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### Liars Should Have Good Memories: Legal Fictions and the Tax Code

John A. Miller

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**LIARS SHOULD HAVE GOOD MEMORIES:  
LEGAL FICTIONS AND THE TAX CODE**

JOHN A. MILLER\*

*I do not intend this book be a tract on behalf of Bokononism.  
I should like to offer a Bokononist warning about it, however.  
The first sentence in The Books of Bokonon is this:*

*“All of the true things I am about to tell you are shameless  
lies.”*

*My Bokononist warning is this:*

*Anyone unable to understand how a useful religion can be  
founded on lies will not understand this book either.<sup>1</sup>*

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I.	INTRODUCTION	

Tax law is riddled with legal fictions. For example, the law "attributes" ownership of property to one person when it is ac-

tually owned by another.<sup>2</sup> It “constructs” non-existent transfers of money between persons.<sup>3</sup> It “deems” property held for a different period of time from that for which it was actually held.<sup>4</sup> And tax law treats transfers of property “as if” they never occurred.<sup>5</sup> The list could go on and on.<sup>6</sup>

Why does tax law set up rules that contradict the facts? Are these “fictions” indispensable to tax law or are they merely convenient habits lawmakers have fallen into? Are there some criteria for the appropriate use of legal fictions in the law of taxation? This article will address these questions along with the more fundamental question of how one defines the term “legal fiction.” Though the definition is the focus of Part II of this article, the question of what constitutes a legal fiction pervades the other parts of the article as well. Each new discussion of some aspect of the fiction, such as a consideration of its purpose, or of its proper application, raises anew the question of what it really is, and sometimes even, whether it truly exists as a distinct form of rule.

This article adopts a perspective that seeks to render the fiction an objective and discrete phenomenon of the law.<sup>7</sup> In doing so, I recognize that other approaches are possible and, in some respects, superior. For example, an affecting recent treatment of the legal fiction that takes a different approach is Professor Louise Harmon’s article, *Falling Off the Vine: Legal Fictions and the Doctrine of Substituted Judgment*.<sup>8</sup> In her article, Professor Harmon, by

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2. See, e.g., I.R.C. §§ 267(c), 318 (1988) (constructive ownership of stock).

3. See, e.g., I.R.C. § 7872 (1988) (imputed payments of interest).

4. See I.R.C. § 1223 (1988) (tacking of holding periods).

5. See I.R.C. § 2518 (1988) (disclaimers of gifts and bequests).

6. See *infra* part IV.

7. This might be described as a “typical male” perspective. See Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465, 465 n.1 (1987) (“‘male’ in the sense that it is ‘scientific,’ ‘objective,’ and ‘individualistic’”).

8. 100 YALE L.J. 1 (1990). The article offers a fascinating account of the development of the doctrine of substituted judgment, the judicial doctrine that authorizes a judge to substitute his judgment for that of an incompetent person on some matter concerning the property or welfare of that person. In an ironic way, Professor Harmon’s conclusions about the legal fiction coincide with those of Lon Fuller discussed in this article *infra* part II.B., though with a more starkly regretful tone. I say ironic because, in the end Professor Harmon has little to say about the legal fiction as a form and does not offer a clear view of what she means by the term. Indeed, from her article, it is not clear to me that the doctrine of substituted judgment is a legal fiction in the same sense as I employ the term in this article. See *infra* part II. But this may be my failing rather than hers. In any event, Professor Harmon’s disenchantment with the doctrine of substituted judgment (quite justified in my inexperienced view) leads her to conclude that we must be wary of fictions because

focusing on a single fiction, brings to life its human consequences through what might be called "legal storytelling."<sup>9</sup> Her purpose is not to objectify the fiction but to humanize it, and she succeeds. The more traditional approach taken here rests on differences in subject matter and scope. I have chosen the emotionally restrained tax context in which to consider the fiction, and for the most part I will be concerned with codified fictions rather than judicial fictions. Moreover, it is not my purpose to defend or denounce specific fictions of tax law (though in the course of this article I may do so). Instead I seek to understand the legal fiction as a form frequently employed in tax law.

Tax law provides a particularly fertile area for considering legal fictions. This is because tax law is more formalistic and rule oriented than other areas of law. As will be discussed, legal fictions feed off of the inflexibility of other rules. The more rules one has within a system of rules, and the more rigidly those rules are interpreted, the more need there is to indulge in fictions to make the system function fairly.

## II. WHAT IS A LEGAL FICTION?

### A. *In General*

The legal fiction has long been an object of inquiry and debate,<sup>10</sup> and it continues to draw the attention of scholars.<sup>11</sup>

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of their potential for grave harm to real people. In this she joins with Fuller and many others who have written on the fiction. She also recognized that fictions "may be benign in one context and dangerous or brutal in another." Harmon, *supra* at 61. As will be seen, this emphasis on the role of context in the application of fictions was also part of Fuller's approach toward fictions. But in the end I found Professor Harmon's article important not for its abstract discussion of the legal fiction but for what it had to say about courts who decide to permit the taking of organs from incompetents, "terminating their life support systems, sterilizing them, and forcing psychotropic medication upon them." *Id.* at 63. It is on this latter score that her article succeeds most clearly by enlisting the reader's empathy for the incompetent and the judge alike as "... two hapless human beings. Neither of them chose his part, and but for the grace of God, either of them could be me." *Id.* at 71.

9. Legal storytelling approaches the law from the perspective of individual narratives. From this perspective, each case is viewed as important not for the rule that arises from it but because some person's life is bound up in that case and its outcome. Legal storytelling is a form of "rebellion against abstraction." Toni M. Massaro, *Empathy, Legal Storytelling, and the Rule of Law: New Words, Old Wounds*, 87 MICH. L. REV. 2099, 2099 (1989).

10. See, e.g., 3 WILLIAM BLACKSTONE, COMMENTARIES \*43, \*152, \*268; JEREMY BENTHAM, A COMMENT ON THE COMMENTARIES AND A FRAGMENT ON GOVERNMENT 441 (J.H. Burns & H.L.A. Hart eds., Univ. of London 1977) (1823); HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN

Moreover, as a device of the law its use seems never to have slackened. But its true nature remains difficult to state with clarity. The legal fiction is an elusive concept because by design it must blend into its surroundings; it must adapt to changing circumstances.<sup>12</sup> On a philosophical level, the legal fiction is the expression of a relation.<sup>13</sup> In legal theory it may be described as a metaphor. On a more pragmatic level, it is a falsehood deemed to be true for limited purposes. But none of these phrases convey a concrete image. The legal fiction is a form that draws its substance from the body of law in which it is employed. Thus, it is only by specific example that the fiction is brought to life. In the course of this article, a number of tax fictions will be offered as illustrations of the various points made.

### 1. The Fiction as Deriving from an Analogy

The legal fiction is most easily understood as having its roots in analogy, that is, it results from a comparison.<sup>14</sup> For example,

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IDEAS, ch. II (1861); JOHN AUSTIN, LECTURE ON JURISPRUDENCE OR THE PHILOSOPHY OF POSITIVE LAW § 877 (1874).

11. See, e.g., Harmon, *supra* note 8. This article offers a brief historical survey of the major scholarly literature concerning the legal fiction that is useful. *Id.* at 2-16. Other recent works involving the legal fiction: Ibrahim J. Wani, *Truth, Strangers and Fiction: the Illegitimate Use of the Legal Fiction in Immigration Law*, 11 CARDOZO L. REV. 51 (1989); K. Scott Hamilton, Comment, *Prolegomenon to Myth and Fiction in Legal Reasoning, Common Law Adjudication and Critical Legal Studies*, 35 WAYNE L. REV. 1449 (1989); Jean-Louis Bergel, *Le role des fictions dans le systeme juridique*, 33 MCGILL L.J. 357 (1988); Bruce Ziff, *The Rule Against Multiple Fictions*, 25 ALBERTA L. REV. 160 (1987); Aviam Soifer, *Reviewing Legal Fictions*, 20 GA. L. REV. 871 (1986); James B. Stoneking, Note, *Penumbras and Privacy: A Study of the Use of Fictions in Constitutional Decision-Making*, 87 W. VA. L. REV. 859 (1985); Kenneth Campbell, *Fuller on Legal Fictions*, 2 LAW & PHIL. 339 (1983); Walter C. Cliff & Benjamin J. Cohen, *Collateral Fictions and Section 482*, 36 TAX LAW. 37 (1982) (a notable tax article involving legal fictions); R.A. Samek, *Fictions and the Law*, 31 U. TORONTO L.J. 290 (1981).

12. The meaning of the word fiction is slippery at best.

The word *fiction* conjures up a fictitious world which is juxtaposed with that of reality. The former is contrived, invented; the latter is simply there, a fact, an inescapable truth. Alas, the distinction is not as simple as it appears. On the one hand, a fiction too has its reality; on the other hand, the notion of *true* reality is a fiction. Both "fiction" and "reality" are instrumental concepts. The difference between them lies in their use, not their ontology.

Samek, *supra* note 11, at 317.

13. See BERTRAND RUSSELL, THE PROBLEMS OF PHILOSOPHY 94-96 (Oxford Univ. Press 1959) ("The relation of resemblance . . . must be a true universal."). "The fiction . . . forces upon our attention the relation between theory and fact, between concept and reality, and reminds us of the complexity of that relation." LON L. FULLER, LEGAL FICTIONS ix (Stanford Univ. Press 1967).

14. This view derives from Vaihinger whose work is detailed *infra* part II.B.1.

the tax fiction attributing the ownership of corporate stock from parent to child<sup>15</sup> may be conceived of as being based on the belief that stock owned by one's parent is more like one's own property than it is like the property of some unrelated third party; in other words, the family is viewed as more like a single economic unit than it is like a group of free-acting individuals. The fiction that comes out of this analogy is that one is deemed to own one's parent's stock. Similarly, the doctrine of constructive receipt is based on the belief that once a taxpayer has an unrestricted right to a sum of money that has actually been set aside for her, the situation is more akin to the taxpayer's having possession of the money than it is to the taxpayer's awaiting payment of the money.<sup>16</sup> The fiction arises when we conclude, from this comparative judgment, that we will treat sums of money which have only been set aside as if in fact they have been received.

## 2. The Fiction as a Falsehood

The common feature of every legal fiction is that it states an apparent falsehood. However, as Professor Ibrahim Wani has noted, "[f]alsity presumes reality which it distorts, which raises the question whether there is a reality or truth."<sup>17</sup> My approach in this article is to assume, without defending the assumption, that there is a reality and that there is truth. But I do not assume that either reality or truth are absolutely known to me. Instead, when I say that a legal fiction states an apparent falsehood, I mean that the rule asserts or implies a fact that would be regarded as false in a non-legal context.<sup>18</sup> This "falsehood" results from the conversion of an analogy (one's parent's stock *is like* one's own stock) into an absolute statement (one's parent's stock *is* one's own stock).

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15. See, e.g., I.R.C. §§ 267(c), 318 (1988). These provisions do more than just attribute ownership from parent to child. They also attribute ownership between other family members and between persons and the entities they control. My example in the text is narrowly drawn for the sake of simplicity.

16. For a discussion of the doctrine of constructive receipt see WILLIAM A. KLEIN ET AL., FEDERAL INCOME TAXATION 55-56, 357-395 (8th ed. 1990).

17. Wani, *supra* note 11, at 56.

18. Campbell contends that "[a]ny assertion is an assertion of a legal fiction only if and insofar as it is an assertion of that which the law itself classifies as a question of fact." Campbell, *supra* note 11, at 356. The law itself, he argues, determines which questions are ones of fact and which questions are ones of law. The question of whether a question is one of fact or of law is a question of law. *Id.* at 358-59. "The fiction arises from the content of the rule being false when regarded as a question of fact according to non-legal classification." *Id.* at 359.

