# First Principles, Substance Over Form, and the Tax Scholarship of Dale Oesterle

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Professor Dale Oesterle began his academic career as a tax scholar. As a 3L at That School Up North, he was the co-author of a tax article with Douglas Kahn, a lion of the field. Before finding his home in corporate scholarship, his teaching portfolio (as he is fond of reminding me) included tax.[2] His early foundation in that sparkling gem among the disciplines allowed his scholarship to bridge the gap between business law's need and Treasury's necessity and to see a common way forward for both interests. His marriage of business and tax scholarship is rooted in first principles that foster simplicity and consistency, and it always is anchored in the reality of transactional practice. Through this lens, he has called for Congress to thin one of the worst thickets in the Internal Revenue Code: the corporate reorganization non-recognition rules.

This essay will highlight the overarching principles of Professor Oesterle's decades-long examination of the taxation of corporate reorganizations and will argue that pushing his approach beyond real-world applications to its logical end demonstrates the incoherence of the system and returns us neatly to pragmatism.

Part II of this essay will identify commonalities between Professor Oesterle's first tax article, *A Definition of "Liabilities" in Internal Revenue Code Sections 357 and 358(d)*,[3] published with Douglas Kahn in the year 1975, and his most recent tax article, *Tax-Free Reorganizations: The Evolution and Revolution of Triangular*

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[1] Lawrence A. Jegen III Chair in Tax Law, Indiana University Robert H. McKinney School of Law. Thanks to Professor Dale Oesterle for the many interesting conversations that led to this essay and to librarian Lee Little for his assistance in compiling resources for it. Thank you, as well, to my family for being supportive of me while I wrote it. Though I would love to blame any errors on my four-year-old or our own version of the Bumpus Hounds, truly they are my own.

[2] *See generally* Douglas A. Kahn and Dale A. Oesterle, *A Definition of "Liabilities" in Internal Revenue Code Sections 357 and 358(d)*, 73 MICH. L. REV. 461 (1975) (I refer to *ichigan, of course. Go, Bucks!).

[3] *Id.*

*Mergers*, published in 2014 with me.[4] The consistencies between the two, and the arc of his thought in between them, paint the picture of a career-long dedication to fostering predictability for business planning and creating consistency in the taxation of transactions through a focus on economic equivalence among them.

Part III of the essay will suggest that Professor Oesterle's focus on first principles and economic equivalence is consonant with a larger trend away from form and toward substance as the primary driver of transactional classification for tax purposes. It also will highlight the tax treatment of corporate reorganizations as an outlier, since the statutory merger categories are almost entirely form-driven rather than substance-driven.

Part IV of the essay will argue that, because corporate taxation relies on a fiction; namely, corporate personhood, application of first principles to it produces an incoherent result, particularly in the context of corporate reorganizations. Because this essay is written in Professor Oesterle's honor, it will use the neoclassical new economic conception of the corporation, which gained prominence around the same time as Professor Oesterle, as a framework for a thought experiment to support that position. (I will hold, though, a deeper analysis of the implications of the neoclassical new economic theory and other prominent conceptualizations of the corporation for future work. My goal here is to show the continuing relevance of Professor Oesterle's approach to taxation, not to explicate the whole of corporate tax, though the project is tempting.)

Part V will conclude that not only does a substance over form approach from first principles about the corporation provide instruction on the intractable complexity of using a legal fiction as a taxable unit for purposes of the federal income tax, but that Professor Oesterle's dual focus on economic substance and equal treatment of economic equivalents is an evergreen approach to assessing the income taxation of complex bases whose form relies to some degree on an element of fiction.

## I. OESTERLE ON THE TAXATION OF CORPORATE REORGANIZATIONS

[4] *See* Stephanie Hoffer & Dale A. Oesterle, *Tax-Free Reorganizations: The Evolution and Revolution of Triangular Mergers*, 108 NW. U.L. REV. 1083 (2014).

Professor Oesterle's tax papers are at once practical and bound together by unifying theory. He focuses on current problems in statutes of importance to corporations. He draws comparisons to equivalent transactions by finding analogous or inverse transactions. He asks what result the motivating theory of the statute in question would produce across those transactional analogs and opposites, and he identifies inconsistencies. His concern with consistency, though, is tempered by pragmatism. Inconsistency, sometimes sanctioned in his work, is acceptable to the extent that it forwards Congress's intention to remove "tax impediments."[5] His pragmatically anchored arguments for theoretical coherence across the Code's corporate provisions might be seen as a preference for statutes drafted with an eye for substance over form, except when bright lines drawn with reference to form are deliberately employed to facilitate Congressionally sanctioned goals. These themes are apparent in both his 1975 and 2014 papers—the papers of a law student in his third year and of a senior scholar returning to the subject after decades of thought.

