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# TAX LAW—FUNDAMENTAL INCONSISTENCY: THE TAX BENEFIT RULE—Hillsboro National Bank v. Commissioner, 103 S.Ct. 1134 (1983)

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TAX LAW—FUNDAMENTAL INCONSISTENCY: THE TAX BENEFIT RULE—*Hillsboro National Bank v. Commissioner*, 103 S. Ct. 1134 (1983).

## I. INTRODUCTION

In *Hillsboro National Bank v. Commissioner*,[1] the Supreme Court of the United States reformulated the working definition of the Tax Benefit Rule (TBR). In doing so, the Court rejected the positions of both the Commissioner[2] and the taxpayer (the "Bank"),[3] whose interpretations together had constituted the working definition of the TBR.[4] The new definition, best described as a hybrid of all past applications of the TBR,[5] now applies a "fundamentally inconsistent" standard when assessing the applicability of the TBR: "The tax benefit rule will cancel out an earlier deduction only when careful examination shows that the later event is . . . fundamentally inconsistent with the premise on which the deduction was initially based."[6] This note will focus on the Supreme Court's analysis with respect to the new formulation of the TBR and will also consider its effect on the already complicated application.

1. 460 U.S. 370 (1983).

2. The government contended that the TBR required inclusion of amounts previously deducted if later events were inconsistent with the deductions and that no recovery was necessary for application of the rule. *Id.* at 381.

3. The Bank, citing Lincoln Nat'l Bank v. Cullerton, 18 Ill. App. 3d 953, 310 N.E.2d 845 (1974), argued that the tax refunds did not constitute taxable income because it never received them, nor was it legally entitled to them. *Hillsboro*, 460 U.S. at 381. In *Lincoln*, the Illinois Appellate Court held that the refunds of personal property taxes made necessary by the United States Supreme Court's decision in Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973), and ILL. REV. STAT. ch. 120 § 676.01 (1971) belonged to the individual shareholders and not to the Bank regardless of who actually paid the taxes. *Lincoln*, 18 Ill. App. 3d at 957, 310 N.E.2d at 849. Because the Bank was, therefore, precluded from recovering any of the refund, it contended that no recovery within the meaning of the TBR took place. *Hillsboro*, 460 U.S. at 377.

4. For a discussion of the origins of the recovery theory, see Putnam National Bank v. Commissioner, 50 F.2d 158 (5th Cir. 1931); Excelsior Printing Co. v. Commissioner, 16 B.T.A. 886 (1929). For a discussion on the origins of the inconsistent event theory, see Barnett v. Commissioner, 39 B.T.A. 864 (1939); Estate of Block v. Commissioner, 39 B.T.A. 338 (1939); South Dakota Concrete Prod. Co. v. Commissioner, 26 B.T.A. 1429 (1932).

5. *Hillsboro*, 460 U.S. at 417 (Stevens & Marshall, J.J., concurring) .

6. *Id.* at 383.

Before 1971, an Illinois statute[7] subjected shareholders of any of its incorporated banks to a personal property tax on the value of their shares. The statute required the banks to retain earnings sufficient to cover the taxes.[8] The banks customarily paid or tendered payment of the taxes for the shareholders and claimed a deduction for the amount paid on the shareholders' behalf.[9] A 1970 amendment to the state constitution invalidated the property tax on shares held in incorporated banks.[10] The Illinois Supreme Court subsequently struck down the amendment on a constitutional challenge.[11] The United States Supreme Court granted certiorari[12] and, pending the disposition of the case, Illinois continued to collect taxes placing the receipts in escrow.[13] The United States Supreme Court ultimately upheld the amendment.[14] The state court, thereafter, ruled that the monies held in escrow belonged to the shareholders.[15] Accordingly, the county treasurer issued refund checks directly to each of the Bank's shareholders, payable only to them individually.[16]

