

Can the Treasury Exempt Its Own Companies from Tax? The \$45 Billion GM NOL Carryforward

*J. Mark Ramseyer
Eric B. Rasmusen*

ABSTRACT

To discourage firms from buying and selling tax deductions, Section 382 of the tax code limits the ability of one firm to use the “net operating losses” (NOLs) of another firm that it acquires. Under the Troubled Asset Relief Program, the U.S. Treasury lent a large amount of money to General Motors. In bankruptcy, it then transformed the debt into stock. GM did not make many cars anyone wanted to buy, but it did have \$45 billion in NOLs. Unfortunately for the Treasury, if it now sold the stock it acquired in bankruptcy, it would trigger Sec. 382. Foreseeing this, the market would pay much less for its stock in GM.

Treasury solved this problem by issuing a series of notices in which it announced that the law did not apply to itself. Sec. 382 says that the NOL limits apply when a firm’s ownership changes. That rule would not apply to any firm bought with TARP funds, declared Treasury. Notwithstanding the straightforward and all-inclusive statutory language, GM could use its NOLs in full after Treasury sold out. The Treasury issued similar notices about Citigroup and AIG.

Treasury had no legal or economic justification for any of these notices, but the press did not notice. Precisely because they involved such arcane provisions of the corporate tax code, they largely escaped public attention. The losses to the public fisc were not minor—they cost the country billions of dollars in tax revenue. That the effect could be so large and yet so hidden illustrates the risk involved in this kind of tax manipulation. The more difficult the tax rule, the more easily the government can use it to hide the cost of its policies and subsidize favored groups. We suggest that Congress give its members standing to challenge unlegislated tax law changes in court.

J. Mark Ramseyer is the Mitsubishi Professor of Japanese Legal Studies at Harvard Law School. Eric B. Rasmusen is the Dan R. and Catherine M. Dalton Professor in the Department of Business Economics and Public Policy of the Kelley School of Business at Indiana University.

We thank William Allen, Andrew Atkeson, Frank Buckley, Michael Doran, Sally James, Victor Fleischer, Michael Schler, and participants in seminars at the online Cyprosia, the Cato Institute, and the Harvard Law School for their many comments, whether positive or negative. We do not imply that any of these generous readers agree with our conclusions.

Can the Treasury Exempt Its Own Companies from Tax? The \$45 Billion GM NOL Carryforward

“Dona clandestina sunt semper suspiciosa.”¹

1. INTRODUCTION

Year after year, General Motors lost money—enormous sums of money. It designed cars. It built cars. But no one wanted to buy the cars. Over time, it accumulated huge operating losses (“net operating losses,” or NOLs). The tax code let GM carry forward these NOLs into the future. It let the firm save the losses for that day in the future when it would once again sell cars that people wanted.

The day never came. Instead, in June 2009 GM (call it “Old GM”) declared bankruptcy. It filed under Chapter 11 of the Bankruptcy Code and sold its assets to a new shell (“New GM”) in a transaction governed by Section 363 of the Code. Old GM’s shareholders lost

¹ “Secret gifts are often suspicious.” From Sir Edward Coke, *Twyne’s Case*, 3 Coke, 80 b (Star Chamber, 1602), in *Cases on the Law of Bankruptcy: Including the Law of Fraudulent Conveyances*, ed. E. Holbrook and R. W. Aigler, 153–157 (Chicago: Callaghan, 1915). *Twyne’s Case* was about a fraudulent conveyance by an insolvent debtor to a friendly creditor.

Another passage from the case will be apt when we consider the relationship between statute and regulation:

To one who marvelled what should be the reason that Acts and statutes are continually made at every Parliament without intermission, and without end; a wise man made a good and short answer, both of which are well composed in verse.

Quaeritur, ut crescitunt tot magna volumina legis?

In promptu causa est, orescit in orbe dolu.

[In our inexpert translation: “It might be asked why such a large amount of law grows? The basic reason is that the world’s evil has grown.”]

And because fraud and deceit abound in these days more than in former times, it was resolved in this case by the whole Court, that all statutes made against fraud should be liberally and beneficially expounded to suppress the fraud.

their investment. They did not receive stock in New GM. Instead, Old GM's creditors became New GM's stockholders: the U.S. Treasury (with 61 percent), the auto unions, and Canada swapped debt claims against Old GM for equity stakes in New GM. Other Old GM creditors acquired a 10 percent stake in New GM as well. In the fall of 2010, the Treasury re-sold a large amount of its New GM shares to the public, cutting its share to 26 percent.

New GM has the factories, offices, designs, and some of the workers that Old GM had. It also acquired some \$18 billion worth of Old GM's NOLs.² New GM could not use them to reduce its tax liability immediately, since it was losing money. But in 2010, New GM did turn a profit and presumably will use its NOLs to avoid corporate income tax on that profit (Bunkley 2011).

Ordinarily, when one company buys another's assets, it does not acquire its tax losses too. But the sale from Old GM to New GM qualified as a tax-free "reorganization" under Sec. 368 of the tax code: neither Old GM nor New GM incurred a tax liability, New GM entered Old GM's assets on its books with Old GM's "adjusted basis," and New GM acquired Old GM's NOLs.

The problem involved Treasury's plans to sell the shares it took in New GM. If the combined equity stake of any group of shareholders in a "loss corporation" like New GM climbs by more than 50 percentage points, Sec. 382 of the tax code limits the firm's ability to use those accumulated NOLs. Given Treasury's large stake in New GM, if it sold its entire stake to the public, those new owners would raise their combined interest by 50 points. New GM would then lose its ability to avoid taxes on future income.

² The losses themselves were \$45 billion; their book value as an asset is listed as \$18 billion. We will use the figure \$18 billion even though it is too high because standard accounting rules for tax assets are absurdly inaccurate.

They are inaccurate for two reasons: First, Generally Accepted Accounting Principles require companies to not discount for the time value of money. If a company expects to save \$1 million in taxes in 16 years using deferred tax losses, it records that as a current tax asset worth \$1 million, even though the present discounted value (at 5 percent interest) is only \$458,000. Second, even if there is a good chance that the company will never make a profit again, it records the full amount if "it is more likely than not" that the company will someday make enough profit. Thus, if the company just mentioned estimated that its chances of failure before 16 years from now are a mere 49 percent, it would still record the \$1 million as \$1 million, not \$510,000 or \$233,580. For a critical view of this rule, see J. E. Ketz, "Deferred Income Taxes Should Be Put to Rest," *SmartPros*, March 2010.

Can the Treasury Exempt Its Own Companies from Tax?

To solve this problem, the Treasury issued a series of notices. The Sec. 382 rules, it declared, would not apply to itself. When it sold its shares in New GM, the new owners might increase their ownership stake by 50 percentage points, but they would not trigger the Sec. 382 limits. The tax code offered no exception for government-owned shares, and the Treasury did not purport to find one. Instead, it just declared that the law did not apply.³

The notices also apply to two other companies, AIG and Citigroup. Both of these companies had ownership changes over 50 percent as a result of the Troubled Asset Relief Program and would ordinarily, as in bankruptcy, lose their NOLs. If they retain them, that reduces the apparent (but not real) cost of the bailout because the government can resell its shares at a higher price.

Through these notices, Treasury accomplished two highly political goals:

- It disguised (by billions of dollars) the true cost of the bailouts of GM and other firms.
- It routed funds (again, several billion dollars) to the administration's supporters at the UAW.

Ordinarily, if an administration wildly misstates the cost of its policies or routes public funds to its friends, the press notices and complains. In this case, it did not. The press missed the manipulation precisely because it involved such a complex and highly arcane provision of the tax code. The more obscure the law, in other words, the greater the risk of political manipulation: precisely because its strategy involved such an *abstruse* corner of the law, the administration was able to hide its politicized policies from the public.

We do not address the wisdom of the bailouts themselves. Neither do we ask whether firms should be able to carry forward operating losses, whether they should be able to reorganize tax-free, or why the United States has a corporate income tax at all.⁴ These are all

³ The last of the notices was Internal Revenue Service Notice 2010-2, "Application of Section 382 to Corporations Whose Instruments Are Acquired and Disposed of by the Treasury Department under Certain Programs Pursuant to the Emergency Economic Stabilization Act of 2008," *Internal Revenue Bulletin* 251.

⁴ Two recent articles on the incidence and distortions due to the corporate income tax are Harberger (2008) and Kotlikoff and Miao (2010). Auerbach, Devereux, and Simpson (2010) survey the pros and cons of corporate income taxes and the various ways to structure them. Their unavoidable complexity, of which the present paper's subject is just one example, is one strong argument against corporate income taxes.

interesting questions, but we have quite enough to do addressing the topic of selective tax relief through executive decree. Rather than explore these larger questions, we focus on the propriety of the Treasury's manufacturing a tax break to distribute and hide government largesse. More generally, we focus on the wisdom of giving a president the ability to invent a tax deduction for his political supporters without a need to answer to the courts or Congress.

1.1 The Bad Man and the Law

Recall Justice Holmes's description of the law as being the prediction of the "Bad Man" about whether a judge would stop him:

If you want to know the law and nothing else, you must look at it as a bad man . . . who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience. . . . If we take the view of our friend the bad man, we shall find that he does not care two straws for the axioms or deductions, but that he does want to know what the Massachusetts or English courts are likely to do in fact. I am much of this mind. The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law. (Holmes 1897)

If a president is Holmes's Good Man, he will obey the Constitution because it is the Constitution. The Treasury gave General Motors an illegal tax break. As a Good Man, he will read our article, feel remorse, and fire everyone involved.

If a president is Holmes's Bad Man, on the other hand—and public choice theory suggests that it is Bad Men who have the best chance of being elected—he will obey the Constitution only when a court can make him obey it.⁵ If he hears of our article, he will ignore it. As a lawyer, he knows that nobody has standing to challenge someone else's tax benefits in court. Thus, his "prophecy about what a court will do" is easy: nothing. The courts will reject any challenge for lack of standing, whatever the merits of a claim might be.

⁵ A politician who upholds his personal principles and resists the will of the median voter or leaves untouched the less honorable tools of political competition will, *ceteris paribus*, lose votes and lose elections. For more explanation, see Ramseyer (1995).

Can the Treasury Exempt Its Own Companies from Tax?

Only potential bad publicity would worry a Bad Man president. But publicity he can skirt by giving the funds through opaque provisions of the tax code. Publicity he can skirt by (take a deep breath) declaring an exemption from the application of Sec. 382 of the tax code to limits on carryforwards of NOLs following a sale under Sec. 363 of the Bankruptcy Code that uses preferred stock, credit bidding, and warrants by one company named GM to a different company also named GM. If the administration gave a billion dollars in cash to its supporters, the press would notice. If it gives it through the obscure details of the corporate tax code, the press will fall asleep.

In the article that follows, we explain the intricacies of the tax break (Section 2). We discuss the law involved (Section 3). If you think all presidents are Good Men, you may stop reading at that point. After all, following the Constitution is just a matter of understanding it. We explain it, you understand it, end of story. Lest some presidents be Bad Men, however, we conclude by exploring procedural reforms Congress might adopt to prevent a recurrence of what happened with GM.

2. WHAT HAPPENED

General Motors was a public corporation with much unsecured debt, including \$21 billion owed to the UAW Trust on behalf of retired workers and \$27 billion owed to bondholders. None of these stakeholders was senior enough to see much return if the company liquidated in pieces. Probably, none would see much return even if the firm found a buyer for the whole company.

The senior creditors were a diverse lot. The U.S. Treasury had a secured interest in \$19.4 billion from TARP loans and \$30.1 billion in other loans. The Canadian government held secured claims of \$9.2 billion. Government senior debt thus totaled \$58.7 billion. Private creditors held another \$5.9 billion in secured loans.

GM filed for bankruptcy under Chapter 11 of the Bankruptcy Code. To restructure its finances, it then negotiated a sale under Sec. 363 of the Code. For this transaction, it formed a new shell, New GM. Old GM then sold its assets to New GM. In exchange for its \$21 billion *unsecured* debt to Old GM, the UAW Trust received 17.5 percent of the common stock of New GM, \$6.5 billion in preferred stock, and \$2.5 billion in debt. In exchange for their \$27 billion of unsecured debt, the other junior creditors received 10 percent of the

common stock of New GM and warrants for another 15 percent. The private secured creditors (the \$5.9 billion claim) were paid in full. The Canadian government received 12 percent of the New GM common stock, and the U.S. Treasury received interests detailed shortly below.