In his 1975 work with Professor Kahn, Professor Oesterle, then a student, focused on current "problems for cash method taxpayers seeking to transfer the assets and liabilities of a going business in a section 351 exchange."[6] Kahn and Oesterle focused their attention on a Tax Court decision, *Raich*, that characterized a corporation's assumption of debt in excess of the basis of transferred assets as recognized gain. They observed that the rationale of this holding, if applied in a subsequent section, would produce the conceptually incoherent result of double taxation of the same gain in the hands of a transferee who later sold the assets.[7] The article provided examples of this inconsistency to "illustrate[] the arbitrariness" of the rule.[8] It also looked to an economically equivalent transaction, the acquisition of accounts receivable in a reorganization, to strengthen the point, explaining that "[j]ust as it is inappropriate to apply assignment of income principles to the transfer of trade accounts receivable in a section 361 reorganization, it is inappropriate to apply them to a transfer of receivables pursuant to a 351 exchange."[9]

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[5] Kahn & Oesterle, *supra* note 2, at 474 (noting that the corporate reorganization provisions of the Internal Revenue Code were meant to remove tax barriers to transactions).
[6] *Id.* at 462.
[7] *Id.* at 463–64.
[8] *Id.* at 464.
[9] *Id.* at 476–77.

As a point of contrast to *Raich*, which produced nonsense results if applied in related contexts, Kahn and Oesterle turned to the Supreme Court's use of "basic principles" in *Crane v. Commissioner*.[10] Interestingly, the paper focused not on *Crane's* landmark holding that the assumption of a mortgage by an acquirer produces income to the seller, but on a relatively less celebrated part of the decision: the Court's notice with approval "that the Commissioner had not treated the overdue interest as an amount realized because interest is 'a deductible item.'"[11] The Court's move pleased Kahn and Oesterle because, unlike the situation in *Raich*, an economically equivalent transaction under *Crane* would produce an equivalent tax result. They wrote, "[t]he *Crane* doctrine treats assumed liabilities as if the transferee had given the transferor money equal to the debt and the transferor had himself paid the debt. The entire transaction balances at zero, making it sound simply to ignore the transfers of debts on deductible items."[12] In other words, though the form of the transaction in *Crane* was different from the form of the transaction described by Kahn and Oesterle, the economic substance and the tax result were the same, indicating the theoretical coherence of *Crane*.

Professors Kahn and Oesterle stopped short, though, of calling for complete consistency and theoretical coherence when they returned to their discussion of the transaction at issue in *Raich*. They noted that while *Raich* had the potential to produce double taxation, an opposite holding might produce double non-taxation.[13] Here, pragmatism won out: "such a 'double' tax benefit may be an appropriate means of implementing the recognized congressional policy of removing tax deterrents to the incorporation or reorganization of businesses."[14]

Professor Oesterle and I took a similar approach to our 2014 paper. The form-based nature of section 368 and its satellites had bothered us both for some time, and we talked about it with

[10] *Id.* at 467 (citing Crane v. Comm'r, 331 U.S. 1 (1947)).
[11] *Id.* at 468 (italics omitted for readability).
[12] *Id.*
[13] *Id.* at 474 (noting that the Code is silent as to whether a transferee of debt can deduct subsequent payments if those payments would have been deductible in the hands of the transferor and suggesting that double non-taxation would further Congress's policy of facilitating corporate reorganizations).
[14] *Id.*

regularity. My memory for conversation is inversely correlated with age, but if I recall it correctly, his pitch for the paper was something along the lines of "these rules are all different; each one of these things has a different set of rules, but a lot of the transactions are the same. The reverse triangular mergers are the most important, but they are the ones that the tax law makes the most difficult. It's too complicated. There oughta be a majority control rule."

Of course, Professor Oesterle's thoughts on the matter, and the resulting paper were significantly more complex. Bringing his characteristic analysis to tax-free reorganizations helped us explain internal inconsistencies in the tax treatment of reorganizations that were economic equivalents of one another. The work again draws comparisons among analogous or inverse transactions. It again looks to the underlying purpose of the statutes for a motivating theory that should produce coherence but does not. And again, Professor Oesterle's concern with theoretical consistency is tempered by pragmatism. He was willing to go so far, but no more, out of concern for the real-life consequences to actual business transactions. Here, it is easy to see the value of his broader focus on entities. He takes a purposive approach to tax law and keeps his focus on the interests of the constituents whom it serves.

