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Whom Do You Trust? A Reply to Prof. Kahn

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WHOM DO YOU TRUST? A Reply to Prof. Kahn
Concerning the *Knight* Case, also known as *Rudkin Trust*

By Stephen B. Cohen

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In his 2008 opinion in *Knight v. Commissioner*,¹ Chief Justice John Roberts harshly criticized then Court of Appeals Judge Sonia Sotomayor. Although Roberts affirmed the result of her second circuit opinion in the case,² he wrote that her approach to the Internal Revenue Code “flies in the face of the statute.” In the August 3 issue of *Tax Notes*, I argued that Roberts’ criticism of Sotomayor was “logically flawed and unwarranted.”³ In the September 21 issue of *Tax Notes*, Prof. Douglas Kahn defended Robert’s criticism of


² The name of the case before the second circuit was *William L. Rudkin Testamentary Trust v. Commissioner.*

Sotomayor as “persuasive and accurate” and attacked Sotomayor’s opinion in the case and my defense of what she wrote. For the reasons explained below, I believe that Prof. Kahn’s arguments are contestable and perhaps even untenable.

The *Knight* case involved Section 67(e)(1), which limits the deduction of “costs which are paid or incurred in connection with the administration of [an] estate or trust and which would not have been incurred if the property were not held in such estate or trust.” The issue was whether Section 67(e)(1) applies to a trust’s expenses for investment advice.

Roberts construed the statute by reading the word “customarily” into the second clause of Section 67(e)(1). According to Roberts, Section 67(e)(1) applies if the costs would not *customarily* have been incurred if the property were not held in trust.

On the other hand, Sotomayor interpreted the statute to mean that Section 67(e)(1) applies if the costs *could* not have been incurred if the property were not held in trust. In effect, she read the statute as saying that Section 67(e)(1) applies if the costs would not *ever* have

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been incurred if the property were not held in trust. In effect, she read the word “ever” rather than the word “customarily” into the statute.

Roberts observed—and Prof. Kahn agreed—that Congress might have substituted the word “could” for the word “would” in the statute but did not. Moreover, Roberts noted that the word “could” is, as he put it, “highly accessible.” Therefore, he concluded, Sotomayor’s reading of Section 67(e)(1) must be incorrect.

Of course, Congress might also have included the word “customarily” in the statute but did not. Nevertheless, both Roberts and Kahn apparently believe that the failure to include “customarily” does not mean that Roberts’ reading is incorrect even though the failure to substitute “could” for “would” does mean that Sotomayor’s reading is wrong. Perhaps both Roberts and Prof. Kahn would explain that the word “could” is more “accessible” to legislators than the word “customarily.” Therefore, the failure to substitute “could” for “would” is more meaningful than the failure to insert the word “customarily.”

Even so, the use of “would” instead of “could” does not necessarily mean that Congress rejected Sotomayor’s reading
Section 67(e)(1). It might signify a lack of consciousness about the ambiguity inherent in the statute as written. Or it might reflect a legislative decision not to resolve this ambiguity and instead to allow courts to determine more specifically how to apply the language. The logical mistake of both Roberts and Kahn is assuming that a failure to resolve the ambiguity through the use of the word “could” in place of “would” necessarily implies a resolution of the ambiguity in one way rather than another.

More generally, suppose that a statute in question is ambiguous and could be read to mean either A or B. A decision by Congress not to modify the language so that it clearly means A does not necessarily imply that Congress means B.

Roberts also argued—and again Prof. Kahn agreed—that Judge Sotomayor’s reading of the second clause in Section 67(e)(1) would make the first clause superfluous. Roberts’ opinion stated:

If the only costs that are fully deductible are those that could not be incurred outside the trust context—that is, that could only be incurred by trusts—then there would be no reason to place the further condition on full deductibility that the costs be “paid or incurred in connection with the administration of the . . . trust,” § 67(e)(1). We can think of no expense that could be incurred exclusively by a trust but would nevertheless not be “paid or incurred in
connection with” its administration.  