This conversion of the relative to the absolute may arise from the need to integrate our analogy into a pre-existing dichotomy in the law. For instance, tax law divides non-liquidating corporate distributions to shareholders into two categories: dividends and redemptions.<sup>19</sup> Generally, the distributee would prefer the finding of a redemption.<sup>20</sup> The finding of a redemption usually entails a finding that the shareholder's relative interest in the corporation has diminished as a result of the corporate distribution. This diminution of interest occurs because in a redemption the shareholder surrenders some or all of her stock in the corporation in exchange for the corporate distribution. In measuring whether the shareholder's interest in the business has diminished, we are forced to choose how we will treat the interests of family members of the shareholder. Has a person's economic interest in a corporation diminished if her stock is "redeemed" when her family continues to own the other outstanding stock in the corporation? The answer we would like to give is "yes *and* no" because in some respects her economic interest in the corporation has declined and in some respects it has not. But the answer we are obliged to give by the dividend/redemption dichotomy is "yes *or* no." Our desire for an all or nothing answer forces us to take our analogy that a parent's stock is more like the child's stock than it is like the stock of an unrelated third party and turn it into the fiction that a child owns her parent's stock.

### 3. Distinguishing Fictions from Mere Generalities

If a fiction is identified by its falsity, how do we distinguish the fiction from other rules that may also embody some degree of falsity but which are not considered legal fictions? For instance, in tax law we differentiate between capital assets and non-capital assets and accord them different tax treatment.<sup>21</sup> But any given asset may partake of the qualities of both a capital asset and a non-capital asset. In such cases, we decide whether the asset is

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19. See I.R.C. §§ 301, 302, 316 (1988).

20. If a redemption is found the taxpayer will be allowed to recover basis and to treat the gain as capital gain. A dividend is simply ordinary income in the full amount of the distribution. See BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 9.02 (5th ed. 1987).

21. The term "capital asset," as defined in I.R.C. § 1221, includes all property except those types of property that are specifically excepted. This definition contains a number of ambiguities. See BORIS I. BITTKER & MARTIN J. MCMAHON, *FEDERAL INCOME TAXATION OF INDIVIDUALS* ¶ 28.3-28.5 (1988).



capital or not on the basis of which category it most resembles. If we decide it most resembles a capital asset, that is what we call it. When we do so, we treat the asset as though it has none of the characteristics of a non-capital asset. Thus, we indulge in the "fiction" that the asset fits neatly into one category and not the other. But would we call our treatment of the asset or our definition of a capital asset a legal fiction? Surely not, for if we did so, most rules would be legal fictions since most rules involve the need to lump into wholly separate categories things that may only differ by degrees.<sup>22</sup> Under such a broad approach to what constitutes a fiction, the concept of the legal fiction would subsume most of the law and would be rendered analytically useless. How then are we to make a distinction between rules such as our definition of capital asset and rules embodying a legal fiction? There are two connected answers.

The first answer is to say that the legal fiction involves a falsehood more striking and pervasive than that implicit in other rules. The legal fiction involves the implied or express assertion of a fact that one standing outside the legal system would regard as clearly false, such as the assertion that a daughter owns her mother's stock or the claim that a person flying off on vacation has this week's pay in hand when in fact the paycheck is still lying on his desk at work. Thus, the fact asserted by the legal fiction must be one that in a non-legal context would strike the non-lawyer as false, and false in all cases. Often the fiction sounds self-contradictory. For example, how can I own my mother's stock if my mother owns it? How can I have possession of my paycheck if I am on board an airplane at thirty thousand feet and my paycheck is at work?

A second way to distinguish legal fictions from other legal falsehoods is to say we are dealing with a legal fiction only when we can identify a fact-based analogy underlying the rule that explains its falsity. Rules that implicitly or explicitly embrace a falsehood are only legal fictions if we can identify a fact-based analogy from which the falsehood derives (my mother's stock is like my stock). Thus, legal fictions are not simply rules that state a generalization that in some cases may be false. Instead legal fictions deliberately overstate a comparative statement and are *always* false.

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22. As Professor Frederick Schauer has written, "[u]nderstanding rules requires grasping the distinction between the general and the particular." Frederick Schauer, *Rules and the Rule of Law*, 14 HARV. J.L. & PUB. POL'Y 645, 647 (1991).

#### 4. The Utility of Finding the Analogy

If a legal fiction is characterized by its analogical roots, finding the analogy on which a fiction is based is a necessary first step in establishing the existence of the fiction. Identifying the analogy is also a beginning point for considering the merits of any particular legal fiction. When the analogy fails to ring true, we cannot help but question the propriety of the fiction because a good fiction should be true at some level. With respect to the constructive stock ownership rules, for example, does the analogy ring true that stock owned by a family member is more like one's own stock than it is like the property of an unrelated third party? I think so, but just barely. As a general matter, stock owned within a family may be thought to provide some economic benefit to all the family members—not just the member in whose name title is held.<sup>23</sup> In turn, this may justify in most cases treating one family member as the owner of stock actually owned by another family member. But in any given case a person may have no connection of any sort with corporate stock owned by a family member. In such a case, it seems unfair to attribute ownership from one family member to the other if by so attributing ownership a detrimental tax effect results to the taxpayer.<sup>24</sup> The fundamental problem with the constructive ownership statutes is that they make an absolute rule out of a comparative statement and thereby give it more weight than it merits. This is a persistent concern we may have about the legal fiction, particularly when it has been set out in a statute. The canonical statement of the fiction in a statute can often seem too inflexible a method of employing the legal fiction.<sup>25</sup> However, a judicially created fiction can suffer from the same infirmity<sup>26</sup> since, by its nature, the fiction is an overstatement or exaggeration.

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23. In saying this, it is worthy of mention that this generalization may be declining in validity. In the modern world family cohesiveness seems increasingly rare. There is also an element of cultural bias inherent in the belief that one family member derives an economic benefit from property owned by another family member. In some societies or segments of society only the immediate family (or even some smaller unit such as mother and child) might be the appropriate measure of that economic unity. In other societies, perhaps the economic unity would extend to distant relatives. Whether the current statutes reflect the appropriate measure of family unity in this country is subject to challenge.

24. Very rarely the courts have agreed that attribution of ownership should not be required where family members are hostile to one another. See, e.g., *Robin Haft Trust v. Commissioner*, 510 F.2d 43 (1st Cir. 1975).

25. This notion is developed more fully *infra* part V where the principle of dropping the fiction from the final reckoning is addressed.

26. See *Harmon*, *supra* note 8, at 63-71.

### B. A Selected Literature Review

In what follows, I have taken the liberty of selecting only two of the many significant writings on the fiction for special treatment: the early twentieth century works of the German philosopher Hans Vaihinger, whose major work was *The Philosophy of 'As If'*,<sup>27</sup> and the work of American law professor Lon. L Fuller, who in 1930 and 1931 published three articles under the title *Legal Fictions*.<sup>28</sup> My reason for focusing on these two writers is that I believe that Fuller's work remains the most complete and comprehensive discussion of the fiction as a form, and that because of Vaihinger's influence on Fuller one must know something of Vaihinger's work to fully appreciate Fuller. This article does not ignore the more contemporary works on the fiction, but it is the work of Professor Fuller that gives this article its point of view.

The discussion of *The Philosophy of 'As If'* which follows attempts to set out the basic tenets of Vaihinger's philosophy with minimal editorial comment. Some aspects of Vaihinger's views may strike the reader as rather mystical or even bizarre. But Fuller was able to extract from Vaihinger's analysis some key points and use them for his own purposes without denigrating the rest of Vaihinger's philosophy. The extent of Fuller's adoption of Vaihinger's tenets concerning the fiction is never made clear by Fuller.

#### 1. Vaihinger and *The Philosophy of 'As If'*

Hans Vaihinger, a follower of Kant,<sup>29</sup> sought to connect scientific, philosophical, and everyday ways of thinking into an over-

27. HANS VAHINGER, *THE PHILOSOPHY OF 'AS IF': A SYSTEM OF THEORETICAL, PRACTICAL AND RELIGIOUS FICTIONS OF MANKIND*, (C.K. Ogden trans., 2d ed. 1949). According to the translator's opening note, the 1949 translation is based on the definitive 6th edition of the original, revised for the purpose by the author. An earlier translation also by Ogden was criticized by Fuller as "quite unsatisfactory." FULLER, *supra* note 13, at 94 (Fuller was first writing on this in 1930). However, it appears that Vaihinger himself did not so regard it because he wrote an "autobiographical" section for the sixth edition. According to the translator's opening note, the text of this edition is "substantially unaltered."

28. L. L. Fuller, *Legal Fictions* (pts. 1-3), 25 ILL. L. REV. 363, 513, 877 (1930-31). In 1967 these three articles were published as a book bearing the same title by Stanford University Press. See FULLER, *supra* note 13. It is the book version to which all future citation will refer. Fuller's effort seems particularly impressive when one considers that he was only twenty-eight years old when this work was first published. See ROBERT SUMMERS, LON L. FULLER 4 (1984).

29. Vaihinger uses Kant's works as "confirmations" of his own philosophy. VAHINGER, *supra* note 27, at 271-318. He also credits many others for influencing his work. These include David Hume, J.S. Mill (*Id.* at vii); the poet, Friedrich Schiller (*Id.* at xxv); Schopenhauer (*Id.* at xxviii); and, most importantly after Kant, Lange (*Id.* at xxxv).

arching conception of human thought. Vaihinger classified his resulting philosophy as "positivist idealism."<sup>30</sup> In philosophy, "idealism" is often used to describe "the doctrine that whatever exists, or at any rate whatever can be known to exist, must be in some sense mental."<sup>31</sup> Vaihinger believed that an absolute ability to know reality was impossible.<sup>32</sup> He believed we could only know the appearance of reality. But he found nothing sorrowful in this conclusion because of his conception of the practical utility of fictions.<sup>33</sup> He called his philosophy "as if" "because it seemed to me to express more convincingly than any other possible title what I wanted to say, namely, that "as if," i.e., appearance, the consciously-false, plays an enormous part in science, in world-philosophies and in life."<sup>34</sup>

According to Vaihinger, a fiction is a consciously false assumption. It is not a lie because it is not intended to deceive. It is not an erroneous conclusion or hypothesis because it is understood to be false. It proceeds from pragmatism.<sup>35</sup> A legal fiction, in particular, is ultimately an analogy. It is the means by which we reduce the unknown to the known.<sup>36</sup> It is how we are able to think about reality without fully comprehending it. This requires some explaining.

Vaihinger believed fictions are different from hypotheses because hypotheses are probable truths that can later be proved or disproved. "They are . . . verifiable. Fictions are never verifiable, for they are hypotheses which are known to be false, but which are employed because of their utility."<sup>37</sup> Vaihinger supports his

30. *Id.* at xlvii.

31. RUSSELL, *supra* note 13, at 37.

32. He distinguished himself from Kant and Spencer in that unlike them, he believed that the limits of the human mind to "know" would also apply to a higher intelligence. VAIHINGER, *supra* note 27, at xliii. This is because the limits of knowledge flow from the nature of thought rather than the nature of the mind. *Id.*

33. In concluding a fifteen point summary of his philosophy, Vaihinger wrote: "It is senseless to question the meaning of the universe, and this is the idea expressed in Schiller's words: 'Know this, a mind sublime puts greatness into life, yet seeks it not therein' (Huldigung der Kunste 1805). This is positivist idealism." *Id.* at xlvii.

34. *Id.* at xli.

35. Vaihinger claims that the "world of motion" and the "world of consciousness" have never been unified by any philosophy. *Id.* at xlv. But he says these problems fade away when we are in action. "We do not understand the world when we are pondering over its problems, but when we are doing the world's work. Here too the practical reigns supreme." *Id.* at xlv.

36. "[A]ll knowledge is a reduction from the unknown to the known, that is to say a comparison." *Id.* at xliii.

