regulation to be unreasonable and plainly inconsistent with the statute."[77]

IV. REASONING OF THE COURT

A. The Majority Opinion

Justice Brennan framed the issue before the Court as "whether the regulatory interpretation . . . is a reasonable implementation of the statute or whether Congress intended the statute to apply only where each person whose stock is taken into account owns stock in each corporation of the group."[78] The Court acknowledged that its role was limited to a determination of the validity of the regulation and that deference is ordinarily owed to the agency construction if "the regulation 'implement[s] the congressional mandate in some reasonable manner.' "[79] The Court pointed out, however, that the general principle of deference merely sets " 'the framework for judicial analysis; it does not displace it.' "[80]

The Court initially considered the weight to be accorded the interpretive regulation. Treasury regulation section 1.1563-1(a)(3) was

73. 634 F.2d at 501.
74. *Id.* at 503.
75. *Id.* at 501. *See* Libin and Abramowitz, *supra* note 13, at 327-28.
76. 634 F.2d at 503.
77. *Id.* at 514 (Smith, J., dissenting).
78. 455 U.S. at 19.
79. *Id.* at 24 (quoting United States v. Correll, 389 U.S. 299, 307 (1967)).
80. 455 U.S. at 24 (quoting United States v. Cartwright, 411 U.S. 546, 550 (1973)).

promulgated under the general authority issued to the Secretary of the Treasury by Congress to "prescribe all needful rules and regulations."[81] As noted by the Court, an interpretive regulation is owed " 'less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision.' "[82] According to the majority, the regulation "purports to do no more than add a clarifying gloss on a term . . . that has already been defined with considerable specificity by Congress,"[83] and, as such "[t]he Commissioner's authority is consequently more circumscribed than would be the case if Congress had used a term 'so general . . . as to render an interpretive regulation appropriate.' "[84]

The Court then considered whether the regulation "harmonizes" with the language and structure of the statute. The statutory language, the Court declared, "while not completely unambiguous, is in *closer harmony* with the taxpayer's interpretation than with the Commissioner's Regulation."[85] According to the majority, the statutory language itself suggests a common ownership requirement because the term "brother-sister controlled group" infers "a close horizontal relationship *between* two or more corporations."[86] The Court then concluded that the structure of the statute strengthens this interpretation and approved the Tax Court's analysis of the statutory language in *Fairfax*.[87]

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81. 455 U.S. at 24 (citing § 7805(a) of the Internal Revenue Code). The Commissioner of Internal Revenue generally promulgates the rules and regulations with the approval of the Secretary. Treas. Reg. § 301.7805-1 (1975).

82. 455 U.S at 24 (quoting Rowan Cos. v. United States, 452 U.S. 247, 253 (1981)).

83. 455 U.S. at 24.

84. *Id.* at 24-25 (citing National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 476 (1979), quoting Helvering v. R.J. Reynolds Co., 306 U.S. 110, 114 (1939)).

85. 455 U.S. at 25 (emphasis added).

86. *Id.*

87. *Id.* & n.8. In *Fairfax*, the Tax Court determined that the phrase "five or fewer persons" is the "conjunctive subject" of both the 80% and 50% tests:

> If ownership of stock in each corporation involved is a precondition to membership in the ownership group for purposes of the 50 percent test, and the ownership groups for the 50 percent test and 80 percent test are one and the same, it follows . . . that one must own stock in each corporation before his stock can be taken into account for purposes of the 80 percent test.

65 T.C. at 803.

The *Vogel* majority agreed with the Tax Court's further conclusion that this interpretation is strengthened by the phrase "each such person":

> The words 'each such person' appearing . . . [in the statute] refer to the 'five or fewer persons' constituting the ownership group for purposes of both the 80 percent and 50 percent tests. The import of such usage is that each person—and not just some of the persons—counted for purposes of the 80 percent test must be also counted for purposes of the 50 percent test.

The Court noted that a regulation that is fundamentally at odds with the statute's origin and purpose will not be sustained simply because it is not "technically inconsistent" with the language of the statute. Upon analyzing the regulation in light of the legislative history of section 1563(a)(2), the Court concluded that "[t]he legislative history . . . resolves any ambiguity in the statutory language and makes it plain that . . . [the regulation] is not a reasonable statutory interpretation."[88] In reaching this conclusion the Court determined that "[t]he intended targets of § 1563(a)(2) were groups of *interrelated* corporations . . . characterized by *common* control and ownership."[89] The Court further concluded that the legislative history illustrates that the eighty percent requirement was intended by Congress to remain the primary basis for determining the interrelationship between two or more corporations.[90]

To reach its conclusion the Court relied primarily upon the Treasury's Technical and General Explanations of the 1969 Act.[91] The following language from the Technical Explanation convinced the Court that the Treasury had explicitly retained a common ownership requirement in the eighty percent test: "[T]he same *five* or fewer persons [must] own at least 80 percent of the voting stock or value of shares of each corporation, and . . . these five or fewer individuals" must also satisfy the fifty percent requirement contained in part B of the statute.[92]

According to the majority, the General Explanation "made it

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455 U.S. at 25-26 & n.8 (quoting *Fairfax*, 65 T.C. at 803).