In my August 3 article, I argued that this criticism misread the statutory scheme:

Section 67(e) divides all trust deductions into two categories: (1) deductions for costs incurred in connection with the administration of a trust; and (2) the standard deduction and deductions for distributions to trust beneficiaries. Section 67(e)(1) requires that deductions in the first category (that is, deductions incurred in connection with the administration of a trust) “would not have been incurred if the property were not held in such trust.” Section 67(e)(2), in contrast, does not impose such a “would not have been incurred” requirement for either the standard deduction or distributions to trust beneficiaries. Thus, the purpose of the “paid or incurred in connection with the administration of [a] trust” language in the first clause of Section 67(e)(1) is to separate deductions subject to the “would not have been incurred” requirement from specified deductions under Section 67(e)(2) that are not subject to that requirement.

Prof. Kahn argued that I am mistaken because the limit on deductions under Section 67(e)(1) applies only to “costs.” The standard deduction and distributions to trust beneficiaries, he continued, are not “costs in any sense” and therefore could never be thought to be subject to the Section 67(e)(1) limits.

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5 552 U.S. 181, ___, 128 S. Ct. 788.
A trust, however, might pay the expenses of its beneficiaries, for example, for education or travel. These expenses would be, in common parlance, costs incurred by the trust. They would not, however, be costs incurred in the administration of trust property as such and therefore should be fully deductible without limit. Thus, the first clause in Section 67(e)(1) is not rendered superfluous by Sotomayor’s reading of the statute. It is needed to confine the limits on deductibility to administrative costs and to insure, for example, that the trust’s payment of expenses of a beneficiary are fully deductible.

There is one other aspect of Prof. Kahn’s article that I find puzzling. I cited, as significant, the fact that both the Treasury and the Solicitor General endorsed Sotomayor’s reading of Section 67(e)(1). Prof. Kahn wrote:

Cohen’s view that approval of a court’s holding by the winning party demonstrates the validity of that holding is extraordinary to the point of being bizarre.

Is it sensible, however, to equate the position taken by the Treasury and the Solicitor General as no different from that of any self-interested private litigant? The Treasury has a special interest in the fair and effective administration of the tax laws. The Solicitor General has an obligation, not just to try to win, but to pursue the fair
and effective application of the U.S. Code. Surely their endorsement cannot be dismissed as if they were private litigants with only private interests to pursue. Surely their endorsement supports the judgment that Sotomayor’s approach did not, as Roberts’ claimed, “fly in the face of the statute.”

For these reasons, I remain convinced that there are at least two plausible interpretations of Section 67(e)(1) and that Roberts was therefore wrong when he claimed that Sotomayor’s reading “flies in the face of the statute.” Moreover, while either interpretation may be plausible, Sotomayor’s makes it easier to administer the admittedly cumbersome and awkward language of the statute. It is easier to determine whether a cost could not have been incurred than whether it would not customarily have been incurred. For reasons of administrative feasibility, therefore, I prefer Sotomayor’s approach.

Prof. Kahn, on the other hand, prefers Roberts’ interpretation because it would narrow the range of trust expenses to which Section 67(e)(1) would apply. This preference for Roberts’ approach emanates from the fact that Prof. Kahn finds the Section 67(e)(1) limits on deducting trust administrative costs to be wrong as a matter of tax policy.
On this question of tax policy, I fully agree. In order to produce a true income figure, the administrative costs of a trust should be fully deductible without limit. Section 67(e)(1) therefore ought to be repealed. Disagreement with the policy or purpose of a statute, however, is not a proper ground for interpreting the language of the statute to limit its scope.

Prof. Kahn goes even further, suggesting that the courts should have interpreted Section 67(e)(1), notwithstanding its language, to permit a deduction in full for trust expenses for investment advice. I am unsure how he would square that position on statutory interpretation – which seems clearly to “fly in the face of the statute” – with his disdain for Sotomayor’s reading of Section 67(e)(1).

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