The Bank did not report any part of the 1973 refund as taxable income.[17] The Commissioner of the Internal Revenue Service issued a notice of deficiency, alleging that the Bank should have reported the amount of the aggregate refund to its shareholders as income on its own 1973 federal income tax return, pursuant to the TBR.[18] The Commissioner contended that recovery of the payments by the share-

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7. ILL. REV. STAT. ch. 120 §§ 557-58 (1971) (repealed 1981, eff. Dec. 31, 1982).
8. *Hillsboro*, 460 U.S. at 372-73.
9. *Id.* I.R.C. § 164(e) (1954), provides:

> Where a corporation pays a tax imposed on a shareholder on his interest as a shareholder, and the corporation is not reimbursed by the shareholder, then:
> (1) the deduction allowed by subsection (a) [of § 164] shall be allowed to the corporation; and
> (2) no deduction shall be allowed the shareholder for such tax.

Subsection (a) of section 164 provides in part:

> Except as otherwise provided in this section the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:
> (1) State and local, and foreign, real property taxes;
> (2) State and local personal property taxes;
> (3) State and local, and foreign, income, war profits, and excess profits;
> (4) State and local general sales taxes.

10. ILL. CONST. amend. art. IX-A.
11. Lake Shore Auto Parts Co. v. Korzen, 49 Ill.2d 137, 273 N.E.2d 592 (1971).
12. Lehnhausen v. Lake Shore Auto Parts Co., 405 U.S. 1039 (1972).
13. *Hillsboro*, 460 U.S. at 374.
14. Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973).
15. Bank & Trust Co. v. Cullerton, 25 Ill. App. 3d 721, 324 N.E.2d 29 (1975).
16. *Hillsboro*, 460 U.S. at 374.
17. *Id.*
18. *Id.*

holders represented income to the Bank to the extent of its prior deduction. The Tax Court agreed[19] and the Court of Appeals for the Seventh Circuit upheld the Tax Court's decision.[20] Relying on its prior decision in *First Trust & Savings Bank v. United States*,[21] the court found the tax benefit rule applicable to the refund even though the Bank had not received the refund directly.[22] The court stated that the rule applies in any case in which one of two situations occur: either an actual recovery of a previously deducted amount or the occurence of an event which is inconsistent with the premise on which the prior deduction was based.[23] The Supreme Court found differently and reversed.[24]

## II. BACKGROUND

The TBR, a judicially developed principle,[25] seeks to create transactional equivalence with some of the inflexible attributes of the annual accounting system.[26] Basically it provides to the Commissioner a mechanism whereby a taxpayer who recovers or collects an amount deducted from his/her taxable income in an earlier year is taxed currently on the amount received, unless the prior deduction was of no tax benefit because it did not reduce his/her tax liability.[27] The doctrine does not limit application of the TBR to an actual physical recovery by the taxpayer of a tangible asset or sum.[28] It has long been accepted that a taxpayer using accrual accounting who accrued and deducted an expense in a tax year prior to the expense becoming payable and who is eventually relieved of that liability must then include that amount of accrued expense in gross income.[29]

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19. Hillsboro Nat'l Bank v. Commissioner, 73 T.C. 61 (1979).

20. Hillsboro Nat'l Bank v. Commissioner, 641 F.2d 529, 531 (7th Cir. 1981).

21. 614 F.2d 1142 (7th Cir. 1980).

22. Hillsboro Nat'l Bank v. Commissioner, 641 F.2d 529, 531 (7th Cir. 1981).

23. *Id.*

24. *Hillsboro*, 460 U.S. at 394-95.

25. Although the rule originated in courts, 1 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 7.34 (2d ed. 1981); Bittker and Kanner, *The Tax Benefit Rule*, 26 UCLA L. REV. 265, 266 (1978), Congress impliedly approved it by partially codifiing it. I.R.C. § 111(g) (1980) provides: "Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce income subject to tax."

26. Bittker and Kanner, *supra* note 25, at 270.

27. Treas. Reg. § 1.111-1(a) (1960) provides that during any taxable year income attributable to the recovery of an amount previously deducted will be excluded from gross income to the extent that no reduction in tax resulted from the earlier deduction.

