Gregory v. Helvering: A Red Herring that Shaped Tax Jurisprudence

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ABSTRACT

The Supreme Court's decision in *Gregory* (affirming Learned Hand's opinion in the Second Circuit) is one of the most influential decisions in the field of taxation. It is the source of a number of significant doctrines, including business purpose, economic substance, substance over form, and sham transactions. Although the literature and the case law continue to disagree about the exact ratio decidendi of Gregory, there is one foundational fact that is undisputed. From those directly involved in the proceedings (including the taxpayer's own counsel) to the generations of commentators and judges over the generations, everyone who has looked at the case agrees that Mrs. Gregory exploited the reorganization provisions of the relevant Revenue Act for the purpose of reducing her tax liability. It is her use, misuse, or abuse – depending upon one's perspective – of those provisions that has been the focal point of debate for almost a century. Today, there is a near unanimous consensus that her exploitation of the reorganization provisions was abusive and that the courts correctly denied her the benefits she sought.

This Article argues that that the decision in *Gregory*, along with most of the subsequent discourse, derives from a basic misunderstanding of Mrs. Gregory's tax planning maneuver. A close examination shows that the corporate reorganization provisions, which have been the focus of the discourse for almost a century, conferred no tax benefit. Rather they were a red herring, successfully diverting attention from the provisions that actually provided the benefits. Had the courts fathomed the inner workings of Mrs. Gregory's tax plan, the result might have been much different, with significant implications for the subsequent development of tax law.

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INTRODUCTION

In 1928, Evelyn F. Gregory wanted to sell some property held by a corporation that she owned. To do so in a tax efficient manner, she created a new corporation, had the old corporation transfer the property to the new corporation in exchange for the new corporation issuing shares to her, and promptly liquidated the new corporation.[1] The transactions to which this corporation was a party during its four days of existence have reverberated through the ages. The Supreme Court's rejection of Mrs. Gregory's planning maneuver— – affirming Learned Hand's opinion in the Second Circuit— – is one of the most influential decisions in the field of taxation and has been extensively analyzed in thousands of subsequent cases, articles, and treatises.[2]

1. *Gregory v. Helvering*, 293 U.S. 465 (1935), *aff'g Helvering v. Gregory*, 69 F.2d 809 (2nd Cir. 1934), *rev'g Gregory v. Commissioner*, 27 B.T.A. 223 (1932).

2. The Supreme Court's decision in *Gregory* has been cited in 2,960 court decisions, 738 law review articles, and 221 treatises. Judge Learned Hand's decision in the Second Circuit has been cited in 332 court decisions, 354 law review articles, and 44 treatises. It is possible that only one tax decision has been more heavily cited by the courts than *Gregory*: *Welch v. Helvering*, 290 U.S. 111 (1933), with 10,455 citing decisions. *See* Paul Caron, T*he Most Heavily-Cited Tax Cases* (Aug. 12, 2009), *available at* https://taxprof.typepad.com/taxprof_blog/2009/08/the-most-heavilycited-tax-case.html. Professor Caron's list does not include *Gregory* (because it was not one of the cases discussed in PAUL CARON (ED.), TAX STORIES (2009)). The second case on his list is *Lucas v. Earl*, 281 U.S. 111 (1933), which currently has 1,744 citing decisions, less than *Gregory*. In the literature, *Gregory* has been discussed even more than *Welch*, which is cited in only 353 articles and 60 treatises. All figures are from LexisNexis as of Feb. 25, 2024.

The question of what exactly was decided in *Gregory* is the subject of ongoing debate, and each of the following propositions has support in the literature or in the case law:

(a) Transactions undertaken without a business purpose will not provide any tax benefit.[3]

(b) Taxpayers cannot rely on the literal words of a statute to frustrate Congressional intent.[4]

(c) The substance, not the form, of a transaction determines the tax consequences.[5]

(d) Courts will refuse to grant credence to transactions lacking economic substance.[6]

(e) Sham transactions will not be recognized for tax purposes.[7]

However, despite the disagreement over what *Gregory* stands for,[8] there is one undisputed foundational fact. From those directly involved in the proceedings (the Commissioner, the taxpayer's own counsel, and the courts) to

3. *See*, *e.g.*, Linda D. Jellum, *Codifying and "Miscodifying" Judicial Anti-Abuse Tax Doctrines*, 33 VA. TAX REV. 579, 592-94(2014); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365, 389 (1988); Anthony P. Polito, *Helvering v. Gregory: All the Perspectives from which Learned Hand Was Wrong*, 29 AKRON TAX J. 65, 65-66 (2014); Donald Arthur Winslow, *Tax Avoidance and the Definition of Insurance: The Continuing Examination of Captive Insurance Companies*, 40 CASE W. RES. L. REV. 79, 113 (1990); Steven A. Bank, *Federalizing the Tax-Free Merger: Toward an End to the Anachronistic Reliance on State Corporation Laws*, 77 *N.C.L. Rev*. 1307, 1337-381338-39 (1999). For a critique of *Gregory*'s business purpose test, *see*, *e.g.*, Stephen B. Cohen, *Honoring Justice Thurgood Marshall: Thurgood Marshall: Tax Lawyer*, 80 GEO. L.J. 2011, 2013-14 (1992) ("*Gregory* never really explained the logical relevance of the existence of a nontax business purpose to whether the taxpayer's form should control. Nor is the relevance obvious. Taxation, after all, is generally a matter of objective economic circumstances. Taxpayers in similar economic circumstances should have similar tax burdens. Therefore, the motives behind a taxpayer's actions should be generally irrelevant.")

4. *See*, *e.g.*, Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 402-406 (2010).

5. *See*, *e.g.*, Cody A. Wilson, *"Form" Determines "Substance": A Call to Reign in Tax Law's Substance-Over-Form Principle*, 3 CREIGHTON L. REV. 533, 558-61 (2020); Allen D. Madison, *The Tension Between Textualism and Substance-Over-Form in Tax Law*, 43 SANTA CLARA L. REV. 699, 716-17 (2003); Tiffany E. Carr, *Compaq, IES, and the Economic Substance Test: The Courts Turn Dividend Stripping into an Economically Significant Transaction*, 51 EMORY L.J. 1654, 1653-54 (2002); Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 STAN. L. REV. 195, 248 (2020); Ray A. Knight & Lee G. Knight, *Substance Over Form: The Cornerstone of Our Tax System or a Lethal Weapon in the IRS's Arsenal*, 8 AKRON TAX J. 91, 92 (1991).

6. *See*, *e.g.*, Gerald W. Miller, Jr., *Corporate Tax Shelters and Economic Substance: An Analysis of the Problem and Its Common Law Solution*, 2434 TEX. TECH L. REV. 1015, 1018 (2003); Christopher M. Pietruszkiewicz, *Economic Substance and the Standard of Review*, 6960 ALA. L. REV. 339, 342 (2009); Jason Quinn, *Being Punished for Obeying the Rules: Corporate Tax Planning and the Overly Broad Economic Substance Doctrine*, 15 GEO. MASON L. REV. 1041, 1049-1050 (2008); Timothy R. Hicks, *Government Victories Using the Economic Substance Doctrine: A Changing of the Tide in Tax Practice?*, 38 CUMB. L. REV. 101, 107-08 (2007-08); Daniel J. Glassman, *It's Not a Lie if You Believe It": Tax Shelters and the Economic Substance Doctrine*, 58 FLA. L. REV. 665, 679 (2006).

7. *See*, *e.g.*, Beckett G. Cantley, *Relearning the Lesson: IRS Judicial Doctrine Attacks on the Captive Insurance Company Pre-Planned Tax Deductible Life Insurance Tax Shelter*, 14 HOUS. BUS. & TAX L.J. 179, 192 (2014); James M. Delaney, *Where Ethics Merge With Substantive Law – An Analysis of Tax Motivated Transactions*, 38 IND. L. REV. 295, 297-99 (2005).

8. Some suggest that the Court relied upon a number of legal doctrines. *See*, *e.g.*, Daniel M. Schneider, *Use of Judicial Doctrines in Federal Tax Cases Decided by Trial Courts, 1993-2006: A Quantitative Assessment*, 75 CLEV. ST. L. REV. 35, 37-38 (2009); Jonathan D. Grossberg, *Attacking Tax Shelters: Galloping Toward a Better Step Transaction Doctrine*, 78 LA. L. REV. 369, 372 (2018); Linda D. Jellum, *Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation is Unconstitutional*, 70 U. MIAMI L. REV. 152, 208 (2015).

the subsequent generations of commentators and judges, everyone who has looked at the case agrees that Mrs. Gregory exploited the reorganization provisions of the relevant Revenue Act for the purpose of reducing her tax liability.[9] Her use, misuse, or abuse— – depending upon one's perspective— – of those provisions that has been the focal point of debate for almost a century. The questions raised by commentators include: (a) whether her tax planning, clearly sanctioned by the statute, should have succeeded, (b) whether it should matter what her motives were, and (c) whether there is a place to consider Congressional intent (or presumed Congressional intent) when the wording of the statute is clear? Today, there is a near unanimous consensus that her exploitation of the reorganization provisions was abusive and that the courts correctly refused to sanction that abuse.[10]

It is difficult to overstate the impact of this case on the development of tax jurisprudence.[11] It has been particularly influential with regard to corporate reorganizations and divisions.[12] As a direct consequence of *Gregory*, the business purpose doctrine dominates both the statutory and the regulatory framework.[13] However, *Gregory*'s effect is not limited to corporate taxation. It permeates the field of tax law in general.[14] One by-product of *Gregory*, the economic substance doctrine,[15] was eventually codified.[16] *Gregory* has been influential in other fields of law as well.[17]

It is therefore surprising to discover that the decision in *Gregory*, along with most of the subsequent discourse, derives from a basic misunderstanding of Mrs. Gregory's tax planning maneuver. A close examination shows that the corporate reorganization provisions, which have been the focus of attention since the

9. *See*, *e.g.*, Joseph Isenbergh, *Musings on Form and Substance in Taxation: Federal Taxation of Income, Estates, and Gifts by Boris I Bittker*, 49 U. CHI. L. REV. 859, 866-870 (1982).

10. For rare dissenting views, *see* John F. Coverdale, *Text as Limit: A Plea for a Decent Respect for the Tax Code*, 71 TUL. L. REV. 1501, 1529-37 (1997); Polito, *supra* note 3; David P. Hariton, *Kafka and the Tax Shelter*, 57 TAX L. REV. 1 (2003).