To consider the stakes involved, note that in December 2010, New GM had stock worth \$54.4 billion and liabilities of \$12.9 billion (Ceraso, Moffatt, and Pati 2010), for a total asset value of \$67.3 billion. In effect, the sale price in the 363 offer was:

- \$58.7 billion in senior credit claims,
- \$5.9 billion paid to private secured creditors,
- \$5.4 billion in stock (10 percent of \$54.4 billion), and
- a portfolio of harder-to-value warrants.

This yields a total of \$67 billion plus warrants (Warburton 2010, p. 536).

Apparently, the 363-sale buyers paid \$67 billion plus the warrant value for assets worth \$67.3 billion. That seems a remarkably high price considering that no other bidder loomed on the horizon. The bankruptcy judge deserves praise for extracting so much value for Old GM's creditors.

This \$67.3 billion in asset value is not the net benefit to the 363-sale buyers or the senior creditors, however. That benefit depends on who owns the New GM equity and debt. Old GM's private secured creditors received \$5.9 billion in cash for their \$5.9 billion in debt. The Canadian government gave up its \$9.2 billion in Old GM debt but took a 12 percent stake in the common stock (worth $0.12 \times \$54.4 \text{ billion} = \6.5 billion) plus \$0.4 billion in preferred stock and \$1.3 billion in debt in New GM—for a total value of \$8.2 billion.

The most glaring anomaly involved the UAW. The union's trust gave up *unsecured* claims of \$21 billion and received:

- 17.5 percent of the stock of New GM worth ($0.175 \times \$54.4 \text{ billion} =$) \$9.5 billion,
- \$6.5 billion in preferred stock, and
- \$2.5 billion in debt,

for a total of \$18.5 billion. Given that the UAW Trust had been a junior creditor, this was a very good deal. By contrast, the other

Can the Treasury Exempt Its Own Companies from Tax?

unsecured creditors gave up claims of \$27 billion and received only 10 percent of the common stock and warrants.

Recall that the U.S. Treasury held secured debt totaling \$49.5 billion. In exchange for its claims, it took 61 percent of the stock in New GM (stock worth $0.61 \times \$54.4 \text{ billion} = \33.2 billion), \$2.1 billion in preferred stock, and a \$6.7 billion debt claim against New GM. All told, it received compensation of \$42 billion.

Focus on the U.S. government. Through the Sec. 363 sale, it—apparently—lost ($\$49.5 \text{ billion} - \$42 \text{ billion} =$) \$7.5 billion. Anyone who loses only ($\$7.5 \text{ billion} \div \$49.5 \text{ billion} =$) 15 percent on a \$49.5 billion loan to a failing firm does well indeed. Yet appearances deceive. The government also gave GM investors \$45 billion in NOLs. If the 363 sale had not gone through or the sale had been made to some outside buyer, these NOLs would have disappeared. The book value of these NOLs is \$18 billion.

To be sure, Treasury was giving tax breaks partly to itself, and the book value of the NOLs exceeds their market value since it would take some years before GM could exhaust them. If the market value of the NOLs were, say, \$12 billion (a little under the estimate of the stock analysts that we cite in Section 2.1 below), then that \$12 billion was incorporated into the \$54.4 billion equity value of the New GM, and we have overestimated the overall value of the deal for the Treasury. Of its \$33.2 billion in stock, \$7.32 billion ($= 0.61 \times \$12 \text{ billion}$) was a tax gift to itself.

More simply, consider the \$12 billion worth of NOLs an additional loss to the Treasury. In effect, the Treasury lent GM \$49.5 billion and lost ($[\$7.5 \text{ billion} + \$12 \text{ billion}] \div \$49.5 \text{ billion} =$) 39 percent. If only Treasury could have inserted a further secret \$20 billion of assets into New GM, New GM's stock price would have been so high that Treasury would have appeared to make a profit from the entire affair.

2.1 As GM Told It

Here is how GM describes its tax situation:

We recorded valuation allowances against certain of our deferred tax assets, which under ASC 852 also resulted in goodwill. (General Motors 2010, p. 82)

In July 2009 with U.S. parent company liquidity concerns resolved in connection with the Chapter 11 Proceedings and

the 363 Sale, to the extent there was no other significant negative evidence, we concluded that it is more likely than not that we would realize the deferred tax assets in jurisdictions not in three-year adjusted cumulative loss positions.

Refer to Note 22 to our audited consolidated financial statements for additional information on the recording of valuation allowances. (General Motors 2010, p. 138)

Table 1 from New GM's securities filings (p. F-121 of its Form 8-K) shows that New GM claimed to inherit over \$18 billion in tax carryforwards from Old GM.⁶ Stock analysts wrote:

We calculate an NPV of GM's deferred tax assets at \$17.2bn of which \$4bn is related to pension contributions and more than \$13bn related to accumulated NOLs and tax credits including R&D credits. (Morgan Stanley 2010)

and

Via a special regulation, GM's highly valuable US tax assets (worth \$18.9B in the US at 09-end) were left intact. . . . Our Dec-2011 price target assumes a present value of \$12.4B of (2011-ending) non-European global tax assets. . . . Present-valuing the \$18.6B face value figure using a 12 percent discount rate (Ford is 8 percent; we use 12 percent for GM to reflect the lower mix of debt in its cap structure), we arrive at a PV for global economic tax assets ex. Europe of \$12.4B at 2011-end. (J. P. Morgan 2010)

Thus, stock analysts were well aware of the existence and value of the NOLs, though they estimated their economic value at lower than their accounting value. This is an important element of the political economy of the situation. It was crucial both that the general public not realize that New GM's value was inflated by the taxes that the Treasury had agreed in advance to forgive, and that stock analysts did understand it. If the analysts missed the point, then when the government sold its GM stock, it would have received a much lower price. It would have given away government revenue,

⁶ Not all these tax carryforwards were necessarily NOLs, strictly speaking. They may also include "built-in losses" on assets that declined in value and unused tax credits.

Table 1
Components of GM's Temporary Differences and Carryforwards That Give Rise to Deferred Tax Assets and Liabilities

	Successor		Predecessor	
	December 31, 2009		December 31, 2008	
	Assets	Liabilities	Assets	Liabilities
Postretirement Benefits Other Than Pensions	\$4,194	—	\$11,610	—
Pensions and Other Employee Benefit Plans	\$8,876	\$406	\$16,171	\$8,648
Warranties, Dealer and Customer Allowances, Claims and Discounts	\$3,940	\$75	\$6,682	\$90
Property, Plants, and Equipment	\$7,709	\$278	\$7,429	\$3,197
Intangible Assets	\$1,650	\$4,984	\$780	—
Tax Carryforwards	\$18,880	—	\$18,080	—
Miscellaneous U.S.	\$5,844	\$1,269	\$8,122	\$288
Miscellaneous non-U.S.	\$3,306	\$1,944	\$3,485	\$773
Subtotal	\$54,399	\$8,956	\$72,359	\$12,996
Valuation Allowances	\$(45,281)	—	\$(59,777)	—
Total Deferred Taxes	\$9,118	\$8,956	\$12,582	\$12,996
Net Deferred Tax Assets (liabilities)	\$162		\$(414)	

Source: General Motors Form 8-K (2010), p. F-121.

but without disguising the cost of its bailout—approximately halving it from \$24 billion to \$12 billion (Terlap 2011).

2.2 Other Firms

Although we focus on GM, Treasury gave legally unauthorized NOLs to two other firms as well. As with GM, it did this by issuing TARP-specific notices about the availability of NOLs. Citigroup, for example, claimed “tax assets” of \$46.1 billion at the end of 2009. In June 2009, Citigroup and the Treasury agreed to exchange the government’s preferred stock for common stock. The government acquired a 33.6 percent ownership stake. In December 2009, Citigroup raised \$20.3 billion by issuing about 24 percent new common stock, so Citigroup had passed the threshold for a 50 percent ownership change. In 2010, Treasury sold all of its 7.7 billion shares of common stock for \$31.85 billion, a gain of \$6.85 billion. According to Citigroup:

The common stock issued pursuant to the exchange offers in July 2009, and the common stock and tangible equity units issued in December 2009 as part of Citigroup’s TARP repayment, did not result in an ownership change under the Code. (Murphy 2010)

By “ownership change,” it referred to the Sec. 382 rule detailed in Section 3 below. It based its claim that the section did not apply to it on the Treasury’s notices.

For Citigroup, the NOLs had additional importance because of its status as a bank. Banks must worry about regulatory capital requirements. As Davidson (2011) explains:

Banks hold NOLs as deferred tax assets (DTA’s). DTA’s, in turn, constitute a portion of a bank’s tier 1 capital. Were Citigroup to have lost its ability to use its NOLs, it might have had to write down its tier 1 capital.

A footnote adds:

12 C.F.R. sec. 225 at appendix A.II.A.1. NOLs may constitute up to 10 percent of tier 1 capital, to the extent that the institution “is expected to realize [a tax deduction by their use] within one year . . . based on its projections of future taxable revenue for that year.”

Can the Treasury Exempt Its Own Companies from Tax?

After many travails, in January 2011 AIG completed a reorganization that gave Treasury 92.1 percent of its common stock. AIG claimed “Deferred tax assets: Losses and tax credit carryforwards” of \$26.2 billion at the end of 2009. It claimed other valuable tax attributes as well,⁷ including “Unrealized loss on investments” of \$8.7 billion (AIG 2009, p. 334). These, too, hinged on notices exempting the firm from the coverage of Sec. 382. AIG acted on the assumption that it had not yet had an “ownership change” for tax purposes. It was worried enough about a private-market 50 percent ownership change that would trigger Sec. 382, however, that it installed a poison pill to prevent large share purchases.

3. THE LAW

In fact, the law—arcane in the extreme—does not grant New GM the NOLs it claims if the government sells its shares. Neither does it grant Citigroup and AIG any right to the tax assets they claimed. To be sure, the law lets the GM NOLs survive the Sec. 363 sale in bankruptcy, as we will show. To that extent, New GM did inherit the NOLs. It can continue to use them, however, only so long as the Treasury holds its stock. Once Treasury sells its shares to the public, New GM should by statute lose its access to most if not all of the loss carryforwards.

New GM did claim the NOLs and the Treasury concurred. For 2010, New GM had access to the losses because the government had not yet sold enough of its stock. But once it sells, New GM will be able to claim the losses only because the Treasury told New GM it could. Through a series of notices, it declared that the statutory limitations on the use of NOLs after a defined “ownership change” did not apply if the Treasury owned the stock. The statute itself did not differentiate between government and nongovernment owners. Nonetheless, as we will explain in detail later, Treasury wrote that New GM could continue to claim the NOLs after it sold its stock, and New GM happily deferred.

First, however, we must go into how New GM could possibly acquire the NOLs in the first place. The law is massively opaque,

⁷ According to AIG (2009), “The application of U.S. GAAP requires AIG to evaluate the recoverability of deferred tax assets and establish a valuation allowance, if necessary, to reduce the deferred tax asset to an amount that is more likely than not to be realized (a likelihood of more than 50 percent).”

but that is the point. Precisely because the corporate tax rules are as complex as they are, the administration could successfully deflect attention from what it did.

3.1 Cancellation of Indebtedness and Net Operating Losses

Consider the tax treatment of cancelled debt, relevant here because of the cancellation of Old GM's debt to the Treasury. Suppose a firm has debt outstanding. It negotiates with its creditors and they agree to trade their debt claims for stock. The firm will have cancellation of indebtedness (COD) income equal to the difference between the face amount of the cancelled debt and the market value of the stock distributed (I.R.C. Secs. 61, 108(e)(8); *U.S. v. Kirby Lumber Co.*, 284 U.S. 1 (1931)).

Now suppose the firm is insolvent. If its creditors swap their claims for stock, under general tax principles it will have COD income. In fact, however, the Internal Revenue Code provides that what would otherwise be COD income will not constitute taxable income. Instead, under Sec. 108 of the code, the firm will need to reduce the amount of its other "tax attributes" by the amount of the COD income excluded. Most relevant here, it will need to reduce the amount of its NOLs by the amount of the excluded income. Given that \$1 of NOL would reduce net taxable income by \$1, this obviously leaves the firm (in many cases) in much the same position as if it had included the COD income all along (I.R.C. Sec. 108(a)(1)(B), (b)(2)(A)).

Finally, suppose the firm is solvent but files for reorganization under bankruptcy. If, as part of its bankruptcy reorganization, the creditors swap their claims for stock, the result (for purposes here) is the same as if the firm were insolvent. Under Sec. 108, it can exclude the COD from income, but it must offset the excluded amount against its NOLs (I.R.C. Sec. 108(a)(1)(A), (b)(2)(A)).