37. *Id.* at xlii.

analysis primarily with examples drawn from math and science.<sup>38</sup> As Fuller notes, he seems to have been relatively unfamiliar with legal fictions.<sup>39</sup> As an example of a juristic fiction, Vaihinger points to the rule that an adopted child is regarded *as if* she were a real child of the adopting parent.<sup>40</sup> I will have more to say about this "fiction" later.

In Vaihinger's view, the processes of thought are like organic processes of growth, development, adaptation, healing, and so on.<sup>41</sup> "The psyche . . . is an *organic formative force*."<sup>42</sup> The quality of our thought processes is vindicated by "practical corroboration."<sup>43</sup> For the most part, the organic function of thought is carried on unconsciously.<sup>44</sup> Human errors of thought originate through taking our thought processes to be copies of reality<sup>45</sup> when, in fact, the utility of our logical processes arises from the divergent route they take in order to achieve coincidence with reality in the end.<sup>46</sup>

Vaihinger distinguished between "rules of thought" and "artifices." Rules of thought are the "totality of all those technical operations in virtue of which an activity is able to attain its object directly."<sup>47</sup> Thus, rules of thought are like rules of logic that state a position directly, with the conclusion flowing inevitably from the stated premises.<sup>48</sup>

38. *Id.* at 17-77. Another, more recent, writer says that "[d]espite the apparent objectivity of the empirical sciences, the use of knowingly false propositions—that is, fictions—is surprisingly pervasive." Hamilton, *supra* note 11, at 1455.

39. FULLER, *supra* note 13, at 117 n. 48. Vaihinger calls them (in translation) "Juristic Fictions" and devotes a brief chapter to them. VAIHINGER, *supra* note 27, at 33-35. He begins that chapter, however, by acknowledging that "the term fiction has hitherto been nowhere better known than in jurisprudence where it forms a favourite subject of discussion." *Id.* at 33.

40. VAIHINGER, *supra* note 27, at 50. Henry Sumner Maine also considered adoption as a form of legal fiction. HENRY SUMNER MAINE, *ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN IDEAS* 33 (10th ed. 1930). Fuller, as will be discussed, would dispute this. FULLER, *supra* note 13, at 39.

41. VAIHINGER, *supra* note 27, at 1-2.

42. *Id.* at 2. He credits Steinthal with "this view of the organic function of the logical movements involved in knowing." *Id.* According to Steinthal, says Vaihinger, "Thought . . . must be regarded as a mechanism, as a machine, as an instrument in the service of life." *Id.* at 5.

43. *Id.* at 3.

44. *Id.* at 7.

45. *Id.* at 8. Vaihinger credits Kant with this idea. *Id.* at 8 n.1.

46. *Id.*

47. *Id.* at 11.

48. The logical syllogism is an apt illustration of a rule of thought. For example, the tax law may provide that all income is taxable (major premise). If we then say that one's

The artifices . . . are those operations . . . which run counter to ordinary procedure in a more or less paradoxical way. They are methods which give one the impression of magic if he be not himself initiated . . . and are able indirectly to overcome the difficulties which the material in question opposes to the activity.<sup>49</sup>

The fiction is an artifice of thought.<sup>50</sup> Such artifices do not mirror reality but serve as tools for moving within it. "Thought begins with slight initial deviations from reality (half-fictions), and, becoming bolder and bolder, ends by operating with constructs that are not only opposed to the facts but are self-contradictory."<sup>51</sup> This view of fictions as tending toward self-contradiction has considerable importance for how fictions are used and misused. Since some fictions ultimately lead to self-contradiction (for example, I have my paycheck in hand even though it is at work, or I own my mother's stock), they are only properly used if their fictive nature is recognized and accepted.<sup>52</sup> Since fictions are by definition false on some level, failure to recognize fictions as fiction leads to their misuse.

Vaihinger describes many categories of fictions,<sup>53</sup> the most significant of which, for our purposes, is the "symbolic" or "analogical" fiction. According to Vaihinger, these fictions are related to poetic similes as well as to myth.<sup>54</sup> These fictions rest on a perceived similarity between one idea or object and another idea or object,<sup>55</sup> and are necessary because we can understand something new only by reference to what we already know.<sup>56</sup> Analogical

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salary is income (minor premise), it logically follows that one's salary is taxable (conclusion). If we wanted to illustrate how a fiction can operate within this framework, we could simply create a falsehood that would activate this syllogism. For instance, we could establish as a rule the fiction that a law student's grades represent income to her. When we plug this fiction into our syllogism, we reach the conclusion that each time a student receives her grades she has taxable income. This is illustrative of the connection between fictions and pre-existing law that is addressed in some detail *infra* part III.A. The usual rule of law, like Vaihinger's rule of thought, approaches its objective directly by means of stated premises. The legal fiction, like the artifice of thought, approaches its objective indirectly by means of falsehoods that activate the rules of law in circumstances where they would ordinarily not apply.

49. VAIHINGER, *supra* note 27, at 11.

50. *Id.* at 12. "[F]ictions are mental structures." *Id.*

51. *Id.* at 15-16.

52. *Id.* at 18-19; *see also id.* at 20, 31, 49, 56 for examples.

53. *Id.* at 17-77.

54. *Id.* at 27.

55. "All cognition is the apperception of one thing through another." *Id.* at 29.

56. According to Vaihinger, Kant demonstrated that it is impossible to attain absolute knowledge of the world "because knowledge is always in the form of categories and these, in the last analysis, are only analogical apperceptions." *Id.* at 29-30.

fictions are symbolic because they rest on perceived similarities between phenomena, and there is no reason to believe that these perceptions accurately portray objective reality.<sup>57</sup>

In Vaihinger's view, the legal fiction is in principle a form of the symbolic or analogical fiction.<sup>58</sup> Commonly, legal fictions cause us to regard something which has not happened as if it has happened or vice versa.<sup>59</sup> Vaihinger offers as an example the rule in German commercial law that failure to timely reject goods is treated as if the goods were accepted.<sup>60</sup> The underlying basis for such treatment is that while, in fact, the two cases are different, in principle they are analogous because in both cases the buyer's conduct with respect to the goods is similar. In short, by keeping silent while keeping the goods, the buyer has acted as though he has accepted the goods.

The most important thing to understand about the fiction, according to Vaihinger, is that its great utility derives directly from its "*deviation from reality*."<sup>61</sup>

Without such deviations thought cannot attain its purposes, and this is quite natural, for how otherwise could thought manipulate and elaborate what is given? It is just the deviation that, in the end, appears to be the natural procedure, and it is absolutely necessary constantly to stress this fact and draw attention to it.<sup>62</sup>

Thus, for instance, the doctrine of constructive receipt is only useful because it states a falsehood. If we have actual possession of our paycheck, there is no need for the doctrine. But when we lack actual possession in circumstances analogous to actual possession, the doctrine serves to treat the analogous circumstance in a fashion that comports with our view of economic symmetry. Even though the doctrine does this by asserting that we have possession at a time when we lack possession, the assertion still seems perfectly natural in the context in which it is made.

It should be apparent that Vaihinger views all categories of fictions, including legal fictions, in a positive light. To him they

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57. "We can only say that objective phenomena can be regarded as if they behaved in such and such a way, and there is absolutely no justification for assuming any dogmatic attitude and changing the 'as if' into a 'that.'" *Id.* at 31. This is a reminder of Vaihinger's belief in "idealism," i.e., that whatever exists is in some sense mental.

58. *Id.* at 33.

59. *Id.* at 34.

60. *Id.* at 35.

61. *Id.*

62. *Id.*

are essential tools of human thought. To view fictions as evil would make no more sense to Vaihinger than to view as evil the water we drink or the air we breathe. This is not to say that he saw no risk in their use. As noted previously, he believed the danger was in failing to recognize the fiction as fiction because, according to Vaihinger, the proper use of a fiction ultimately required one to "drop" the fiction in the final reckoning.<sup>63</sup> This cryptic notion of dropping the fiction was picked up and expounded by Fuller in his discussion of the legal fiction.

## 2. Fuller

Lon Fuller's main work on the legal fiction first appeared in 1930 and 1931 in a series of articles in the *Illinois Law Review*.<sup>64</sup> Those articles were collected and published as a book in a slightly altered form in 1967 by Stanford University Press. The latter publication is relied upon here for an understanding of Fuller's views. However, it must be remembered that it was the state of law, science, and philosophy of the 1920s that most heavily influenced Fuller. In his introduction to the 1967 version, Fuller acknowledges, "at the time when I began to study the literature of fictions, the subject was surrounded by the romantic aura of Hans Vaihinger's *The Philosophy of 'As If,'* with its mysterious title promising obscurely some mind-expanding reorientation of human perspectives."<sup>65</sup> Fuller goes on to acknowledge that some aspects of his work, particularly in reference to physics, may strike the reader as archaic. However, he asserts that the problems addressed by fictions remain the same, and he suggests with a tinge of humor that one interested in fictions "must be tolerant of allegory."<sup>66</sup>

Though greatly influenced by Vaihinger, Fuller put his own stamp on the fiction. His knowledge of the legal fiction in particular far outstripped Vaihinger's, and his analysis brought to the subject an unusual talent for synthesis.<sup>67</sup> He divided his treatment

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63. *Id.* at 127, 227. Vaihinger did not believe that this correction was necessary for legal fictions but Fuller disagreed and attributed Vaihinger's error to his "lack of intimate acquaintance with the legal fiction." FULLER, *supra* note 13, at 117.

64. See *supra* note 28. See also FULLER, *supra* note 13, at vii.

65. See FULLER, *supra* note 13, at viii.

66. *Id.* at xiii.

67. Fuller not only draws on the work of Vaihinger but also upon the writings of Bentham, Ihering, Gray, Maine, Blackstone and others. I do not propose to retrace the history that has already been written so cogently by Fuller. My goal is to take what Fuller has written and to build upon it in the modern tax context. The space devoted to a consideration of Vaihinger is explained by his profound effect on Fuller. Though Fuller may have studied everything he could find that related to the legal fiction, it was Vaihinger who captured his imagination.



of the legal fiction into three parts, each titled with a question. Part One asks: "What is a Legal Fiction?" Part Two asks: "What Motives Give Rise to the Legal Fiction?" Finally, Part Three asks: "Is Fiction an Indispensable Instrument of Human Thinking?" I will draw upon Fuller's work following much the same format. The reader will observe from the outset that Fuller was more skeptical about the benefits of legal fictions than his fascination with *The Philosophy of 'As If'* might suggest. Like Vaihinger he believed that our reliance on fictions was inescapable, but he did not find this an entirely happy circumstance. Throughout Fuller's work one encounters an essential ambivalence toward the fiction.

*a. The Fiction as a Patch in "Law's Fabric of Theory"*

In Fuller's view:

[T]he fiction represents the pathology of the law. When all goes well and established legal rules encompass neatly the social life they are intended to regulate, there is little occasion for fictions. . . . Changing the figure, we may liken the fiction to an awkward patch applied to a rent in the law's fabric of theory.<sup>68</sup>

According to Fuller, it is the desire for a comprehensive system that forces the use of fictions.<sup>69</sup> The fiction is designed to bridge the gap between concept and reality.<sup>70</sup> This explains in part why its use in the law has often been regarded as shameful yet necessary.<sup>71</sup> The very fact that we are called upon to employ a fiction is an admission of the law's failure to properly express the deeper principles on which it is based.

*b. The Fiction as Metaphor*

Like Vaihinger, Fuller asserts that a fiction is neither a truth nor a lie. It is not a lie because, although it is false, it is not intended to deceive as to its main thrust.<sup>72</sup> Nor is it an erroneous

68. *Id.* at viii. Elsewhere he wrote, "the fiction is the cement that is always at hand to plaster together the weak spots in our intellectual structure." *Id.* at 52.

69. *Id.* at x-xi.