28. Tennessee-Carolina Transp., Inc. v. Commissioner, 582 F.2d 378, 382 (6th Cir. 1978).

29. *See* Mayfair Minerals, Inc. v. Commissioner, 456 F.2d 622 (5th Cir. 1972) (per

Prior to the *Hillsboro* decision, the TBR applied in two situations: an actual recovery of an earlier deduction[30] or another event inconsistent with the premise on which the prior deduction had been based.[31] The *Hillsboro* decision, however, redefined the application of the TBR. The standard now requires that the subsequent event be *fundamentally* inconsistent with the premise on which a deduction was initially based as well as that the taxpayer obtained a tax benefit from the earlier deduction.[32]

As clearly expounded by Justice Stevens in his concurring opinion, the *Hillsboro* standard creates confusion in the analysis of the TBR by requiring a distinction between "inconsistent" events and "fundamentally inconsistent" events.[33] The Court itself attempted to distinguish between the two by drawing a line between merely unexpected events and inconsistent events.[34] The Court highly criticized the government's approach, which viewed any unexpected event as inconsistent.[35] It failed, however, to offer any guidance as to why an unexpected event is not fundamentally inconsistent with an earlier deduction.[36] The real distinction between "fundamentally inconsistent" events and "inconsistent" events may lie in the actual analysis of the applicability of the TBR in a given situation.[37]

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curiam); Bear Mfg. Co. v. United States, 430 F.2d 152 (7th Cir. 1970), *cert. denied*, 400 U.S. 1021 (1970); Haynsworth v. Commissioner, 68 T.C. 703 (1977), *aff'd mem.*, 609 F.2d 1007 (5th Cir. 1979).

30. MERTENS, *supra*, note 25, at § 734.

31. *See* Tennessee-Carolina Transp. Inc. v. Commissioner, 582 F.2d 378 (6th Cir. 1978); Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir. 1940), *cert. denied*, 311 U.S. 658 (1940). Estate of Block v. Commissioner 39 B.T.A. 338 (1939). For example, a taxpayer using the accrual accounting method is allowed a tax deduction for expenses accrued but not paid as of the close of the taxpayer's taxable year. The TBR requires the accrual basis taxpayer to include in income accrued expenses deducted in an earlier tax year, if he/she is later relieved of his/her obligation. Although no actual physical recovery of the deducted amount by the taxpayer occurs, he/she is required to include the earlier deducted amount in gross income because of the tax benefit received from the earlier deduction. From this point of view the taxpayer's argument that a recovery is necessary for the application of the TBR neither serves the purpose of the rule nor accurately reflects the case law that established the rule. Putoma Corp. v. Commissioner, 601 F.2d 734, 738 (5th Cir. 1979). If a recovery is necessary for the TBR to be applicable, then all accrual basis taxpayers would receive "tax benefits" in the form of accrued expenses which may never be paid.

32. *Hillsboro*, 406 U.S. at 383-84.

33. *Id.*

34. *Id.* at 383-84. The Court offered no real definition of the term "unexpected event." The Court's usage and placement of the term suggests that an "unexpected event" ordinarily occurs only once rather than repeatedly.

35. *Id.* at 383-84 & nn. 15-16.

36. *Id.* at 383-86 & nn. 15-16, 393-94.

37. The "fundamentally inconsistent" standard requires a case-by-case analysis when

The Court presented its new test by stating "only if the occurrence of the event in the earlier year would have resulted in the disallowance of the deduction can the Commissioner require a compensating recognition of income when the event occurs in a later year."[38] The Court drew on its analysis in *Lehnhausen v. Lake Shore Auto Parts Co.*[39] in which it upheld an amendment to the Illinois Constitution imposing a personal property tax on corporations and similar entities, but not individuals, against an equal protection challenge by certain corporations and other non-individual "entities."[40] Yet, as Justice Stevens discussed in his concurrence, the Court suggested that if it had ruled on *Lehnhausen* in 1972, the Hillsboro Bank would have been entitled to deduct the monies paid that were not used to satisfy a tax liability.[41] The Internal Revenue Code allows deductions only for expenses specifically excluded.[42] Consistency with the logic of the Code required that the Court reach a contrary holding in *Hillsboro*, if that were the case, because the premise underlying the deduction no longer existed after *Lehnhausen* and the lack of basis for the deduction would have occured in the same accounting period as the deduction itself. Internal Revenue Code section 164(e),[43] therefore, no longer applied.