The *Vogel* majority concluded that the presence of this clause strengthens "the suggestion that there is one fixed, indivisible, group of shareholders whose holdings are to be considered throughout application of both [tests]." 455 U.S. at 25-26 n.8.

88. 455 U.S. at 26.

89. *Id.* at 27. In reaching this conclusion the Court relied on a House Ways and Means Committee Report which noted that

> large organizations have been able to obtain substantial benefits . . . by dividing the organization's income among a number of related corporations. Your committee does not believe that large organizations which operate through multiple corporations should be allowed to receive the substantial and unintended tax benefits resulting from the multiple use of the surtax exemption and the other provisions of present law.

H.R. REP. No. 413, 91st Cong., 1st Sess. pt. 1, 98, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 1746-47.

90. 455 U.S. at 27. The dissent labeled the majority's conclusion "entirely speculative" as well as "entirely without support in the legislative history." According to the dissent, the majority derived its conclusion from the fact that the Treasury had described § 1563(a)(2) as an "expansion" of the pre-1969 statutory scheme which considered corporations to be part of a controlled group only if the same person owned 80% of the stock in each corporation. *Id.* at 37 & n.2 (Blackmun, J., dissenting).

91. 455 U.S. at 28-29.

92. *Id.* at 29. *See* Technical Explanation, *supra* note 48, at 5168.

clear" that the eighty percent test would remain the key factor under the 1969 amendment in determining whether corporations represent the same financial interests.[93] Based on the General Explanation, the Court viewed the 1969 test as simply an "expansion" of the 1964 test, "necessary to 'close the present opportunity for easy avoidance' of the 80-percent test." Because the ownership group had been expanded from one to five persons, the fifty percent test was added to " 'insure that the new expanded definition is limited to cases where the brother-sister corporations are, in fact, *controlled* by the group of stockholders as one economic enterprise.' "[94] The Court also noted that all examples included in the Treasury's explanations indicated a common ownership requirement for purposes of the eighty percent test.[95]

The Court pointed out that although the Congressional understanding of what was enacted is ultimately controlling, "great weight" attaches to agency representations to Congress when the agency has participated in drafting and has voiced its views in committee hearings.[96] The majority took the position that the legislative history of the statute confirms that Congress adopted not only the Treasury proposal, but also the Treasury's explanation and interpretation, which the Court viewed as "wholly incompatible" with the regulation.[97] The Court found the Ways and Means Committee Report[98] to include the Treasury's explanations, and concluded that the eighty percent test is an expanded version of the 1964 statute that measures overlapping interest, while the fifty percent test is an additional provision necessitated by the expanded number of shareholders.[99]

According to the majority, the eighty percent test under the regulation "measures *only* whether or not the brother-sister corporations are closely held." The Court concluded that "[t]he fact that a corporation is closely held, absent common ownership, is irrelevant to the congressional purpose of identifying interrelationship."[100]

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93. 455 U.S. at 29.

94. *Id.* at 29-30 (quoting General Explanation, *supra* note 49, at 5396; emphasis added by *Vogel* majority).

95. 455 U.S. at 30 n.10.

96. *Id.* at 31 (citing Zuber v. Allen, 396 U.S. 168, 192 (1969)).

97. 455 U.S. at 31-32.

98. *See supra* note 38.

99. 455 U.S. at 32. The Court noted that the language of the Senate Committee Reports is essentially identical to that employed by the House. *See* S. REP. No. 552, 91st Cong., 2d Sess. 135, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2027, 2167.

100. 455 U.S. at 30. In reaching this conclusion, the Court cited with approval the statement in Judge Webster's dissent in *T.L. Hunt*: "It is not the *smallness* of the number of

The Court briefly considered but was unpersuaded by three other arguments advanced by the Commissioner:

(1) The Commissioner contended that because the 1969 amendment of section 1563 contains language identical to that contained in the previously enacted section 1551(b)(2),[101] Congress thereby approved and adopted the interpretation of that language set forth in the regulations under section 1551.[102] The Court dismissed this argument, finding that the section 1551 regulations did not support the Commissioner's position.[103]

(2) The Court also rejected the Commissioner's contention that Congress implicitly approved regulation section 1.1563-1(a)(3) when it incorporated by reference the section 1563(a) controlled group definitions in section 1015 of the Employee Retirement Income Security Act of 1974 (ERISA).[104] The Court refused to apply the doctrine of statutory re-enactment, reasoning that the "passing reference" to section 1563(a) in section 414(b), which was enacted only two years after the regulation was promulgated, could not be said to constitute "legislative approval of a long standing administrative interpretation" from which congressional acceptance could be inferred.[105]

(3) Finally, the Court disagreed with the Government's assertion that the common-ownership requirement "leads to the assertedly nonsensical result" that ownership of a single share could create a brother-sister controlled group.[106] The Government pointed out that if Crain held so much as one share of Vogel Popcorn stock, section 1563(a)(2) would apply under *either* interpretation of the statute. The Court re-

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persons in each company that triggers § 1563; it is the *sameness* of that small number." T.L. Hunt, Inc. v. Commissioner, 562 F.2d at 537 (8th Cir. 1977) (Webster, J., dissenting).