Professor Oesterle's concern for businesses is evident in both papers' focus on tax neutrality in decision-making. The 2014 paper notes, "For triangular mergers, this means that tax considerations should not affect the choice between straight and triangular forms or between forward and reverse forms of merger. When the Code treats these forms differently, disparate treatment should reflect normatively relevant differences among forms."[15] The paper then demonstrates that the Internal Revenue Code's reorganization provisions produce different federal tax treatments for economically equivalent transactional results when those results are reached through different state statutory pathways.[16] The paper argues that, in the context of corporate reorganizations at least, there can be no meaningful normative distinctions among transactions whose forms vary but the results of which literally are identical; consequently, the

[15] *See* Hoffer & Oesterle, *supra* note 4, at 1096.
[16] *Id.* at 1096–99 (cataloging the differences in tax treatment of economically equivalent reorganizations).

tax law should be amended to make the choice among state statutory pathways tax neutral.[17]

Tax neutrality in business decision-making is only possible when the law relies on substance rather than form to determine outcomes. As the paper notes, "the consequences of the merger, rather than its form, should trigger nonrecognition treatment . . . ."[18] To the extent that Form A and Form B produce similar real-world outcomes but different tax results, tax may inefficiently drive taxpayers' choices. For this reason, the paper recommends moving away from a form-driven tax regime for reorganizations.[19]

The paper stops short, though, of pushing its substance over form argument to the logical conclusion. Professor Oesterle's view of both the business and tax sides of reorganization transactions, and his very real-world concern for the workings of business led the work to "propose changes that are explicitly pro-deal" based on the assumption "that cash is dear and that immediate tax recognition in such deals would stop many at the margin."[20] The paper recommends as a solution the abandonment of the complex set of rules currently in place.[21] To determine whether a target will recognize taxable gain in a reorganization transaction, the law would employ a bare control test.[22] This solution reflects the pragmatic approach that Professor Oesterle brings to his tax scholarship. It recognizes the motivating principle of the reorganization provisions—protection of deals when there is continuity of enterprise and capital that taxation ought not disrupt—while creating consistency, protecting the interest of taxpayers in simplicity, and increasing predictability of the tax outcomes of transactions.

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[17] *Id.* at 1099 ("The problem created by complexity and overlap within the nonrecognition laws is not only costly but also seemingly intractable. For this reason, we suggest two responses: one pragmatic and one that raises normative questions about the nonrecognition scheme generally.").
[18] *Id.* at 1104.
[19] *Id.* at 1113 (recommending that "Congress should strive to pry corporate income tax free from state laws on corporate personhood and governance, focusing not on form, but instead on deciding on substance what income is, to whom it should be attributed, and when it should be taxed.").
[20] *Id.* at 1099 (introducing the paper's pragmatic response to the conceptually incoherent state of the triangular reorganization provisions).
[21] *Id.* at 1106.
[22] *Id.* at 1106–07 (control for this purpose would be "the percentage of stock necessary under state law to elect a majority of the target's directors. . . . ").

## II. SUBSTANCE OVER FORM

Elevating substance over form has been a common theme in tax law for nearly a century. The substance over form doctrine was first iterated in *Gregory v. Helvering* by the Supreme Court in 1935 when the Court held that where a transaction's form is "a disguise for concealing its real character," taxation must follow the substance and that to do otherwise "would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."[23] In addition, "[i]n applying the doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed."[24] Today, though, the substance over form doctrine is widely acknowledged as fundamental,[25] and it has given rise to the related step transaction doctrine and the economic substance doctrine.[26] Using any of these doctrines, a court may recharacterize a transaction for tax purposes, allowing the government to levy tax according to the actual rather than the reported economic activity.[27]

Since its inception in *Gregory*, the substance over form doctrine has served as an important (if sometimes ambiguous) check on taxpayer behavior.[28] The doctrine is appealing because "[t]reating economic substitutes differently for tax purposes is inefficient (as

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[23] Gregory v. Helvering, 293 U.S. 465, 469–70 (1935).
[24] Frank Lyon v. United States, 435 U.S. 561, 573 (1978).
[25] True v. United States, 190 F.3d 1165, 1174 (10th Cir. 1999) (substance over form is a "fundamental tax principle").
[26] *See* Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517, 1521 (10th Cir. 1991) ("The step-transaction doctrine developed as part of the broader tax concept that substance should prevail over form."); Bail Bonds by Marvin Nelson, Inc. v. C.I.R., 820 F.2d 1543, 1549 (9th Cir. 1987) ("The economic substance factor involves a broader examination of whether the substance of a transaction reflects its form, and whether from an objective standpoint the transaction was likely to produce economic benefits aside from a tax deduction.").
[27] For instance, a court may recharacterize debt as equity, which would prevent a taxpayer from claiming interest deductions for disguised dividend payments. *See, e.g.,* Laidlaw Transp. v. Comm'r, 75 T.C.M. (CCH) 2598 (1998).
[28] *See* Jonathan H. Choi, *The Substantive Cannons of Tax Law*, 72 STAN. L. REV. 195, 201–02 (2020) (noting that the substance over form doctrine is one of the most famous tax anti-abuse doctrines and that it has been applied inconsistently); Gladriel Shobe*, The Substance Over Form Doctrine and the Up-C*, 38 VA. TAX. REV. 249, 266–67 (2018) ("The substance over form doctrine is controversial and ambiguous, but remains an important tool for Treasury and the Service to attack transactions that technically comply with tax statutes but attempt to circumvent broader tax policy principles.").