It is well-established that the TBR encompasses the recovery of previously deducted taxes and that the refund is treated as income in the year received.[44] Although in the *Hillsboro* case the Bank did not

assessing the applicability of the TBR. *Hillsboro*, 460 U.S. at 385. Additionally, one must review the congressional history of the nonrecognition provision of the Code which originally gave rise to the deduction in order to determine if any conflict exists between the Code and TBR. *Id.* If conflict existed, the Code would supercede the TBR. *Id. See infra* notes 63-65 and accompanying text.

38. *Hillsboro*, 460 U.S. at 389.

39. 410 U.S. 356 (1973).

40. *Id.* at 365.

41. Hillsboro Nat'l Bank v. Commissioner, 460 U.S. 370, 418 (1983). (Stevens & Marshall, J.J., concurring). Justice Stevens implies that if the decision had been reached prior to the close of the taxpayer's annual accounting period, an adjustment could have been made to the accounting records to reflect the fact that the Bank was not obligated to pay state taxes on behalf of its shareholders.

42. *See* Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955); I.R.C. § 161 (1983).

43. *See supra* note 9.

44. Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 299-300 (1946); Mayfair Minerals, Inc. v. Commissioner, 456 F.2d 622, 623 (5th Cir. 1972) (per curiam); Union Trust Co. v. Commissioner, 111 F.2d 60, 61 (7th Cir. 1940), *cert. denied*, 311 U.S. 658 (1940); Universal, Inc. v. Commissioner, 109 F.2d 616, 617 (7th Cir. 1940); Nash v. Commissioner, 88 F.2d 477, 478 (7th Cir. 1973), *cert. denied*, 301 U.S. 700 (1937).

In *Mayfair Minerals*, the duty of the taxpayer to make refunds was subsequently cancelled and the Commissioner determined that under the TBR the previously deducted receive the proceeds from the refund,[45] it did receive a tax benefit.[46] The TBR, in its simplest form, would have required the inclusion of an amount equal to the prior deduction in the Bank's current income upon a finding that the taxpayer derived an earlier tax benefit from the prior deduction.[47] The Court, however, rejected the simple approach.[48] The Court instead focused on the historical interpretation of the Internal Revenue Code section on which the deduction was based to ascertain whether there was Congressional intent to supercede the application of the TBR.[49] The Court concluded that the simple application of the TBR would not suffice in all situations.[50]

Balancing the TBR theories of the government and the taxpayer,[51] the Court in *Hillsboro* found that the TBR must be applied on a case-by-case basis.[52] The purpose and function of the provision granting the deduction affect the facts and circumstances surrounding the application of the rule.[53] The Court explained that when a later event takes place in the context of a nonrecognition provision of the Code, inherent tension exists between the TBR and that provision.[54] Since the TBR was judicially created, it cannot supercede statutes enacted by Congress.[55]

## III. Analysis

The Court's new approach implies a rule that a conflict between a nonrecognition provision of the Code and the TBR be resolved in favor of the Code, regardless of the tax benefit bestowed upon the tax-

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amounts had to be restored to the taxpayer's income. *Mayfair Minerals*, 456 F.2d at 623. The Court stated: "When an accrual basis taxpayer accrues an expense and offsets it against taxable income, and subsequently the expense is not paid, the prior deduction must be restored to income in the year the liability is extinguished. . . . Taxpayer, having received the prior tax benefits from accrued deductions realized income." *Id.* at 629.