70. *Id.* at xii.

71. *Id.* at 2. Bentham hated them. *Id.* Blackstone found them useful but was apologetic about their use. *Id.* at 3. Fuller illustrates how readily even its critics fall prey to the use of the fiction. *Id.* at 4.

72. *Id.* at 6. Fuller, however, acknowledges the judgment offered by Henry Sumner Maine that the purpose of some fictions may be seen as a way to conceal the enlargement of the authority of the creator of the fiction. *Id.* at 6-7. Thus, judges may use fictions as a way to make law while appearing only to find it.

conclusion because it is adopted with knowledge of its falsity.<sup>73</sup> A fiction is an expedient but false assumption that frequently serves as "a metaphorical way of expressing a truth."<sup>74</sup>

To convey what is meant by this, let us look to a tax fiction: the imputed interest rules of section 7872. This section provides, in part, that for income tax purposes, an employer who makes an interest free loan to its employee is deemed to have made a payment of the foregone interest as compensation to the employee and is also deemed to have received from the employee a payment of the foregone interest.<sup>75</sup> This would cause the employer to have ordinary income in the amount of the foregone interest under section 61 and an offsetting salary expense deduction under section 162. The employee will have compensation income under section 61 in an amount equal to the foregone interest and may or may not have an offsetting interest expense deduction under section 163. Whether the employee is entitled to an interest expense deduction will depend on how he utilized the loan principal.<sup>76</sup> None of these imputed payments between the employer and the employee actually occurred. In this sense the statute is a plain, unvarnished falsehood. However, on the level of economic theory the statute is thought to embody a truth. Under this theory, an interest free loan from employer to employee is the economic equivalent of payment of a sum of money equal to the foregone interest by the employer to the employee as compensation, followed by the payment of the interest by the employee to the employer as interest.<sup>77</sup> By characterizing the loan in this fashion, the statute causes the income tax consequences to comport with the presumed underlying economic consequences of an interest free loan. Thus, the apparent falsity of the statute is deemed to state a more significant underlying truth that justifies the falsehood.

This example not only illustrates the idea that a legal fiction is a metaphorical statement of a truth; it is also useful for understanding the analytic importance of recognizing the existence of a fiction. Once we recognize that no actual payments of money have occurred, we are naturally driven to understand the rationale for

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73. *Id.* at 7.

74. *Id.* at 10.

75. See I.R.C. § 7872(a)(1) (1988). In the discussion that follows, my description of this statute will greatly simplify its workings.

76. See, e.g., I.R.C. § 163(a), (h) (1988).

77. H.R. REP. NO. 432, 98th Cong., 2d Sess. 1371-73 (1984); see also BITTKER & McMAHON, *supra* note 21, ¶ 31.4; MICHAEL J. GRAETZ, FEDERAL INCOME TAXATION, PRINCIPLES AND POLICIES 147 (2d ed. 1988).

the statute's formulation. As Fuller wrote, "[a] doctrine which is plainly fictitious must seek its justification in considerations of social and economic policy; a doctrine which is nonfictitious often has a spurious self-evidence about it."<sup>78</sup> When a statute contradicts reality, we want to know why the statute contradicts reality. In a case such as section 7872, we may have difficulty in comprehending the underlying economic theory, but at least our recognition of the statute's falsity<sup>79</sup> has set us upon the path toward understanding. Taking note of the fiction is the first step toward understanding its purpose or attacking its utility.

### c. *Recognizing the Fiction*

In response to this last point one might be tempted to ask: So what? Is not the existence of the fiction quite obvious? Why should anyone ever fail to take note of the fiction? There is some justice in this observation because the fiction is not intended to deceive. Thus, typically, no effort is made to conceal its falsity. The fiction is a falsehood but not a lie. In fact, its objective is to state a deeper truth. But those persons charged with applying legal fictions may become so accustomed to the fictions that they forget about their falsity. We can get into an "a-rule-is-a-rule" mind-set where the fiction passes us by. In tax law, our fictions can take such abstract forms that we may have trouble recognizing them as such. Consider, for example, the estate tax provision section 2036(a). Is it a tax fiction? I believe so, but others might disagree.

Even those readers who are familiar with section 2036(a) may be wondering what is meant by calling it a fiction. In order to see the fiction in section 2036(a), one must first consider the rule of section 2033. Section 2033 provides that property owned by a decedent at death is included in her estate for estate tax purposes.<sup>80</sup>

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78. FULLER, *supra* note 13, at 71.

79. One might question whether in any sense the statute is false as long as the statute carries an acknowledgement that no money in fact has changed hands. This point will be discussed *infra*. However, it is useful to remember that the falsehood in the fiction need not, and is not, intended to deceive anyone. By saying the statute states a falsehood, we simply mean that someone standing outside the legal system would consider the fact established by the statute to be false.

80. I.R.C. § 2033 (1988) provides: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." One of my colleagues has pointed out to me that § 2033 "is itself philosophically confused, if not a fiction" because a dead person really owns nothing. I think this is the sort of fiction that is not a legal fiction because the falsehood is not one that a person standing outside the legal system would be troubled by. Most people would simply assume that persons die owning whatever they owned the instant before they died.

This rule may be thought of as the paradigmatic rule for the estate tax since the tax is an excise on the privilege of transferring property at death.<sup>81</sup> That is to say, in general, the estate tax is intended to tax property owned by the decedent and transferred by her at her death. In general, section 2036(a) embellishes upon the rule in section 2033 by providing that property that one transferred away during life is still included in one's estate if one retains a life estate in that property. The fiction in section 2036(a), thus, is that one is treated as the owner at death of a fee simple interest in property in which one had but a life estate.<sup>82</sup> The analogy upon which this fiction is based is that property that one has given away while retaining a life estate is more like continuing to own a fee simple until death than it is like owning a life estate that came from someone other than the decedent. In short, section 2036 rests on an analogy to the paradigm of section 2033.<sup>83</sup>

Section 2036 is defended by some experts as a means to plug what is perceived as a loophole in the estate tax.<sup>84</sup> But there is no loophole in need of plugging unless the analogy between sections 2033 and 2036 is appropriate. On the whole, does section 2036 seem an appropriate "patch applied to a rent in the law's fabric of theory"? In responding, one can say that the ability to enjoy property for all of one's life (after having named one's successor to that enjoyment when one dies) is much like complete ownership of the property. But it would be foolish to argue that the analogy is a perfect one. A life tenant who has forfeited any right to invade a trust corpus and who possesses no right to change the remainderman is in a far different position than a fee simple owner of property. The factor that probably tips the scales in favor of section 2036(a) is that the value of the remainder interest is so speculative at the time of its transfer that there is little assurance

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81. For a brief history of the transfer tax system in this country, see STANLEY S. SURREY ET AL., *FEDERAL WEALTH TRANSFER TAXATION* 1-12 (Successor ed. 1987).

82. At the moment of death, taking into account the fact of death, the owner of a life estate has nothing to transfer.

83. I would contend that §§ 2034-44 of the estate tax all rest on analogy to § 2033. They are all fictions that Congress has judged state a truth at a more abstract level.

84. See, e.g., RICHARD B. STEPHENS ET AL., *FEDERAL ESTATE AND GIFT TAXATION* ¶ 4.08 (6th ed. 1991). The authors perceive the ability to make transfers of remainders while retaining a life estate without any estate tax consequence as a tax loophole. Of course, the transfer of the remainder may be subject to gift tax. Presumably, the loophole derives from the fact that under actuarial principles a remainder may have little present value. One could construct a counterargument, however, that no loophole is present under these facts as long as the remainder is accurately valued. There is a fundamental problem involved in valuing a future interest, that is, we do not know the future.

that the gift tax will catch its fair share of tax. This is a policy consideration extrinsic to the analogy. This, in turn, suggests that one cannot simply reduce a fiction to its analogical basis in order to decide whether the fiction is good or bad on the level of tax policy. But finding the analogy is a useful first step. In the most general way, we can say that sound analogies make for good fictions and poor analogies make for bad ones.

#### *d. Legal Fictions Versus Legal Relations*

There is a basis for challenging the status of section 2036(a) as a legal fiction. Such a challenge would derive from the view that section 2036 simply describes a legal relation between persons, property, and the estate tax. Indeed, it is possible that Professor Fuller would not have regarded section 2036(a) as a legal fiction. This is because Fuller believed “[a] legal relation, accurately described and actually enforced, cannot, with utility, be regarded as a fiction.”<sup>85</sup> Fuller doubted that such things as “fictitious legal rights and duties or supposititious titles” even exist<sup>86</sup> because the only reality such concepts have in the first place is that which the law grants them.<sup>87</sup> Thus, despite his admiration for Vaihinger, Fuller disagreed with Vaihinger’s characterization of adoption as a legal fiction. “A legal right reaches objectivity through court action; we have no other test of its ‘reality.’ If it meets this test, it is a real right—whatever may be the protestations of the agency enforcing it.”<sup>88</sup>

Legal concepts, Fuller goes on to say, are generally so flexible and vague in their abstract meanings that rarely may one consider them to have the requisite falsity to constitute a fiction.<sup>89</sup> After

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85. FULLER, *supra* note 13, at 33. He goes on to add, “[b]ut a description of an existing and enforced legal relation can be so inadequate and misleading as to deserve the term fiction.” *Id.* Ultimately it is not clear to me that Fuller actually abides by the distinction he seeks to draw between “artificial” legal relations and legal fictions. I use the word artificial here to denote the fact that though the law may consider an adopted child as if a child of the blood, the lack of actual consanguinity between parent and child remains unaltered. The transubstantiation is purely a legal one.

86. *Id.* at 27-31.

87. Fuller contends that legal institutions such as marriage and adoption are not legal fictions but social realities. *Id.* at 38. I agree with respect to marriage but not with respect to adoption. Whatever its origins, marriage as an institution is no longer a metaphor for some other state. It has its own status separate and distinct from all other human conditions. When we say an adopted child is treated as if it is a child born of the marriage, however, we are taking immediate refuge in metaphor.

88. *Id.* at 29.

89. *Id.* at 28.

all, how can we view a legal relation as a fiction when there is no less abstract level at which it is false? In general, Fuller's view derives from the more basic conclusion that legal relations have no analogical equivalent outside the law. In other words, the legal relation does not rest on analogy in the same way that a legal fiction does.<sup>90</sup> Nor does it rest on pretense. As an example, Fuller points to the concept of legal "title."<sup>91</sup> He illustrates with the proposition: "Title, as between the parties, had passed to the mortgagee; as to third parties, title remained in the mortgagor."<sup>92</sup> Although the statement has a fictive appearance because title is lodged in two places at once, an apparent impossibility if we were dealing with a tangible object, the fiction is more apparent than real. There is no pretense in the proposition that title has a tangible existence; title merely serves "as a means for grouping together rather complex legal results in a convenient formula."<sup>93</sup> That title is lodged in two places at once is a legal fact with no distinct analogical relationship to any extralegal fact. The concept of title is merely descriptive of the legal relationship between a person and property.