11. *See*, *e.g.*, Lawrence Zelenak, *Thinking About Nonliteral Interpretations of the Internal Revenue Code*, 64 N.C.L. REV. 623, 667 (1986) ("*Gregory v. Helvering* was perhaps the most influential case in the development of the progovernment interpretive bias."); Christopher H. Hanna, *From Gregory to Enron: The Too Perfect Theory and Tax Law*, 24 VA. TAX REV. 737, 756 (200) ("One of the most well-known and important U.S. Supreme Court tax cases is *Gregory v. Helvering*.").

12. Zelenak, *supra* note 11 at 668.]

13. *See, e.g.*, Treas. Reg. §§ 1.355-2(b), 1.368-2(b)(2); IRCI.R.C. §§ 355(b)(1)(A), (2)(B). As opposed to the regulatory provisions, the statute does not explicitly refer to business purpose; however, the theme underlying the statutory requirement for an active trade or business is that the distribution of shares in a corporation whose only assets are passive investments is likely to lack a business purpose. *See*, *e.g.*, DAVID ELKINS, CORPORATE TAXATION: STRUCTURE, FUNCTIONS, AND FLAWS 326-27 (2018).

14. *See*, *e.g.*, *Aiken Industries, Inc. v. Commissioner*, 56 T.C. 925, 934 (1971) (relying on *Gregory* to deny protection ostensibly due under a tax treaty for corporations characterized as conduits).

15. *See* Lederman, *supra* note 4, at 402 ("*Gregory v. Helvering* is almost universally identified as the first major case applying a precursor of the modern economic substance doctrine.").

16. *See* I.R.C. § 7701(o).

17. *See*, *e.g.*, *Abramski v. U.S.*, 573 U.S. 169, 185 (2014) (relying on *Gregory* in upholding conviction for purchase of firearms); *Cole v. U.S. Capital*, 389 F. 2d 719 (7th Cir., 2004) (relying on *Gregory* in determining that a flyer was not a "firm offer of credit" under the Fair Credit Reporting Act).

Bureau of Tax Appeals first considered the case in 1932, were a red herring. In and of themselves, the reorganization provisions provided no tax benefits whatsoever. They merely set the stage for the exploitation of a number of inconsistencies in the corporate tax regime. Moreover, not only were these inconsistencies well-known at the time, but exploiting them to reduce one's tax liability would almost certainly have been viewed as unobjectionable tax planning. Had the courts fathomed the inner workings of Mrs. Gregory's tax plan, the result might have been much different, with significant implications for the subsequent development of tax law.

Part II will tell the story of the case, from the inception of the plan until its ultimate defeat in the Supreme Court. Part III will then describe the legislative and regulatory responses to Mrs. Gregory's tax planning maneuver.

Part IV will explain why the reorganization provisions were a red herring of which Agatha Christie could well have been proud, providing a false trail that permitted the actual perpetrator to escape scrutiny. This Part will describe the true aim of Mrs. Gregory's maneuver and will clarify why the reorganization provisions were a peripheral detail. I will argue here that had the courts understood the inner workings of the plan, the case might— – and should— – have had a different outcome.

Part V will consider the impact that a different decision in *Gregory* might have had on the subsequent development of the tax law. Fully cognizant of the problematic nature of "what-if" history, I will offer a few conjectures on how a decision in *Gregory* in line with the analysis proposed in this article could have played out. Part VI will present some a few concluding thoughts.

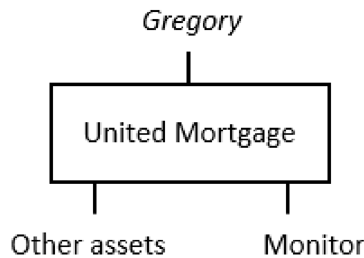
I. The Story of *Gregory*: From Inception to the Supreme Court

This Part will narrate the story of *Gregory*. It will begin by describing the preexisting state of affairs, what Mrs. Gregory desired to achieve, and how she chose to do so. It will continue with the reaction of the Commissioner to her actions and the decisions of the Board of Tax Appeals, the Second Circuit, and ultimately the Supreme Court.

A. The Plan

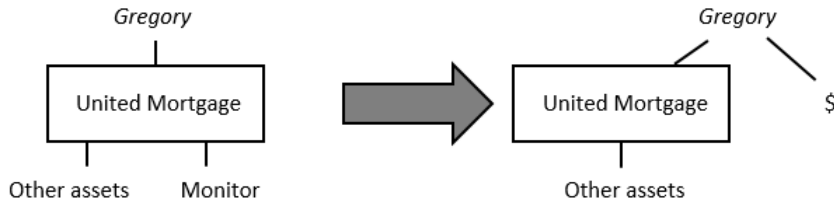
The heroine of our tale was the sole shareholder of United Mortgage Corporation ("United Mortgage"). United Mortgage, in turn, owned a number of assets, among them 1,000 shares of Monitor Securities Corporation ("Monitor"). The Monitor shares had greatly increased in value since the time of their purchase by United Mortgage:

DIAGRAM I



Mrs. Gregory wanted to monetize her indirect investment in Monitor. In other words, she wanted to replace her indirect holding of the Monitor shares with a direct holding of cash:

DIAGRAM II



The question she faced was how to accomplish this end in the most tax efficient manner possible.

Had United Mortgage sold the shares and distributed the proceeds to Mrs. Gregory, it would have been subject to tax on the now realized gain and she would have been taxed at ordinary rates on the dividend. In an effort to avoid this tax-heavy route, Mrs. Gregory's advisors formulated an alternative multi-stage plan:

First, Mrs. Gregory formed a new corporation, "Averill" (Stage 1 to Stage 2 in the diagram below).[18]

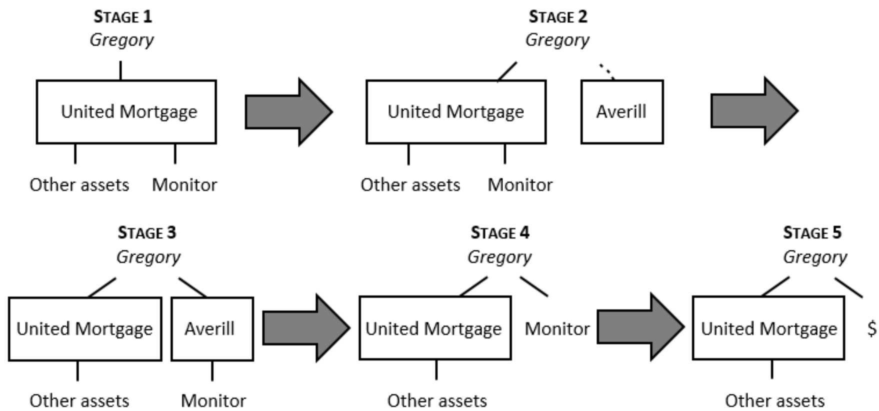
Second, United Mortgage transferred its Monitor shares to Averill. In exchange, Averill issued stock to Mrs. Gregory (Stage 2 to Stage 3 in the diagram below).

Third, Averill was liquidated and Mrs. Gregory received the Monitor shares as a liquidating distribution (Stage 3 to Stage 4 in the diagram below).

Finally, Mrs. Gregory sold the Monitor shares for cash (Stage 4 to Stage 5 in the diagram below):

18. The dotted line connecting Mrs. Gregory to Averill indicates that the corporation had at the time no assets and the shares therefore had little or no value.

DIAGRAM III



This entire series of events occurred within a period of four days.

Ostensibly, this more roundabout way of terminating the investment carried the same tax burden as the more direct route. Exchanging the Monitor shares for the Averill shares was a realization event from the perspective of United Mortgage.[19] For Mrs. Gregory, the receipt of the Averill was effectively a dividend from United Mortgage.[20]

However, the Revenue Act of 1928 ("RA 1928") contained a number of provisions that, when applied to the structure devised by Mrs. Gregory's tax advisors, appeared to exempt United Mortgage from tax and also greatly reduced the tax to which Mrs. Gregory herself would be subject.

With regard to United Mortgage, RA 1928 § 112(b)(4) provided as follows:

> No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of a plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

United Mortgage transferred its Monitor shares to Averill solely in exchange for Averill stock.[21] Thus, United Mortgage would recognize no gain on the exchange, subject only to the provisos that United Mortgage and Averill were

19. The realized gain was the fair market value of the Averill stock (presumably equal to the fair market value of the Monitor stock) minus United Mortgage's basis in its Monitor shares. It is irrelevant that Averill issued the shares to Mrs. Gregory instead of the United Mortgage. Effectively, United Mortgage exchanged its Monitor shares for newly issued Averill shares and then distributed the Averill shares to Mrs. Gregory.

20. On the bright side, from her perspective, she would not have been subject to any further tax on either the liquidation of Averill or the subsequent sale of the Averill shares. Having reported the dividend as gross income, she would take a fair market value basis in the Averill shares, and, as a consequence, would not have realized any gain on the deemed exchange of those shares for the Monitor shares within the framework of Averill's liquidation. Similarly, she would then take a fair market value basis in the Monitor shares, which would prevent her from realizing any gain following her sale of those shares.

21. Stage 2 to Stage 3 of Diagram III.

parties to a reorganization and that the exchange was pursuant to a plan of reorganization.

With regard to Mrs. Gregory, RA 1928 § 112(g) provided as follows:

> If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in another corporation party to the reorganization, without the surrender by such stockholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

Mrs. Gregory, who was a shareholder in United Mortgage, received stock in Averill without surrendering any stock or securities in United Mortgage.[22] Thus, Mrs. Gregory would recognize no gain on the receipt of such stock, again subject to the provisos that United Mortgage and Averill were parties to a reorganization and that the distribution was pursuant to a plan of reorganization.

As noted, the non-recognition of gain proffered by these two provisions was subject to the provisos that the corporations were each "a party to a reorganization" and the distribution was "in pursuance of a plan of reorganization." The key term "reorganization" was defined in RA 1928 § 112(i)(1)(B) as including:

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred...

The only requirement mentioned is that following the transfer, either the transferor, or its shareholders, or both, are in control of the corporation to which the assets are transferred. Immediately after the transfer, Mrs. Gregory (the shareholder of United Mortgage) did indeed control Averill (the corporation to which the assets were transferred).[23] Therefore, under the statutory scheme, the transfer of the Monitor shares from United Mortgage to Averill was a "reorganization," United Mortgage and Averill were each "a party to the reorganization," and the transfer of the Monitor stock to Averill and the subsequent distribution of Averill stock to Mrs. Gregory were "in pursuance of a plan of reorganization." Consequently, under the statutory scheme, neither United Mortgage nor Mrs. Gregory would recognize gain on the transfer of the Monitor stock to Averill in exchange for Averill's issuing new shares to Mrs. Gregory (Stage 2 to Stage 3 of the diagram below).