45. *Hillsboro*, 460 U.S. at 373-74.

46. *Id.*

47. The primary purpose of the TBR presumably is to allow for a mechanism whereby the inflexibility of the annual accounting system is neutralized to a degree. Thus at the time the Illinois statute placing a personal property tax on shares of stock held in incorporated banks became invalid, the premise for the Bank's deduction, pursuant to I.R.C. § 164(e), no longer existed. In retrospect, therefore, the deduction should not have been allowed. *See infra* notes 67-77 and accompanying text.

48. *Hillsboro*, 460 U.S. at 382-83.

49. *Id.* at 391-94 (construing I.R.C. § 164).

50. *Id.* at 384-85.

51. *See supra* notes 2-3 and accompanying text.

52. *Hillsboro*, 460 U.S. at 385.

53. *Id.*

54. *Id.* at 386.

55. Putoma Corp. v. Commissioner, 601 F.2d 734, 738 (5th Cir. 1979).

payer.[56] The new approach parallels the position of the Supreme Court in *Nash v. United States*[57] and, more recently, of the Fifth Circuit Court of Appeals in *Putoma Corp. v. Commissioner*.[58] Its application in *Hillsboro*, however, differs substantially from the approach utilized in *Nash* and *Putoma*.[59] In them, the Court found that the earlier deduction was not includable in the taxpayer's gross income when the later event occurred pursuant to other nonrecognition provisions of the Code.[60] In *Hillsboro*, however, the Court used section 164(e), the very Code provision which gave rise to the initial deduction, in order to find that the Code preempted the TBR.[61] A careful analysis of that section reveals that no tension exists between the TBR and the Code under the *Hillsboro* facts, as was the case in the *Nash* and *Putoma* situations.[62] The Code simply provides that a deduction shall be allowed if a corporation pays a tax which is imposed on a shareholder and based on his proportional interest held in that corpo-

56. *See Hillsboro*, 460 U.S. at 394-95. *Hillsboro* suggests that the "tax benefit" received by the taxpayer is irrelevant in the analysis of whether the TBR and the particular nonrecognition provision are in conflict. Of major concern is whether the nonrecognition provision prevails over the TBR. *Id.* at 385-86.

57. 398 U.S. 1 (1970).

58. 601 F.2d 734 (5th Cir. 1979).

59. In *Nash*, a taxpayer incorporated a partnership under I.R.C. § 351, which provides that no gain or loss on the transfer of assets to a controlled corporation will be recognized. *Nash*, 398 U.S. at 2-3. The partnership had taken bad debt deductions to create a reserve and, when the partrnership terminated, it no longer needed the reserve. *Id.* at 4-5. The accounts receivable together with the reserve were transferred to the corporation. *Id.* at 2-3. The Court found that the taxpayer had made no recovery and that no inconsistent event existed to invoke the TBR. *Id.* at 5. The Commissioner argued that although a nonrecognition of gain complied with § 351, the partnership had to acknowledge a gain on the transfer of the asset since it had, in previous years, taken bad debt deductions to create the reserve. *Id.* at 3. Once the accounts receivable left the taxpayer's possession, no further need remained for the bad debt reserve and, therefore, the premise of the prior deduction became extinguished. *Id.* at 5.

In *Putoma.*, the court held that the taxpayer corporation, which previously had accrued and deducted interest it owed but never paid to one of its shareholders, did not realize income when the shareholder cancelled the liability for the accrued interest. *Putoma Corp.*, 601 F.2d at 751. The court found that the cancellation of interest represented a gift to the corporation within the meaning of I.R.C. § 102 as a contribution to capital within the meaning of I.R.C. § 118. *Id.* at 751. Hence, I.R.C. § 118, a nonrecognition provision, superceded the TBR. *Id.*

60. *Nash*, 398 U.S. at 1, 4 (under I.R.C. § 351, no gain or loss is recognized on a transfer of assets to a controlled corporation in exchange for stock of that corporation); Putoma Corp. v. Commissioner, 601 F.2d 734, 751 (5th Cir. 1979) (under I.R.C. §§ 102, 118, gifts and contributions to capital do not constitute taxable income). In *Nash*, I.R.C. § 166(c) formed the basis of the initial bad debt deduction used to create the reserve. *Nash*, 398 U.S. at 2. In *Putoma*, the taxpayer deducted the accrued interest expense pursuant to I.R.C. § 161. *Putoma Corp.*, 601 F.2d at 238.