3.1.1 Tax Reorganizations

Many reorganizations under the bankruptcy code also constitute "reorganizations" under the tax code. If, but only if, a transaction qualifies as a "reorganization" under the tax code, a firm that takes the assets of another firm may also take its NOLs. Note that although both the bankruptcy and the tax codes use the term "reorganization," the word refers to different concepts in each. Those concepts are not interchangeable.

Can the Treasury Exempt Its Own Companies from Tax?

In general, reorganizations in bankruptcy are “G reorganizations” under the tax code, meaning that they fall under Sec. 368(a)(1)(G) of the Internal Revenue Code:

[A] transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case; but only if . . . stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

Note two points relevant here: First, “Section 363 sales” occur in a “title 11 or similar case.” “Title 11” (not “Chapter 11”) refers to the Bankruptcy Code, and “section 363” refers not to Sec. 363 of the tax code but to Sec. 363 of the Bankruptcy Code. As a result, if a “debtor in possession” (a bankruptcy concept) sells its assets under Sec. 363, it sells its assets in a Title 11 case. The court of *In re Motors Liquidation Co.*, 430 B.R. 65 (S.D.N.Y. 2010) explicitly indicated that a Sec. 363 sale (indeed, exactly the GM sale at issue here) could constitute a qualifying G reorganization. This is the position the Treasury has long taken as well (e.g., in Ltr. 8503064 (Oct. 24, 1984); Ltr. 8521083 (Feb. 27, 1985)).

Second, Sec. 354 of the tax code requires merely that *some* security holders (not *only* security holders) of the old firm receive “stock or securities” of the new firm. I.R.C. Sec. 354(a) provides:

No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization . . . are . . . exchanged solely for stock or securities in . . . another corporation a party to the reorganization.

Suppose the creditors to the old firm include both long-term bond holders and trade creditors. Suppose both receive stock in the new firm. The former held “securities” in the old firm, but the latter did not (i.e., bonds are securities, trade credit is not). For at least three decades, the Treasury has taken the position that the transaction qualifies under Sec. 354 even though some of the stock goes to creditors who did not hold securities. Instead, it has argued that a transaction qualifies under Sec. 354 if at least one of the old firm

creditors who received stock in the transaction held a security of the old firm.⁸

3.1.2 *Net Operating Losses*

Only in a qualifying tax reorganization will a firm that acquires the assets of another also acquire its NOLs. Suppose again that a firm induces its creditors to swap their claims for stock. Suppose further that some NOLs remain after the Sec. 108 adjustments detailed earlier.

Generally, if a debt-for-stock swap occurs as part of a transaction in which a firm sells its assets to another firm, the acquiring firm will not obtain its NOLs, too. After all, the losses are specific to the selling firm. The acquiring firm buys the seller's assets, but it does not—indeed, legally cannot—buy its “tax losses.” Conceptually, these tax attributes describe the financial characteristics of a firm; they are not “things” that firms can buy and sell.

Under Sec. 381 of the tax code, however, if one firm buys the assets of another firm in a qualifying tax “reorganization,” it also acquires its NOLs. More specifically, Sec. 381(a) provides:

In the case of the acquisition of assets of a corporation by another corporation . . . in a transfer to which section 361 . . . applies, but only if the transfer is in connection with a reorganization described in subparagraph . . . (G) of Section 368(a)(1), the acquiring corporation shall succeed to . . . the items described in subsection (c) of the . . . transferor corporation.

Note two observations. First, if a firm exchanges its assets for stock as part of a G reorganization, Sec. 361 will apply to the exchange. In turn, that section specifies that the two firms recognize no gain or loss on the transaction. Second, Sec. 381(c)(1) lists “net operating losses.” Provided the debt-for-stock swap occurs in a G reorganization, an acquirer takes the seller's NOLs along with its assets.

⁸ For examples, see “Bankruptcy Tax Act of 1980: Report of the Committee on Ways and Means, U.S. House of Representatives on H.R. 5043” (Washington: Government Printing Office, 1980); Ltr. 8503064 (Oct. 24, 1984); Ltr. 8521083 (Feb. 27, 1985); and see generally Pickerill (2009).

3.1.3 *The Law Applied to GM*

Now turn to the reorganization of GM. Insolvent, GM filed for reorganization in bankruptcy court in the Southern District of New York. It sold its assets to a newly formed corporation (New GM) in a Sec. 363 sale. In exchange, it received stock in the new firm that it distributed to its bond holders and other creditors.

Absent Sec. 108, GM would have had COD income equal to the difference between the amount of its debt and the value of the stock it distributed. We will see next, however, that in bankruptcy the rule may be different.

3.2 **Change in Control**

A firm that buys another firm's assets in a G reorganization cannot necessarily use the transferor's NOLs immediately. To limit "trafficking" in tax losses, Sec. 382 of the tax code limits a firm's ability to use the NOLs of a "loss corporation" that it buys (defined at Sec. 382(k)). The limits apply whenever one set of the loss corporation's shareholders sells over 50 percent ownership to another set within a three-year period.⁹ And these limits then restrict the amount of the NOLs that the firm can use to a "section 382 limitation" amount:

The section 382 limitation for any post-change year is an amount equal to-

- (A) the value of the old loss corporation, multiplied by
- (B) the long-term tax-exempt rate.

⁹ I.R.C. Sec. 382(g)(1). The statute says an ownership change is triggered by an increase of 50 percentage points by a 5-percent shareholder. The statute lumps all small shareholders together as a single fictitious 5 percent shareholder. Thus, if a 100 percent owner sells out entirely to small shareholders, that counts as an increase of over 50 percentage points by a 5 percent shareholder. If, however, the new small owners then trade 60 percent among themselves without anybody reaching 5 percent, that does not count.

The regulations clarify using examples. CFR Sec. 1.382-2T(j)(2)(iii)(B)(2), Example (3) says:

L is entirely owed by Public L. L commences and completes a public offering of common stock on January 22, 1988, with the result that its outstanding stock increases from 100,000 shares to 300,000 shares. No person owns as much as five percent of L stock following the public offering. . . .

New Public L is a 5-percent shareholder that has increased its ownership interest in L by more than 50 percentage points during the testing period (by 66 2/3 percentage points). Thus, there is an ownership change with respect to L.

Consider how this 382 scheme works. Suppose, first, that a *solvent* firm *not* in bankruptcy convinces its creditors to swap their debt claims for stock. It will recognize COD income. It will apply its NOLs against that income. And if any NOLs remain, then if one set of shareholders sells over 50 percent ownership to another, the firm will be able to use only the product of its earlier value and the long-term tax-exempt rate (I.R.C. Sec. 382(b)(1)).

Suppose, second, that a firm convinces its creditors to swap their claims for stock in a bankruptcy proceeding. As noted earlier, under Sec. 108 it will not recognize its COD as income but will reduce the amount of its NOLs by the amount of that excluded COD. Importantly, under some circumstances Sec. 382 will *not* thereafter limit its ability to use its NOLs *even if* there has been a Sec. 382 change in control. Instead, Sec. 382(l)(5) states that the limits do not apply if

- the transaction occurs in a Title 11 case, and
- “the shareholders and creditors of the old loss corporation . . . own . . . stock of the new loss corporation” equal to at least 50 percent (I.R.C. Sec. 382(l)(5)).

Potentially, NOLs could (only “could”—even under (l)(5) the NOLs do not necessarily live) survive bankruptcy proceedings in full.

Suppose, third, that an insolvent firm does not file for bankruptcy but still induces its creditors to swap their debt claims for stock. Absent more, according to Sec. 382, its NOLs will disappear. They will disappear because the firm can thereafter only use a portion of its earlier value (“the value of the old loss corporation”), and Sec. 382 defines that earlier value as “the value of the stock” of the insolvent corporation (I.R.C. Sec. 382(e)(1)). Because the firm was insolvent, its stock was worth nothing (or nearly nothing). The product of the “value of the old loss corporation” and the “long-term tax-exempt rate” will fall to zero, and the NOLs will disappear.

Finally, suppose an insolvent firm does not meet Sec. 382(l)(5)’s 50 percent test. Provided it negotiates its debt-for-stock swap within a bankruptcy filing, under Sec. 382(l)(6) it may add to the value of the firm used to calculate the amount of annual useable NOLs the value created by canceling the creditors’ claims. It can use each year, in other words, a proportional share not just of the value of the pre-reorganization firm but of that value plus any value attributable to the debt cancellation (I.R.C. Sec. 382(l)(6)).

3.2.1 *The Law Applied to GM*

After its Sec. 363 sale, the creditors of Old GM owned 100 percent of the stock of New GM. Under Sec. 382(l)(5), all of its NOLs may have survived. If the old creditors obtained less than 50 percent of the stock of New GM, then under Sec. 382(l)(6) New GM would have been able to use only an amount of NOLs calculated by adding the value of the canceled debt to the value of Old GM.

3.3 **Later Control Shifts**

Even for New GM, however, Sec. 382 created a risk. First, suppose that New GM tried to avoid the limits on its NOLs through Sec. 382(l)(5). If within two years of the reorganization, the stock owned by any set of 5 percent shareholders increased by 50 percentage points, then the NOLs disappeared. Subsec. (l)(5) couples its apparent generosity with a draconian penalty: if a firm meets the terms of (l)(5), it potentially enjoys the NOLs without the standard Sec. 382 reduction; but if it then shifts ownership within two years, it loses those NOLs entirely.

Second, even if New GM does not claim the Subsec. (l)(5) benefit, it still jeopardizes much of its NOLs if ownership changes. Suppose New GM claimed the benefit of Subsec. (l)(6) instead. If within three years one set of shareholders sells over 50 percent ownership to another, then the firm will be able to use only the "section 382 limitation" amount.

The problem for New GM lay in the fact that it exited its G reorganization with the U.S. government holding 61 percent of its stock. If the government recovers its investment by selling all of that stock within two years (for Subsec. (l)(5)), or three years (for Subsec. (l)(6)), it will probably cause an ownership change under the terms of Sec. 382. We say "probably" because we do not know how many other shareholders will trade during the same period. If it does trigger an "ownership change," it will either face the Sec. 382 limits to its NOLs under Subsec. (l)(6) or lose its NOLs entirely under Subsec. (l)(5).

In November 2010, the Treasury did reduce its stake in GM from 61 percent to 33 percent. If Treasury, or any other large shareholder, transfers an additional 22 percent of the stock, GM will face the Sec. 382 limits on its net operating losses.

The cases of AIG and Citigroup are even clearer. Already, the government has triggered an ownership change in both companies. The Treasury acquired a majority of AIG's stock, and it acquired enough of Citigroup's stock that, combined with Citigroup's new

capital issue, it caused a 50 percent ownership change. Thus, by law, both firms should lose their NOLs.

3.3.1 *The IRS Notices*

If the Treasury lets a firm claim a NOL to which the law does not entitle it, Treasury merely gives the firm a gift. TARP does authorize Treasury to give gifts. As a result, the superficial choice would seem to be, if Treasury wants to enrich a firm, it can either give it money under TARP or let it take an extra NOL. Either way, it transfers funds from the public fisc to the firm.

To give funds under TARP, however, Treasury must follow statutory guidelines. It must give its gifts in amounts and to firms and for purposes described by Congress in the legislation. When it unilaterally authorizes NOLs, by contrast, it escapes all those congressional constraints.

And that is exactly what the Treasury did. From 2008 to 2010, it issued a series of notices exempting firms in specified industries from the statutory restrictions under Sec. 382 on the use of NOLs. The statute establishing TARP authorized Treasury to issue “regulations and other guidance” to implement it,¹⁰ and Sec. 382(m) authorized Treasury to issue the regulations necessary to implement Sec. 382.

Treasury issued the first of these notices in mid-2008. Notice 2008-76 exempted from Sec. 382 the acquisition of stock of a loss corporation by the United States under the Housing and Economic Recovery Act of 2008. The notice covered Fannie Mae and Freddie Mac. Notice 2008-83 authorized banks to take certain deductions under 382(h). Commonly called the “Wells Fargo Ruling,” it was predicted to cost the government between \$105 to \$110 billion (Paley 2008). The Jones Day law firm estimated its cost at \$140 billion.¹¹ (As we will see, this notice was terminated, so the actual costs were much smaller.)

¹⁰ *Emergency Economic Stabilization Act of 2008*, P.L. 11-0343, 122 Stat. 3765, Sec. 101(c)(5).