taxpayers may incur costs to access preferential treatment) and inequitable (as some taxpayers are treated more favorably than others due to the form of their activities.)"[29] Consequently, through use over time, substance over form and other anti-avoidance doctrines have become "background norms familiar to drafters of statutes" that "underlie the best reading of the Code."[30] They are so well-trodden that Professor Jonathan Choi has argued for treating the common anti-abuse doctrines, including the substance over form doctrine, as substantive canons of interpretation applicable to tax statutes.[31]

Tax law's preference for substance over form is not confined to a canon, though. Indeed, the Internal Revenue Code contains numerous examples of statutory drafters deliberately elevating substance over form in the statutes themselves, many of them crafted in response to tax avoidance strategies based on form.[32] They include provisions like section 269, which permits the recharacterization of acquisitions made for the purpose of avoiding income tax,[33] partnership accounting rules on the allocation of loss and other attributes that require the partners to actually experience the economic effect of those allocations,[34] attribution rules for indirect stock ownership that account for related-party chains of business ownership and control,[35] limitations on the deduction of losses incurred in sales to a related party,[36] look-through rules in the foreign tax credit and passive foreign investment company contexts that recognize instances when the activity and assets of subsidiaries

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[29] *See* Ari Glogower, *A Constitutional Wealth Tax*, 118 MICH. L. REV. 717, 733 (2020) (cases on the constitutionality of taxes often frame the distinction between the base of the tax and factors affecting the base as a question of "substance and form").

[30] *See* Choi, *supra* note 28, at 199 (substance over form and other anti-avoidance cannons are so pervasive that they can be employed as canons of interpretation for tax statutes).

[31] *Id*. at 199–200.

[32] *Id*. at 197 (noting that anti-abuse doctrines have arisen in response to taxpayers creatively working with the letter of the Code rather than its spirit to create tax shelters).

[33] I.R.C. § 269 (2014).

[34] I.R.C. § 704 (2017) (requiring partnership allocations of tax attributes to have economic substance).

[35] For example, section 318 requires taxpayers and the IRS to attribute stock ownership of partnerships, trusts, and other entities to the owners of those entities. *See* I.R.C. § 318(a) (2005).

[36] I.R.C. § 267 (2015) (seller may not deduct a loss incurred on a sale to a related party).

may be a part of the parent company's business,[37] transfer pricing rules that require sales between related parties to be priced in ways that are comparable to sales between unrelated parties,[38] and many others, like the recent codification of the economic substance doctrine, which specifies that taxpayers must have non-tax reasons for engaging in tax-saving transactions.[39]

As Professor Oesterle and I have previously written, in contrast to tax law's general move toward a focus on substance, the tax treatment of corporate reorganizations is driven primarily by form (and we are scarcely alone in this observation).[40] The corporate tax statutes were drafted at a time when the law's philosophical conceptualization of the corporation as an independent entity versus an aggregation of its shareholders was unclear (and indeed it remains unclear), and the tax treatment of corporate reorganizations was built atop that discrepancy.[41] Professors Ginsburg and Ferguson wrote in 1973 that "[i]t is hard to justify the fictions and formalisms present in reorganization tax law on any basis other than history."[42] Today, the formalism of the reorganization rules retains vital importance. As Professor Shobe has written, the IRS so far has failed to bring a substance over form challenge against a popular reorganization

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[37] *See e.g.,* I.R.C. § 954(c)(3) (2020) (a dividend received by a controlled foreign corporation from a subsidiary with an active trade or business in the same country is not treated as subpart F income); I.R.C. § 1297(c) (2017) (describing the inclusion of the assets of a corporation's subsidiary among the corporation's assets for purposes of determining passive foreign investment company status).

[38] I.R.C. § 482 (2018).

[39] *See* I.R.C. § 7701(o) (2018) (a transaction has economic substance if it "changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position," and the taxpayer has a substantial non-tax purpose for engaging in the transaction.).

[40] *See generally* Hoffer & Oesterle, *supra* note 4.

[41] *See* Steven A. Bank, *Mergers, Taxes, and Historical Realism*, 75 TUL. L. REV. 1, 62–63 (2000) ("[T]he original reorganization provision evidences a compromise between the accretion and consumption tax models."). *See also* Charlotte Crane, *Toward a Theory of the Corporate Tax Base: The Effect of a Corporate Distribution of Encumbered Property to Shareholders*, 44 TAX L. REV. 113, 142 (1988) (arguing that prior to 1986, the scope of the corporate tax base was indeterminate); Marjorie E. Kornhauser, *The Story of Macomber: The Continuing Legacy of Realization*, *in* TAX STORIES: AN IN-DEPTH LOOK AT THE TEN LEADING FEDERAL INCOME TAX CASES 53, 56–57, 95 (Paul Caron ed., 2003) ("[T]he realization concept in general encourages, at a minimum, a hybrid income/consumption tax because it provides a rationale for the many consumption aspects of the income tax.").