101. *See supra* notes 40, 48 and 52.

102. 455 U.S. at 32-33. The Government focused on regulation § 1.1551-1(g)(4), Example 4, to support its contention that the 80% test does not require common ownership. *Id.* at 33 and n.13.

103. According to the Court, the example relied on defines "a concept [transfer] that obviously has no application under § 1563(a)(2)." *Id.* The Court stated that even if it is assumed that Congress was aware of the regulations under § 1551, those regulations do not support the Commissioner's regulation under § 1563(a)(2) since they contain no language similar to the words "singly or in combination" that appear in regulation § 1.1563-1(a)(3). The Court noted further that the regulations under § 1551 contain no suggestion that the Treasury Department had ever interpreted § 1551(b)(2) as not having a common ownership requirement. *Id.* at 33.

104. *Id.* In dismissing this argument, the Court noted that the intent of the 1969 Congress that amended § 1563(a) is controlling, not the intent of the Congress that enacted § 414 in 1974. *Id.* at 34.

105. *Id.* at 34.

106. *Id.*

jected the argument out of hand, pointing out that Congress had purposefully substituted an objective test for the former subjective approach.[107]

B. The Dissent

Although Justice Blackmun acknowledged that the majority opinion persuasively defended a possible interpretation of section 1563(a)(2), he objected to the majority's failure to establish the unreasonableness of the Treasury's interpretation.[108] Because "the only certainty about the language and history of § 1563(a)(2) is that both are ambiguous," Justice Blackmun would have deferred to the judgment of the Commissioner.[109]

Justice Blackmun attacked the majority's statement that the statutory term "brother-sister controlled group" is in "closer harmony" with the taxpayer's interpretation than with that of the regulation because of the relationship connoted by the term. Noting that the statute is entirely silent as to whether *each* member of the alleged controlled group must own stock in each corporation, Justice Blackmun admitted his own difficulty in inferring such a conclusion from a term that is "hardly a household term with an intuitively obvious meaning."[110]

Justice Blackmun also took issue with the majority's analysis of the statutory structure. While the majority interpreted the phrase "5 or fewer" as requiring the same shareholders to satisfy both the fifty percent and eighty percent tests, the dissent construed the same phrase to mean only that the total number of shareholders considered for both tests may not exceed five.[111] Justice Blackmun argued that the presence of an explicit common ownership requirement in part B of the statute, coupled with the absence of such a requirement in part A, indicates that Congress did not intend to include a common ownership re-

107. *Id.* The Court noted that "a sharp dividing line that is crossed by incremental changes in ownership" is inherent in such a mechanical formula. *Id.* According to the majority, it is "obvious" that a shareholder would not acquire a small amount of stock in order to create a controlled group of corporations. *Id.* The Court concluded its analysis by stating that "mere" ownership is an important aspect of the test because

> [it] insures that each of the "5 or fewer" shareholders representing the bulk of the financial interest of the corporations actually knows of the other corporations within the putative brother-sister controlled group. Under this construction of the statute, controlled-group membership cannot catch such a shareholder by surprise, as it could under the Commissioner's construction. *Id.* at 34-35.

108. 455 U.S. at 35 (Blackmun, J., dissenting).

109. *Id.*

110. *Id.*

111. *Id.* at 35-36 & n.1.

quirement in the eighty percent test.[112] According to the dissent, a "simpler and normal" reading of the statute supports the Commissioner's interpretation, whereas the majority approach runs counter to the statutory structure in that the fifty percent common ownership requirement is swallowed by the eighty percent test.[113]

Justice Blackmun criticized the majority's conclusion that the legislative history resolves any ambiguity in the statutory language as "substantially overstated."[114] Furthermore, he found no support in the legislative history for the Court's conclusion that Congress had intended the eighty percent requirement to be the primary requirement for determining the interrelationship between two or more corporations.[115]

The dissent was also critical of the Court's heavy reliance on the Treasury Department proposals, which were characterized as ambiguous. According to Justice Blackmun, the Treasury Explanations need not be read as requiring *each* individual to own stock in every corporation tested,[116] but could easily be construed to require only that a given *set* of five satisfy both tests.[117] In light of these conflicting constructions, Justice Blackmun found the majority's reliance on the proposals to be ill-founded.