Nevertheless, Mrs. Gregory was not to escape without any tax liability, even according to the analysis of her tax advisors. As under current legislation,[24] the liquidation of a corporation was viewed as an exchange by the shareholders of their shares in the liquidated corporation for the cash or the other property

22. Stage 3 to Stage 4 of Diagram III.

23. Stage 4 in Diagram III. Alternatively, under the construction described in note 19, *supra*, it was United Mortgage that controlled Averill for an instant before distributing the Averill shares to Mrs. Gregory.

24. *See* I.R.C. § 331(a).

received in the liquidation.[25] Thus, on the liquidation of Averill, Mrs. Gregory would realize and recognize capital gain equal to the difference between the fair market value of the Monitor stock that she received in the liquidation and her basis in the Averill stock.[26]

One advantage of structuring the transaction in the manner devised by Mrs. Gregory's tax advisors involved the computation of her gain from the deemed sale of the Averill shares. When she received the Averill shares, her basis in the pre-distribution United Mortgage stock would have been be allocated to (a) her post-distribution United Mortgage stock, and (b) her newly received Averill stock, in proportion to their respective fair market values.[27] Her taxable gain was, therefore, the difference between the fair market value of the Monitor shares and that portion of her original basis in the United Mortgage Shares that had been allocated to the Averill shares.[28] In contrast, had she received the Monitor shares or the proceeds of their sale as a dividend, she would have had to report as gross income the entire value of those shares. However, this advantage was merely one of timing, as she would now have a truncated basis in her United Mortgage shares.[29] The second— and probably more significant— advantage was that under the structure devised by her advisors, the gain from the receipt of the Monitor shares would be subject to the low tax rates applicable to capital gains (at the time 12.5%).[30]

B. The Commissioner's Position

The Commissioner was not enamored of Mrs. Gregory's tax planning maneuver. He took the position that transferring the Monitor shares to Averill in exchange for newly-issued shares and then liquidating Averill was not a true "reorganization," as it had no business purpose other than to avoid taxation. Therefore, he treated the transfer and liquidation as nullities and viewed the entire transaction as if United Mortgage had simply distributed the Monitor

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25. *See* RA 1928 § 115(c).

26. At the same time, she would take a fair market value basis in the Monitor stock. When she then sold her share in Monitor (Stage 4 to Stage 5 of Diagram III), she would not recognize any further gain (assuming there was no change in market value between the liquidation and the sale and that she sold the stock for its fair market value, the amount she received would necessarily equal her basis in the stock).

27. *See* RA 1928 § 113(a)(6). For example, if her basis in the pre-distribution United Mortgage stock was $60, the fair market value of the Averill stock was $140, and the fair market value of the post-distribution United Mortgage stock was $70, then her basis in the Averill shock would be $40 and her basis in the post-distribution United Mortgage would be $20.

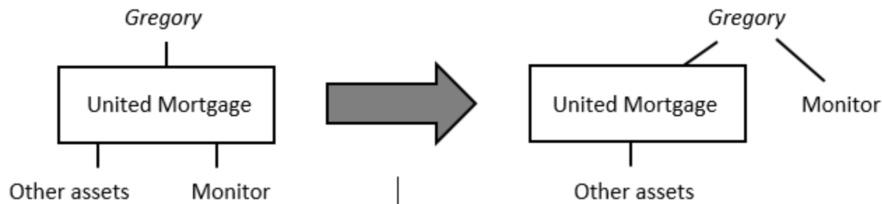
28. Following the example in note 27, *supra*, her realized gain on the liquidation of Averill would have been $100 (the difference between the presumed $140 value of the Monitor shares minus her $40 basis in the Averill shares).

29. Again, following the example in note 27, *supra*, the basis is her United Mortgage shares was reduced from $60 to $20. Consequently, when she eventually sold her United Mortgage shares she would report a greater capital gain (or a lower capital loss) than she would have had the shares retained their original basis.

30. *See* RA 1928 § 101. The highest marginal rate for ordinary income was 25%. RA 1928 §§ 11(c), 12(a).

shares to Mrs. Gregory as a dividend. She was, he decided, liable to being taxed at ordinary rates for the full fair market value of the shares:[31]

DIAGRAM IV



C. The Decisions: Board of Tax Appeals, Second Circuit, and Supreme Court

In response, Mrs. Gregory petitioned the Board of Tax Appeals (the precursor to the current Tax Court).[32] Rejecting the Commissioner's position, the Board held that because the word "reorganization" was so meticulously defined in the statute, there was little room for interpretive intervention.[33] The transfer of the Monitor shares to Averill was a "reorganization" within the meaning of the statute. The receipt of Averill stock by Mrs. Gregory was pursuant to that reorganization and was consequently entitled to non-recognition treatment. The Commissioner appealed.

Writing for the Second Circuit, Judge Learned Hand agreed with the Commissioner that Mrs. Gregory's tax planning maneuver could not succeed. He began by noting, in one of the most widely quoted passages in a tax case, that[34]

> a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.

Echoing the words of the Board of Tax Appeals, he added that[35]

> as the articulation of a statute increases, the room for interpretation must contract.

However, he went on to declare, that[36]

31. *Gregory v. Commissioner*, 27 B.T.A. 223, 224-25 (1932). Comparing Diagram IV to Diagram III, we can see that the Commissioner simply ignored Stage 2 and Stage 3 of Diagram III and went directly from Stage 1 to Stage 4. Although he did not phrase it in these terms, his construction seems to anticipate what is known today as the step-transaction doctrine.

32. *Gregory v. Commissioner*, 27 B.T.A. 223 (1932).

33. *Id.* at 225 ("A statute so meticulously drafted must be interpreted as a literal expression of the taxing policy, and leaves only the small interstices for judicial consideration.").

34. *Helvering v. Gregory*, 69 F.2d 809, 810 (2nd Cir. 1934).

35. *Id.* at 810.

36. *Id.* at 810-11.

> the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes.

A "reorganization," averred the court, is a readjustment undertaken for reasons germane to the conduct of the venture in hand. Transactions undertaken to "dodge the shareholders' taxes" do not constitute a reorganization.[37]

Nonetheless, the court disagreed with the Commissioner regarding the consequences of that determination. Recall that the Commissioner ignored the intermediate transfers and viewed the situation as if United Mortgage had simply distributed the Monitor shares to Mrs. Gregory. The Second Circuit held that, whatever Mrs. Gregory's motives, Averill *did* exist (albeit for a short period), United Mortgage *did* transfer its Monitor shares to Averill, Mrs. Gregory *did* receive Averill stock, Averill *was* liquidated, and only *then* did Mrs. Gregory receive the Monitor shares as a liquidating distribution. These events cannot simply be ignored. What the court did hold was that, as these events did not constitute a "reorganization" as it understood the term, RA 1928 § 112 was inapplicable and these events were fully taxable transactions. Thus, Mrs. Gregory's receipt of the Averill shares constituted a non-liquidation distribution and she was liable to tax at full ordinary rates on the fair market value of those shares.[38] On appeal, the Supreme Court adopted the Second Circuit's analysis.[39]

Parenthetically, a second consequence of the Second Circuit and Supreme Court analysis is that United Mortgage would seem to be liable for tax on the transfer of the Monitor stock to Averill.[40] However, there is no record that the Commissioner attempted to tax United Mortgage's gain. His focus was entirely on Mrs. Gregory.[41]

II. RESPONSES TO *GREGORY*

The Board of Tax Appeals' ruling in favor of Mrs. Gregory was handed down in December 1932. In March 1934, the Second Circuit reversed and held for the Commissioner. In May 1934, while Mrs. Gregory's appeal was pending before the Supreme Court, Congress enacted the Revenue Act of 1934. Seeing how Mrs. Gregory's tax planning maneuver had succeeded in the court of first instance

37. *Id.* at 811.

38. *Id.*

39. *See Gregory v. Helvering*, *supra* note 1.

40. United Monitor transferred its shares to Averill in exchange for Averill shares (which were issued to Mrs. Gregory, effectively at United Mortgage's request). *See supra* note 27. In the absence of a statutory non-recognition provision, this would appear to be a taxable transaction. As the Second Circuit and the Supreme Court held that the transfer was not a reorganization, RA 1928 § 112(b)(4) would not apply.

41. It is possible that the reason lies in the fact the that by the time the Second Circuit and the Supreme Court handed down their decisions (in January and December of 1935, respectively), the statute of limitation had already run on United Mortgage's 1928 return. RA 1928 § 275. However, this does not explain why the Commissioner did not assess a deficiency against United Mortgage based upon his own view of the transaction (ignoring the existence of Averill and viewing United Mortgage as having distributed the Monitor shares directly to Mrs. Gregory). *See* Part 5.C, *infra*.

and, either unwilling to wait for the Supreme Court to set things right or unwilling to rely on the judiciary to counter all attempts at what it considered abusive tax planning, Congress did not reenact RA 1928 § 112(g). As we saw, this provision granted non-recognition treatment to the distribution of stocks and securities in one corporation to the shareholders of another corporation, provided that both corporations were parties to a reorganization and the shareholder did not surrender any stocks or securities. It was upon this provision that Mrs. Gregory relied to avoid paying tax on the receipt of the Averill shares (in modern parlance, this type of distribution is referred to as a "division," and specifically as a "spin-off").[42]

Seventeen years later, Congress relented and reinstated non-recognition treatment for spin-offs.[43] However, it simultaneously enacted two provisos in an attempt to prevent *Gregory*-type tax avoidance. First, it provided that a spin-off would not be tax free if any corporation party to the reorganization was not intended to continue the active conduct of a trade or business after the reorganization.[44] Second, it provided that a spin-off would not be tax-free if it was used principally as a device for distributing earnings and profits.[45] Over time, these two restrictions were considerably expanded in scope and now appear as intricate statutory anti-avoidance watchdogs applicable to all corporate divisions (not just spin-offs).[46] In tandem with Congress imposing these restrictions, the Treasury incorporated the judicial business purpose test in elaborate regulations.[47] Other regulations expound on the statutory "active conduct of a trade or business" and "device" restrictions.[48] Moreover, the impact of *Gregory* has not been restricted to the narrow confines of corporate divisions. In dozens of instances, the Code now specifies that tax consequences depend upon on the "principle purpose" of the taxpayer's behavior or upon whether a particular action was undertaken to avoid federal income tax.[49]

42. *See generally,* BORIS I. BITTKER, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 325 (1959).