[42] M. Carr Ferguson & Martin D. Ginsburg, *Triangular Reorganizations*, 28 TAX L. REV. 159, 210 (1973).

transaction known as the Up-C, despite its widespread use and despite the SEC's issuance of a letter characterizing the transaction based on its substance rather than its form for securities regulation purposes.[43] The different approaches of the two agencies in this case perhaps demonstrates how thoroughly ingrained form is in the tax treatment of reorganizations, in juxtaposition to the preference for substance in other areas of tax law.

Professor Oesterle and I asked, in our prior work, what it might look like to draft triangular merger statutes that prefer substance over form.[44] We began by exploring this use of the concept of substance over form by separately conceptualizing the corporation first as an independent entity, and then as an aggregation of its shareholders.[45] We confined our analysis to triangular mergers, and as a result of Professor Oesterle's steadying influence, we remained mindful of the implications of our recommendation for actual businesses.[46]

What result would we reach, though, if we set aside pragmatism and tried to design the Internal Revenue Code's reorganization provisions on a clean slate, creating a tax structure that prefers substance over form in light of traditional legal and scholarly theories of the corporation? A reimagination of the tax treatment of acquisitive reorganizations in this way suggests that the tax treatment of corporations is, itself, conceptually infirm. There is no theoretically coherent way to tax or not tax corporate reorganizations because there is no one applicable theory that coherently explains corporate form (at least for tax purposes).[47] When examined in this light, Professor Oesterle's bright line approach is much more than a business-friendly punt. It is a compromise between competing and irreconcilable conceptions of the corporation.

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[43] *See* Shobe, *supra* note 28, at 251 (arguing that the SEC's Up-C letter "supports using a substance over form approach to the Up-C for both securities and tax law purposes because the technical arguments for using a substance over form approach to the Up-Care are essentially identical whether you are analyzing the structure for tax or securities law purposes.").
[44] *See generally* Hoffer & Oesterle, *supra* note 4.
[45] *Id*. at 1103–08.
[46] *Id*. at 1106–07 (focusing on a state-law driven majority control test).
[47] *Id*. at 1113 (noting trade-offs between consistency and normative coherence).

The next section will describe neoclassical new economic theory, a theory of the corporation that was well-known during the course of Professor Oesterle's career and will use it to ask whether the tax treatment of corporate reorganizations might be reimagined in a way that moves away from the transactional forms described in section 368 toward a unified regime focused on substantive results. To be frank, the answer is (as it was in Professor Oesterle's prior work with me) that a normative solution that elevates substance over form, treats economic equivalents with equivalency, and is theoretically coherent is impracticable because of the conflation of corporate ownership and rights with shareholder ownership and rights inherent in the corporate fiction.

## III. CONCEPTUALIZATIONS OF THE CORPORATION

Revising the taxation of corporate acquisitions in a way that elevates substance over form requires an attempt to understand the nature of corporations themselves. Because corporations are created and maintained through the interaction of a number of constituents, including shareholders, corporate management, suppliers, employees, lenders, and customers,[48] any attempt to define the substance of corporate reorganizations must embody a relational component. Incorporating a relational component into tax statutes is easier said than done, though, since simple indicia of shareholdership may not tell the whole story.

Since the early 1900s, business scholars have sought to explain the relationship among corporations, shareholders, and broader society using variations of two themes: conceptualization of corporations as aggregations of their shareholders or as independent persons.[49] Two theories of the corporation—neoclassical new economic theory on one hand and real entity theory on the other—are frequently cited in this regard.[50] A related and newer idea, institutional new economic theory, occupies a middle ground.[51]

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[48] *See* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 229 (1990) (describing the new economic theory of the corporation, which views the corporation as the sum of agreements among individuals).

[49] *See generally id.* (reviewing natural entity theory, corporate entity theory, aggregate theory, and new economic theory of the corporation).

[50] *See id.* at 216, 229 (real entity theory and new economic theory).

[51] *See* William W. Bratton Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1481 (1989) (distinguishing institutional new economic theory from neoclassical new economic theory).

Here, a disclaimer is needed. This essay does not cover the waterfront of corporate theory, or even a small fraction of it, but instead presents a single example, in the broadest of brush strokes, for purposes of discussion.[52] A more thorough look will have to wait for another day and a longer-form article.