¹¹ The law firm backtracked some months later to defend the notice strongly and say that it was “quite modest” and “not a significant tax subsidy.” See *Revisiting Notice 2008-83*, Jones Day, December 2008. Jones Day had estimated the Wells Fargo merger alone to have benefited by some \$25 billion. The original Jones Day article was taken down from the web, but it is quoted in Paley (2008). Just one other merger, PNC’s acquisition of National City, benefited by an estimated \$5.1 billion. See J. Drucker, “PNC Stands to Gain From Tax Ruling; Acquisition of National City Will Bring Billions in Deductions, Experts Say,” *Wall Street Journal*, October 30, 2008.

Can the Treasury Exempt Its Own Companies from Tax?

In Notice 2008-84, the Treasury announced that it would not test for ownership changes on days when the United States owned a 50 percent interest in a loss firm.

Notice 2008-100 declared that an acquisition by Treasury of acquired stock in a loss corporation would not trigger the 382 limitations. Since Treasury acquired New GM's stock in a G reorganization qualifying under Sec. 382(l)(5), GM may have escaped the Sec. 382 limitations in its initial reorganization anyway. By contrast, firms like Citigroup and AIG were not G reorganizations.

Notice 2009-14 of February 17, 2009, purported to "amplify" 2008-100. In fact, it explicitly covered the auto industry and provided that the Treasury's initial acquisition would not trigger the Sec. 382 limitations (again, given that GM used a G reorganization, ultimately it would not need the assurance 2009-14 offered). Notice 2009-38 continued in much the same vein.

Only in January 2010, half a year after GM's Sec. 363 sale, would the Treasury tackle the firm's real Sec. 382 problem: What happens when Treasury sells its stock? To resolve this question, January 11th's Notice 2010-2 changes the law in two crucial ways.

First:

For purposes of measuring shifts in ownership by any 5-percent shareholder on any testing date occurring on or after the date on which an issuing corporation redeems stock held by Treasury that had been issued to Treasury pursuant to the Programs. . . , the stock so redeemed shall be treated as if it had never been outstanding.

Picture the problem. Rather than sell its shares to other investors, the Treasury might sell its shares back to the firm. If it did so, the percentage held by the other investors would—necessarily—rise. In Notice 2010-2, the Treasury declared that the increase would not trigger Sec. 382.

Second:

If Treasury sells stock that was issued to it pursuant to the Programs . . . and the sale creates a public group ("New Public Group"), the New Public Group's ownership in the issuing corporation shall not be considered to have increased solely as a result of such a sale.

Even if the Treasury sells its shares to the public, the sale will not trigger Sec. 382. Thus, in Notice 2010-2, the Treasury finally addressed New GM's Sec. 382 problem.

3.3.2 *The Statutory Amendment*

But could the Treasury legally issue Notice 2010-2? Could it legally issue any of these Sec. 382 notices?

Congress in its legislation objected to some of what Treasury did, validated some, and left most notices unaddressed. The issues of the Treasury's TARP-related Sec. 382 notices came up in the American Recovery and Reinvestment Tax Act of 2009 (better known as the 2009 stimulus bill).

First, the Conference Committee added a provision to the tax code, Sec. 382(n)(1), to exempt from Sec. 382 advances of TARP funds that had an explicit requirement for a restructuring plan (neither the original House nor the original Senate version had anything like this). From the conference report (U.S. Congress 2009, pp. 560–61):

The limitation contained in subsection (a) shall not apply in the case of an ownership change which is pursuant to a restructuring plan of a taxpayer which-

(A) is required under a loan agreement or a commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and

(B) is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.

(2) SUBSEQUENT ACQUISITIONS.-Paragraph (1) shall not apply in the case of any subsequent ownership change unless such ownership change is described in such paragraph.

The same auto-industry Sec. 382 exemption (but explicitly for auto companies) had been proposed in December 2008 in a bailout bill that passed the House and was supported by Republican President George W. Bush, but was killed by Senate Republicans.¹²

¹² See: J. Puzzangherra, "Auto Bailout Dies in Senate: Big 3 Could Opt for Bankruptcy after a Late Compromise Attempt Fails to Satisfy GOP Opponents." *Los Angeles Times*, December 12, 2008; M. Leone, "Grab Coveted Losses, Buy a Car Company," *CFO.com*, December 12, 2008.

Can the Treasury Exempt Its Own Companies from Tax?

Second, the act authorized the Wells Fargo notice as far as bank mergers that happened before January 16, 2010, but not afterward. The drafters explained that Congress did this because it found Treasury's various TARP notices outrageous but thought it should save taxpayers who relied on them anyway. The drafters continued:¹³

Congress finds as follows:

- (1) The delegation of authority to the Secretary of the Treasury, or his delegate, under section 382(m) does not authorize the Secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers;
- (2) Internal Revenue Service Notice 2008-83 is inconsistent with the congressional intent in enacting such section 382(m);
- (3) the legal authority to prescribe Notice 2008-83 is doubtful;
- (4) however, as taxpayers should generally be able to rely on guidance issued by the Secretary of the Treasury, legislation is necessary to clarify the force and effect of Notice 2008-83.

3.3.3 Notice 2010-2

Now return to Notice 2010-2 and ask the obvious question: Given Sec. 382(n), why did Treasury issue the notice? It did so because Subsec. (n) did not cover a sale by the Treasury to the public. Subsec. (n)(1)(A) may have covered the Treasury's initial stock acquisition. After all, the Treasury took its equity interest as part of its TARP investment, so perhaps it "required" the stock "under a loan agreement." Ironically, however, Treasury did not need Sec. 382(n) for GM since GM restructured itself as a tax-free G reorganization. And Sec. 382(n) was not applicable to the purchases of equity in Citigroup and AIG because they were financial firms, not manufacturers.

Subsec. 382(n)(1) did not protect GM from Treasury's re-sale of the stock it acquired. When Treasury lent GM the money, it did not "require" its own re-sale under the loan agreement. It would be an odd agreement that required the lender to sell any stock it obtained. And if it did not require the re-sale, then Sec. 382(n)(1) did not

¹³ P.L. 111-5, American Recovery and Reinvestment Act of 2009, section 1261 (paragraph indentation added).

exempt Treasury's sale of its shares to the public from the Sec. 382 limitations.

This put Treasury in a bind. Congress claimed not to like the way the Treasury helped the financial institutions. It declared that it had not authorized Treasury to issue the notices it did.¹⁴ But absent a notice, Treasury would trigger the Sec. 382 limitations at GM when it sold its stock.

Apparently Treasury responded, "Congress won't mind." To move \$18 billion to New GM, it needed to be able to assure the firm and its investors that GM would continue to have access to the accumulated losses after Treasury sold its stock. Sec. 382(n) did not offer that assurance. Through Notice 2010-2, Treasury offered it anyway.

4. RATIONALE, DEFERENCE, AND RELIANCE

Treasury does not explain why the notices promote the policy behind Sec. 382. Davidson (2011) nicely lays out the case Treasury might have made (without endorsing it; she later gives the counterargument, too):

Section 382(m) gives the Secretary authority to issue regulations "necessary or appropriate to carry out the purposes of" section 382, so one must look to the purpose of section 382.

As a broad matter, section 382 is meant to prevent the trafficking in losses and to preserve "the integrity of the carryover provisions," which perform an "averaging function by reducing the distortions caused by the annual accounting system." More specifically, Congress was concerned with matching items of income and loss.

The TARP Guidance did not violate these principles by trafficking in losses, in the generally understood meaning of the phrase. The government did not acquire shares in these banks in order to use their loss carryforwards; it did so to stabilize the financial sector. Looking beyond the acquirer's motives, because the government does not pay taxes, it is not even

¹⁴ Although Congress spoke sternly in the 2009 stimulus bill of how the Wells Fargo notice infringed on its authority as legislature, it made no comment on the other dubious notices that Treasury had issued by February 2009. A footnote on p. 560 of the stimulus bill conference report (U.S. Congress 2009) mentions the Treasury notices 2008-39, 2008-100, and 2009-14 without commenting on their validity.

Can the Treasury Exempt Its Own Companies from Tax?

capable of trafficking in losses in the traditional sense. The TARP Guidance also did not violate the integrity of the carry-over provisions. Losses created by TARP banks remain with the bank—they will only be used to offset income of that bank. When shares are sold to the public, the guidance was careful to limit its application to buyers in the public group. This prevents another corporation from acquiring the bank to use its NOLs. Losses of a TARP bank will not be able to be used by any other institution by means of a TARP-related acquisition. From the perspective of avoiding the trafficking in losses and maintaining the integrity of the carryover provisions, the TARP Guidance were “appropriate to carry out the purposes of” section 382. [Footnotes omitted.]

This is unsatisfactory. The Treasury does not pay taxes, but the other investors in New GM do. For them, the ability to invest in a company that earns its income tax-free for the indefinite future is a major advantage.

What is more, the purpose behind a section does not matter when its language is clear. Sec. 382 routinely covers transactions not motivated by tax avoidance, and the Treasury does not exempt them from the section by appealing to “purpose.” Sec. 382 covers non-abusive transactions because it is, at root, a “prophylactic rule.” By their very nature, prophylactic rules cover transactions one would not necessarily cover if “purpose” were all that mattered.

That the government buys stock does not itself imply that different ownership change rules should apply. The United Kingdom, for example, imposes a rule similar to Sec. 382. It does not make special allowance for government-owned stock. As KPMG explained:

The UK tax code contains similar provisions preventing the carry forward of losses following a 50 percent or more ownership change, but only when there is a “major change in the nature or conduct of the trade” within three years of the change of ownership. But, in contrast to the position in the US, the acquisition of shares by the UK government does count in measuring whether there has been an ownership change. (KPMG 2010)

The U.S. statute does not exempt government-owned stock and neither does the UK’s.

Ultimately, tax benefits did play a major role in these transactions. By letting New GM keep NOLs to which it was not legally entitled, Treasury gave the firm (and its owners, including the UAW) \$18 billion more in assets. Had the administration tried to give GM \$18 billion forthrightly, voters might have complained. By hiding the gift in an obscure tax section, it reduced that electoral scrutiny. But the investors who bought New GM shares noticed. They paid a higher price than they otherwise would have paid.¹⁵ And necessarily, the UAW, the government of Canada, and the former bondholders also noticed.

4.1 Court Deference

The executive branch continually interprets statutes as it issues regulations. Courts do too, and often make interpretations that outsiders such as ourselves consider ridiculous. It is generally accepted that courts should be allowed to have the final word in interpretation nonetheless. Could it be that the executive branch, in interpreting tax law, similarly has the final word? In fact, courts have ruled it does not—a sensible rule. Courts do defer to executive branch interpretations of statutes in many circumstances, but not in those like the TARP notices.

On January 11, 2011, the U.S. Supreme Court made clear in *Mayo Foundation v. U.S.*, 131 S. Ct. 704 (2011), that courts should treat tax regulations just like any other regulations. The case concerned a statute that exempted students from Social Security and Medicare taxes withholding. In 2004, the Treasury promulgated regulations under which medical residents were not students. The Mayo Clinic challenged the regulation, and the Court held it valid. Courts should treat tax regulations like any other, it explained.

Under the well-known “*Chevron*” rule by which it sometimes defers to executive agencies (*Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984)), explained the Supreme Court, courts should first ask whether Congress had “directly addressed the precise question at issue.” If not, then they should defer to the agency unless the rule was “arbitrary or capricious in substance, or manifestly contrary to the statute” (*Mayo* 2011, p. 711). It would not, the Court explained, “carve out an approach to administrative

¹⁵ Note that this reduces the net cost to the government of the notice, since the Treasury will be able to re-sell its shares at a higher price.

Can the Treasury Exempt Its Own Companies from Tax?

review good for tax law only. . . . The principles underlying our decision in *Chevron* apply with full force in the tax context” (p. 713).

Nonetheless, this deferential standard applies only when Congress intended to delegate to the agency and the agency followed standard rulemaking procedures. Continued the Court (p. 714):

We have explained that “the ultimate question is whether Congress would have intended, and expected, courts to treat [the regulation] as within, or outside, its delegation to the agency of ‘gap-filling’ authority.” [*Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 157, 173 (2007)]. In the *Long Island Care* case, we found that *Chevron* provided the appropriate standard of review “[w]here an agency rule sets forth important individual rights and duties, where the agency focuses fully and directly upon the issue, where the agency uses full notice-and-comment procedures to promulgate a rule, [and] where the resulting rule falls within the statutory grant of authority.”