43. *See* Revenue Act of 1951 ("RA 1951") § 316(a) (adding § 112(b)(11).) to the Internal Revenue Code of 1939 ("IRC 1939")).

44. IRC 1939 § 112(b)(11)(A), as amended by RA 1951 § 316(a).

45. IRC 1939 § 112(b)(11)(B), as amended by RA 1951 § 316(a).

46. I.R.C. § 355(b) (active trade or business), 355(a)(1)(b) ("device").

47. Treas. Reg.26 C.F.R. § 1.355-2(b).), 26 C.F.R. § 1.355-2(b)(2), 26 C.F.R. § 1.355-2(b)(3) (in many instances, the regulations seem to go far beyond judicial doctrine. For instance, they state that the business purpose test is a corporate as opposed to a shareholder purpose. Treas. Reg. § 1.355-2(b)(2). In other words, even if a division is not tax-motivated it will not pass muster under the business purpose test unless it serves a corporate as opposed to a shareholder business purpose. Furthermore, under the regulations, even if a division is undertaken for a business purpose, it will not be entitled to non-recognition treatment if it is possible to achieve that purpose by means of a different non-taxable transaction that is neither impractical or unduly expensive. Treas. Reg. § 1.355-2(b)(3)…).

48. Treas. Reg 26 C.F.R. §§ 1.355-3, 1.355-2(d).

49. *See*, *e.g.*, I.R.C. §§ 148(f)(4)(D)(ii)(III) (arbitrage on state and local bonds); 168(h)(4)(D) (ACRS); 170(f)(9) (contribution for lobbying activities); 197(f)(9)(F) (date of acquisition of section 197 intangible); 265(b)(3)(E) (expenses related to tax-exempt income); 269 (acquiring control to secure benefit of tax attribute); 269A (personal service corporation); 306(b)(4) (disposition of section 306 stock);

Moving to the administrative and judicial spheres, the business purpose test, the economic substance test, and the sham doctrine— – all byproducts of *Gregory*— – are among the primary weapons wielded by the Commissioner in his ever-running battle against what he views as abusive tax avoidance. Consequently, tax planners routinely attempt to embellish the contemplated moves with a business purpose or economic substance or— – perhaps more accurately— – what they hope will be recognized as a business purpose or economic substance.

III. THE RED HERRING

As described in Parts I and II, the focus of attention in *Gregory*— – both while the case was being litigated and during the subsequent 90 years— – has consistently been the taxpayer's alleged abuse of the reorganization provisions of RA 1928 § 112. Due to this alleged abuse, the Commissioner ignored the transfer of the Monitor shares to Averill and taxed Mrs. Gregory as if she had received the shares directly from United Mortgage. Rejecting the Commissioner's analysis but nevertheless denying Mrs. Gregory the tax advantage that she sought, the Second Court, and in its wake the Supreme Court, refused to consider a transfer undertaken without a business purpose as a statutory "reorganization." The Treasury embodied the judicial doctrine in extensive regulations. Congress, while never formally codifying the business purpose test, imposed numerous conditions on what came to be known as corporate divisions, conditions whose underlying theme is to prevent the non-recognition provisions from becoming a tool for tax avoidance. In academic literature, Mrs. Gregory's maneuver is consistently presented as a paradigmatic example of abusive tax avoidance.

However, with all of the attention focused on *Gregory* and the principles, rules, and regulations that evolved from it, no one at the time or since seems to have noticed that the reorganization provisions of RA 1928 § 112 were a red herring and played at most only a minor role in the actual tax planning. It is true that Mrs. Gregory attempted to reduce her tax bill by exploiting a loophole— – to use an extraordinarily imprecise term of art— – in the corporate tax

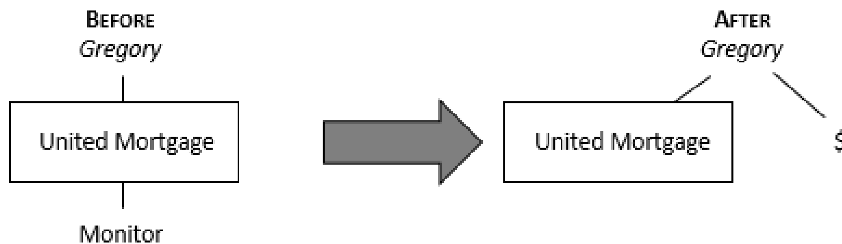
312(m) (earnings and profits); 357(b)(1) (assumption of liability in anticipation of 351 exchange or reorganization); 382(l)(1)(A) (contribution to old loss corporation); 453(e)(7) (installment sales); 453(g)(2) (installment sales); 467(b)(2) (accrual of rents); 467(b)(4)(B) (accrual of rents); 532(a) (accumulated earnings tax); 542(c)(8) (personal holding company); 14(e)(1) (depletion allowance); 631(c) (disposal of coal or iron ore); 643(f)(2) (multiple trusts); 845 (reinsurance agreements); 871(h)(4)(A)(ii) (portfolio interest); 871(h)(4)(B) (portfolio interest); 877 (expatriation); 1031(f)(2) (exchange of real property); 1031(f)(4) (exchange of real property); 1059(f)(2)(C)(i) (extraordinary dividends); 1256(e)(3)(C)(v) (mark-to-market and hedging transactions); 1259(c)(4)(B) (constructive sales of appreciated financial position); 1272(a)(2)(D)(ii) (original issue discount); 1281(b)(2)(A)(i) (discount on short-term obligations); 1298(d)(3)(B) (leased property); 1298(e)(2)(B)(ii) (licensed intangibles); 2107(d) (expatriation); 2652(c)(2) (property held in trust); 6015(c)(4) (innocent spouse); 6113(b)(2)(B) (non-deductibility of contributions); 7872(c)(2) (tax avoidance loans); 7872(c)(3)(B) (compensation-related and corporate-shareholder loans); 7872(d)(1)(B) (gift loans).

structure.[50] In fact, she exploited a number of loopholes. However, the loopholes that she exploited had nothing to do with the reorganization provisions. They lay elsewhere entirely. Moreover, had she exploited these loopholes directly, her planning maneuver would most likely not have been challenged, and, had it have been challenged, it most likely would have survived intact.

A. Some Hypotheticals

To explain why the reorganization provisions of RA 1928 § 112 were a red herring and to identify the true culprits, I will begin by modifying the fact pattern of *Gregory*. Assume, counterfactually, that United Mortgage had held no assets other than its Monitor shares. As in the actual case, Mrs. Gregory wished to convert her indirect holding of Monitor shares into a direct holding of cash:

DIAGRAM V

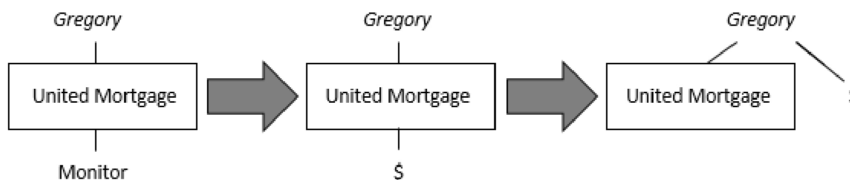


Let us consider a few of the methods by which she could have accomplished her aim of moving from "before" to "after."

Option 1: Sell and then distribute

Perhaps the simplest way of achieving her goal would have been to cause United Mortgage to sell the Monitor shares and then distribute the proceeds to the taxpayer as a dividend:

DIAGRAM VI



However, structuring the transaction in this manner would have carried a relatively high overall tax burden. First, on the sale of the Monitor shares, United

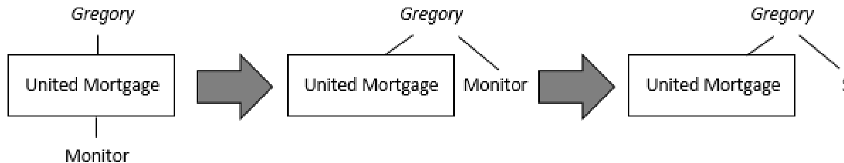
50. For discussions on the obscure nature of the ubiquitous term "loophole, *see, e.g.*, Boris I. Bittker, *Income Tax "Loopholes" and Political Rhetoric*, 71 MICH. L. REV. 1099, 1102-07 (1973); Heather M. Field, *A Taxonomy for Tax Loopholes*, 55 HOUS. L. REV. 545, 552-560 (2018).

Mortgage would have been taxed on the appreciation of those shares (i.e., on the difference between the amount received and the adjusted basis).[51] Second, the distribution of cash from United Mortgage to Mrs. Gregory would have been treated as a dividend, subject to tax at ordinary rates.[52]

Option 2: Distribute and then sell

An alternative would have been for United Mortgage to distribute its Monitor shares to Mrs. Gregory and for her then to have sold them for cash:

DIAGRAM VII



From the perspective of Mrs. Gregory, the tax consequences would be the same as under Option 1. Upon receiving the Monitor shares, she would have reported dividend income equal to the fair market value of the shares and taken a basis in the shares of that same amount.[53] The subsequent sale of the stock—– presumably for fair market value and assuming no change in the market value of the stock from the time of receipt until the time of sale— – would not have produced any additional taxable gain. In other words, whether the corporation had sold the stock and distributed the proceeds (Option 1) or had distributed the stock directly to her (Option 2), Mrs. Gregory would pay tax at ordinary rates on the value of what she received.

With regard to United Mortgage, the tax consequences of distributing the shares were not entirely clear. RA 1928 contained no statutory provision delineating the effect of property distributions on the distributing corporation's taxable income. In *General Utilities*, the Supreme Court resolved the issue by ruling that the distribution of property by a corporation to its shareholders does not in and of itself constitute a realization event.[54] In other words, under the *General Utilities* principle, United Mortgage would not have been subject to tax on the appreciation of the Monitor shares had it simply distributed them to Mrs. Gregory.

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51. *See* RA 1928 § 111(a).

52. *See* RA 1928 §§ 22(a), 115(a).

53. *See* RA 1928 § 115(a) ("The term 'dividend' when used in this title…means any distribution made by a corporation to its shareholders, whether in money *or in other property*…" [emphasis added]).