The dissent accused the majority of reading between the lines of the statute, and thus "[losing] sight of the fact that certain statutory ambiguities cannot be neatly and finally resolved."[118] Although the dissent did not take the position that the Commissioner's interpretation is compelled by the legislative history, it concluded that the regulation is not " 'unreasonable or meaningless' [because] 'it insures that the stock is closely held.' "[119] Because the regulation was not unreasona-

112. *Id.* at 36 n.1.

113. *Id.* at 36.

114. *Id.*

115. *Id.* at 37 & n.2. Noting the absence of any explicit statement in the legislative history regarding which test should serve as the primary test of interrelationship, the dissent argued that the legislative materials are not inconsistent with the Commissioner's contrary view that the 50% test was designed to serve as the test of interrelatedness. *Id.* at 37 n.2.

116. *Id.* at 37-39.

117. *Id.* & n.3. The interpreted proposal declares that the 80% test "is satisfied if the group of five or fewer persons as a whole owns at least 80 percent of the voting stock or value of shares of each corporation, regardless of the size of the individual holdings of each person." Technical Explanation, *supra* note 48, at 5169.

Justice Blackmun observed that during the course of litigation over the statute, both taxpayers and the Government have drawn support from the same portions of the Treasury's proposals. 455 U.S. at 38 n.3.

118. 455 U.S. at 39.

119. *Id.* (citing Allen Oil Co. v. Commissioner, 614 F.2d at 340).

ble, the courts should refrain from interference: " '[t]he choice among reasonable interpretations is for the Commissioner, not the courts.' "[120]

V. ANALYSIS OF THE DECISION

A. The Commissioner's Regulation Was Not Unreasonable

The role of prescribing all needful rules and regulations for the enforcement of the Internal Revenue Code was delegated by Congress to the Commissioner of Internal Revenue, not to the courts.[121] This delegation was designed to insure that the rules and regulations will be written by the "masters of the subject" who will be administering those rules and regulations.[122] Prior Supreme Court cases have established the well-settled principle that Treasury regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes."[123] Treasury regulations are presumed valid if they "implement the congressional mandate in some reasonable manner."[124] When confronted by a challenge to the validity of a regulation, the Court has applied the following test:

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.[125]

120. 455 U.S. at 39 (quoting National Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 488 (1979)). *See* United States v. Correll, 389 U.S. 299, 307 (1967).

121. I.R.C. § 7805(a) (1976).

122. National Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 477 (1979) (citing United States v. Moore, 95 U.S. 760, 763 (1878)).

123. Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948).

124. United States v. Correll, 389 U.S. 299, 307 (1967).

125. National Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 477 (1979) (citing Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948); Helvering v. Winmill, 305 U.S. 79, 83 (1938)).

In upholding the regulation defining a "business league," the Court noted that although the Commissioner's reading of § 501(c)(6) was perhaps not the only possible interpretation,

The *Vogel* majority failed to establish that the Commissioner's regulation is, in fact, "unreasonable and plainly inconsistent" with the statute. Both the language of the statute itself and the legislative history can be interpreted to support the Commissioner's regulation. Although the language and legislative history can also be read to support the majority's interpretation, neither mandates invalidation of the regulation. Thus, as Justice Blackmun observed, the " 'choice among reasonable interpretations is for the Commissioner, not the courts.' "[126]

1. Statutory language

The majority conceded that the language of the statute is not completely unambiguous, but considered that language to be in "closer harmony" with the interpretation of the taxpayer than with the Commissioner's regulation.[127] Although the statute is silent as to whether each member of the set of five must own stock in each corporation tested, the majority found a common ownership requirement in the statutory term "brother-sister controlled group."[128] The Court attempted to find support for this position in the structure of the statute. Relying on the approach of the Tax Court in *Fairfax*, the majority concluded that because the phrase "5 or fewer persons" is the conjunctive subject of both tests, the same persons must be taken into account in each.[129] Furthermore, the Court determined that the phrase "each such person" in the fifty percent test relates back to the words "5 or fewer persons" to require each person counted for purposes of the eighty percent test to be counted for the purposes of the fifty percent test as well. The presence of this clause led the majority to conclude that the holdings of one fixed, indivisible group of shareholders are to be considered for purposes of both tests.[130]

The Court's construction of the statute is not necessarily evident from the language of the statute. The Court simply assumed that the term "brother-sister controlled group" connotes a close horizontal relationship between two or more corporations.[131] The dissent's observation that the "simpler and normal" reading of section 1563(a) would

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"it does bear a fair relationship to the language of the statute, it reflects the views of those who sought its enactment, and it matches the purpose they articulated." 440 U.S. at 484.

126. 455 U.S. at 39 (Blackmun, J., dissenting) (quoting National Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. at 488).

127. 455 U.S. at 25.

128. *Id.*

129. *Id.* at 25-26 & n.8. *See supra* note 87 and accompanying text.

130. *Id.* at 25-26 & n.8.