Notice 2010-2 fails both of those requirements. First, Congress expressly declared that it did not intend to delegate this authority to Treasury. Notice 2010-2 applied only to financial institutions, automobile companies, and other specific TARP recipients. Yet, Congress announced in its committee report, “section 382(m) does not authorize the Secretary to provide” “special rules that are restricted to particular industries or classes of taxpayers.” As a result, the earlier TARP Notice 2008-83 was “inconsistent with the congressional intent” and of only “doubtful” “legal authority.” Notice 2010-2 is precisely such an industry-specific rule.

Second, Notice 2010-2 is not a regulation. It is a “notice.” The *Mayo* Court declared *Chevron* appropriate where an agency uses “full notice-and-comment procedures to promulgate a rule.”¹⁶ By contrast, the Supreme Court explained in *Christiansen v. Harris County*, 529 U.S. 576 (2000):

¹⁶ The Treasury is notorious for its cavalier attitude toward the Administrative Procedure Act. In *Intermountain Insurance Service of Vail v. Commissioner of Internal Revenue Service*, No. 10-1204 (June 21, 2011), p. 32 (D.C. Circuit, 2011), the Commissioner “simultaneously issued immediately effective temporary regulations and a notice of proposed rulemaking for identical final regulations and then held a 90-day comment period [receiving just one comment] before finalizing the regulations.” The opinion goes on to say that this procedure is “typical of the Commissioner’s practice.”

Interpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant *Chevron*-style deference. Instead, interpretations contained in formats such as opinion letters are [governed by *Skidmore*].

Turning now to *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), the Supreme Court considered the agency's logic, but made its own decision (p. 140):

We consider that the rulings, interpretations and opinions of the Administrator . . . constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.

In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court went further and declared that as a general rule an agency interpretation would have to go through notice and comment to receive *Chevron* deference. In Notice 2010-2, Treasury did not try to reason or persuade. It simply declared the rule so. As Smith (2011, pp. 1260, 1261) puts it:

Mayo benefits taxpayers by clarifying that the *Mead* principles apply in tax. When the *Mead* test is applied to revenue rulings, revenue procedures, and notices, the conclusion is that they are not among the types of agency guidance that receive *Chevron's* high level of deference.

. . . Any pre-*Mayo* case law on the status of revenue rulings, revenue procedures, and notices should generally be considered obsolete unless the opinion reflects *Mead* analysis. The clear conclusion that those forms of guidance do not qualify for the level of deference described in *Chevron* is another benefit to taxpayers from *Mayo*.

Because the Treasury did not follow notice-and-comment procedures, the GM notices would not qualify for *Chevron* deference, even if the statutes they purport to interpret were indeed ambiguous.¹⁷

4.2 Taxpayer Reliance

Suppose the TARP notices were invalid. Should taxpayers be able to rely on them anyway, since it is the fault of Treasury and not the taxpayer?¹⁸ Notice 2010-2 provides:

Taxpayers may rely on the rules described in Section III of this notice. These rules will continue to apply unless and until there is additional guidance.

This is profoundly self-serving, of course. The Treasury cannot change the law by fiat. A bureaucrat cannot give his friend funds illegally and then protect that friend by declaring his friend's reliance protected. If a court held Notice 2010-2 illegal, GM could not cite the notice as authority for deducting \$45 billion in NOLs anyway.

The relevant question goes to penalties: May a taxpayer who relies on the notices avoid civil and criminal penalties? As Rogovin and Korb (2008, p. 341) explain:

As with revenue rulings and revenue procedures, announcements and notices can provide substantial authority sufficient to relieve taxpayers from the negligence and substantial understatement penalties and, consequently, may be relevant to whether certain penalty provisions apply.

¹⁷ We should mention a caveat. In *Intermountain Insurance*, cited earlier, the court gave *Chevron* deference to Treasury regulations in Treasury's appeal, even though those regulations were written after Treasury had already lost in Tax Court. Perhaps Treasury could re-issue the GM regulations with a pretence of notice and comment. The tax provision at issue in *Intermountain*, however, is important and has resulted in split circuits (3-2), and so is likely to go to the Supreme Court. See K. B. Friske and D. Pulliam, "Circuit Split Deepens on Six-Year Period for Basis Overstatements," *Journal of Accountancy*, May 2011.

¹⁸ Before the Treasury and other owners (including the 10 percent given to Old GM) sell enough stock to trigger the 50 percent threshold, use of the NOLs would be legal even without Notice 2010-2. GM is now, however, a publicly traded company and has told the public that the NOLs are part of its assets, though without 2010-2 they will not be if the Treasury sells its stake. Thus, the immediate question would be whether GM has thereby violated federal securities laws.

Sec. 6662 of the code imposes a penalty for any “substantial understatement of income tax.” Subsec. (d)(2)(B) protects a taxpayer who relies on “substantial authority.” According to the Treasury, its own notices are “substantial authority” (Rogovin and Korb 2008, Reg. 1.6662-4(d)(3)(iii)), though it also explains that the “weight accorded an authority depends on its relevance and persuasiveness” (Reg. 1.6662-4(d)(3)(ii)).

Consider the weight appropriate to Notice 2010-2. First, the Treasury itself declares it “substantial authority.” This is, of course, again self-serving. Acting on behalf of the administration, the Treasury has manipulated tax procedure to route \$18 billion to its supporters’ car company. In essence, it also argues that its manipulation insulates those favored taxpayers from “substantial underpayment” penalties.

Second, Notice 2010-2 does not try to persuade. It simply declares. But if an IRS notice were to announce that Microsoft did not have to pay taxes because Bill Gates paid the Treasury secretary \$1 million in bribes, the announcement would hardly give Microsoft substantial authority. Here, the Democratic administration has given a massive tax benefit to one of the party’s biggest supporters. Like other labor unions, the UAW provided the Obama campaign with elaborate assistance. Some of the help came in person, and some came as money. From 1989 to 2010, the UAW spent over \$27 million on political campaigns, 98 percent of it on behalf of the Democratic Party.¹⁹ In 2008 alone, it spent \$2,119,937 on political campaigns, \$2,101,187 of that for Democrats.²⁰

Suppose that Notice 2010-2 had said:

The President is grateful to the UAW for the assistance it provided his party. In gratitude for that political support, the Treasury announces that, should it sell the stock that was issued to it pursuant to the Programs . . . and should the sale create a public group (“New Public Group”), the New Public Group’s ownership in the issuing corporation shall not be considered to have increased solely as a result of such a sale.

The only difference between this hypothetical notice and the real Notice 2010-2 is the explicit character of the reason for the largesse.

¹⁹ “Top All-Time Donors, 1989–2010,” OpenSecrets.org.

²⁰ “United Auto Workers,” OpenSecrets.org.

It is an odd approach to statutory interpretation that would make a notice illegal if it articulates its reason, but legal if it leaves the reason unsaid.

5. LEGISLATIVE RESOLUTION

Return to the problem at stake: the manipulation of the highly arcane minutiae of the corporate tax rules to route huge sums to favored groups. The question is what anyone can do about it.

Political remedies are unlikely to work. Voters do not understand transactions like this well enough to punish a candidate in the next election. Much less will they impeach anyone for a transaction like this. Voters understand politicians who take briefcases stuffed with cash; they do not understand G reorganizations and NOL carryforwards. Congress has complained, asking TARP's inspector general to investigate the validity of the notices and their motivation.²¹ Sen. Jim Bunning (R-KY) even introduced a bill with the sole purpose of repealing Notice 2010-2.²² Unless Congress can override the notices by a veto-proof two-thirds majority, however, it can do little more than badger the administration with its oversight authority and complain to the public.

5.1 The Standing Problem

All this leaves a lacuna in the law. As the GM notices illustrate, it leaves an \$18 billion lacuna.

To explore how Congress might try to address the problem, consider the following fantasy IRS notice:

Internal Revenue Bulletin: 2010-999
February 24, 2011
Notice 2011-999

Application of Title 26 to Certain Persons Pursuant to the
Emergency Economic Stabilization Act of 2008

I. BACKGROUND

Section 7805(a) of the Internal Revenue Code ("the Code") provides that except where such authority is expressly given

²¹ Office of the Special Inspector General for the Troubled Asset Relief Program, "Engagement Memo—Review of the Section 382 Limitation Waiver for Financial Instruments Held by Treasury," Aug. 10, 2010.

²² S. 2916 [111th]. The bill was sent to committee and never returned.

to any person other than an officer or employee of Treasury, the Secretary shall prescribe all needful rules and regulations for the enforcement of Title 26, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

Section 101(c)(5) of EESA provides that the Secretary is authorized to issue such regulations and other guidance as may be necessary or appropriate to carry out the purposes of EESA.

II. GUIDANCE REGARDING CERTAIN PERSONS

Any funds received by J. Mark Ramseyer or Eric B. Rasmussen shall not constitute "income" under Sec. 61 of the I.R.C., and shall be entirely exempt from taxation.

DRAFTING INFORMATION

The principal author of this notice is John B. Doe of the Office of Associate Chief Counsel (Individual). For further information regarding this notice, contact Robert B. Roe at (202) 999-9999 (not a toll-free call).

Few readers would dispute the notion that Notice 2011-999 straightforwardly violates the Code. It does not even try to argue that sparing us from the income tax furthers the purposes of the 2008 stimulus bill. If it did, you, our readers, would laugh. But you could not laugh in court. You would not have standing.

Under current law, voters cannot challenge these transactions in court (see Hickman 2008 for discussion). If a rule benefits some people but does not harm others, nobody will have "standing" to challenge it. Justice Powell articulated the point most famously:

I cannot now imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else. (*Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 46 (1975) (Powell, J., concurring))

A more recent example appeared in a Chrysler case in which Justice Roberts held that taxpayers lacked standing to challenge other people's tax benefits. The plaintiffs argued that Chrysler's tax breaks hurt them:

Plaintiffs principally claim standing by virtue of their status as Ohio taxpayers, alleging that the franchise tax credit

Can the Treasury Exempt Its Own Companies from Tax?

“depletes the funds of the State of Ohio to which the Plaintiffs contribute through their tax payments” and thus “diminishes the total funds available for lawful uses and imposes disproportionate burdens on them.” (*DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332,342 (2006))

Justice Roberts said “No.”

As an initial matter, it is unclear that tax breaks of the sort at issue here do in fact deplete the treasury: The very point of the tax benefits is to spur economic activity, which in turn increases government revenues.

Plaintiffs’ alleged injury is also “conjectural or hypothetical” in that it depends on how legislators respond to a reduction in revenue, if that is the consequence of the credit. Establishing injury requires speculating that elected officials will increase a taxpayer-plaintiff’s tax bill to make up a deficit; establishing redressability requires speculating that abolishing the challenged credit will redound to the benefit of the taxpayer because legislators will pass along the supposed increased revenue in the form of tax reductions. Neither sort of speculation suffices to support standing. (*DaimlerChrysler*, 547 U.S. at 344)

Various authors have proposed reforms to the standing rules (e.g., Rosenberg 1996). Unfortunately, their proposals simultaneously increase the incidence of frivolous suits, venue shopping, and collusive litigation, as Stearns (1995) points out. In the name of policing frivolous litigation, GM (and Ramseyer and Rasmusen) keep their special deals. Although Treasury cannot get away with arbitrary interpretations of the statutes that increase someone’s taxes (since that person would have standing to object in court), it can get away with equally unreasonable interpretations that reduce someone’s taxes.²³

One might also think that giving away tax breaks was criminal. In fact, the Anti-Deficiency Act, 31 U.S.C. Sec. 1341, makes it a criminal offense for a government officer or employee to give away government money that Congress did not appropriate (he may not

²³ For examples of how Treasury gets around Supreme Court decisions using taxpayer-favorable (and hence unreviewable) regulations, see Polsky (2004).

“make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation,” 31 U.S.C. Sec. 1341(a)(1)(A)). If he does, 31 U.S.C. Sec. 1350 provides that he may be fined up to \$5,000 or imprisoned for up to two years, and 31 U.S.C. Sec. 3528 requires him to repay the improper expenditure.

Should the Treasury secretary fear the possibility of spending two years in jail and having to repay \$12 billion (perhaps splitting the amount with his predecessor, Henry Paulson)? Treasury secretaries have thought about this before; in a November 2008 speech, Paulson said that because of the Anti-Deficiency Act, Treasury could not have bailed out Lehman Brothers.