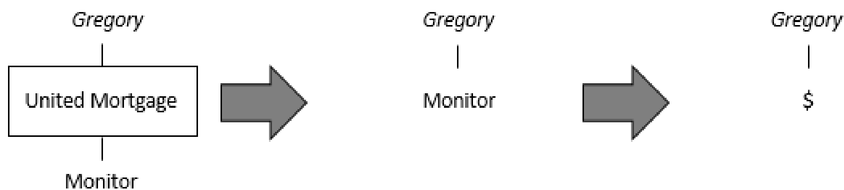
54. *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935), *rev'g Helvering v. General Utilities & Operating Co.*, 74 F.2d 972 (1935), *rev'g General Utilities & Operating Co. v. Commissioner*, 29 B.T.A. 934 (1934).

However, *General Utilities* was not decided until Dec. 9, 1935, over 11 months after the Supreme Court delivered its opinion in *Gregory*.[55] Thus, when Mrs. Gregory's advisors were considering her options in 1928, they could not have known whether United Mortgage would be subject to tax on the distribution of the shares. Nevertheless, from a tax planning perspective, the distribution of shares would have been preferable to a sale by the corporation and a distribution of the proceeds. Because the law was unsettled, the corporation could have adopted a reasonable reporting position that the distribution was not a realization event. Moreover, in light of the Court's subsequent ruling in *General Utilities*, it is highly likely that, were the Commissioner to have challenged such a position, the corporation would have prevailed.

Option 3: Liquidate and then sell

A third possible plan would have been for the taxpayer to liquidate United Mortgage and to receive the Monitor shares as a liquidation distribution. She could then have sold the Monitor shares for cash:

DIAGRAM VIII



As already noted, shareholders who receive distributions from a corporation in complete liquidation were viewed as having exchanged their shares in the liquidated corporation for the property received.[56] In other words, Mrs. Gregory would be treated as if she had traded her shares in United Mortgage for the Monitor stock. Consequently, she would report as capital gain the difference between the current fair market value of the Monitor stock and her adjusted basis in United Mortgage. As in the previous scenario, her subsequent sale of the Monitor stock would produce no further gain.[57]

With regard to United Mortgage, in this scenario it would have escaped tax liability. Under a then-current regulation, the distribution of property by a corporation in complete liquidation was not considered a realization event.[58]

55. The Supreme Court's ruling in *Gregory* was handed down on January 7, 1935.

56. *See,* RA 1928 § 115(c).

57. Having taken the value of the Monitor stock into account when computing her taxable gain from the deemed sale of her United Mortgage stock, she would take a fair market value basis in the Monitor stock.

58. *See* Treas. Reg. § 45, art. 71 (1928), reprinted in 138 UNITED STATES REVENUE ACTS 1909-1950 20 (Bernard D. Reams, Jr., ed., 1979),

Faced with these three options, the hypothetical Mrs. Gregory would almost certainly have chosen the third:

Option 3 (as opposed to Option 1) would have allowed United Mortgage to escape tax on the appreciation of the Monitor shares. With regard to Option 2, the tax consequences were at the time unclear. Had Mrs. Gregory in fact chosen that route, United Mortgage would apparently have avoided taxation under what eventually become known as the *General Utilities* principle.

Option 3 (as opposed to either Option 1 or Option 2) would have permitted Mrs. Gregory to deduct her basis in United Mortgage when computing her taxable gain.

Option 3 (again as opposed to either Option 1 or Option 2) would have allowed her to report the gain from the receipt of the Monitor shares as capital gain, which was subject to tax at preferential rates.

B. *Analyzing the Options*

Until now, we have been examining the options available to our hypothetical Mrs. Gregory from the perspective of a tax planner whose job it is to minimize her overall tax burden. At this point, let us move away from the role of tax planner and instead adopt a more critical approach as neutral observers of the tax system.

The key analytical question that we need to address concerns the source or sources of the disparate tax treatment of each of the three options. In particular, what legal rules underlie the different tax treatment accorded Option 3 (the most tax-favored course of action) as opposed to Option 1 (the least tax-favored course of action)? Why did these different but economically equivalent means of going from Point A to Point B carry such diverse tax consequences?

The first reason for the discrepancy between Option 1 and Option 3 is the preferential treatment accorded by statute to shareholders receiving liquidation distributions as opposed to those receiving ordinary distributions. Ordinary distributions (to the extent of the distributing corporation's current and accumulated earnings and profits) were classified as dividends, that is, as ordinary income in the hands of the shareholders.[59] In contrast, the law viewed a corporate liquidation as a barter transaction, in which shareholders cede their shares in the liquidating corporation in exchange for the money and other property that they receive within the framework of the liquidation.[60] This resulted in two significant advantages for shareholders: (a) their gross income was not the full value of what they received but only the difference between the value of what they received and their adjusted basis in the liquidated corporation, and (b) the gain was subject to tax at preferential capital gains rates.

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https://research.ebsco.com/c/tppfyx/details/meta7ttbzj?limiters=FC%3AY&q=UNITED%20STATES%20REVENUE%20ACTS%201909-1950%20 ("No gain or loss is realized by a corporation from the mere distribution of its assets in kind upon dissolution, however they may have appreciated or depreciated in value since their acquisition.").

59. RA 1928 §§ 22(a), 115(a).

60. RA 1928 § 115(c).

The second reason for the discrepancy between the two options is a rule that was then ensconced in a Treasury regulation and that eventually, and in expanded form, came to be called the *General Utilities* principle. Ordinarily, when a corporation sells appreciated property, it reports and pays tax on the appreciation. Under the regulation, corporations were not taxed on the gain if the property was distributed to its shareholders in complete liquidation.[61] In *General Utilities*, the Court expanded that rule and held that a corporation is not liable to tax when it distributes appreciated property to its shareholders, even as a non-liquidating distribution.[62] Note that in either case, the shareholders would take a fair market value basis in the property. In other words, the corporate-level tax was not simply deferred. The appreciation of the property in the hands of the corporation would never be subject to corporate-level tax.

Given the tax advantages of distributing appreciated property within the framework of a liquidation (as opposed to selling the property and distributing the proceeds or distributing the property to shareholders without liquidating the corporation), it would be extraordinarily naïve to assume that corporations and their shareholders would not arrange their affairs accordingly. In other words, any reasonable person in the shoes of the hypothetical Mrs. Gregory would choose to liquidate United Mortgage, rather than have United Mortgage sell its Monitor shares and then distribute the proceeds (and any tax advisor who did not counsel the liquidation of the corporation prior to the sale of the appreciated corporate property would have been guilty of gross malpractice). Acting in such a manner would almost assuredly have been considered legitimate tax planning and would presumably not have been challenged by the Commissioner.

C. Back to Reality

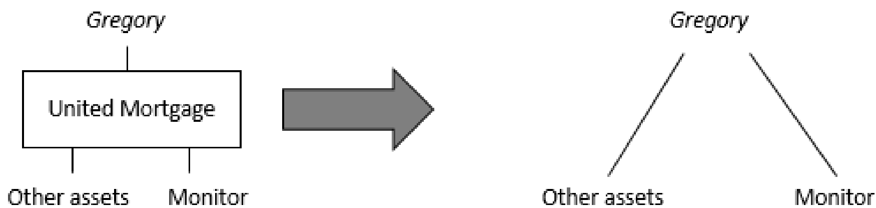
The hypothetical state of affairs that we have been discussing is identical to the actual fact pattern of *Gregory*, except for one seemingly trivial and yet extraordinarily significant detail: United Mortgage held a number of other assets in addition to its Monitor shares. This detail does not affect the analysis of Options 1 and 2. Had United Mortgage sold the Monitor shares and distributed the proceeds (Option 1), United Mortgage would have paid tax on the appreciation of those shares and Mrs. Gregory would have reported the cash as a dividend. Had United Mortgage distributed the shares themselves to Mrs. Gregory (Option 2), the tax position of United Mortgage was unclear. Mrs. Gregory would have reported the fair market value of the Monitor shares as a dividend.

61. Treas. Reg. § 45, note 58. *See* Treas. Reg. § 45, art. 71 (1928), reprinted in 138 UNITED STATES REVENUE ACTS 1909-1950 20 (Bernard D. Reams, Jr., ed., 1979) ("No gain or loss is realized by a corporation from the mere distribution of its assets in kind upon dissolution, however they may have appreciated or depreciated in value since their acquisition.").

62. *General Utilities, supra*, note 54 at 206.

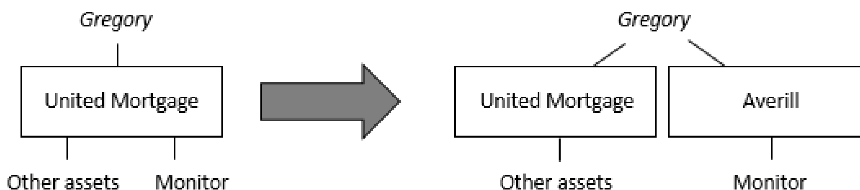
However, the fact that United Mortgage owned other assets (besides its Monitor shares) presented a conundrum for Option 3. Had Mrs. Gregory chosen to liquidate United Mortgage, she would have received not only United Mortgage's Monitor shares but also its other property as a liquidating distribution. The amount realized on her deemed sale of the United Mortgage shares would have been the fair market value of all of United Mortgage's assets.[63] The liquidation of United Mortgage by the real Mrs. Gregory could thus have proved quite costly:

DIAGRAM IX



Therefore, what her tax advisors attempted to do, via the reorganization provisions of RA 1928, was to transform the actual fact pattern into our hypothetical fact pattern by splitting United Mortgage into two separate corporations, one holding the Monitor shares and the other holding the remaining assets:

DIAGRAM X



The right half of the final stage shows Mrs. Gregory as the sole shareholder of Averill, and Averill holding the Monitor stock. This is identical to the starting point of our hypotheticals, (with Averill taking the place of United Mortgage). Mrs. Gregory could now adopt Option 3 by liquidating Averill and subsequently selling the Monitor shares. [64]

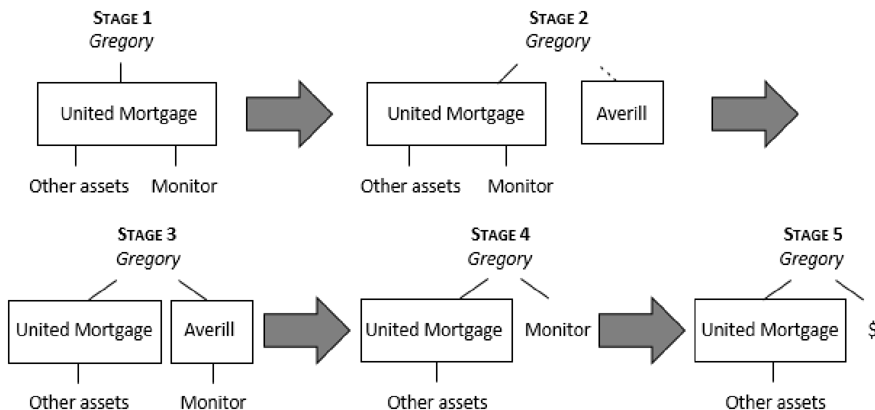
Mrs. Gregory was clearly— and by her own admission— engaged in tax avoidance. She chose what her advisors believed to be the most tax-efficient

63. *See,* RA 1928 § 101.
64. *See supra* Diagram V.

method of moving from Point A to Point B, and from the moment she did so almost a century ago, the discourse has taken as a given that she exploited the reorganization provisions of RA 1928 to obtain what most consider to be an unwarranted tax advantage. Consequently, the focus has been on efforts to prevent this abuse. The Second Circuit and, in its wake, the Supreme Court held that the transfer of assets to a related corporation is not a "reorganization," even though it meets all of the express legislative criteria, unless it is motivated by a business purpose. Treasury Regulations and subsequent case law fleshed out this non-statutory requirement. After initially attempting to thwart the perceived abuse by removing spin-offs from the ambit of reorganizations, Congress eventually reinstated non-recognition treatment but instituted a barrage of statutory proscriptions to prohibit taxpayers from exploiting the corporate division provisions for tax avoidance purposes.