131. *See supra* text accompanying notes 85-86.

impose no common ownership condition upon the eighty percent test is well-taken.[132] Had Congress intended to limit the eighty percent test to situations in which each shareholder owns stock in each member of the controlled group, it would have drafted an explicit provision such as that contained in part B of the statute with respect to the fifty percent test.

As noted by the dissent and the Second Circuit in *Allen Oil*, the majority's reading of the statute renders the fifty percent test virtually meaningless.[133] The Court of Claims reasoned that such an interpretation of the statute causes the fifty percent test to come into play only in an "atypical" ownership arrangement.[134] For example, assume that the stock of Corporation ABC is held eighty percent by Shareholder A and twenty percent by Shareholder B; the stock of Corporation XYZ is held eighty percent by Shareholder B and twenty percent by Shareholder A. Although the eighty percent test is satisfied in this situation, the fifty percent test is not and the corporations are not members of a brother-sister controlled group. Thus, despite the fact that Congress intentionally designed a two-pronged test, the Court's interpretation has essentially eliminated the applicability of the fifty percent test, except in situations such as the above example.[135] This is contrary to the general rule cited by the court in *Allen Oil*, that a statute must, if reasonably possible, be construed "to give force and effect to each of its provisions rather than render some of them meaningless."[136]

Critics of the regulation have argued that the regulation virtually eliminates the eighty percent test by focusing on the fifty percent test as the primary determinant of control.[137] This criticism fails to take into

132. 455 U.S. at 36 (Blackmun, J., dissenting).

133. *Id.*; Allen Oil Co. v. Commissioner, 614 F.2d at 339.

134. 634 F.2d at 502 & n.5. The Court of Claims conceded that under its interpretation, application of the 50% test by itself would result in the exclusion of a group of corporations from treatment as a brother-sister controlled group only in an "atypical" stock ownership arrangement. The court took the position that the 50% test was designed precisely to exclude such arrangements from treatment as a brother-sister controlled group. The Supreme Court did not consider this point in its opinion.

135. This concern was brought to the attention of the Ninety-seventh Congress. The proposal raised the question of whether the 50% identical ownership requirement continues to have any significant, independent function under the *Vogel* common ownership requirement. H.R. 6725, 97th Cong., 2d Sess. (1982). *See supra* note 23 and accompanying text.

136. Allen Oil Co. v. Commissioner, 614 F.2d 336, 339 (2d Cir. 1980) (citing FTC v. Manager, Retail Credit Co., 515 F.2d 988, 994 (D.C. Cir. 1975); United States v. Blasius, 397 F.2d 203, 207 (2d Cir. 1968), *cert. denied*, 393 U.S. 1008 (1969)).

137. This point is emphasized in Judge Webster's dissenting opinion in *T.L. Hunt*:

> It is not the *smallness* of the number of persons in each company that triggers § 1563; it is the *sameness* of that small number. The 80 percent financial interest requirement is meaningless unless it is the *same* group of five or fewer persons that

account the fact that under the regulation the eighty percent test operates to insure that all members of the group will be closely held, thereby facilitating operation as a single economic enterprise. As stated by the Second Circuit in *Allen Oil*:

> the 80% test is designed to assure that within the group of five persons or fewer the overall control of or financial interest in each of the corporations will beyond question be substantially more than 50% (i.e., 80%, whereas the 50% test is intended to assure that there will be a minimum commonality or community of interest between members of the five or fewer persons in control; otherwise there might be no tie between persons controlling one corporation and those controlling another.[138]

Under the Commissioner's approach, the eighty percent and fifty percent tests each serve a distinct purpose and work in conjunction to identify those entities under common ownership and control which should be restricted to a single tax benefit.

On the other hand, the approach taken by the Court in *Vogel* ascribes both of these functions to the eighty percent test and relegates the fifty percent test to the role of identifying the "atypical" ownership situation. Without doubt, the language of section 1563(a)(2) may be construed to support a number of interpretations, each of which will necessarily cause one test to become subordinate to the other.[139] Under the Commissioner's interpretation, however, each part of the statute has independent significance, yet both parts operate in concert to determine whether a controlled group exists.

2. Legislative history

In view of the ambiguity of the statutory language, the Court was forced to examine the legislative history in its attempt to resolve the conflict. Throughout the course of litigation over section 1563(a)(2), courts have examined the same history and arrived at opposite conclusions.[140] Thus, the Court's conclusion that the legislative history resolved "any ambiguity in the statutory language" was an overstatement; this history does not *conclusively* support either interpretation.

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own 80 per cent of each company within the controlled group. It is this requirement of "economic entity" which is entirely eviscerated by Reg. § 1.1563-1(a)(3).

562 F.2d at 537 (Webster, J., dissenting).

138. Allen Oil Co. v. Commissioner, 614 F.2d at 340.

139. *See* Libin and Abramowitz, *supra* note 13, at 327-28.

140. *See supra* notes 14, 61 and 117 and accompanying text.