In my view, Fuller overstates the case for rejecting legal relations as a form of legal fiction because legal relations can have

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90. A legal relation may have rested on analogy at one time but the analogy may have long since disappeared. Concepts that some would call fictions may have no analogical basis. For example, Professor Wani describes "sovereignty" as a fiction. Wani, *supra* note 11, at 63. I would not describe it as such. I believe describing such a concept as a legal fiction renders the concept of a legal fiction too amorphous for useful discussion. If sovereignty has its basis in analogy, it is probably an analogy between the State and God. This is not an analogy to which I am sympathetic (That "vainest of all legal fictions, the doctrine of sovereign immunity" is asserted to derive from the axiom that the "King can do no wrong."). *United States v. Dalm*, 494 U.S. 596 (1990) (Stevens, J., dissenting) (citing 1 WILLIAM BLACKSTONE, COMMENTARIES \*238). I should point out that Wani finds sovereignty, at least as the term is employed in immigration law, a very bad fiction. Thus, in some sense, he and I are in agreement because I contend that fictions that rest on poor analogies are likely to be bad fictions. Professor Wani also describes the concept of "entry" as it is employed in immigration law as a legal fiction. Here I have no difficulty in agreeing with him. As he describes it, aliens seeking to gain permanent admission to the United States have different legal rights depending on whether they have "entered" the country. Wani, *supra* note 11, at 90. However, the legal concept of "entry" is not identical to the common meaning of the word. In particular, under the doctrine of entry, one who has physically "entered" the United States may not have "entered" the country for purposes of the law. I believe the legal concept of entry is a legal fiction because it has a fact-based analogical basis, i.e., that one who has entered the United States without complying with lawful procedure is more like an alien situated outside the United States than he is like a lawful resident. This may be a bad analogy, but at least it is recognizable as some sort of analogy.

91. FULLER, *supra* note 13, at 28-29.

92. *Id.* at 28.

93. *Id.*

a social context as well as a legal context. Moreover, Fuller acknowledges that the distinction between "legal facts" and "extra-legal facts" is actually one of degree rather than of kind,<sup>94</sup> but the distinction he seeks to draw between legal relations and legal fictions derives from that distinction. He seeks to resolve this problem, unsuccessfully in my opinion, by drawing the further distinction between statements of fact and statements of legal relation.<sup>95</sup>

He illustrates this distinction by setting out the draft and final versions of a provision in the German Civil Code. The draft version provided, "[a]n illegitimate child and its father are unrelated."<sup>96</sup> The final version provided, "[a]n illegitimate child and its father are not deemed related."<sup>97</sup> Both versions meant the same thing—that is, there is no legal parental relationship between an illegitimate child and its biological father. The first version could be viewed as a deliberate false statement of fact, though without any intent to deceive. The latter implicitly acknowledges the fact of biological parenthood but accords that fact no legal effect. Both versions were intended as negative statements of a legal relation. Does their slight difference in wording alter this? Fuller seems of two minds on this point. At the time he sets out the example, he appears to be saying that the first version is a statement of fact and the second is a statement of a legal relation, but a few pages later he contends that the difference between assertive fictions and assumptive fictions is merely one of form.<sup>98</sup> An assertive fiction is one which simply states a fact which is false. An assumptive fiction carries a "grammatical acknowledgment of its falsity."<sup>99</sup> Thus, an assumptive fiction typically contains the language "as if" or "deemed" to show that the creator of the fiction was aware of the falsity.

The distinction between the two statutes concerning illegitimate children is that one is assertive and one is assumptive. In my view, both versions of the statute involve a legal fiction because they both rest on a fact-based analogy that, when stated positively,

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94. *Id.* at 29. Cf. Campbell, *supra* note 11, at 356-59.

95. FULLER, *supra* note 13, at 30.

96. *Id.*

97. *Id.*

98. *Id.* at 30, 37. Fuller asserts, correctly I believe: "When we are dealing with statements that are known to be false, it is a matter of indifference whether the author adopts a grammatical construction that concedes this falsity, or makes his statement in the form of a statement of fact." *Id.* at 37.

99. *Id.* at 36.

goes like this: as concerns paternal parenthood, one's illegitimate child is more like someone else's child than it is like one's own child. The accepted analogy may be a bad one (as I believe it is), but it is an analogy all the same. The fiction that comes from this analogy, then, is that an illegitimate child is not its father's child. The fiction is present in both forms of the statute.

The counterargument is to contend that neither version states a legal fiction because neither version has a non-legal context in which it is false. This lack of non-legal falsity stems from the use of the phrase "illegitimate child" in stating the analogy and in the rule proceeding from the analogy. The phrase carries with it a legal context whenever it is employed. It cannot be employed in a non-legal context. In part my response is to say that it is the resulting contradiction of the facts which distinguishes the fiction. However we state the fiction, the ultimate effect is to permit a father to point to his child and *rightly* (in the eyes of the law) say: "that is not my child." A second response is to say that concepts such as illegitimacy and adoption, though legalistic in nature, still possess a non-legal context because of their wide acceptance among the general populace. Illegitimacy has a social meaning as well as a legal meaning.

Returning now to section 2036(a), I would suggest that it is a legal fiction because it is best understood by reference to an analogy between a retained life estate and outright ownership, and because the rule that comes from that analogy is false under a common sense view of the matter (that rule being that one is treated as owning and transferring a remainder at a point in time when one does not in fact own or transfer that remainder). Obviously, however, it is also a statement of legal relations. Moreover, even my analogy is couched in terms ("life estate" and "ownership") that may be characterized as descriptive of legal relations.

The legal and non-legal worlds shade into one another by degrees. In the area of overlap, legal fictions and legal relations may coincide. A statement of legal relation may involve a legal fiction or it may not. A statement of legal relation that is best understood as the conversion of a fact-based analogy into an absolute rule may involve a legal fiction. It is a legal fiction if, by converting the analogy into a rule, we have asserted something that is false from a non-legal perspective. Thus, for instance, I believe the rule that an adopted child is legally equivalent to one's natural child is a borderline legal fiction because it is best understood by reference to a factual analogy such as "one's adopted



child is more like one's own child than it is like someone else's child." I say "borderline" because I believe there would be some ambiguity in how non-lawyers would understand the assertion deriving from such an analogy that "an adopted child is its parents' child."<sup>100</sup> The legal fiction in the adoption rule may be "dying."<sup>101</sup> On the other hand, I believe that the concept of title is not a legal fiction because it is best understood by reference to abstract principles of law rather than by a factual analogy.<sup>102</sup> Admittedly, the distinction in any given case is one of degree. Moreover, it still may force us to distinguish between legal facts and extralegal facts, and, as Fuller asserted, this can be exceedingly difficult. But at least the effort to identify the analogy supporting the fiction possesses some practical utility as a means to examine the legal fiction from a policy perspective. In order to judge the quality of the fiction, we can begin by considering the quality of the analogy that brought it to life. As noted earlier, in the most general way, we may say that good analogies make for good fictions, and bad analogies make for bad fictions.<sup>103</sup>

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100. Which set of parents, biologic or adoptive, would a non-lawyer believe were being referred to? Probably either. Moreover, even if the proffered statement were, "an adopted child is its adoptive parents' child," a non-lawyer would not necessarily disagree. The non-lawyer would understand that no assertion of biological parenthood was being made. This is because the word "adopted" carries with it the implicit assertion of a legal context. The non-lawyer would be inclined to discard the potential falsehood of the assertion and consider the statement as true in its intended sense. This view of adoption is consonant with the discussion of how fictions "die." See *infra* part II.B.2.e.

101. In a society where multiple marriages verge on being the norm and where adoptions are commonplace, it may not be clear what the phrase "my child" means in the non-legal context. For example, if I point to a child on the playground and say, "that's my child," would you automatically assume that I was claiming biological parenthood? If the child were Asian and I were White, would you assume I was lying?

102. If we describe title as a "bundle of rights" we tend to mix the two. But of the two ideas expressed, "rights" has more consequence than "bundle."

103. In my view, the adoption analogy is a good analogy and produces a good fiction. The analogy is a good one because the social relationship between an adoptive parent and her adopted child closely resembles the social relationship between a parent and her biological child. Over time, the bond between the adopted child and its parent is likely to mirror the bond between a natural child and its parent. The fiction is a good one because, by treating the adopted child as a natural child, the law reinforces the positive development of a close relationship and emphasizes the social responsibility that the adoptive parent has assumed for the adopted child.

In my view, the illegitimacy analogy is a bad analogy and the fiction flowing from it is a bad fiction. The analogy is a poor one because it understates the causal connection between the child's birth and the biological father's relationship with the child's mother. The fiction is a bad fiction because it deemphasizes the moral and social responsibility the father has to that child. I see no justice in allowing the father to avoid his obligations to his illegitimate child.

*e. The Life Cycle of the Legal Fiction*

Fuller asserted that fictions possess an organic quality. That is, they may evolve or die in the course of time. They may disappear as a result of rejection or of acceptance. Disappearance through acceptance occurs because the fiction derives from the meanings given words, and those meanings can change. The fiction is a linguistic phenomena because whether a statement is true or not depends on the standards of language we are applying to it.<sup>104</sup> Because fictions are commonly metaphorical usages of words with more concrete meanings, they die when the metaphor is no longer perceived as a metaphor.<sup>105</sup> Thus, according to Fuller, live fictions die with changes in the meanings of words and with the shape of the surrounding law.<sup>106</sup> This view must be reconciled with the principle that fictions are falsities embodying some other principle at a metaphorical level. If the metaphor disappears, does the fiction then become a simple falsehood? Not at all. When the metaphor dies, it is because the previously metaphorical meaning of the fiction has replaced the previously false meaning as the chief meaning of the words employed to state the former fiction. Thus, the abstraction indirectly stated in the fiction has replaced the apparent falsehood as the more definite and paramount meaning of the language employed. According to this view, then, the fiction dies by becoming victorious.

The distinction between live fictions and victorious dead fictions is important because, as discussed later, while a fiction continues as a fiction it is most usefully employed when it is recognized as a fiction. A fiction does not die in the sense of ceasing to be false just because we fail to recognize it. It dies when the falsehood "drops out" and the underlying principle it supports becomes its first meaning.<sup>107</sup> In a metaphorical sense, proper use of a legal fiction always involves the death of the

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104. FULLER, *supra* note 13, at 11-12.

105. *Id.* at 15-16.

106. *Id.* at 14-15.

107. Fuller asserts that one can tell if a fiction is live or dead by asking whether it involves a "pretense." *Id.* at 19. He goes on to state, "[t]he death of a fiction may indeed be characterized as a result of the operation of the law of economy of effort in the field of mental processes." *Id.* Thus, he concludes, fictions may be eliminated not only by rejection but also by redefinition. Redefinition involves defining words to mean literally what we metaphorically intend. *Id.* at 19-20. As an example, he reminds us that the word "person" once meant "mask." Its application to human beings was at first metaphorical. Now, of course, that metaphorical usage has become its primary usage. The metaphor has died. *Id.*

fiction. A less cryptic way to state this last proposition is to say that while a fiction is alive it should be applied with a consciousness of its falsity and with an intention to give expression to its underlying truth. This is what Vaihinger and Fuller called "dropping the fiction." This notion of dropping the fiction will be addressed more fully in Part V.

### III. WHY DOES THE TAX CODE EMPLOY LEGAL FICTIONS?

#### A. *The Connection Between the Legal Fiction and Pre-Existing Law*

One might question why we should employ fictions if their proper application involves dropping the fiction. There is no simple answer to this question. The immediate motive for the creation of any fiction is a desire on the part of the fiction's creator to change existing law. But one can change existing law without indulging in legal fictions. Why does a lawmaker choose to employ a fiction in changing the law? The answer lies in the peculiar way in which the fiction operates. The fiction changes existing law by *indirectly* expanding or contracting the range of application of other, usually pre-existing, rules of law.<sup>108</sup> For example, section 7872 constructs transfers of money between a lender and a borrower, but section 7872 does not itself determine what tax consequences arise from the monetary transfers it creates. Instead, by creating those transfers, section 7872 activates other pre-existing rules which operate with respect to the constructive transfers in the same fashion as they would operate with respect to actual transfers of money in like circumstances.<sup>109</sup>

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108. "Any rule creating a fiction is necessarily parasitic on another rule, since a fiction has a purpose and effect only if there is another rule whose range of application will be changed by the fiction's existence." Campbell, *supra* note 11, at 366. Rather than parasitic, I would characterize the fiction as having a symbiotic relationship with the rule it modifies. The two rules work together to achieve some (hopefully) desirable aim. One might also describe the fiction as a catalyst because it only creates the conditions for change without directly participating in that change.