However, for all the attention paid to *Gregory*— – as noted, one of the most widely cited cases in the field of taxation— – there appears to be no recognition of the fact that the reorganization provisions of RA 1928 were a peripheral aspect of her tax planning. They were merely the means by which she put herself into position to engage in what would have been considered entirely legitimate tax planning. Consider once again the *Gregory* flow chart:

DIAGRAM III



As we have seen, the actual tax minimization occurred during the movement from Stage 3 to Stage 4. It was here that the rules favoring (a) the distribution as opposed to the sale of appreciated property, and (b) liquidating distributions as opposed to non-liquidation distributions came into play. Without these preferences, there would have been no tax advantage whatsoever to utilizing the reorganization provisions to move from State 1 to Stage 3.

Mrs. Gregory's use of the reorganization provisions of the relevant Revenue Act was innocuous. The restructuring of her corporate holdings did not enable

her to avoid tax, neither at the corporate nor at the shareholder level. To understand why the reorganization did not avoid tax, let us consider what the tax consequences of the *Gregory* fact pattern would have been without the other incongruities in the corporation tax regime. In other words, let us assume that (a) from the perspective of the corporation, property distributions were treated as realization events, and (b) from the perspective of the shareholders, liquidating distributions were accorded the same tax treatment as ordinary distributions. On the liquidation of Averill (Stage 3 to Stage 4), the appreciation of the Monitor shares would have been subject to corporate-level tax and Mrs. Gregory would have reported the fair market value of those shares as a dividend, just as if the reorganization had not taken place and instead United Mortgage had (proceeding from Stage 1) simply sold the Monitor shares and distributed the proceeds.

What underlay Mrs. Gregory's tax planning maneuver was not the reorganization provisions of RA 1928, but rather the benevolent treatment of liquidation distributions. The reorganization provisions were nothing more than a red herring. Nevertheless, as in any good detective story, they succeeded in drawing attention away from the actual culprits.

D. Realization, Reorganization, and Deferral

Our analysis hitherto of *Gregory* accords with the concept underlying the statutory treatment of reorganizations. These statutory provisions were enacted in order to address some of the problems created by the realization doctrine, the principle that accession to wealth deriving from asset appreciation is not subject to tax until the asset is sold or exchanged.[65] During the course of corporate reorganization, assets will usually move from one legal entity to another, and shareholders may receive shares in one corporation in exchange for (or in addition to) shares that they held in another corporation. These events are likely to constitute realization events from the perspective of the corporation, the shareholders, or both. However, Congress was of the opinion that, despite the change in legal title, a corporate reorganization is closer conceptually to the (untaxed) retention of property than it is to the (taxed) sale of the property to an unrelated party.[66] Therefore, it provided that the transfer of property or the receipt of shares within the framework of a reorganization is not a recognition

65. The classic case for the proposition that unrealized gain is not income is *Eisner v. Macomber*, 252 U.S. 189 (1920), (which held that Congress is not constitutionally authorized to tax unrealized gain. Today, the requirement that income be realized is usually justified in terms of administrative convenience.); *See*, *e.g.*, DONALD B. TOBIN & SAMUEL A. DONALDSON, PRINCIPLES OF FEDERAL INCOME TAXATION OF INDIVIDUALS 157-63 (2017).

66. *See*, *e.g.*, E.*I. Du Pont de Nemours & Co. v. United States*, 471 F.2d 1211 (Ct. Cl. 1973) ("The section is designed to give present tax relief for internal rearrangements of the taxpayer's own assets, accompanied by no sacrifice of control and no real generation of income for the owner – and to defer taxation until a true outside disposition is made.").

event. Instead, tax on the hitherto unrealized gain is deferred until the property or shares are actually sold in the future.

The rationale behind the reorganization provisions is well demonstrated in Diagram III. Between Stage 1 and Stage 3, the Monitor shares moved from one legal person (United Mortgage) to another (Averill), and Mrs. Gregory effectively exchanged a portion of her United Mortgage shares for her new Averill shares. However, not only was there no change in actual economic ownership, but also all of the assets that had been held by United Mortgage remained in corporate solution. It was this series of moves— – from State 1 to Stage 3— – that was accorded non-recognition treatment under RA 1928 § 112 (b)(5) and (g). The reorganization, in and of itself, did not permit Mrs. Gregory to avoid tax. As already noted, the sale (starting at Stage 3) of the Monitor shares by Averill and the distribution of the proceeds to Mrs. Gregory in a non-liquidating distribution would entail the same tax consequences as the sale (starting at Stage 1) of the Monitor shares by United Mortgage and the distribution of the proceeds to Mrs. Gregory in a non-liquidating distribution. The reorganization provisions merely permitted her to reach the starting point in our hypothetical. If the liquidating of the hypothetical United Mortgage was a legitimate tax planning technique, then it is difficult to see why the same should not be said about the actual liquidation of Averill.

In other words, the move from Stage 1 to Stage 3 was innocuous. All it did was reshuffle assets within the family of corporations owned by Mrs. Gregory. In and of itself, it did not accord any tax advantages. It was the subsequent move from Stage 3 to Stage 4 that permitted Mrs. Gregory to avoid tax, but this move relied on other statutory and regulatory provisions: those that favored the distribution of appreciated assets over their sale and the receipt of liquidation distributions over ordinary distributions. Moreover, the exploitation of those statutory and regulatory provisions was presumably considered a legitimate tax planning technique. Thus, the focus on the role played by the reorganization provisions in Mrs. Gregory tax avoidance was entirely misplaced, and, given the law at the time, her plan should have been allowed to succeed.

IV. Effect on Subsequent History

Our discussion suggests that in *Gregory*, both the Commissioner and the courts missed the bigger picture. It was clear to them that Mrs. Gregory had engaged in a series of transactions with a view to securing a tax advantage, (an assertion that Mrs. Gregory herself did not deny). However, rather than addressing the anomalies within the corporate tax structure that lay at the heart of Mrs. Gregory's tax planning maneuver, they focused instead on a peripheral component: the reorganization of the corporate structure that put her in a position to exploit those anomalies. Perhaps a good portion of the blame can be placed on Mrs. Gregory's counsel for his failure to emphasize this fact. In his brief before

the Supreme Court, her attorney mentioned not even once the actual anomalies exploited by Mrs. Gregory. He too concentrated on the reorganization provisions of the relevant Revenue Act and rested his argument on the claim that Congress did not prescribe an investigation into the taxpayer's motives for restructuring the corporation.[67] Whether drawing attention to the real issues would have convinced the Court to rule in favor of his client is of course undeterminable, but it is certainly within the realm of possibility.

What if the Court had adopted the analysis that this Article is proposing? What if it had decided that Mrs. Gregory had indeed arranged her affairs so as to reduce her tax liability, but that what procured her the tax advantage that she sought was not the corporate restructuring, but rather the subsequent liquidation of Averill, and that liquidating a corporation holding appreciated assets in order to benefit from a number of inconsistencies in the corporate tax regime was an accepted and legitimate tax planning device? How would such a decision have affected the subsequent development of the law?

Trying to determine how ensuing events would have unfolded had a major tax case been decided differently is highly speculative. Moreover, the very concept of "what if" history may be a misnomer, not merely because we lack the means of determining how history would have played out given a different set of initial conditions, but also, and more importantly, because subsequent events are not predetermined.[68] In other words, history could have played in any number of ways.[69] Nevertheless, it is interesting to try and speculate, in very broad terms, the impact that a decision in *Gregory* along the lines proposed by this Article could have had on the development of tax law. Therefore, and with a thorough recognition of the limits of this type of speculation, I will present here a few general thoughts.

A. Tax Avoidance Jurisprudence

Gregory is the seminal case in the field of anti-avoidance jurisprudence, the intellectual godfather of all of the doctrines that seek to restrict tax-planning opportunities: business purpose, step transaction,[70] substance over form,[71] sham

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67. The two amicus briefs filed in support of Mrs. Gregory's position adopted similar lines of reasoning. See Assaf Likhovski, *The Story of Gregory: How are Tax Avoidance Cases Decided?*, *in* BUSINESS TAX STORIES 89, 99-100 (Steven A. Bank & Kirk J. Stark, eds., 2005).

68. *See, e.g.*, EDWARD HALLET CARR, WHAT IS HISTORY? (1961); JOHN LEWIS GADDIS, THE LANDSCAPE OF HISTORY: HOW HISTORIANS MAP THE PAST 72-89 (2002); RICHARD EVANS, ALTERED PASTS: COUNTERFACTUALS IN HISTORY 1-30 (2014).

69. *See*, *e.g.*, GREG JENNER, ASK A HISTORIAN: 50 SURPRISING ANSWERS TO THINGS YOU ALWAYS WANTED TO KNOW 131-37 (2021).

70. *See*, *e.g.*, *Comm'r v. Court Holding Co.*, 324 U.S. 331, 334 (1945) (citing *Gregory* for the proposition that "[a] sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title.")