In its 1969 proposal to Congress, the Treasury Department advocated an expansion of the definition of a brother-sister controlled group whereby the number of shareholders that could be considered in determining whether the eighty percent ownership test is satisfied was increased from one to "five or fewer."[141] The Treasury's proposal also added the new fifty percent test which was explained as follows:

> [I]n order to insure that this expanded definition of brother-sister controlled group applies only to those cases where the five or fewer individuals hold their eighty percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of the five or fewer individuals must constitute more than fifty percent of the stock of each corporation, considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation.[142]

The Senate and the House adopted the Treasury's proposed definition of a brother-sister controlled group without further explanation. Neither the General Explanation nor the Technical Explanation relied on by the Court addresses the question of whether the eighty percent test requires common ownership. The Technical Explanation merely states that the stock ownership test would be the same test employed in section 1551 of the Code.[143]

It is difficult to understand how the majority so readily concluded that the General Explanation clearly establishes Congress' intent that the eighty percent test remain the primary basis for determining whether two or more corporations represent the same financial interests.[144] As noted by the dissent, this view is entirely without support in the legislative history.[145] Furthermore, the Treasury explanations may also be interpreted to *support* the Commissioner's interpretation. The relevant portion of the Technical Explanation states that the eighty percent test "is satisfied if the *group* of five or fewer persons as a whole owns at least 80 percent of the voting stock or value of shares of each corporation, regardless of the size of the individual holdings of each person."[146] As Justice Blackmun pointed out, this statement "obvi-

141. *See supra* note 52 and accompanying text.
142. General Explanation, *supra* note 49, at 5394.
143. Technical Explanation, *supra* note 48, at 5168.
144. 455 U.S. at 27.
145. *Id.* at 37 (Blackmun, J., dissenting). *See also supra* text accompanying note 114.
146. Technical Explanation, *supra* note 48, at 5169 (emphasis added).

ously suggests that the crucial inquiry is whether a given set of five satisfies both tests, not whether each individual owns stock in each corporation."[147] The *Vogel* Court placed too much emphasis on ambiguous legislative history that failed to yield any clear interpretation of the statute.

3. Purpose of the statute

Congress amended the definition of a brother-sister controlled group in 1969 upon determining that the eighty percent test as originally enacted in 1964 had failed to eliminate the abuse it was intended to remedy.[148] Thus, in 1969 it was Congress' intent to expand the circumstances in which a group of related corporations would constitute a controlled group. This goal was achieved by broadening the definition of control by increasing the number of shareholders who may be considered in determining whether a controlled group exists from one to "5 or fewer."[149] Congress added the fifty percent identical ownership test contained in part B of the statute to insure that the expanded definition would apply to corporations operating as one economic entity.[150] The majority's narrow interpretation thus runs counter to the overall statutory scheme which Congress attempted to implement by *broadening* the definition of control. Under the Supreme Court's interpretation of the statute, it is possible to avoid classification as a controlled group simply by structuring stock ownership so that no member of a group of five or fewer persons holds stock in every corporation of the group.[151]

Critics of the regulation have argued that application of the Com-

147. 455 U.S. at 39 (Blackmun, J., dissenting).

148. *See supra* text accompanying note 49; notes 53-54 and accompanying text.

149. *See supra* note 53 and accompanying text.

150. *See infra* note 154 and accompanying text.

151. For example, assume the following stock ownership pattern:

Individuals	Corporations				
	A	B	C	D	E
1	—	25	25	25	25
2	25	—	25	25	25
3	25	25	—	25	25
4	25	25	25	—	25
5	25	25	25	25	—

Under *Vogel* there are no controlled groups in the above pattern. With respect to any two corporations the 50% test is met because three shareholders each hold 25% of both corporations resulting in identical ownership of 75%. However, because the other two individuals own stock in only one of the two corporations tested the 80% test is not satisfied under the *Vogel* common ownership requirement. Under the regulation, however, any combination of two corporations would constitute a controlled group since the stock holdings of all five individuals may be counted for purposes of the 80% test.

missioner's interpretation of the regulation broadens the impact of the statute substantially beyond the scope intended by Congress.[152] It must be remembered, however, that in amending section 1563 in 1969, Congress expressly intended to expand the reach of the 1964 statute that had failed to stop the proliferation of multiple corporations.[153] The Commissioner's regulation is not unreasonable in light of this overall statutory scheme. Congress explicitly chose to make the rule applicable to a greater number of situations by taking into account the stock ownership of up to five persons. Congress specifically added the fifty percent test as a safeguard to insure that there would be common control of each corporation by some members of the group. As set forth in the General Explanation:

> Expanding the 80-percent ownership test from one person to five will close the present opportunity for easy avoidance of that 80-percent test. However, adding the 50-percent identical ownership test will insure that the new expanded definition is limited to cases where the brother-sister corporations are, in fact, controlled by the group of stockholders as one economic enterprise.[154]

The majority's interpretation of the statute substantially increases the opportunity for easy avoidance of the eighty percent test—a result which is contrary to the intent of both the Treasury and Congress to close the loophole.