### *A. Neoclassical new economic theory in a very, very small nutshell*

Neoclassical new economic theory, which owes its popularity to Coase, argues that a corporation is the sum of agreements made among individual constituents.[53] The corporation, then, should not be regarded as an independent actor. Rather, "[t]he theory of the corporation sketched here conceives of the firm as nothing more or less than the product of individual actors freely contracting according to their own utility calculations."[54] More specifically, it is "a legal fiction that serves as a nexus for a set of contracting relations among individual factors of production."[55] Through this fiction, investors who acquire shares from the enterprise are contracting with managers who will act as the investors' agents in the conduct of the business.[56] So to grossly oversimplify for purposes of this essay, under neoclassical new economic theory, a corporation may be viewed as an aggregation of individuals: investors contracting with managers, managers contracting with employees, suppliers, and lenders, and so on. In this conception of an enterprise— as a coordinated focal point of contracting for the increased utility of the contracting parties— the corporation might be seen through a tax lens as conduit for transactions that result in gains and losses to its stakeholders. The idea is not new in the realm of taxation, but it is the underpinning of Subchapter K on partnerships rather than Subchapter C on corporations.[57]

If neoclassical new economic theory (or, at least, the truncated version of it presented here) were to serve as the starting point for

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[52] *Id*. at 1472 (asserting that historically, there have been many accounts of the corporation and that the predominance of a few currently obscures the contribution of the others).
[53] *See* Millon, *supra* note 48, at 229.
[54] *Id*. at 231.
[55] *See* Bratton, *supra* note 51, at 1478.
[56] *Id*. at 1479.
[57] This same idea is recognizable as the basis of the pass-through regimes described in subchapters K and S of the Internal Revenue Code.

crafting a corporate tax regime, nominally levying tax on corporate gains first at the level of the entity and then at the level of the shareholder would make little sense, since the corporation is merely an instrument of coordination. Because the theory does not view the firm as conceptually separate from its stakeholders, treating it as a separate taxpayer would require some normative justification outside of simply asking it to bear its share of the cost of government (and, of course, the conversation is much more complex than the confines of this essay permit, since there likely are such normative justifications, including considerations relevant to elasticity of various actors and the incidence of taxation in relation to taxing deployed capital). But to speak in generalities: (1) treating the firm as a taxable unit makes little sense if there is no corporate share of the cost of government, and (2) there is no corporate share of the cost of government if the corporation itself is nothing more than a legal fiction used to describe a dynamic hub of stakeholder transactions. This conception of the corporation, pushed to its logical end, shoves tax law toward the integration of firm-level and shareholder level income taxes.

But how would the idea play out in the reorganization context, where the focus of the transaction is squarely on the acquisition or division of the firm, rather than its shareholders?

If we wed the neoclassical new economic theory of the corporation to a substance-over-form tax treatment of corporate reorganizations, the picture is more complicated. As Professor Oesterle and I noted in our prior article, current tax statutes on reorganization transactions look for continuity at both the entity level and the shareholder level when determining whether a target corporation or its shareholders will be taxed or will, instead, receive non-recognition treatment.[58] From a neoclassical new economic perspective, though, the relevant question should be whether a shareholder has severed one investment (a realization event under section 1001)[59] and entered into another by severing one contractual relationship and entering into another. If so, the next question must be whether the difference between the two is so stark as to obviate

[58] *See* Hoffer & Oesterle, *supra* note 4, at 1100 (the law allows non-recognition treatment if the target is a party to a reorganization, and the reorganization definitions contain elements of both shareholder continuity and entity continuity).
[59] *See* Cottage Savings v. Comm'r, 449 U.S. 554, 566 (1991) ("an exchange of property gives rise to a realization event so long as the exchanged properties are 'materially different'—that is, so long as they embody legally distinct entitlements.").

the justifications for non-recognition of the resulting gain or loss. Under current law, this inquiry is inextricably bound up in what one believes stock to be for a particular shareholder: is it simply a passively held property interest, or is it participation in the underlying endeavor, or both?[60] In other words, to know whether a shareholder has maintained or discontinued the notional contract described by neoclassical new economic theory, we first must understand that contract's nature and scope.

Prioritizing substance over form in this context renders impossible a one-size-fits-all approach to the question of how tax law should view corporate reorganizations. Any given class of shares may impart to its owners' rights to govern, receive dividends or other distributions, receive a share of the residual upon dissolution, or other benefits to the extent permitted by the terms of the shares and the applicable state law. To the extent that these rights are substantially altered in the reorganization, a tax regime built on neoclassical new economic theory would require recognition of gain in the absence of countervailing normative or policy justifications for non-recognition.