61. *Hillsboro*, 460 U.S. at 393-94.

62. *See supra* note 59.

ration and the corporation is not reimbursed by the shareholder.[63] If the shareholder need not pay a tax on his interest, no deduction can be allowed to the corporation pursuant to the Code.[64] The Court failed to cite any other nonrecognition provision in the Code to evidence the inherent tension described in *Nash* and *Putoma*.[65]

In its analysis, the Court went beyond the plain language of the Code and the Regulations, however, and examined the historical development of section 164(e).[66] Congress intended section 164(e) of the Internal Revenue Code to provide relief for corporations which voluntarily made payments of taxes imposed on their shareholders.[67] The Court stated that nothing in the Code or in Congressional history prevented the corporation from taking a deduction if the state held the tax monies in escrow and refunded them to the shareholders.[68] The Court particularly stated that the congressional focus of section 164(e) centered on the act of payment rather than the ultimate use of the funds.[69] Hence, the Court held that as long as the bank that initially paid the tax did not itself get the refund no reason prevented the corporation from including the refund to the shareholders in its taxable income.[70] The change in the character of the funds in the hands of the state does not require the corporation to recognize income.[71]

The Court in *Hillsboro* failed, however, to consider two basic points. First, the absence of any indication in the Internal Revenue Code or Congressional history of the particular nonrecognition provision, which would disallow the deduction if the monies were refunded, does not necessarily imply that the deduction will be allowed.[72] To

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63. I.R.C. § 164(e) (1954). *See supra* note 9.

64. *Id.*

65. In *Hillsboro*, the Court noted only the I.R.C. § 164(e) nonrecognition provision as creating tension between the TBR and the Code. *Hillsboro*, 460 U.S. at 391-92.

66. *Hillsboro*, 460 U.S. at 393-94.

67. *Id.*

68. *Id.* at 394. The Court stated:

> [I]t is difficult to conclude Congress intended that the corporation have no deduction if the State turned the tax revenues over to . . . independent parties. We conclude that the purpose of § 164(e) was to provide relief for corporations making these payments, and the focus of Congress was on the act of payment rather than on the ultimate use of the funds by the State.

*Id.*

69. *Id.*

70. *Id.* at 394. Under the Court's analysis, which deemed the refund of the state personal property tax to be an unexpected event, the only fundamentally inconsistent event which could trigger the application of the TBR would be a recovery. *Id.*

71. *Id.* at 394-95.

72. The Court narrowed its focus at this point by questioning only whether the Bank actually had received the refund. A better analysis would have been to focus on the general

the contrary, the basic principle of the Internal Revenue Code is to tax all accretions to wealth unless specifically excluded by the Code.[73] The Court continued by stating that it is "difficult to conclude that Congress intended that the corporation have no deduction if the state turned the tax revenues over to independent parties."[74] A careful examination of the facts, however, reveals that from the outset, the monies in question were held in an escrow account and not by the Illinois state treasurer[75] and that the state treasurer did not voluntarily refund the money to the shareholders.[76] Not until the Illinois appellate division decided *Bank & Trust Company v. Cullerton*[77] was it determined that the monies belonged to the shareholders.[78] Secondly, and more importantly, a section 164(e) deduction is premised on the theory that the bank paid a personal property tax that represented an obligation of its shareholder.[79] A deduction cannot be allowed pursuant to section 164(e) when in fact no tax obligation existed,[80] as *Lehnhausen*[81] proved. Justice Blackmun stated it best in his dissenting opinion. Speaking of the application of the TBR in the *Hillsboro* case, he said "[T]he propriety of the . . . deduction by the Bank depended upon the payment by the Bank of a state tax on its shares. This Court's decision in *Lehnhausen* . . . rendered any such tax nonexistent and any deduction therefore unavailable."[82]