109. In effect, when we engage in a fiction, we redefine reality to comport with existing law as a method of changing the law to meet new realities or to meet new insights into reality. This method of adapting the law to changing circumstances and perceptions is saved from absurdity by its underlying rationality. As noted earlier, when used properly the legal fiction is a rule of law embodying an unconcealed falsehood at one level and a deeper truth at another more important level. The falsehood is often made necessary because of the pre-existing structure of the law, and is justified (if it is justified) by the deeper underlying truth contained within the falsehood.

The fiction is motivated by a wish to change the operation of pre-existing law without changing the language of pre-existing law.<sup>110</sup> A fiction does this by contradicting reality (viewed from a non-legal perspective) by creating a fact or destroying a fact in order to make the facts of a specific case comport with (or fall outside) the law antedating the fiction. But why does it seek to make pre-existing law apply (or not apply) to the new case? Because the fiction's creator has judged that the new case is like (or unlike) the cases addressed by pre-existing law and, therefore, should be decided in the same way (or differently) from the cases addressed by pre-existing law. For example, the doctrine of constructive receipt creates the fact of receipt in order to make applicable to a case outside its apparent ambit the rule of cash accounting that one reports income when one receives it.<sup>111</sup> Why was the doctrine of constructive receipt created? Because the new case is deemed to be within the underlying but unstated principles of the pre-existing law. Thus, the constructive receipt fiction is an attempt, by way of metaphor, to pull within pre-existing law that which was intended to be covered by that law but which was not (at least as judged by the common, natural or expected meanings of the words employed in the pre-existing law).<sup>112</sup>

In the judicial context, it is easy to see a motive to employ the fiction. In the common view, a judge is not supposed to make law, but rather to find it. In doing so, she is also supposed to "do justice." The fiction contrives to do justice even when the pre-existing law seems inadequate to the task while also permitting the judge to pay obeisance to her designated role of law finder. But why do legislators, who are licensed to make law, also employ the fiction? In the end, the motives of the legislator are not so different from the motives of the judge.

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110. As Fuller put it, "[g]enerally a fiction is intended to escape the consequences of an existing, specific rule of law." FULLER, *supra* note 13, at 53. Campbell says:

The reason for the existence of fictions follows from their nature. As a specific legal technique they are used to give any rule of law a wider, or narrower, ambit than it would have if applied non-fictitiously, while at the same time preserving the rule's original form and the meaning of its terms.

Campbell, *supra* note 11, at 365.

111. See *Hornung v. Commissioner*, 47 T.C. 428 (1967); Treas. Reg. § 1.451-1(a), -2 (1954).

112. Fuller defends the use of fictions from the criticism that the law should be stated directly rather than by the less precise means of metaphor, by saying "[m]etaphor is the traditional device of persuasion. Eliminate metaphor from the law and you have reduced the power to convince and convert." FULLER, *supra* note 13, at 24.

### B. *The Conservative Nature of the Fiction*

Fuller identifies a number of motives for the creation of legal fictions. The common denominator in all these motives is that they are essentially conservative. He states that the motive for using the fiction as the means for change may rest in "policy," "emotional conservatism" or in "conservatism of convenience."<sup>113</sup> The motive of policy refers to the desire of a judge to change the law while conforming his decision to the outward forms of the law. This was the fiction which Jeremy Bentham so despised because he saw it as intended to deceive.<sup>114</sup> The motive of emotional conservatism concerns the desire to change the law while clinging to the old forms in order to achieve a sense of stability and continuity with the past.<sup>115</sup> The motive of convenience concerns the use of the fiction to obtain a desired result without the necessity of overhauling the whole system of rules and without the necessity of re-educating all the lawyers and judges as to that new system.<sup>116</sup> Fuller also notes that the fiction may proceed from "intellectual conservatism"; that is, it may arise because one does not know how else to state the new principle one is applying.<sup>117</sup> (This matter of intellectual conservatism will be addressed in Part IV.) Finally, according to Fuller, fictions may also serve as "a convenient shorthand" where we wish to avoid spelling things out.<sup>118</sup>

### C. *The Particular Utility of the Fiction in Tax Law*

The tax fiction, I believe, partakes of all these motives. When a fiction is properly drawn, it is a refinement in our thinking about the law. But usually it does not involve a radical change in existing paradigms or principles. Instead, by its nature, the fiction builds upon the existing law. Thus, the fiction is a conservative device for change, and that conservative aspect of the fiction makes it particularly appropriate for use in the tax context.

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113. *Id.* at 56-57.

114. Bentham regarded the legal fiction as a contemptible stratagem because he saw it as a way of making law while pretending only to follow existing law. See Samek, *supra* note 11, at 296-99; Soifer, *supra* note 11, at 877-78.

115. FULLER, *supra* note 13, at 58.

116. *Id.* at 59-63.

117. *Id.* at 63-70.

118. *Id.* at 81.

### 1. Taxation as a Politically and Economically Sensitive Matter

Taxation is a politically and economically sensitive topic. Radical changes in the amounts or sources of taxes are likely to be viewed with distrust by the public and the government alike. Moreover, since the major federal taxes are likely to intersect the lives of most of the working public, a dominant impulse with respect to the main provisions of those major taxes is likely to be one of maintaining the status quo. Fictions allow one to chip away at the edges of the law without altering its main shape and this sort of incremental change is well suited to the sensitive aspect of tax law.

### 2. Tax Professionals and the Legal Fiction

The conservative aspect of the fiction also means that tax professionals are likely to find it an appealing mechanism for change. As a system of rules grows more complex, those persons whose livelihood depends on their ability to work with those rules have greater incentive to resist radical change because of the amount of relearning involved. The federal income tax, in particular, has achieved the level of complexity that is likely to breed resistance to further change in those who have already invested long years in mastering the existing law. The fiction permits one to change the law without uprooting or amending existing provisions and without overturning the existing understanding of those provisions.<sup>119</sup> This means that as the law changes, the background and perspective already attained by tax professionals continues to be relevant and useful, and the effort involved in assimilating those changes is reduced. The attraction of the fiction, then, for tax professionals derives from its respect for existing law.

### 3. Tax Fictions and Tax Formalism

Another aspect of the fiction that makes it particularly suitable for use in tax law is its inherent suitability for those rule systems, such as tax, where there is both a strict regard for the letter of

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119. Of course, in a sense the fiction does change the existing rules and their meanings by extending or reducing their current applications. But it does so in a way that is less traumatic.

the law<sup>120</sup> and a desire to treat individual cases fairly. The legal fiction is a legal formalist's<sup>121</sup> device for doing justice in cases that do not fit the formal language of the pre-existing law. Consider, for instance, section 2518, the disclaimer provision. In effect, the disclaimer rules provide that a refusal of a gift or bequest will cause the gift or bequest to be treated as if it was never made. The fact-based analogy on which this fiction rests is that a refused bequest is more like no bequest than it is like a bequest.<sup>122</sup> The effect of the disclaimer rules is to override other rules that would otherwise cause a gift or bequest to have some specific tax consequence. Thus, for instance, the disclaimer rules may create the fiction that a husband was not bequeathed property by his wife and in this way avoid the effects of the rule that would require the decedent's estate to take the marital deduction for such a bequest.<sup>123</sup> In this way, the decedent's estate may take advantage of the unified credit which would otherwise be lost.<sup>124</sup>

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120. I am speaking in generalities here. There are many notable examples dating at least as far back as *Gregory v. Helvering*, 293 U.S. 465 (1935), of courts taking a non-literal view of the Code. See Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982) (reviewing BORIS I. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* (1981)); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365, 385-88 (1988).

121. What is legal formalism? I accept the view expressed by Professor Frederick Schauer. He said:

At the heart of the word "formalism," in many of its numerous uses, lies the concept of decisionmaking according to *rule*. Formalism is the way in which rules achieve their "ruleness" precisely by doing what is supposed to be the failing of formalism: screening off from a decisionmaker factors that a sensitive decisionmaker would otherwise take into account.

Frederick Schauer, *Formalism*, 97 YALE L.J. 509, 510 (1988). Formalists treat rules as having concrete and specific meanings that force some outcomes and exclude others. It is difficult to think of any area of the law that is more formalistic in this sense than tax.

122. See William P. Streng, *Estate Planning*, 11-11th, *Tax. Mgmt. Est. Gifts & Tr. Part.* (BNA) No. 11-11th, at A-154 (1991). In some contexts, "[t]he effect of the disclaimer is to treat the disclaimant as having predeceased the decedent." *Id.* at A-155. The present disclaimer rules embodied in § 2518 are an attempt to establish uniform rules out of various principles deriving from case law and earlier statutory rules. The courts early recognized that it made no sense to give effect for tax purposes to a gift that was refused by the intended donee. After all, the effect of the donee's refusal was to cause the donor to retain ownership of the property. If there is no completed gift there should be no gift tax liability. It might be suggested that because there was no completed gift, the disclaimer rules do not involve a fiction. My reason for considering the disclaimer rules as a legal fiction is that from a non-legal perspective there was, in fact, a gift or bequest. For a discussion of some of the history of disclaimers, see RICHARD B. STEPHENS ET AL., *FEDERAL ESTATE & GIFT TAXATION* 9-8 (3rd ed. 1974).

123. See I.R.C. § 2056 (1988 & Supp. II 1990). The marital deduction is mandatory in most cases of property left by a decedent to the decedent's spouse.

124. See I.R.C. § 2010 (1988 & Supp. II 1990). The unified credit is applied against

The reason one may say that this is a formalist's device for doing justice is that the disclaimer rule permits us to continue to interpret all of the existing rules in a literal fashion without allowing that formalism to operate unfairly with respect to disclaimed gifts or bequests. Without a rule like section 2518, a court interpreting the marital deduction provision in cases where a spouse has refused to accept a marital bequest could still reach a fair result by treating a marital bequest as a nullity, but to do so, the court would have to say that the bequeathed property did not "pass" from the decedent to the surviving spouse.<sup>125</sup> But in a very formal sense, the property "passed" and then was "passed" back. Thus, to reach a result that most would regard as the fair result, the court would have to disregard the formalities of the law.

The disclaimer rules permit us to continue to have regard for the formalities while dealing fairly with the present exigencies. The tax fiction that a refused bequest is no bequest comports with one of the tax code's basic underlying principles; that is, that tax consequences should be determined by the economic substance of a transaction rather than by the form in which it presents itself. Distinguishing between substance and form is, of course, often quite problematic. Indeed one may question whether the distinction is always viable.<sup>126</sup> Even so, it is one which we persist in making.<sup>127</sup> Economically, a disclaimed gift or bequest has no effect, and section 2518 is an effort to cause the tax law to mirror that lack of economic effect.<sup>128</sup>

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a tax liability that in turn is derived by applying the tax rate to the value of the taxable estate. If the marital deduction reduces or eliminates the taxable estate, there may not be sufficient tax liability to absorb the credit. This is important because the credit can serve to insulate property from tax as it passes from one generation to the next. The marital deduction, on the other hand, does not insulate the property from being taxed in the surviving spouse's estate. Thus, by wasting the credit in the estate of the first spouse to die, the ultimate tax burden on the combined estates of the two spouses is increased to the detriment of their posterity.

125. Section 2056(a) provides a marital deduction for "the value of any interest in property which passes or has passed" to the surviving spouse. Section 2056(c) defines "passing" to include all sorts of transfers of property interests from the decedent to her spouse. The statute seems to assume acceptance by the donee spouse.