71. *See*, *e.g.*, *Esmark, Inc. v. Comm'r*, 90 T.C. 171, 197 (1988), *aff'd* 886 F.2d 1318 (7th Cir. 1989) ("Stripped to its essentials, this case is a rematch of the principles expressed in *Gregory v. Helvering*, 293 U.S. 465 (1935), the source of most "substance over form arguments.").

transaction,[72] and economic substance.[73] Finding a case involving the prevention of tax avoidance that did not rely directly or indirectly on *Gregory* (i.e., on *Gregory* or one of its progeny), would be challenging if not impossible.

Let us now imagine that the courts in *Gregory* had properly comprehended Mrs. Gregory's tax maneuver and had understood that it only peripherally involved the reorganization provisions. Imagine they had fathomed that she was merely taking advantage of two presumably well-known and oft-exploited incongruities in the corporate tax structure, one explicitly and intentionally sanctioned in the statute, the other explicitly and intentionally sanctioned in the regulations. Imagine further that the Court had effectively informed Congress and the Treasury that if they insist on providing inconsistent tax treatment for different means of extracting profits from corporate solution, they should not be surprised that taxpayers choose the path carrying the least oppressive tax burden. In other words, imagine that they had sanctioned Mrs. Gregory's tax planning maneuver on the grounds that what she had done was no different from what countless other shareholders had done when they liquidated corporations holding appreciated assets and that if Congress and the Treasury were not satisfied with the situation, it would behoove them to repeal or amend the provisions that created the anomalies.[74]

Had the *Gregory* courts taken such a position, the jurisprudence of tax avoidance might have followed a different path and much more strictly circumscribed the use of anti-avoidance doctrine. When tax avoidance involves choosing among a number of options proffered by the Code or the regulations, even when the taxpayers have to engage in a certain degree of manipulation in order to arrive at the preferred path, courts would perhaps have been more inclined to consider the behavior legitimate tax planning, rather than abusive tax avoidance.

A different outcome in *Gregory* could have affected not only the judicial sphere, but also the statutory and regulatory realms. For example, on numerous occasions, the Code and regulations specify that certain beneficial provisions will not apply if one of the principal motivations of the taxpayer in bringing herself within the scope of the provision was the avoidance of federal income tax. These formulations flow directly from *Gregory*.[75] Here, too, had the Court in *Gregory* pointed out that the tax maneuver was simply an exploitation of

72. *See*, *e.g.*, *Knetsch v. United States.*, 364 U.S. 361, 363, 368-68 (1960) (quoting from *Gregory*, at 470: "To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.").

73. *Dow Chemical Co. v. United States* 435 F.3d 594, 601-03 (6th Cir. 2006) (relying upon *Knetsch*, *id*., which in turn relied upon *Gregory*).

74. *See* David Elkins, *Embracing Tax Avoidance*, 2434 U. FLA. J.L. & PUB. POL'Y _ (2024) (forthcoming) for further exploration of this idea.

75. The entire RA 1928 referred to intent to avoid tax on only two occasions: with regards to the surplus accumulation tax (§ 104) and with regards to consolidated returns (§ 141(b)).

incongruities in the corporate tax structure, it may have inspired Congress and the Treasury to take a different approach to tax avoidance. Rather than leaving the anomalies in place and focusing on preventing taxpayers from exploiting them, perhaps they would have been moved to take a more substantive approach remedying the underlying anomalies themselves.

However, even if an alternative result in *Gregory would* have instigated such a dramatic departure from the jurisprudence that did develop from the case, it does not necessarily follow that taxpayers would have obtained free rein to engage in all manner of tax avoidance. The thesis of this article— – and what we are imagining the *Gregory* Court having adopted— – is not that Mrs. Gregory had the right to exploit the literal reading of the reorganization provisions to obtain an unfair, unjust, or unintended tax advantage. Nor is it the thesis that the taxpayer's motive for choosing a particular course of action is necessarily inconsequential. Rather, the thesis of this article is that the reorganization provisions did not confer upon Mrs. Gregory any tax advantage, so there was no need to examine her motive in exploiting them. All that they enabled her to do was divide the corporation that she owned into two units: one holding the assets that she wished to retain and one holding the assets that she wished to divest. It was her subsequent action of liquidating one of those units that procured her a tax advantage, and liquidating a corporation holding appreciated property for the purpose of avoiding corporate-level tax and reducing shareholder-level tax was a permissible tax planning technique. Thus, the Court could have sanctioned Mrs. Gregory's maneuver without taking a position regarding what we would now describe as textualism or purposivism, and without expressing an opinion on the limits of legitimate tax planning. It is quite possible— – I would even venture to say highly probable— – that later cases would have filled the void left by an alternative decision in *Gregory* and that many, if not all, of the doctrines with which we are now familiar would have developed from a different line of cases.

It is, of course, impossible to determine where exactly the balance would have been struck between (a) recognizing that when the statute or the regulations impose different tax burdens on parallel courses of action, taxpayers are entitled to choose the least burdensome alternative (and that the appropriate remedy is to equalize the tax burden on the alternative courses of action), and (b) not permitting taxpayers to exploit the literal reading of a statutory provision to obtain a result that Congress never intended. In fact, it is not at all clear where the line is located under current law. Nevertheless, one may speculate that in our alternative history scenario, the point of departure for any analysis may have been that it is primarily Congress' responsibility to provide a coherent tax regime and that if it does not, taxpayers are not obliged to ignore tax consequences when planning their actions.

B. Taxation of Dividends

One of the foci of Mrs. Gregory's planning was the differential treatment accorded by the then-current Revenue Act to non-liquidating and liquidating distributions: whereas the former was considered a dividend to the extent of the distributing corporation's accumulated earnings and profits, the latter was viewed as the exchange of shares for the cash and other property received. Consequently, when computing gross income, shareholders receiving a liquidating distribution could deduct their basis, while shareholders receiving a non-liquidating distribution could not. A second difference was that dividends from a non-liquidating distribution were ordinary income, while the gain realized as the result of a liquidation was classified as capital gain subject to tax at preferential rates.

The ability to deduct basis was probably less significant than the rate differential. For example, when a shareholder establishes a corporation and invests in its capital, the capital of the corporation will equal the shareholder's basis in her shares. Thus, when the corporation is liquidated, the shareholder's taxable gain— – the excess of the amount received over her basis in the shares— – will likely be equal to the corporation's accumulated earnings and profits (although under the regulations at the time, any unrealized gain or loss in the property distributed would not have been recognized and therefore would not have affected the corporation's earnings and profits account). In other cases, the difference would merely be one of timing. The *Gregory* fact pattern is a case in point. Following the spin-off, Mrs. Gregory's basis in her United Mortgage shares was allocated between her post-spin-off United Mortgage shares and her new Averill shares. Liquidating Averill enabled her to reduce her reportable gain from the distribution of the Monitor shares, but at the cost of truncating her basis in the United Mortgage shares. When she eventually sold (or liquidated) United Mortgage, her taxable gain was presumably larger than it would have been had some of the basis not been syphoned off to Averill and used in the computation of her gain.

On the other hand, the rate differential is a permanent, clearly quantifiable benefit. In Mrs. Gregory's case, long-term capital gains were taxed at exactly half the rate of ordinary income.[76] From a broader perspective, throughout the twentieth century, much of the tax planning— – and inevitable anti-avoidance measures— – in the corporate sphere centered on the conversion of dividend income into long-term capital gain.[77] It was not until 2003 that Congress finally remedied this situation, when it lowered the tax rate on qualified dividends to

76. *Supra* note 30; *See* RA 1928 § 101.

77. *See*, *e.g.*, SCHWARZ & LATHROPE, FUNDAMENTALS OF CORPORATE TAXATION: CASES AND MATERIALS 8 (2019).

that of long-term capital gains.[78] True, the primary impetus for the change was not a desire to equalize the tax burdens of liquidating and non-liquidating distributions, but rather the desire to eliminate, or at least to mitigate, the double tax on corporation earnings.[79] Nevertheless, following the 2003 reform, a great many prevalent tax avoidance maneuvers became superfluous.[80] As a case in point, had the post-2003 regime been in force in 1928, it is quite possible that Mrs. Gregory would not have gone to the trouble of creating and then liquidating Averill, but instead would simply have caused United Mortgage to distribute the Monitor shares to her as a non-liquidating dividend. In either case, she would have been subject to tax at preferential long-term capital gains rates.

Let us now imagine that the *Gregory* Court had sanctioned Mrs. Gregory's tax planning maneuver on the grounds that (a) the supposed abuse of the reorganization provisions was a red herring, (b) the statutory provision that she was actually exploiting was the one that treated the liquidation of a corporation as a sale of shares instead of as the distribution of a dividend, and (c) Congress had the choice, if it wished, to equalize the tax treatment of liquidating and non-liquidating distributions. Such a decision, pinpointing the disparate treatment and refusing to prevent taxpayers from engaging in behavior directed at exploiting the discrepancy, may have prompted Congress to respond by removing the disparity sooner than it did. Of course, conjecturing whether Congress would have adopted the same solution that it did almost 70 years later (reducing the tax rate on non-liquidating distributions to that applicable to long-term capital gains) or an alternative solution (such as classifying liquidating distributions, to the extent of the corporation's accumulated earnings and profits, as dividends and subjecting them to tax at ordinary rates) involves speculation of a second order of magnitude and is even is harder to determine than whether it would have acted at all. Nevertheless, it is not outside the realm of possibility that had the Court adopted the analysis proposed in this article, it would have stimulated a fundamental reform of the corporate tax regime in the 1930s and that the dynamics of corporate taxation during most of the 20th century could have been substantially different.

78. I.R.C. § 1(h)(11), (added to the Code by the Jobs and Growth Tax Relief Reconciliation Act of 2003).

79. Dept. of the Treas., *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* 11-22 (February 2003), https://home.treasury.gov/system/files/131/General-Explanations-FY2004.pdf.

80. *See*, *e.g.*, SCHWARZ & LATHROPE, *supra* note 77 at 281 ("Section 304 is another area where the tax stakes are less significant as long as dividends and long-term capital gains are taxed at the same preferential rates."), 311 ("Section 306 is one of several provisions in Subchapter C that are much less significant as long as dividends and long-term capital gains of noncorporate taxpayers are taxed at the same preferential rates.").