When the Court assessed the applicability of the TBR in *Hillsboro* it should have focused on the payment of tax by the taxpayer rather than the recipient of the refund.[83] The TBR embodies the basic principle of disallowing a taxpayer a "tax benefit" from an earlier deduction

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policy of the Code: to tax all accretions to wealth not specifically excluded by the Code. *See* Glenshaw Glass Co. v. Commissioner, 348 U.S. 426, 430 (1955).

73. *Id.*

74. *Hillsboro*, 460 U.S. at 394.

75. *Id.* at 373.

76. The county treasurer refunded the amounts in escrow attributable to shares held by individuals. *Id.*

77. 25 Ill. App. 3d 721, 324 N.E.2d 29 (1975).

78. *Id.* at 726, 324 N.E.2d at 33.

79. *See supra* note 9.

80. I.R.C. § 161 (1983) allows deductions from taxable income for expenses incurred during the ordinary course of business. If the expense does not fall within the parameters of § 161, the Commissioner allows no deduction.

81. 410 U.S. 356 (1973).

82. *Hillsboro*, 460 U.S. at 422 (Blackmun, J., dissenting).

83. For a taxpayer to deduct an expense, I.R.C. § 161 (1983) requires that the expense fall into allowable deductions under the Code. In *Hillsboro*, the deduction taken by the Bank did not qualify. Since the tax imposed by the state of Illinois was repealed in Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973), no reason existed for the allowance of the deduction.

when later events indicate that he was not entitled to it.[84] If no other nonrecognition provision of the Code is in conflict with the TBR, as in *Nash* and *Putoma*,[85] and neither Code language nor Congressional history indicate a conflict, application of the TBR must follow in order to disallow a "tax benefit" bestowed upon a taxpayer who was not entitled to it.

One explanation for the *Hillsboro* decision might be its treatment of the shareholder and the Bank as separate entities.[86] Since the state repealed the tax[87] and declared the refund to belong to the shareholders,[88] the Court might have thought itself obligated to allow the deduction despite the absence of any factual basis for it. Using a "but for" approach, the Court might have reasoned that the allowance of a deduction by the Bank pursuant to section 164(e) led the Bank to pay the shareholder's tax. When the *Cullerton* court held that the monies kept in escrow belonged to the shareholders,[89] the Court might have concluded that it would be penalizing the Bank by requiring it to include the monies in taxable income.[90]

## IV. Conclusion

The "fundamentally inconsistent" theory complicates the tax system. "Inconsistent event" analysis forces a deviation from the traditional pattern of calculating income during a given year. The traditional pattern simply identified the transactions that made the taxpayer wealthier, determined the history of those transactions which should be characterized as having produced income, and then determined how much of the income must be recognized. The new theory advanced by the *Hillsboro* Court requires an analysis of the Congressional history of a nonrecognition provision each and every time the TBR may be applicable. The new analysis complicates implementation of the tax system by requiring interpretation of Congressional in-

84. *See* Bittker and Kanner, *supra* note 25 at 265-66.

85. *See supra* note 59.

86. *Hillsboro*, 460 U.S. at 394.

87. *See supra* note 10 and accompanying text.

88. Bank & Trust Co. v. Cullerton, 25 Ill. App. 3d 721, 726, 324 N.E.2d 29, 33 (1975).

89. *Id.*

90. By allowing the deduction by the Bank to be unaffected by the TBR, the Court, in effect, allowed the Bank to deduct a dividend to its shareholders. Such a deduction offends the general structure of the corporate tax provisions. I.R.C. § 301 (1954).

tent concerning a provision to find possible conflict with the TBR. It exacerbates an already complicated system.

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