B. The Standard of Review

The majority recognized that the issue to be resolved was whether the regulation is a reasonable interpretation of the statute.[155] That was not, however, the issue the Court resolved. In holding for the taxpayer, the majority concluded that the taxpayer's interpretation was in "closer harmony" with the statute than that of the Commissioner.[156] Yet, the Court failed to establish that the regulation was in fact an unreasonable interpretation of the statute. Under the standard of review established in previous cases, the regulation should have been upheld since it was not shown to be an unreasonable interpretation of the statute. The Court has repeatedly ruled that Treasury regulations are to be upheld if they are not plainly inconsistent with the statute and if they implement

152. *See supra* note 13.
153. *See supra* note 38.
154. General Explanation, *supra* note 49, at 5396.
155. 455 U.S. at 24.
156. *Id.* at 25.

the statute in a reasonable manner.[157] As the Court explained in *United States v. Correll*:

> Alternatives . . . are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code . . . . The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.[158]

Thus, it was not open to the Supreme Court in *Vogel* to determine whether the taxpayer and the Court of Claims had advanced a *more* reasonable interpretation of the statute than had the Commissioner.

The *Vogel* Court noted that an interpretive regulation is appropriate to define a general term used by Congress, which lacks a well-defined meaning or common usage. In contrast, the Court observed, the Commissioner's authority is substantially circumscribed when an interpretive regulation adds no more than a "clarifying gloss" on a term well-defined by Congress in the statute itself.[159] As such, the Court diminished the weight to be accorded interpretive regulations that merely clarify a term defined by the perimeters of the statute. Although the term "brother-sister controlled group" was in fact defined with "considerable specificity" by Congress,[160] the definition was sufficiently ambiguous to make an interpretive regulation appropriate. Thus, the "clarifying gloss" added by the Commissioner was not only reasonable, but also necessary to implement the Congressional mandate.

The legislative history relied on by the Court to clarify the statutory ambiguity is itself unquestionably ambiguous and may be construed to support either of the conflicting interpretations. However, the Court ignored the underlying purpose of the 1969 legislation which was to *expand* the reach of the statute in order to halt the proliferation of

157. Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948); Bingler v. Johnson, 394 U.S. 741, 749-50 (1969); Fulman v. United States, 434 U.S. 528, 533 (1978); National Muffler Dealers Ass'n v. United States, 440 U.S. 472 (1979); Commissioner v. Portland Cement Co., 450 U.S. 156 (1981). *See supra* text accompanying notes 123 and 124.

158. United States v. Correll, 389 U.S. 299, 306-07 (1967).

159. 455 U.S. at 24 (citing National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 476).

160. 455 U.S. at 24.

multiple corporations. Viewed in this context, the regulation harmonizes with the statute's origin and purpose and is not an unreasonable interpretation of the statute.

There is no indication in the majority opinion that the Court intended to change the standard of review of interpretive regulations. It appears, however, that the Court failed to apply its long-standing rule that an interpretive regulation need only be a *reasonable* interpretation of the statute.[161] In so doing, the Court has arguably heightened the standard of reasonableness that must be met by interpretive regulations, thereby potentially encouraging future taxpayer suits challenging the validity of Treasury regulations, and increasing the likelihood of their success.

C. Consequences of the Decision

Congress enacted section 1563(a)(2) in response to a specific problem: its purpose was to prevent large companies from subdividing into smaller entities in order to obtain multiple surtax exemptions.[162] As a result of the *Vogel* decision, multiple surtax exemptions and other benefits of multiple incorporation will be easier to obtain than under the invalidated regulation. For example, assume that individual X owns a business that operates in ten separate geographic locations. *Vogel* permits X to create ten separate corporations and obtain a surtax exemption for each by structuring the stock ownership so that X retains as much as seventy-nine percent of the stock of nine of the corporations and 100% of the remaining corporation, with the remaining twenty-one percent in each of the nine corporations being owned individually by each of nine unrelated shareholders. None of these corporations will constitute a brother-sister controlled group because each of the minority shareholders holds stock in only one of the corporations. Using *Vogel*'s common ownership requirement, only X's stock is counted for purposes of the eighty percent test. Under the Commissioner's regulation, however, in order to avoid classification as a controlled group, X's ownership would be limited to no more than fifty percent of nine of the corporations. Under the Commissioner's regulation, this ownership pattern would constitute a brother-sister controlled group: the eighty percent test would be satisfied because the group of five or fewer persons owns eighty percent of each corporation; the fifty percent test

161. Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948).
162. *See supra* note 38.

would be satisfied by X's identical ownership of more than fifty percent of two or more corporations.