C. Distribution of Appreciated Assets

Under the regulations at the time, the distribution of appreciated assets in complete liquidation did not trigger any recognition of gain at the corporate level. This non-recognition was not merely a matter of timing: as shareholders took the property with a fair-market basis, the appreciation that had accumulated while the corporation held the property would never be subject to corporate-level tax. As has already been noted, eleven months after *Gregory*, the Supreme Court handed down its landmark decision in *General Utilities*, in which it applied the same principle to non-liquidating distributions.[81] Whereas the Commissioner maintained that a (non-liquidating) property distribution should be treated as a sale or exchange and that the corporation should therefore pay tax on any appreciation, the Court disagreed and ruled that the distribution of appreciated property is not in and of itself a realization event.

In 1954, Congress codified the judicial rule.[82] Thirty-two years later it reversed course and repealed *General Utilities*, at least as far as appreciated property is concerned. Today the Code provides that, on the distribution of appreciated property, gain shall be recognized as if such property were sold to the shareholders at its fair market value.[83]

Going back to *Gregory*, one curious aspect of the case is why the Commissioner did not attempt to impose tax on United Mortgage. Recall that in *Gregory*, the Commissioner ignored the transfer of the Monitor shares to Averill, the distribution of the Averill shares to Mrs. Gregory, and the liquidation of Averill, and instead viewed the situation as if United Mortgage had simply distributed the Monitor shares directly to Mrs. Gregory. In other words, his view was that the distribution of Monitor shares to Mrs. Gregory was part of a non-liquidation distribution and, accordingly, not covered by the regulation at the time that granted non-recognition treatment to liquidating distributions. Given that construction, why did the Commissioner not adopt the same position that he did in *General Utilities* and argue that the distribution of the Monitor shares constituted a realization event for the corporation?[84] Strangely, this question does not seem to appear anywhere in the extensive literature on *Gregory*. Commentators routinely claim that under the then prevailing *General Utilities* doctrine, the distribution of the Monitor shares was not a realization event,

81. *Supra* note 54.

82. Internal Revenue Code of 1954, P.L. 591, § 311(a)(2) ("no gain or loss shall be recognized to a corporation on the distribution…of…property.").

83. I.R.C. § 311(b). The *General Utilities* principle continues to apply to the distribution of depreciated property, *i.e.*, property whose fair market value is less than its adjusted basis. I.R.C. § 311(a).

84. In each of the two cases, the distribution occurred in 1928. They were litigated simultaneously, and the Supreme Court decision in each case was handed down in 1935.

without apparently being cognizant of the fact that *General Utilities* was not decided until after *Gregory*.[85]

Of course, it is possible that what came to be described as the *General Utilities* principle was established practice even before the Supreme Court's pronouncement, and that in *General Utilities*, the government unsuccessfully attempted to challenge that practice.[86] However, even if that were true, it would not fully explain why the Commissioner did not raise the issue in *Gregory*, in parallel with his position in *General Utilities* (in both cases, the distribution occurred in 1928 and the Supreme Court decision was handed down in 1935). Nevertheless, the Commissioner did not attempt to impose tax on United Mortgage, but instead focused his attention on Mrs. Gregory herself.

Moving back to the *Gregory* decision and its potential impact on later-unfolding events, let us assume that the Court had adopted the analysis proposed in this article and had declared that (a) that Mrs. Gregory's use of the reorganization provisions was innocuous as it had not provided her with any particular tax advantage, (b) that the discrepancies in the tax law that she had actually exploited were the capital gains treatment afforded liquidation distributions and the non-taxation of hitherto unrealized gain on the distribution of property in liquidation, and (c) that as the former was explicitly enshrined in statute and the latter in regulations, there was no reason for the Court to look askance at her tax strategy. Now fast forward eleven months from January 1935, when the Court handed down its decision in *Gregory*, to December 1935, when the Court decided *General Utilities*, and consider the impact of such a decision. Had the *Gregory* Court pointed a judicial finger at the non-taxation of property distributions as one of the weaknesses in the corporation tax regime that Mrs. Gregory's tax avoidance scheme had exploited, is it not possible that when the issue was formally presented to the Court that same year, it would have taken a different view? Is it not possible that the Treasury would have revisited its regulation and provided instead that a distribution of appreciated property (whether in complete liquidation or not) is to be viewed as a sale or exchange and of the property, subjecting the corporation to tax on the appreciation? Is it not possible that, seeing how the non-taxation of appreciated gain had been exploited by Mrs. Gregory, Congress would have statutorily repealed it half a century earlier than it did? While it is true that "what-if" history is, perhaps by its very nature, an exercise in futility, I would posit that it is not outside the realm

85. *See*, *e.g.*, Lederman, *supra* note 4, at 405 n. 62 (2010) ("Under the then-existing *General Utilities* doctrine, taxpayers could avoid imposition of a corporate-level tax on the distribution of appreciated property."); Assaf Likhovski, *The Story of Gregory: How are Tax Avoidance Cases Decided?*, *in* BUSINESS TAX STORIES 89,Likhovski, *supra note 67, at 91* (Steven A. Bank & Kirk J. Stark, eds., 2005).

86. *See*, *e.g.*, Polito, *supra* note 3, at 87 ("While it is true that the definitive pronouncement of the *General Utilities* principle did not come until almost twenty-one months after Hand's opinion in *Gregory*, the issue was clearly percolating through the system. Corporations were already taking the position that the distribution of appreciated assets triggered no gain recognition…." Curiously the author offers no reference for that assertion.).

of possibility that the incongruity of taxing corporations on the sale of appreciated assets but permitting them to escape tax by distributing the assets to their shareholders would have been nipped in the bud back in 1935, instead of surviving until 1986.

CONCLUSION

The story of *Gregory* is interesting in its own right as a dramatic case study of a litigated tax controversy. In its opening scene, we encounter a shareholder who wishes to monetize an investment. To do so in the most tax-efficient manner, she creates a new corporate entity, effects a reorganization, promptly liquidates the new corporate entity, and then sells the property that she received in the liquidation. By means of this maneuver, she avoids corporate-level tax, reduces her own taxable income, and pays tax on that income at the low rate prescribed for capital gains rates.

The next scene shows the Commissioner challenging this blatant attempt at tax avoidance. He ignores the actual transactions and, entering what we would now call a virtual world, taxes her as if the original corporation had distributed the property directly to her (although mysteriously and inexplicably limiting his assessment to the shareholder herself and disregarding the tax liability that the corporation would have faced in the virtual world he envisioned). The Board of Tax Appeals rejects the Commissioner's view and tells him, in effect, to deal with the world as it is and not as it might have been. The Second Circuit, speaking through the legendary Judge Learned Hand and employing some of the most riveting rhetoric ever to emanate from a tax decision, follows suit and furthermore admonishes the Commissioner that there is nothing wrong with working within the system to minimize one's tax burden.

At that point, the tide suddenly turns for the Commissioner. Judge Hand tells him that even in the real world he can prevail. The tax planning maneuver that lies at the heart of the drama is only effective if the first several moves constitute a statutory reorganization, and although Congress did not say so explicitly, it clearly intended to provide relief only for reorganizations undertaken for a business purpose. Because there was no business purpose, but only a tax avoidance purpose (not, as Judge Hand had waxed poetic just a few sentences earlier, that there is anything wrong or even unpatriotic about tax avoidance), the sequence of events at bar was not a reorganization. Consequently, the Commissioner could impose tax on what was actually done, while ignoring the reorganization provisions of the relevant Revenue Act. Ironically, in the end, it was those very steps that the Commissioner so wanted to ignore that enabled to him to collect tax. In perhaps a post-climactic finish, the Supreme Court affirms.

As with any skillfully crafted drama, it turns out that there is more here than meets the eye. The hidden truth— – one might say hidden in plain sight— – is that the underlying corporate structure provided drastically different tax

treatment for parallel courses of action. Shareholders ordinarily encountered a lower tax burden when receiving a liquidating distribution than when receiving an equivalent non-liquidating distribution. The transfer of appreciated property to shareholders in complete liquidation eliminated corporate-level tax. Given these escape hatches, only the fool in our drama would cause a corporation to sell appreciated property and then distribute the proceeds to its shareholders in a non-liquidating distribution. It would be far better to liquidate the corporation, thus saving tax at both the corporate and the shareholder levels.

Our (anti-)heroine wanted to do just that, to follow the road most traveled by. Had she done so, her maneuver almost certainly would not have been challenged. However, she could not simply liquidate the corporation— – or at least not do so conveniently— – because her corporation owned other assets, in addition to the one she wanted to sell. So instead of liquidating the corporation, she created a new corporation, had the old corporation transfer the asset she wanted to sell to the new corporation, and then liquidated the new corporation. The heart of her tax planning operation was not the reorganization, but rather the liquidation.

No one involved in the drama seems to have been aware that Mrs. Gregory's exploitation of the corporate reorganization provisions was a red herring, drawing attention away from what was really happening. From the Commissioner to the Justices of the Supreme Court, everyone focused on her supposed exploitation of the reorganization provisions. Even her own counsel did not draw attention to the fact that the reorganization, in and of itself, provided her with no particular tax benefit, and that all she was trying to do was to set up a presumably well-known and respected tax minimization strategy.

The misunderstanding of the tax planning maneuver that lay at the heart of *Gregory* is not merely a fascinating element in an intricate legal drama. It also informs a much larger picture. It describes how optics can frame an almost century-long legal discourse. *Gregory* is widely hailed as one of the most significant tax decisions ever handed down. It is the fountain from which flow the plethora of anti-avoidance doctrines that permeate the law of taxation, and it has been cited in thousands of articles and subsequent cases. It has been discussed, analyzed, and dissected in minute detail, and yet, for almost a century, the red herring has continued to dominate the discourse.

However, the most lasting effect of *Gregory*'s red herring may not be the decision's robust legacy, but rather the legacy that it could have had. Had the courts in *Gregory* recognized that the basis of the taxpayer's planning maneuver was not the innocuous reorganization provisions, but rather other discrepancies in the tax law, those discrepancies might have been addressed and reformed at the time. The loophole that allowed corporations to avoid tax by distributing appreciated assets was not closed until 1986. The tax rates imposed on liquidating and non-liquidating distributions were not equalized until 2003. The

difference between the two types of distributions with regard to the computation of taxable income has still not been addressed.

The pivotal place that *Gregory* occupies in tax history is perhaps a direct result of its focus on the reorganization provisions and its adding to them the judicial requirement of a business purpose. Had it recognized the red herring, it might not have had the impact that it did. Instead, it might have been remembered as the case that triggered much needed corporate tax reform. Nevertheless, the idea that almost a century after she lost her case, Mrs. Gregory would have morphed into the bête noire of the campaign against tax avoidance would doubtlessly have surprised our heroine.