There are several reasons why the secretary need not fear at the present time. To start, the Anti-Deficiency Act speaks of “expenditures.” A “tax expenditure,” no matter how big or unlawful, might reasonably be excluded from its scope. Whether it is excluded probably does not really matter, though. Under 31 U.S.C. Sec. 3528(b)(1)(B), the comptroller general may relieve the spendthrift official from liability for repayment if the expenditure was made in good faith or not specifically prohibited by law (see also 31 U.S.C. Sec. 3527). What is more, criminal charges would have to be brought by the attorney general or his subordinates, and they are part of the administration. We do not allow private prosecutions for federal crimes.²⁴

Thus, U.S. law must be changed if we are to be able to deal with unlawful tax expenditures in any way other than trying to explain them to voters so as to unseat the offending official at the next election.

5.2 Three Alternatives

There are three possible changes in law that could discourage such tax expenditures in the future. Below, we consider each one.

²⁴ Another obstacle to unlawful tax rules, in principle, might be the ethical code of the Bar. What would a Good Man IRS attorney do if asked to authorize an unlawful notice? What would a Bad Man IRS attorney do out of fear of the Bar? We do not know what the Good Man would do, but we are sure the Bad Man need not fear disbarment. See Kwon (2010) for a discussion of the ethical obligations of IRS attorneys generally.

Can the Treasury Exempt Its Own Companies from Tax?

5.2.1 *The Canadian Rules*

In Canada, a taxpayer does have standing. Public-interest standing was extended to taxpayers in *Harris v. Canada (Minister of National Revenue)*, [2001] 4 F.C. 37 (Ct. of App.).

George Harris alleged that the minister of national revenue acted in bad faith and violated his fiduciary duty when he overruled his professional staff and made a favorable tax ruling (an “advance ruling”) at the request of influential taxpayers, the billionaire Bronfman family.²⁵ Harris asked the court for a declaration that the minister of national revenue was obliged to try to collect the taxes from a particular transaction.

An appellate court ruled that Harris did have standing, saying:

In *Borowski*, Martland J. for the majority held that to obtain public interest standing, a plaintiff must (1) demonstrate that there is a serious issue as to the invalidity of legislation, (2) that the plaintiff has a genuine interest, and (3) there is no other reasonable and effective manner to bring the issue before the court. (*Harris v. Canada (Minister of National Revenue)*, [2001] 4 F.C. 37 (Ct. of App.), referring to *Minister of Justice of Canada et al. v. Borowski* [1981] 2 S.C.R. 575)

A few years after *Borowski* gave standing for constitutional law issues, *Finlay v. Canada (Minister of Finance)*, [1986] 2 S.C.R. 607, extended it to standing for statutory issues. Therefore, the *Harris* court gave standing to Harris to contest the application of the tax code. In *Harris v. Canada (Minister of National Revenue)*, 2001 DTC 5322 (Trial Div.), the trial court even granted Harris’s application for discovery of internal government documents relating to the Bronfmans’ requests for an advance ruling.

Harris did lose his case in the end, but on the merits rather than on standing. In *Harris v. Canada (Minister of National Revenue)*, [2002] 2 F.C. 484 (Trial Div.), the trial court ruled against Harris on the merits, finding no bad faith on the part of the government and no fiduciary duty violation. It even accepted his argument that he was entitled to be paid for out-of-pocket costs because he had benefited the public by arguing the case despite his loss (which in Canada

²⁵ K. Foss, “Judge Scolds Tax Officials, but Crusader Loses Case,” *Globe and Mail*, December 20, 2001.

would ordinarily mean he would pay the other side's costs, though in this case the government waived its claim against him).

English courts have also given people standing to contest tax policy, albeit only if a genuine public interest is at stake. See the 1978 R.S.C., Ord. 53 and *Inland Revenue Comrs v. National Federation of Self-Employed and Small Businesses Ltd*, [1981] 2 All ER 93 (House of Lords). In that case, the Federation challenged a tax amnesty given to casual employees in the printing industry. The Federation lost, but only because the Law Lords all agreed that the government clearly had the discretion to grant an amnesty in this particular case.

Thus, one policy change for the United States would be to adopt the Canadian or English law of standing. We are hesitant to propose this change, however, because of the problems the United States has had with frivolous litigation, forum shopping, and activist judges (on which see, e.g., the forthcoming book edited by F. Buckley).

5.2.2 *Congressional Litigants*

To limit Treasury's ability to offer special deals to political favorites, we offer two alternatives that might yet constrain frivolous suits. First, Congress could offer standing to members of Congress:

Tax Regulation Enforcement Bill

Any two members of Congress shall have standing to challenge in court any interpretative or other notices, rules, regulations, or guidelines of the Internal Revenue Service as arbitrary and capricious. The members bringing the action need not be current members of Congress and need not have voted for or against the statute in question. Should they win, they shall each be entitled to liquidated damages of \$1,000. The Declaratory Judgement Act (28 U.S.C. sec. 2201) shall not apply to this legal action.²⁶ As a remedy, the Court may issue injunctions as appropriate, but not temporary restraining orders or preliminary injunctions.

²⁶ The Tax Anti-Injunction Act of 1867, 26 U.S.C. Sec.7421(a), says, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." This provision would continue to apply and would restrict our new statute to injunctions to collect more tax, but not less. We suspect that this would help prevent congressmen from filing frivolous suits to demonstrate sympathy with their constituents.

Can the Treasury Exempt Its Own Companies from Tax?

Any number of these suits may be filed concurrently. They shall be filed in any District Court of the United States.

Limiting challenges to just the grounds of “arbitrary and capricious” Treasury rules would narrow the range of suits drastically. The court need only look at the second part of the *Chevron* test ruling for the Treasury unless the statute is unambiguously contrary to the Treasury position. Yet these challenges would narrow the range of unlawful actions Treasury could take even more. There are, at most, dozens of ways the ambiguities in a sentence can be construed, but there is an infinite number of “interpretations” that are totally unfounded. A congressman could not successfully challenge an IRS interpretation of “after several years” as being anywhere from 2 to 10 years, but he could challenge an interpretation as “after 200 years” or “after the taxpayer has traveled to Kashmir.”²⁷

Requiring two congressmen rather than one will help to reduce the number of frivolous suits, though we recognize that we will not eliminate them. We originally thought to require five congressmen rather than two but recalled how in 1940 Vichy, the resolution that France needed a new constitution passed by 395–3 in the Chamber of Deputies and 229–1 in the Senate.²⁸

Allowing more than one suit and in different courts will prevent collusive suits that block review. If only the Tax Court had jurisdiction, for example, then a pro-Treasury plaintiff could bring suit there, “take a dive,” and refrain from appealing—thereby blocking a real plaintiff.²⁹

5.2.3 *A Qui Tam Statute*

An alternative to allowing congressmen to challenge Treasury notices would be a *qui tam* statute. A short version, worded for

²⁷ “After the taxpayer has traveled to Kashmir” is ridiculous, of course. But we must keep in mind that the Bad Man asks not whether an interpretation is ridiculous but whether he can get away with it.

²⁸ W. Shirer, *The Collapse of the Third Republic* (New York: Simon and Schuster, 1969), p. 933. Two Socialist and one Radical deputy voted against; the only dissenting senator was the right-wing Marquis de Chambrun.

²⁹ Congress cannot completely delegate the executive power to enforce the laws. In *Unique Product Solutions, Ltd. v. Hy-Grade Valve, Inc.* (February 23, 2011, N.D. Ohio), the court held that the president could not give a private plaintiff complete authority to pursue a criminal case against someone who labeled a product as patented after the patent expired. To do so was, it explained, an unconstitutional delegation of the president’s duty to “take care” that the laws be faithfully executed.

contrast to allow many more suits than our previous statute, might go as follows:

Qui Tam Tax Regulation Enforcement Bill

It shall be illegal for any employee of the Treasury Department to misinterpret a federal statute. Any employee found willfully to have misinterpreted a statute shall pay a civil fine of \$500. Any two members of Congress may bring a civil action against such violator in any District Court of the United States.

Conceptually, the *qui tam* statute performs much the same function as the standing rule. Unfortunately, it does present the same non-trivial risk of frivolous litigation. Either version enables two members of Congress to file suit to challenge any action by the Treasury to route funds to politically favored institutions.

It may seem imprudent to enlarge the power of the courts in a notoriously litigious United States already known for accusations that judges abuse their power by imposing their personal political views. The policy area we are opening up to judicial review, however, is not one known for judicial activism. Indeed, it is generally thought that judges dislike deciding tax cases. Even Justice Antonin Scalia, who made his name in administrative law in his academic career, said, "The constitutional work can be dull, too, but it's not like the tax code. Philosopher-kings do not read the Internal Revenue Code, believe me."³⁰ Justice William Douglas, famed for his expertise in business law and his activism, wrote to an ill Justice Black, "Take good care, lie low, and forget about these dull tax cases—which are now droning on and on" (Richards 2001). And Judge Learned Hand, known for his common-law decisions in private law, said in 1947:

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception

³⁰ "A Look at the Hidden World of U.S. Associate Justice Antonin Scalia," *National Post*, June 12, 1992, as quoted in Richards (2001). Note, too, what former tax lawyer Justice Blackmun said: "If one's in the doghouse with the Chief, he gets the crud. He gets the tax cases and some of the Indian cases, which I like, but I've had a lot of them." (R. Woodward and S. Armstrong, *The Brethren* [New York: Simon and Schuster, 2005].)

Can the Treasury Exempt Its Own Companies from Tax?

upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness.

One can only imagine what the less economics-minded judges must think about tax cases. Yet it is perhaps in tax cases—particularly business tax cases—that even the limited intelligence of the courts most exceeds the intelligence of the voter, just as it is there that we can expect judges to face the least temptation to care enough about policy to impose their own preferences instead of trying to follow the law.³¹ Legislatures, in contrast, while also having neutral ideological preferences, can use the opacity of tax law to transfer large sums of money to sophisticated supporters or to conceal extravagance with public funds. Criminal procedure presents the opposite combination of relative expertise and ideological conflict of interest. Judges seem to like deciding this kind of case, if we look at the willingness of the U.S. Supreme Court to accept cert, despite the fact, or perhaps because of the fact, that they involve situations that the average voter can understand and laws that politicians cannot use to transfer money from one interest group to another. (See Stuntz 1997, 2006, for close analysis of the pathological judicialization of the criminal justice process.)

6. CONCLUSIONS

Authority over tax administration is authority easy to abuse. I.R.S. Notice 2010-2 and its predecessors purported to exempt companies

³¹ The incentives and expertise of Supreme Court clerks are perhaps just as important, since they customarily do the first cut of cert petitions in deciding which cases are worth consideration by the Court. How many clerks have taken a tax course? We have not found articles on the self-interest of clerks in cert petition triage, but on more measurable considerations in tax cases and cert, see Staudt (2004).

partly owned by the government from taxes they would have had to pay had their owners been entirely private. The case of GM is the clearest in terms of the bailout of a favored constituency because that transaction resulted in a large subsidy to a labor union that had strongly supported the administration's party. Yet all of the notices helped hide the real cost of the TARP bailouts from the public.

It is hard for Congress to overturn executive actions that have no basis in statute, requiring as it does the agreement of two-thirds of both the Senate and the House of Representatives to override a presidential veto. The natural place to check invalid interpretations of statutes is in the courts. Currently no one has standing to challenge tax interpretations that benefit a few at the expense of taxpayers in general. Toward that end, we propose giving standing to members of Congress.

CASES

- Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).
Christiansen v. Harris County, 529 U.S. 576 (2000).
DaimlerChrysler Corp. v. Cuno, 547 U.S. 332 (2006).
Finlay v. Canada (Minister of Finance), [1986] 2 S.C.R. 607.
Harris v. Canada (Minister of National Revenue), [2001] 4 F.C. 37 (Ct. of App.).
Harris v. Canada (Minister of National Revenue), [2002] 2 F.C. 484 (Trial Div.).
Harris v. Canada (Minister of National Revenue), [2001] DTC 5322 (Trial Div.).
In re Motors Liquidation Co., 430 B.R. 65 (S.D.N.Y. 2010).
Inland Revenue Comrs v. National Federation of Self-Employed and Small Businesses Ltd, [1981] 2 All ER 93 (House of Lords).
Intermountain Insurance Service of Vail v. Commissioner of Internal Revenue Service, No. 10-1204 (June 21, 2011) (DC Circuit, 2011).
Long Island Care at Home, Ltd. v. Coke, 551 U.S. 157 (2007).
Mayo Foundation v. U.S., 131 S. Ct. 704 (2011).
Minister of Justice of Canada et al. v. Borowski [1981] 2 S.C.R. 575.
Simon v. E. Ky. Welfare Rights Org., 426 U.S. 26, 46 (1975).
Skidmore v. Swift & Co., 323 U.S. 134 (1944).
Twyne's Case, 3 Coke, 80 b. (Star Chamber, 1602).
U.S. v. Kirby Lumber Co., 284 U.S. 1 (1931).
Unique Product Solutions, Ltd. v. Hy-Grade Valve, Inc. (February 23, 2011, N.D. Ohio).
United States v. Mead Corp., 533 U.S. 218 (2001).