126. See Isenbergh, *supra* note 120, at 879.

127. See, e.g., JOSEPH DODGE, *THE LOGIC OF TAX*, 264-73 (1989).

128. One might contest the assertion that a disclaimer has no economic effect by pointing out that the disclaimer of a bequest will have the economic effect of causing the property to pass to someone else, usually either a contingent beneficiary or the residuary beneficiary. Can a disclaimer ever truly be said to have no economic effect? Perhaps not. But recall that it is in the nature of a legal fiction to take an analogy and convert it into an absolute rule. This conversion results in a falsehood. We are forced by pre-existing



In an area such as constitutional law where rules are fewer and where practitioners and judges apply what rules there are in a highly purposive fashion, there may be less need for fictions. In less formalistic areas of law, those persons obliged to make the law work are asking functional, purposive questions in the first place. In the area of tax, on the other hand, the inclination is to seek a rule for everything. We are concerned with forms and believe that the forms make a difference. Thus, we take existing forms seriously and are loathe to change their meanings even when they seem to lead to an inappropriate outcome in a particular case. The fiction allows us to accommodate our view of the proper outcome with our wish to preserve the existing form.

#### 4. Tax Fictions, Tax Complexity, and the Matter of Convenience

The simple convenience of the fiction is also particularly attractive in tax law. In a body of law as interconnected and complex as the Internal Revenue Code, changes one place in the law often impact many other provisions. By employing the fiction, the law can be changed without the necessity of making technical amendments to other provisions. For example, the disclaimer rules of section 2518 change the operation of many other provisions of the estate tax, gift tax, and generation skipping transfer tax without necessitating changes in the existing language of those rules. If we sought to accomplish more directly the same end result as is brought about by section 2518, it would be necessary to change each of the individual rules which it effects. Thus, for instance, it would be necessary to amend the marital deduction rules to provide that only bequests from one spouse to another that are "accepted" by the donee spouse qualify for the marital deduction. The tax fiction is the easy way out of the labyrinth. Like a new piece in a puzzle, it changes our perspective without eliminating what came before it.

The motives that bring about tax fictions may be described in various ways, but in some fashion they all relate to the essentially conservative desire to connect the new with the old or the unknown with the known. The tax fiction is an accommodation between what we said yesterday and what we believe today.

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dichotomies in the law to make an absolute choice between treating a disclaimed bequest like any other bequest or like no bequest. When we judge that a disclaimed bequest is more like no bequest than an actual bequest, then we must opt for the fiction that the disclaimed bequest never occurred.

#### IV. IS THE TAX FICTION AN INDISPENSABLE MECHANISM OF TAX LAW?

The tax fiction seems to be with us for some time to come. Indeed, it appears to be flourishing.<sup>129</sup> Beginning as a device of judges and the common law,<sup>130</sup> it has evolved into a common statutory mechanism in the tax law.<sup>131</sup> This is no accident. It has already been suggested that the legal fiction is particularly suited for use in tax law. Tax lends itself to formalism. The fiction is a formalistic device because the need for it arises out of the perceived inflexibility of pre-existing law. The tremendous elaborative complexity of tax law is also particularly suited to the employment of legal fictions. We have so many rules that any refinement of our

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129. It is likely that one will find a tax fiction whenever a tax statute employs the word "deemed" or the phrase "as if." See H.R. REP. No. 651, 97th Cong., 2d Sess. 2 (1982) ("The word 'deemed' is used where a legal fiction, or what may in some cases be a legal fiction, is intended."). In a recent computer search I found that the word "deemed" is employed in over 300 code sections. The phrase "as if" is also employed in the Code. See, e.g., § 1(g) ("certain unearned income of minor children taxed as if parent's income"). "As if" is not, however, a searchable phrase in LEXIS. Soifer asserts that the use of legal fictions (or our perception of their use) has increased over the last half-century. Soifer, *supra* note 11, at 874-76. "In our post-realist world . . . our sense is that legal fictions are not some small, awkward patch but rather the whole seamless cloth of the law." *Id.* at 876. I have tried to set forth a view of the fiction that treats it as a sufficiently specific form of rule to warrant specific attention. Nonetheless, at times I wonder if lines can truly be drawn in an area with so many shades of difference.

130. Some tax commentators argue that the widely employed substance-over-form doctrine is a tax fiction. See Cliff & Cohen, *supra* note 11, at 38. I would be more inclined to describe it as an underlying paradigm justifying the use of legal fictions. Perhaps this is what Messrs. Cliff and Cohen meant because they go on to describe § 482 as a legal fiction giving expression to the substance-over-form doctrine. *Id.* at 39.

131. Tax fictions run the gamut from the innocuous to the dramatic. For example, some minor tax fictions are found in § 1223 (the tacking of holding periods), and § 168 (e.g. § 168(b)(4) (assumption of zero salvage value for depreciation purposes)); § 168(d) (the applicable conventions establishing when property is put into service for depreciation purposes). Of more consequence is the constructive dividend rule in § 305(c) or the fiction in § 1014(b)(6) granting the basis step-up to the surviving spouse in her half of the community property upon the death of her spouse. It is arguable that the whole of § 1014 is a legal fiction, founded on an analogy between a beneficiary of a decedent's estate and one who bought the property from the decedent for its date of death fair market value. Certainly, to view § 1014 from this perspective is to begin to expose its indefensibility on a tax theory plane. However, I believe § 1014 so plainly represents a political choice as to render discussion of it as a tax fiction largely irrelevant. For a criticism of § 1014, see U.S. TREASURY DEPT., TAX REFORM STUDIES AND PROPOSALS, 91st CONG., 1st SESS., pt. 3, 331-40 (1969), reprinted in FRANK E.A. SANDER & DAVID WESTFALL, READINGS IN FEDERAL TAXATION 542-551 (1970). As discussed later in the text, the non-recognition provisions could be regarded as tax fictions. The same could be said of the anti-tax shelter rules such as §§ 465 and 469. Moreover, any provision that employs the term "deemed" or the phrase "as if" may well be a tax fiction. See *supra* notes 128-29.

thinking in how the system should work could necessitate mass changes in the rules. But the fiction changes the operation of existing rules without changing their forms or meanings. Thus, a fiction can change the way the law works without changing the pre-existing structure of the law. The more elaborate the pre-existing structure of the law, the more useful it is to employ legal fictions to effect changes in that structure. But recognizing that use of the fiction is particularly convenient in tax law is not the same as saying that tax fictions are indispensable or unavoidable. Must we employ the fiction in tax law, or do we simply choose to employ it?

*A. Putting Aside the Question of Whether the Fiction is Inherent to Human Thought*

One could contend that the legal fiction is inescapable as a device of the law because, as Vaihinger believed, fictions are inherent to human thought.<sup>132</sup> For example, any attempt to classify or categorize may be viewed as the creation of a fiction because generalizations are always false when applied to some individuals within the supposed class they describe.<sup>133</sup> Yet without classifica-

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132. Fuller embraced Vaihinger's idea that the use of fictions is a fundamental trait of human reason. FULLER, *supra* note 13, at 94. In order to deal with the world we are obliged to reduce reality into something we can comprehend. Fuller suggested that the processes by which our minds capture reality are of two types. The first he called "the process of simplification and organization." *Id.* at 106. The second he called "the process of converting new experiences into familiar terms." *Id.* The process of simplification and organization often involves the use of what Vaihinger called "neglective fictions," those where we disregard certain elements in a fact situation. *Id.* The assumption that man is an economic animal is an example of such a fiction. *Id.* These are useful but dangerous. One must keep in mind the purpose for which the fiction is employed. The neglected facts may be unimportant in one context and of major importance in another. *Id.* at 107. Other examples of the mind's tendency to simplify by classifying and categorizing have already been mentioned. The mind has an "inveterate hang" toward "organized simplicity." *Id.* at 111. The second process, "the process of converting new experiences into familiar terms," is addressed in this article's main text.

133. Fuller wrote:

The most elementary thought cannot proceed without classifications, yet Vaihinger regards classifications as fictions. They are fictions for two distinct reasons. (1) We treat the class as a distinct entity, though it is composed of individuals that vary among themselves. We speak of the class 'man' though it is impossible to think of a man in the abstract. If we visualize a man, he must be black or white, short or tall. Yet our abstract man must be a black-white, short-tall man. (2) 'Natural' classes rarely, if ever, exist. We are constantly encountering borderline cases which upset our classifications. We were beginning to feel that 'man' formed a natural class when someone dug up *Pithecanthropus erectus*. Even those qualities which seem so opposed that they are used as synonyms for the idea of contrast—black and white, life and death—shade into one another by imperceptible degrees.

*Id.* at 102.

tions and categories much of human speech and thought becomes impossible.<sup>134</sup> In the tax context, it is clear that classifying and categorizing are ongoing processes. Some of those classifications have a distinctly fictional caste.<sup>135</sup> But it was said almost from the

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134. Fuller asserted that the postulating of classes is a way of simplifying and organizing our thoughts, and that language does this almost automatically. *Id.* at 109.

135. Consider, for instance, the passive loss rules of § 469 introduced into tax law in 1986. Those rules create a new category of tax losses based on who is entitled to benefit by them. See I.R.C. § 469(c)-(d) (1988). In general, the statute provides that a taxpayer's passive loss is her net loss from a trade or business in which she does not "materially participate." See Michael A. Oberst, *The Passive Activity Provisions—A Tax Policy Blooper*, 40 U. FLA. L. REV. 641, 646 (1988) (the question of what constitutes material participation has been addressed at some length in Treasury Regulation § 1.469-5T). The legal effect of calling a loss passive is to deny it deductibility against non-passive income. I.R.C. § 469(a) (1988). It would be difficult to argue that passive losses represent a natural category or classification of losses. The concept of a passive loss is an artificial mental construct. Vaihinger would have called it a fiction. But is it a legal fiction? The answer depends on the level of abstraction one is willing to accept in defining fictions.

Fuller might have contended that the concept of passive losses lacks the requisite falsity to be a fiction. After all, the concept of a passive loss is merely descriptive of a legal relation between a taxpayer and an item of deduction. By defining a passive loss in a certain way the statute has called it into being. The statute does not contradict (directly, at least) what we know as reality; it simply re-describes it in a fashion different from our accustomed fashion. One could say, however, that § 469 does contain a falsehood in the sense that it contradicts more basic notions of what it means to have a "loss." Moreover, under the approach offered in this article for distinguishing legal fictions from mere legal relations, the question is whether the concept of a passive loss is derived from a fact-based analogy. We could say that it is. The analogy upon which the passive loss rules are based is that passive losses are more like unrealized losses than real economic losses. Indeed, an analogy to unrealized or artificial losses is probably a basis for all of the loss denial provisions. See, e.g., I.R.C. § 267 (1988) (denying losses realized on sales to related persons) and I.R.C. § 465 (1988 & Supp. II 1990) (denying losses in excess of the taxpayer's at risk amount). Based on that analogy to unrealized losses, § 469 prevents the current deduction of passive losses (against non-passive income) until a later time when they are deemed actually realized, such as when the interest in the passive activity is sold. See I.R.C. § 469(g)(1) (1988). This analogy may be a bad analogy, and § 469 may be bad fiction. But that is not the same as saying it does not rest on an analogy. Nor is it the same as saying it is no fiction.

The use of fictional classifications in tax law is not restricted to those that protect the treasury. Most of the income deferral provisions may be viewed as tax fictions based on an analogy to unrealized gains. For instance, § 1031 grants gain recognition deferral with respect to exchanges of "like kind" business or investment property. I.R.C. § 1031(a) (1988 & Supp 1990). The provision is often justified on the grounds that gains from such exchanges are only "paper gains." Marjorie E. Kornhauser, *Section 1031: We Don't Need Another Hero*, 60 S. CAL. L. REV. 397, 407 (1987). The underlying analogy might be stated in this way: a like kind exchange is more like no exchange than it is like a real exchange. Again, we might say the analogy is a bad one. Bad analogies may make for bad fictions, but they make fictions nonetheless.