Practically, though, determining the tax consequences of a reorganization based solely on the formal rights conferred by ownership of stock would be insufficient for substance over form purposes. Nominal ownership of governance rights, for example, may not connote actual control. In addition, the percentage of shares held by a particular shareholder will affect the shareholder's ability to meaningfully exercise its rights. Management may be less responsive to the interests of minority shareholders, and minority shareholders cannot, unless they act in concert, make meaningful changes in the identity of the managers. Otherwise put, while in form, shares may grant to their owners a vote, in substance, for certain minority shareholders, the shares may be analogous to, say, passively owned rental property the exchange of which would be entitled to non-recognition under section 1031.[61] A substance driven approach to the taxation of reorganizations may, for example, prefer non-recognition of gain for a shareholder who has little ability to influence the corporation either pre- or post-reorganization, since the nature of shareholder's relationship to the corporation has not

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[60] Of course, practically speaking, this will depend in large part on the kinds of rights associated with the shareholder's particular share class.

[61] *See* I.R.C. § 1031 (2017) (describing non-recognition treatment for the like-kind exchange of real estate).

changed, even though the perhaps the identity of the corporation has. Conversely, a substance driven approach to the taxation of reorganizations may prefer taxation over deferral in the case of a previously influential shareholder who becomes less so in the transaction. Why? Neoliberal new economic theory focuses on the contractual relationships of the parties, and practically speaking, the contract represented by the shares has substantively changed in nature as a result of dilution of the shareholder's ownership.

Both of the prior scenarios make clear that judging the substance of a reorganization solely by reference to the nominal contract rights inherent in swapped or newly issues shares is insufficient for substance over form analysis. This point finds support in tax laws outside of the reorganization context, and in this way, the reorganization provisions are quite different from many of the Subchapter C statutes that surround them. Take, for example, the potential problem created simply looking at the stated rights of target shares in juxtaposition to the stated rights of acquirer shares to determine continuity of interest. Such an approach would pay insufficient attention to substance. Tax law currently gives voice to this substance-over-form-based conception of business ownership in the estate tax context, where minority interests may be afforded a valuation discount.[62] On the other hand, if a shareholder nominally has little legal right to participate in corporate governance but, in reality, can wield power, its shares connote not only ownership of an interest in the corporation, but also a meaningful right to govern, even if that right is not apparent on the face of the shares. Again, an approach that considers only the nominal rights of the shareholder pays insufficient attention to substance. Tax law currently takes this substance over form approach in a similar situation for purposes of the definition of the controlled foreign corporation, which applies when United States shareholders own, directly or through attribution, fifty percent or more of the total combined voting power **or** the total combined value of the shares.[63]

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[62] *See* JACK BOGDANSKI, FEDERAL TAX VALUATION ¶ 4.03–4.04 (describing, for estate tax purposes, discounts in the valuation of ownership interests in businesses for the effect of minority and marketability when the ownership interest is not a controlling interest).

[63] I.R.C. § 957(a) (2018).

The conflict highlighted here and in my earlier work with Professor Oesterle[64] suggests that reorganization tax rules would remain intractably complex under a neoclassical new economic conception of the corporation. If, similar to the Code's like-kind exchange[65] or involuntary conversion[66] rules, reorganization rules are meant, in part, to shelter gains to capital that remain at risk in a related investment post-transaction, the necessary inquiry should be whether the deemed contractual relationship created by a shareholder's stock ownership has been modified so substantially as to be treated as a new contract, and if so, in which cases is the modification simply too stark to justify non-recognition. For this, a facts and circumstances approach would be necessary to determine the scope of the shareholder's influence over the target's management versus the new corporation's management and the extent of the proportionate alteration of the shareholder's rights to distributions, the residual, and other property interests. And these questions are compounded in acquisitions where the target remains intact as a subsidiary of the acquiring corporation.

It is simply not practical to engage in a case-by-case inquiry of how substantially a particular shareholder's relationship to the firm has changed. A system based on assessing the extent of modification of a shareholder's notional contract with a corporation that is a party to a reorganization would be unworkable. Why? Because the taxation of reorganizations in light of the neoclassical new economic theory of the corporation would require the Code to address the concentration or dilution of a shareholder's actual, rather than nominal, rights. In essence, the substantive nature and power of those rights are at the heart of the notional contractual relationship described by the theory. They would be affected by the ratio of the shareholder's claim to distributions and residual assets prior to and after the transaction and by the change in the ratio of voting power held by the shareholder in comparison to other shareholders. These inquiries require the law to look across all of the parties involved: the

[64] *See* Hoffer & Oesterle, *supra* note 4, at 1102–04 (discussing the difference in treatment between influential and ineffectual shareholders under a substance over form approach to the taxation of triangular mergers).
[65] *See* I.R.C. § 1031 (real property exchanged for other real property will not result in recognition of realized gain on the exchange except if a taxpayer receives non-like kind property in the exchange).
[66] *See* I.R.C. § 1033 (2018) (proceeds received as the result of involuntary conversion of property will not result in recognition of realized gain to the extent that they are used to acquire similar property).