Thus, the Supreme Court's interpretation of the statute permits X to own as much as seventy-nine percent of the other nine corporations, whereas the regulation would limit X's ownership to no more than fifty percent. This twenty-nine percent difference in stock ownership is likely to have significant ramifications. X will be more likely to use the multicorporate structure if able to retain seventy-nine percent of the stock in each corporation than if forced to relinquish an additional twenty-nine percent to obtain the benefits of multiple incorporation.

The twenty-nine percent difference is even more significant in the context of corporate control. The invalidated regulation, which required X to relinquish ownership of fifty percent of nine of the corporations to obtain the tax benefits of multiple incorporation, also required X to relinquish voting control of those corporations. Because *Vogel* permits X to retain seventy-nine percent of the stock without being classified as a controlled group, X need no longer choose between control and tax benefits; both may be retained. Moreover, in states where cumulative voting is mandatory, if the board of directors consists of three or fewer directors, the twenty-one percent shareholder will be unable to elect even a single director unless permitted to do so by X.[163] X could elect the same three individuals to the board of each of the ten corporations and manage the corporations as a single integrated entity.

Although *Vogel*'s primary effect is to increase the availability of multiple surtax exemptions, the Court's decision allows corporations that avoid controlled group classification to reap other tax benefits as well.[164] Perhaps the most significant of these benefits is the opportunity to exclude employees from coverage in qualified retirement plans. Section 414(b) of the Internal Revenue Code provides that employees of corporations that are members of a controlled group as defined by section 1563 must be treated as if employed by a single employer. Thus, all such employees must be considered in analyzing whether the coverage and anti-discrimination rules have been satisfied.[165] In the hypothetical example considered above, one of the corporations that

163. Section 708 of the California Corporations Code (West 1977 & Supp. 1983) provides that directors shall be elected by cumulative voting.

The percentage of ownership necessary to elect *one* director can be calculated under the following formula:

$$\frac{100}{x+1} + 1, \text{ where x equals the number of directors to be elected.}$$

164. *See supra* note 22.

165. I.R.C. §§ 401 and 410 (1981).

employs X could adopt a retirement plan that covers only the employees of that corporation. Because the corporations do not constitute a controlled group under *Vogel*, the employees of the remaining nine corporations need not be covered by the plan. This allows X to provide significant pension benefits for himself or herself while holding to a minimum the cost of providing benefits to the remaining employees.[166]

The Court's narrow interpretation of the controlled group definition could result in proliferation of multicorporate entities to such an extent that the Commissioner, to protect the fisc, may be forced to resort to the subjective tests employed prior to the enactment of section 1563.[167] This would be ironic in view of the fact that the mechanical tests embodied in section 1563 were enacted specifically to replace these inadequate subjective tests.

As a result of the *Vogel* decision taxpayers who were considered members of a controlled group under the regulation may file amended returns for open taxable years to obtain a tax refund. Taxpayers will find it easier to avoid controlled group status with relatively minor restructuring of stock ownership. A further, and perhaps more important, consequence of the decision may be that taxpayers will attempt to invalidate other regulations by offering a "more reasonable" interpretation of the statute.

VI. CONCLUSION

The applications of the controlled group test urged by the Treasury and adopted by the Supreme Court in *Vogel* are at opposite ends of the spectrum. Under the interpretation adopted in *Vogel*, a brother-sister controlled group of corporations will exist in only the narrowest of circumstances. Thus, the Supreme Court has frustrated Congress' 1969 efforts to curb the abuse of multiple corporations by broadening the reach of the statute.

The Court's attempt to read between the lines of ambiguous legis-

166. *Id.* at § 414(m) (1981). This section was added to the Code in 1980 by Pub. L. No. 96-605, § 201, 94 Stat. 3521, 3526, and provides that the employees of all corporations within an "affiliated service group" must be treated as though employed by a single employer for purposes of measuring compliance with the coverage and anti-discrimination rules contained in §§ 401 and 410. The corporations referred to in the example in the text could constitute an affiliated service group if the corporation that employs X provides X's services to any of the other corporations. An analysis of § 414(m) is beyond the scope of this note. For a more in-depth discussion *see generally* Schiffmacher, Stiglitz and Furst, *Qualified Plan for Closely Held Businesses—Pension Plans as Tax Shelters*, 33 UNIVERSITY OF SOUTHERN CALIFORNIA INSTITUTE (MAJOR TAX PLANNING): 1981 S. Calif. Inst. ¶ 300.

167. *See supra* notes 39-42 and accompanying text.

lative history led to a result that is inconsistent with the policy inherent in section 1563: limitation of tax benefits available to multiple corporations. In view of the ambiguity of both the statutory language and the legislative history, the Court should have deferred to the judgment of the Commissioner since the regulation is neither unreasonable nor plainly inconsistent with the statute. Because the Court's decision will have an impact beyond the precise issue addressed in *Vogel* and will often produce results that are inconsistent with the policy of limiting the tax benefits available to multiple corporations, Congress should once again amend section 1563 to remove the common ownership requirement imposed by *Vogel*.

M. Katharine Davidson