REFERENCES

- AIG. 2009. *American International Group Inc., 2009 Annual Report*.
 Auerbach, A., M. Devereux, and H. Simpson. 2010. "Taxing Corporate Income." In *Dimensions of Tax Design: The Mirrlees Review*, ed. J. Mirrlees et al. Oxford, UK: Oxford University Press.

Can the Treasury Exempt Its Own Companies from Tax?

- Buckley, F., ed. Forthcoming. *An American Illness*. New Haven, Conn.: Yale University Press.
- Bunkley N. 2011. "Resurgent G.M. Posts 2010 Profit of \$4.7 Billion." *New York Times*, February 4.
- Ceraso, C. J., R. Moffatt, and S. Pati. 2010. *General Motors Co.* New York: CreditSuisse.
- Davidoff, S., and D. Zaring. 2009. "Regulation by Deal: The Government's Response to the Financial Crisis." *Administrative Law Review* 61: 463–535.
- Davidson, B. 2011. "Tax Policy or Treasury Policy? Treasury's Conflicted Position in Its Ownership Stakes under TARP." Unpublished manuscript.
- General Motors Company. 2010. "Amendment 2 to Form S-1 Registration Statement under the Securities Act of 1933."
- Hand, L. 1947. "Thomas Walter Swann." *Yale Law Journal* 57: 167–72.
- Harberger, A. 2008. "Corporation Tax Incidence: Reflections on What Is Known, Unknown and Unknowable." In *Fundamental Tax Reform: Issues, Choices, and Implications*, ed. J. Diamond and G. Zodrow. Cambridge, MA: MIT Press.
- Hickman, K. 2008. "A Problem of Remedy: Responding to Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements." *George Washington Law Review* 76: 1153–215.
- Holmes, O. 1897. "The Path of the Law." *Harvard Law Review* 10: 457–78.
- J. P. Morgan. 2010. "General Motors: Reborn, High Octane SAAR and Product Play; Initiative with Overweight." December 28.
- Kotlikoff, L., and J. Miao. 2010. "What Does the Corporate Income Tax Tax? A Simple Model without Capital." NBER Working Paper 16199, July.
- KPMG. 2010. *Frontiers in Tax: People Thinking Beyond Borders in Financial Services*, July.
- Kwon, M. 2010. "Four of the Hardest Ethical Questions for a Government Lawyer." Texas Tech University School of Law Working Paper.
- Morgan Stanley. 2010. "General Motors Re-In-Car-Nation." December 28.
- Murphy, R. 2010. "Citi's Deferred Tax—An Asset of Dubious Worth." *Tax Research UK*, September 7.
- PajamasMedia. 2008. "Detroit's Downturn: It's the Productivity, Stupid: Union Work Rules Make It Almost Impossible for the Big Three to Keep Up with Foreign Competitors." December 16.
- Paley, A. 2008. "A Quiet Windfall for U.S. Banks." *Washington Post*, November 9.
- Pickerill, C. 2009. "Regarding the Advisability of a Prohibition on the Taxable Asset Sale to Creditors in Bankruptcy." *Tax Law* 62: 357.
- Polsky, G. 2004. "Can Treasury Overrule the Supreme Court?" *Boston University Law Review* 84: 185–246.
- Ramseyer, J. 1995. "Public Choice," Chicago Law and Economics Working Paper Series, 34 (second series).
- Richards, N. 2001. "The Supreme Court Justice and 'Boring' Cases." *Green Bag*, 2d, 4: 401–7.
- Rogovin, M., and D. Korb. 2008. "The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within." *Duquesne Law Review* 46: 223–374.
- Rosenburg, J. 1996. "The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane." *Virginia Tax Law Review* 16 (2): 155.
- Smith, P. 2011. "Life after Mayo: Silver Linings." *Tax Notes* 131: 1251–64.
- Staudt, N. 2004. "Agenda Setting in Supreme Court Tax Cases: Lessons from the Blackmun Papers." *Buffalo Law Review* 52: 889–922.

CATO PAPERS ON PUBLIC POLICY

- Stearns, M. 1995. "Standing Back from the Forest: Justiciability and Social Choice." *California Law Review* 83: 1309–414.
- Stuntz, W. 1997. "The Uneasy Relationship between Criminal Procedure and Criminal Justice." *Yale Law Journal* 107: 1–76.
- . 2006. "The Political Constitution of Criminal Justice." *Harvard Law Review* 119: 780–851.
- Terlap, S. 2011. "GM Stock Sag Weighs on U.S. Exit." *Wall Street Journal*, June 23.
- U.S. Congress. 2009. *Making Supplemental Appropriations for Job Preservation and Creation, Infrastructure Investment, Energy Efficiency and Science, Assistance to the Unemployed, and State and Local Fiscal Stabilization, for the Fiscal Year Ending September 30, 2009, and for Other Purposes: Conference Report to Accompany H.R. 1*. February 12.
- Warburton, A. 2010. "Understanding the Bankruptcies of Chrysler and General Motors: A Primer." *Syracuse Law Review* 60: 531–82.

Comment

Efraim Benmelech

This provocative paper by Mark Ramseyer and Eric Rasmusen provides a useful overview of the restructuring of General Motors, and in particular highlights the political economy of the GM deal in which the U.S. Treasury wore two hats, being both an equity holder and a regulator. They focus on one of the main assets GM had on its balance sheets: its net operating losses (NOLs) valued at \$45 billion. The reorganization of “Old GM” into “New GM” enabled New GM to retain the NOLs. Owning the NOLs increased the value of New GM and facilitated a restructuring deal that was favorable to the United Auto Workers (UAW) pension and health plans. However, as Ramseyer and Rasmusen argue, because of the 1986 Tax Reform Act, once the Treasury sells its holdings in New GM, the NOLs should be canceled and the value of New GM should decline dramatically.

THE GM BANKRUPTCY

Ramseyer and Rasmusen do an excellent job describing the details of the GM case, and the reader should refer to their article for the fine details. In my discussion, I provide only a brief summary of the facts.

GM filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Under this reorganization, Old GM was sold under Section 363 of the Bankruptcy Code to a new company, New GM. Typically, when one company acquires another company’s assets, it does not acquire its tax losses, but in this specific case, New GM attained the NOLs of Old GM.

However, given that the Treasury plans to sell the shares it acquired in New GM, a problem may arise in the future: Under the

Efraim Benmelech is the Frederick S. Danziger Associate Professor of Economics at Harvard University and an NBER faculty research fellow.

1986 Tax Reform Act, a corporation's ability to carry forward NOLs (and other tax credits) is limited when more than 50 percent of the stock changes hands over a three-year period (Ross, Westerfield, and Jaffe 2006). To solve this problem, the Treasury issued a series of notices declaring that Section 382 of the tax code does not apply to the Treasury. According to these notes, when the Treasury sells its shares in New GM, Section 382 will not be triggered even if more than 50 percent of ownership will change hands.

RAMSEYER AND RASMUSEN'S CRITIQUE

Ramseyer and Rasmusen make two points: First, Treasury had no *legal* justification to exempt GM NOLs from Section 382, hence the Treasury gave GM an illegal tax break. Second, the Treasury had no *economic* justification to exempt the NOLs from Section 382. In fact, Ramseyer and Rasmusen argue, there is a political economy explanation in which the exemption from Section 382 led to overvaluation of GM, which in turn made the government's position in GM look better and resulted in a transfer from the Treasury to other stakeholders—most notably the UAW, which held unsecured claims of \$21 billion in GM.

THE ECONOMIC RATIONALE

In my discussion, I will focus on the second point, according to which the Treasury had no economic justification to exempt GM's NOLs from Section 382. In order to assess the economic rationale behind the decision to exempt the NOLs from taxes, we need to evaluate the cost to the Treasury if the NOLs were not allowed to be carried forward to New GM. Ramseyer and Rasmusen argue that the UAW, as a junior creditor, got a very good deal in the restructuring of GM and that crafting such a deal was possible because of the "overvaluation" of GM stemming from the exemptions of the NOLs from Section 382. However, what would have been the cost to the Treasury if it failed to reach an agreement with the UAW?

Consider, for example, the case of GM retirees' medical benefits. As part of the restructuring, GM's Voluntary Employees' Beneficiary Association (VEBA) received from GM \$2.5 billion of new notes, \$6.5 billion in preferred stock with a 9 percent cash dividend, 17.5 percent of New GM common stock, as well as warrants for an additional 2.5 percent of the common stock of New GM. Ramseyer

and Rasmusen argue that the Treasury actions led to a transfer to the UAW VEBA, which in turn is responsible for providing medical benefits to retirees.

Yet, had the restructuring of GM failed, VEBA's assets would have been depleted, and it would have been unable to pay benefits in 2009.¹ As a result, it is likely that many more of GM's retirees would have had to rely on federal health insurance programs such as Medicare, imposing additional costs on the Treasury.

What about GM's pension plans? The restructuring agreements of GM provided that New GM take over the responsibility for the GM UAW pension plan. However, had the restructuring of GM failed, those pension liabilities would not have been assumed by New GM but would have rather been reneged. Moreover, had GM dumped its pension, it could have triggered other companies with underfunded pension plans to make a similar play. For example, other automakers could have tried to rid themselves of their defined benefit plans.²

The wrinkle is, however, that GM's UAW pensions are insured by the Pension Benefit Guaranty Corporation (PBGC), which is a U.S. government agency. Had GM's pension plans collapsed, the PBGC would have picked up a large part of the tab. As Brown (2008) argues, since the PBGC receives no tax revenues, and given that it relies on premiums that are set by Congress, the PBGC's financial position has deteriorated, having in 2006 an \$18.9 billion deficit. This is another example in which the Treasury could have ended up paying more had the restructuring of GM failed—and it is likely that GM would have failed to emerge from bankruptcy if its NOLs were not allowed to be carried forward.

SUMMARY

One can think about additional implications of a failure to restructure GM. Those include—but are not limited to—failures of auto-parts makers and suppliers, further increases in unemployment, and other forms of local economic activity, resulting in even higher costs for the federal government.

¹ See "A Message to UAW GM Retirees" available at http://bankrupt.com/misc/gm_uawretireeletter.pdf.

² See, for example, Benmelech, Bergman, and Enriquez (2011) for an analysis of pension dumping in the airline industry.

There is some rationale in having the Treasury structure a deal that leads to higher recovery by the UAW. An analysis of the transfer from Treasury to the UAW needs to take into account the different hats and pockets of the government. It is not clear that, on economic grounds, Treasury was not making the correct calculations.

REFERENCES

- Benmelech, E., N. K. Bergman, and R. Enriquez. 2011. "Negotiating with Labor under Financial Distress." NBER Working Paper 17192.
- Brown, J. R. 2008. "Guaranteed Trouble: The Economic Effects of the Pension Benefit Guarantee Corporation." *Journal of Economic Perspectives* 22 (11): 177–98.
- Ross, S. A., R. W. Westerfield, and J. Jaffe. 2006. *Corporate Finance*, 8th edition. Columbus, Ohio: McGraw-Hill/Irwin.

Comment

F. H. Buckley

Mark Ramseyer and Eric Rasmusen ask three questions in their paper. First, was the Treasury notice that allowed the reorganized “New” General Motors to take the benefit of “Old” GM’s past operating losses inconsistent with American tax law? Second, if it was inconsistent, might this have been an abuse of executive power? Third, if it was an abuse, is there a remedy for this? What the answers to the first two questions might be, I do not know. The third question I think I can answer.

I shall assume that the Treasury notice was inconsistent with general principles of American law. If so, the Treasury Department’s decision to waive compliance with the tax laws amounted to a gift to all of the debt- and equity-holders of New GM other than the United States, including the United Auto Workers (\$18.5 billion) and the Canadian and Ontario governments (\$8.2 billion). Ramseyer and Rasmusen suggest that this amounted to a sweetheart deal for a labor union that was a prominent political supporter of the Obama administration. The gift, moreover, was not easily detected, and this makes it all the more suspicious.