acquirer, the target, and the target's shareholders as a percentage of the combined shareholders, but instead of looking through the procedural lens of form, the law would force shareholders to plumb the facts and circumstances of their own situations. Little if any simplification would be possible—facts and circumstances tests are minefields that invite a thicket of administrative guidance and litigation—and in that case, if we must have a corporate tax despite the fictional nature of the entity itself, perhaps Professor Oesterle's pragmatic solution based on state laws of governance truly is the workable solution.[67]

## IV. From First Principles to a Pragmatic Position

Using neoclassical new economic theory as the basis of a thought experiment and trying to maintain focus on the substance of transactions rather than their form, this essay has reached an impasse for rewriting the tax treatment of reorganizations. The form of the corporation is a fiction. Its substance is open to interpretation. If it is a tool for the coordination of complex networks of contracts, section 368 and its associated regulations should be rules about contract modification under the neoclassical new economic conception. In some ways, they are. For instance, they ask about continuity of shareholder interest, about continuity of business interest, about whether substantially all of the assets are acquired, and about which lines of business go where.[68] All of these factors might affect the scope of a shareholder's rights post-transaction and the shareholder's ability to meaningfully exercise those rights. But the current rules do not focus on the individual circumstances of particular shareholders, which is what a contracts-based approach would seem to require.

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[67] I am not alone in this conclusion. Professor David Weisbach has written in a related context that "firm-level taxes have an irreducible core of complexity." *See* David A. Weisbach, *The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in Corporate Tax*, 60 TAX L. REV. 215 (2007). The problem is one of dual ownership, a term that he uses to describe two potential avenues of ownership by corporations: directly or through a subsidiary. *Id*. The concept applies more broadly, however. In describing the hoops that a system would have to jump through to produce comparable results for asset sales and stock sales, Weisbach concludes, "[t]he resulting compromises needed to produce an administrable system cause the mistaxation, complexity, and incoherence associated with current firm-level systems. There is no way out of this dilemma." *Id*.

[68] *See, e.g.*, 26 C.F.R. § 1.368-1(d) (2011) (describing reorganization requirements for continuity of business enterprise before and after the transaction); 26 C.F.R. § 1.368-1(e) (describing the requirement for continuity of shareholder interest).

They also do not create economic equivalence among equivalent transactions, though with neoclassical new economic theory, the inquiry must be shareholder focused and as a result, more granular. So taking Professor Oesterle's perspective (and the perspective of many others as well), the current tax treatment of corporate reorganizations is non-normative because its focus on form produces different results for transactions the end result of which is the same. Something different is needed.

Rewriting the Code by elevating substance over form and adopting neoclassical new economic theory cannot solve the problem, though intuitively it should. Building from first principles *should* create consistency and coherence. Perhaps in a world of perfect information it could. That is, however, not our world. Rarely would shareholders and the parties to the reorganization understand the effect of the transaction on the rights and roles of all of the various constituents. Creating that information would be costly, and likely impossible. In the absence of it, though, what path exists to move the statutory tax treatment of reorganizations toward concern for the substance of the transaction rather than the form?

In the absence of perfect information, the law must rely on proxies. In legal regimes that require consistency, chosen proxies must send consistent signals that denote sameness or differentness of the underlying relevant but less visible information that they represent. In the reorganization context, given the failure of the current statutory framework and the lack of perfect information to feed into a purely substantive shareholder by shareholder analysis, the law must find proxies to differentiate between reorganizations in which shareholders continue their investment in an enterprise and stock or asset sales in which they do not. And the proxies, because they are not themselves the desired information, will be imperfect. So through a thought experiment bound up in fundamental tax principles and a historic theory of the firm, we have arrived back at Professor Oesterle's original point about the disparate treatment of various forms of triangular merger, but it is a larger point now— one that could apply regardless of an acquisition's form: "It's too complicated. There oughta be a [insert your favorite proxies here] rule."

## V. CONCLUSION-EVERYTHING OLD IS NEW AGAIN

Professor Oesterle's approach to complex tax questions should have traction not just in the context of reorganizations, but in other areas of complexity where innovation outstrips Congress's capacity for legislation. The reorganization statutes have proven unable to keep pace with the creativity of deal lawyers or the development of new state statutory frameworks. In response, Professor Oesterle has suggested amendments focused on substance, namely by providing equal treatment to economic equivalents. The same approach could apply to Congress's attempts (if any are made) to draft income tax rules for innovations in property ownership, such as NFTs and cryptocurrency, or innovations in investment, such as short-sale derivative swaps (if such a thing truly exists), or innovations in work, such as the gig economy. By returning to first principles and crafting tax results that elevate substance rather than legislating responsively by analogy to existing transactional forms, Congress could disrupt the growing complexity and inefficiency of the Code.