This is not to say that the Treasury notice was corrupt and devoid of reason. It is true that much of GM’s trouble had resulted from an overly generous contract with the UAW; that the sale to New GM gave an unsecured creditor, the UAW, more than it would have received under the priority rules of a Chapter 11 bankruptcy; that the claims of equally senior creditors were disregarded; that rescue bids from third parties were not accepted unless they offered the same sweetheart deal for the UAW; that, since firms in Chapter 11 have the ability to reject union contracts, GM might have ripped up

F. H. Buckley is Foundation Professor of Law at the George Mason University School of Law.

the UAW contract; that, given unemployment rates, one might have thought that an employer would be in the driver's seat; and that investors must now ask how strongly America is committed to the rule of law (see Skeel 2011). First, there was the GM bailout, then there was the UAW bailout. However, the propriety of the administration's decision is a deeply partisan issue, like every administration decision today, and it is not without its defenders who argue that it is prudent for a firm in reorganization to make a special accommodation for its employees, on whose loyalty the success of the firm depends. And so I suspend judgment on the second question.

One thing I do know: the gift to Canada was a splendid method of reaffirming the traditional friendship of the American and Canadian peoples.

A JUDICIAL REMEDY?

That leaves the third question. Assuming that the tax break was inconsistent with U.S. tax law and that this might have been an abuse of executive power, what is the remedy for it? Ramseyer and Rasmusen argue that political solutions, in which a misbehaving government is held accountable by voters, are not feasible. The separation of powers under the Constitution immunizes the executive, and in any event, voters are too ignorant to deal with matters as convoluted as this. In place of a political remedy, they propose a judicial one: let the matter be litigated before the courts.

If the courts are to confront this issue, two questions arise: First, should the executive *ever* have the discretion to waiver compliance with a law for the benefit of a single person or group? Second, if the executive does have such power, is it impracticable for a court to distinguish between a proper and improper exercise of that discretion? If the answer to both questions is yes, then the Ramseyer-Rasmusen proposal is a nonstarter.

At first glance, it might seem odd that the executive should ever have the power to dispense with a law of general application on behalf of anyone, for good reason or bad. The dispensing power would seem to invite abuse, and indeed was the subject of the first two articles of the 1689 English Bill of Rights:

The Lords Spiritual and Temporal and Commons . . . do . . .
(as their ancestors in like case have usually done) for the

Can the Treasury Exempt Its Own Companies from Tax?

vindicating and asserting their ancient rights and liberties declare:

That the pretended power of suspending the laws or the execution of laws by regal authority without consent of Parliament is illegal;

That the pretended power of dispensing with laws or the execution of laws by regal authority, as it hath been assumed of late, is illegal.

This would make the Ramseyer-Rasmusen proposal an easy matter for any judge. Every executive waiver would be null unless Parliament or Congress had specifically authorized it in the legislation in question. And there is indeed something to be said for a prophylactic measure of this sort. When the executive has the power to waive compliance with a law, Congress can be expected to take less care in drafting it, with the result that more bad laws are enacted. Moreover, the need to repeal the law is lessened, with the result that bad laws will stay on the books. There is, further, a concern that the executive will cut special deals for its friends, imposing the whole cost of a bad law on its enemies. For example, that concern has been voiced in the waivers for Obamacare that have been granted to labor unions (Hemingway 2011; are we seeing a pattern here?). Finally, giving the executive the power to dispense with compliance with a law might be thought to weaken the separation of powers by strengthening an already oversized executive branch (Posner and Vermeule 2011).

However, a flat prohibition of executive waivers would undoubtedly go too far. Think of waivers granted to states to come up with alternatives to federal welfare or educational mandates. Even Locke saw a value in the dispensing power. The legislature will inevitably enact overbroad laws, he said, which only the executive can easily remedy:

The good of the society requires, that several things should be left to the discretion of him that has the executive power: for the legislators not being able to foresee, and provide by laws, for all that may be useful to the community, the executor of the laws having the power in his hands, has by the common law of nature a right to make use of it for the good of the society, in many cases, where the municipal law has

given no direction, till the legislative can conveniently be assembled to provide for it. . . . Nay, it is fit that the laws themselves should in some cases give way to the executive power. (Locke 1689, at XIV)

For that matter, the dispensing power asserted by King James II, to which Parliament so strenuously objected, would have freed Catholic priests from the most sanguinary of punishments for the exercise of the religion they shared with their monarch. Even that good Whig, T. B. Macaulay, could find no fault with this exercise of the king's prerogative:

For to place a Papist on the throne, and then to insist on his persecuting to the death the teachers of that faith in which alone, on his principles, salvation could be found, was monstrous. In mitigating by a lenient administration the severity of the bloody laws of Elizabeth, the King violated no constitutional principle. He only exerted a power which has always belonged to the crown. Nay, he only did what was afterwards done by a succession of sovereigns zealous for Protestantism, by William, by Anne, and by the princes of the House of Brunswick. (Macaulay 1849, Ch. 4)

Assume therefore that the executive has a dispensing power. Assume further that some waivers are benign and some corrupt, that (as Ramseyer and Rasmusen put it) the executive might be a Good Man or a Bad Man. The role of the courts, then, would be to distinguish between the two kinds of executives, between a proper and improper exercise of discretion in granting waivers.

The quite obvious problem here is that making such a distinction would necessarily involve political questions that courts wisely decline to answer. Would we want to turn over to unelected judges the question whether the bailout was needed and whether it amounted to a sweetheart deal to a loyal supporter of the Democratic Party? If we could do so, why would we need a legislature or an executive? This explains why, in a case cited by Ramseyer and Rasmusen, the Supreme Court wisely refrained from granting standing to taxpayers who claimed they had been prejudiced because another taxpayer benefited from a waiver.¹ In similar circumstances,

¹ *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006).

Canadian courts granted standing to a complaining taxpayer, but then rejected his claim because he had failed to show that the tax authorities had acted in bad faith. Same result; the American courts just got there faster.²

A POLITICAL SOLUTION?

If political problems should be kept from the courts, should we then look to the political process for a remedy and leave politics for the politicians? But Ramseyer and Rasmusen argue that this would not cure the UAW bailout. I think the authors are right, but for the wrong reason.

Ramseyer and Rasmusen first note that the separation of powers in the Constitution immunizes executive decisions, such as the GM reorganization, unless Congress is able to muster a supermajority to override a likely presidential veto. From this they conclude that corruption of this kind cannot be policed through the political process. There is something to this, but the paper nevertheless fails to account for the fact that parliamentary governments have been defeated for the same kinds of sweetheart deals, notwithstanding the dominance of the prime ministers in parliamentary systems.

In Canada, Prime Minister Pierre Trudeau famously described his backbenchers as “nobodies,” and their lack of power was recently underlined by another Liberal prime minister, Paul Martin:

Over the last forty years or so, Canadians have seen the influence of individual members of parliament eroded as the power of the prime minister and the executive branch of government grew. . . . They vote according to the dictates of their party, and too often, when their party is in power, no one in the government cares particularly what they have to say. (Martin 2008, pp. 244–245)

The party, in turn, is dominated by the prime minister’s office, which has no parallel in American politics.

Like American presidents, then, Canadian prime ministers are largely immunized from legislative control. There is always a possibility of a backbencher revolt in Parliament, but these happen very rarely. Instead, a prime minister takes his government to the people

² *Harris v. Canada (Minister of National Revenue)*, [2002] 2 F.C. 484.

in an election, and, if defeated, steps down and is replaced as prime minister by the opposition and as party leader by his party. And that is just what happened after a scandal that in some ways resembles the UAW sweetheart deal. The “sponsorship scandal,” in which a Liberal government directed revenues to favored advertising firms from 1996 to 2004 to promote the image of Canada in Quebec, was a prominent reason for the government’s defeat in the 2006 general election. The government gave out \$2 million in no-bid contracts to its friends, and \$1.5 million was awarded for work that was never done. Small potatoes compared to the New GM reorganization, but enough to topple a government.

The Canadian example shows the weakness of another Ramseyer-Rasmusen argument against political solutions to government misbehavior. They argue that voters are irredeemably ignorant about anything so convoluted as the GM reorganization (and, having read their paper, I see the force of this objection). If so, they ask, how could we expect voters to discipline their bad executive?

And yet, in 2006, Canadian voters turned out a government that engaged in an equally questionable and obscure payoff. What Ramseyer and Rasmusen forget is the role that informational intermediaries can play in reducing a complicated set of facts to a simple message: a government of rogues is giving away your money to its friends.³ These intermediaries include political parties (which would not exist if they failed to cure an informational asymmetry), the media (new and old), and (in Canada at least) government watchdogs. The sponsorship scandal came to light because Auditor-General Shelia Fraser had a nose for corruption and a taste for digging up government shenanigans. She became a media figure in her own right, and in a CBC poll was ranked as 66th on a list of the “Greatest Canadians” (behind Pamela Anderson but ahead of Joni Mitchell).

That couldn’t happen here. It’s hard to imagine an American comptroller general becoming a media figure. In fact, when President Obama fired Inspector General Gerald Walpin after the latter had suspended an Obama supporter for financial misdealings (*Wall Street Journal* 2009), there was barely a ripple of protest. This sort of thing helps to explain

³ Voters are regrettably ignorant about economics, as noted in Caplan (2007). However, they seem more than able to discipline a government that has been tarnished by scandal, as the Canadian example shows.

Table 1
Transparency International's Perception of
Corruption Index

	Rank	Score
Denmark	1	9.3
Sweden	4	9.2
Canada	6	8.9
Australia	8	8.7
Switzerland	8	8.7
Hong Kong	13	8.4
Germany	15	7.9
Japan	17	7.8
United Kingdom	20	7.6
United States	22	7.1

Source: Transparency International Corruption Perception Index 2010, http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results.

why the United States does not come out particularly well on cross-country measures of corruption. Transparency International conducts surveys of business leaders on their perceptions about bribery, kick-backs, and public-sector anti-corruption efforts, and it ranks the United States behind many of its first-world competitors.⁴

This likely understates America's corruption problem, if corruption is understood to embrace wasteful congressional earmarks. One doesn't see legislative earmarks in Trudeau's Parliament of nobodies. Take Ruth Ellen Brosseau M.P., for example. In the 2011 Canadian election, the voters of Berthier-Maskinongé in Quebec elected the comely Brosseau, a 27-year-old barmaid. Brosseau did not visit the riding during the election campaign because she did not speak the language, and instead holidayed in Las Vegas. Her party's website notes that "one of her passions is rescuing and rehabilitating injured animals. For many years Ruth Ellen has committed her time and energy to finding homes for stray animals in her community." Did I mention she is comely?

When members of Parliament are "nobodies," voters don't expect them to bring any pork back to the riding. Instead, any pork comes from the national party, which has broader incentives than, say, a

⁴ The Transparency International corruption rankings are quite similar to those of the World Bank. See "Worldwide Governance Indicators," www.worldbank.org.

John Murtha does. Brosseau might not possess Murtha's legislative skills, but a parliament of Brosseaus more closely resembles the idealized assembly described by Edmund Burke in his Address to the Electors of Bristol, an assembly "of *one* nation, with *one* interest, that of the whole; where, not local purposes, not local prejudices, ought to guide."⁵

In sum, the Ramseyer-Rasmusen conclusion that the political process will not afford a remedy for the UAW bailout is likely correct. But it's not because the executive is too strong; and it's not because voters are too stupid to understand political corruption when it is pointed out to them. Rather, it's because the bailout is business as usual here.

REFERENCES

- Caplan, B. 2007. *The Myth of the Rational Voter*. Princeton, N.J.: Princeton University Press.
- Hemingway, M. 2011. "Over Half of All Obamacare Waivers Given to Union Members." *WeeklyStandard.com*, May 16.
- Locke, J. 1689. *The Second Treatise on Government*. London: Awnsham Churchill.
- Macauley, T. B. 1849. *The History of England*. Philadelphia: Porter and Coates.
- Martin, P. 2008. *Hell or High Water: My Life In and Out of Politics*. Toronto: McClelland and Stewart.
- Milligan, K., and M. Smart. 2005. "Regional Grants as Pork Barrel Politics." Center for Economic Studies and Ifo Institute for Economic Research.
- Posner, E. A., and A. Vermeule. 2011. *The Executive Unbound: After the Madisonian Republic*. Oxford, UK: Oxford University Press.
- Skeel, D. 2011. "The Real Cost of the Auto Bailouts." *Wall Street Journal*, June 6.
- Wall Street Journal*. 2009. "The White House Fires a Watchdog." June 17.

⁵ This is not to say that pork barrel spending is unknown in parliamentary systems. On average, government spending in Canada is higher in constituencies represented by the party in power. See Milligan and Smart (2005).