How useful is it to think of provisions such as §§ 469 and 1031 as legal fictions? It may be suggested that by giving the legal fiction such a broad definition it is rendered meaningless as an analytical tool. My response is that each case must be judged on its own

outset of this article that not every rule that is over-inclusive or under-inclusive is a legal fiction, and it is best not to challenge that analysis at this late stage. The legal fiction shades into other forms of rules by degrees, but the concern throughout this article is to deal with it in its more distinctive variations. In this context, the question becomes whether the more overt form of legal fiction that has been the subject of this article is an indispensable mechanism of tax law.

### B. *The Unavoidable Analogy*

On occasion the use of fictions appears inescapable. This is due, in part, to the fact that we are continually faced with new situations.<sup>136</sup> Our usual method of coming to grips with new situations involves converting new experiences into the terms of those experiences with which we are already familiar. Fuller uses the example of a boy who, upon first seeing a horse, called it a "big dog."<sup>137</sup> This, of course, is an example of reasoning by analogy. As previously suggested, analogies are fundamental tools of lawyerly thinking.<sup>138</sup> Analogies are also the basis for legal fictions.

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merits. There is nothing magical or sacred about the legal fiction. "*Reasoning by analogy* is said to be the basic way we 'think like a lawyer.'" Anthony D'Amato, *Pragmatic Indeterminacy*, 85 NW. U. L. REV. 148, 184 (1990) (citing J.M. Balkin, *Nested Oppositions*, 99 YALE L.J. 1669, 1671 (1990) (reviewing JOHN M. ELLIS, *AGAINST RECONSTRUCTION* (1989)) and RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE*, 86-93 (1990)). If in a given case it helps us to understand a rule's purpose or function by examining its analogical connections to the real world, then it may be useful to think of that rule as a fiction. This is a natural consequence of any purposive theory of legal interpretation. It is not demeaning to describe a rule of law as involving a legal fiction. The fiction is not a falsification in a moral or philosophical sense, but rather it is an adaptation of the human mind to the intransigent crudity of language and the ineluctable modality of life.

If we dealt with reality as it is, in its crude, unorganized form, we should be helpless. Instead of that, our minds have the capacity for altering, simplifying, rearranging reality. This process of elaboration and alteration is—to preserve the organic simile—but the sign of a good mental digestion; it indicates the vigor and capacity of our minds.

FULLER, *supra* note 13, at 104.

136. Fuller reached this same conclusion about legal fictions generally. FULLER, *supra* note 13, at 94. Samek echoed this view. He argued that fictions are valuable to the law because of "their ability to stretch its criteria. . . . [They make us] see the doctrine in a new light." Samek, *supra* note 11, at 313.

137. FULLER, *supra* note 13, at 113.

138. Vaihinger stressed that "human thought must always proceed by analogy and that analogies must always be taken from an existing stock of experience." *Id.* Does an analogy represent alteration of reality? Fuller says it need not but that in practice, it generally does because we give too much credence to our analogies. *Id.* at 115 ("A metaphorical element taints all our concepts.").

The fiction may be the only appropriate device for resolving a case fairly because of the way in which the fiction permits us to think about things we are only beginning to understand by comparing them to things with which we are already familiar.<sup>139</sup> This is illustrated by section 7872. Most of us can understand an arrangement between an employer and its employee in which the employer loans money to the employee at a reasonable rate of interest. If the employer later pays a sum to the employee equal to the amount of interest owed by the employee, we could understand that the employee has compensation income and the employer has a deductible expense. And if the employee then makes his required interest payment to the employer, we could understand that the employer has interest income and the employee may have a deductible expense. But in earlier, less economically sophisticated days, few of us, without any prodding, would have seen an economic equivalence to all those things in an interest free loan from the employer to the employee.<sup>140</sup> Section 7872 bridges the gap between our less sophisticated past and our increasing understanding of the time value of money. In that sense, the fiction is a way of connecting the known with the unknown.<sup>141</sup>

Is there a non-fictitious way to describe the appropriate income tax consequences of an interest free loan? I, at least, would be hard pressed to find it. For the time being, the fiction of section 7872 may be the only way to express our vision of what constitutes economic justice. Though it is probable that any fiction can be avoided by a sufficiently radical shift in paradigms, such radical shifts in paradigms are not everyday events. The fiction helps us to get by until new insights show us a better way.

### C. *Pragmatism and the Fiction*

At times, there are only two strategies for avoiding the employment of fictions. We can either change or eliminate the existing

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139. Fuller believed that "[t]he function of the fiction, as affecting an adjustment between new situations and an existing conceptual structure, has a parallel in the methods of the natural scientist." *Id.* at 71. "The motive of the scientific fiction is the same as that of the historical legal fiction proceeding from intellectual considerations; i.e., a new situation is made 'thinkable' by converting it into familiar terms." *Id.* at 72.

140. The principle of § 7872 may seem obvious to many. However, as one charged with teaching it to intelligent people with many years of education already behind them, I can testify that it strikes most people as much less than obvious.

141. By the same token, one may well wonder whether in years to come someone will offer a new insight into interest free loans that shows that § 7872 reflected only a partial understanding of the economic significance of such loans. If this occurs, we may then say that § 7872 served as only an intermediate analogical step in bridging the gap between the known and the unknown.

rule that motivates us to resort to the fiction, or we can accept the injustice that comes from employing the existing rule in the absence of the fiction. For example, we could forego employing the fiction of constructive ownership in the context of non-liquidating corporate distributions if we were willing either to eliminate the distinction between dividends and redemptions or if we were willing to ignore that family members often function as an economic unit.<sup>142</sup> In a pragmatic sense, neither of those strategies may be available. Elimination of the dividend-redemption dichotomy would simply entail too radical a departure from accepted tax norms. Choosing to ignore the family as an economic unit would open the door to wholesale avoidance of the dividend rules. In this circumstance, some version of constructive ownership seems inevitable, though perhaps the fiction could be more flexibly drawn than the current version.

#### *D. The Fiction as Merely a Rule with a Twist*

Whether our attachment to existing paradigms proceeds from intellectual conservatism or from more pragmatic concerns, it is this attachment to existing paradigms that maintains the indispensability of the fiction. In this sense, the fiction is simply a more striking version of what we do when we apply a rule of law to a hard case; that is, we adapt the rule to the novel circumstances.<sup>143</sup> We give the rule a new twist. This is the most ordinary of procedures. When we have difficulty stating a general rule that adequately encompasses all the possibilities we think should be included within its terms, we make up lesser rules that seem analogous with, though different from, our general one. The peculiarity of the fiction is that our lesser rule adapts the law by "altering" the facts. But still, fictions are a way of fairly adapting new fact patterns to the legal theory already in operation without overthrowing the old system. The form of the existing law is saved while

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142. Some might argue that there is a third alternative, that of employing a facts and circumstances test where the judge is given discretion to attribute or not attribute stock ownership between family members based on all the facts of the particular case. I think such an approach simply shifts the choice of whether to employ the fiction of constructive ownership from the Congress to the judge. But I recognize that it may be superior to establishing a blanket rule.

143. Fuller wrote, "the fiction is often but a cruder outcropping of a process of intellectual adaptation which goes on constantly without attracting attention." FULLER, *supra* note 13, at 66.

the present exigencies are resolved in an equitable manner.<sup>144</sup> The aim, then, of the fiction is to give new expression to some underlying premise already embodied in the law.<sup>145</sup> In this respect, fictions may be seen as a basic component of the orderly growth of law.

*E. The Tax Fiction, Economic Symmetry, and a Caveat*

In the tax context, the fiction is usually employed as a means to express some vision of economic symmetry. Thus, for instance, section 2036, and the various other rules causing inclusion in the gross estate of property not actually transferred at death,<sup>146</sup> are based on the premise that property arrangements that are analogous to transfers at death should be treated in the same manner as property transferred at death. A further premise is that such arrangements as those described in those rules do in fact resemble transfers at death. If these analogical premises are correct, fictions deriving from them act in combination with the main rule they modify to achieve a comprehensive and symmetrical treatment of a unique category of economic events.

There are risks in employing tax fictions to achieve economic symmetry. Economic symmetry is a matter of judgment. If our fiction is too narrowly drawn, there may be economically similar arrangements that escape taxation and, thus, our symmetry is still incomplete. On the other hand, if our fiction is too widely drawn, we may catch economically dissimilar arrangements in our tax net. Even if our fictions are well drawn, we may arrive at a level of complexity that is not warranted by our desire for symmetry. If we continue to build fictions around a larger underlying premise, this suggests that the underlying premise (for example, taxation of

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144. *Id.* at 59-61.

The purpose of the fiction consists in making lighter the difficulties connected with the assimilation and elaboration of new, more or less revolutionary, legal principles; in making it possible to leave the traditional learning in its old form, yet without hindering thereby the practical efficiency of the new in any way.

*Id.* at 61-62 (quoting Ihering). Fuller later suggests that it is not necessarily more convenient to create a fiction than to state a new rule in non-fictitious terms, but there may be times when the reform cannot be stated in non-fictitious terms. *Id.* at 63. For instance, the judge may use the fiction because he does not know how else to state and explain the new principle he is applying. *Id.* at 64. "We are forced to deal with new problems in terms of an existing conceptual apparatus which in the nature of things can never be entirely adequate for the future." *Id.* at 65.

145. "A fiction serves to reconcile a legal result with some expressed or assumed premise. . . . Where no intellectual premises are assumed, the fiction has no place." *Id.* at 51.

146. See I.R.C. §§ 2034-2044 (1988 & Supp. II 1990).



property transferred at death in the case of the estate tax) may need to be changed.<sup>147</sup> In other words, a proliferation of fictions within an area of law suggests the need for a new paradigm. We should not try to do too much with the legal fiction. It is by nature a conservative device. When sweeping reforms are desirable, the fiction should take a back seat to more direct means of establishing the law. But the main business of lawmaking is not radical change. Instead, lawmaking largely involves refinements upon existing rules. In this area, the fiction is not only useful but also, on occasion, indispensable.

## V. WHY IS IT NECESSARY TO DROP THE FICTION FROM THE FINAL RECKONING?

“The use of legal fictions is a conservative strategy for change. There is nothing wrong with such a strategy as long as it is employed as a means and not as an end.”<sup>148</sup> However, legal fictions overstate the analogies upon which they are based by making absolute rules out of relative statements.<sup>149</sup> Once we have made such absolute rules, we place ourselves in an awkward position with respect to their application. If we apply them literally, we are likely to apply them toward unjust ends in some cases. If we apply them in a purposive fashion, we may feel that the rule is uncertain in its application in some cases. I believe Fuller embraced the view that uncertainty is to be preferred over arbitrariness.

### A. *Dropping the Fiction as Awareness of the Analogy that Gave it Life*

Fuller adopts Vaihinger’s precept for using fictions that the fiction “must drop out of the final reckoning.”<sup>150</sup> Fuller says we

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147. A different paradigm that would eliminate the need for fictions like § 2036(a) has been suggested by Professor Edward C. Halbach, Jr. See Edward C. Halbach, Jr., *An Accessions Tax*, 23 REAL PROP. PROB. & TR. J. 211 (1988) (proposing to tax wealth transfers at the time each interest comes into actual possession).

148. Samek, *supra* note 11, at 315.

149. There may be some cases where the fiction does not overstate its underlying analogy. Section 7872 may be an example of such a fiction. See *supra* part IV.B.

150. FULLER, *supra* note 13, at 116-23.

As all thinking proceeds through analogy and comparison, thought will be speeded up if we can group related phenomena into units convenient for comparison. But these constructs must be used as *instruments* of thought only; we must treat them as servants to be discharged as soon as they have fulfilled their functions. They are foreign elements which may be inserted into the equation provisionally to

do this in the law by extracting from the fiction the meanings associated with it which are inappropriate. He says that fictions die through this process. When the fiction is widely understood correctly without the need of any qualifying remarks, it is dead.<sup>151</sup>

Unfortunately, Fuller's explanation for how the fiction is dropped from the final reckoning is the least exact aspect of his analysis of the legal fiction. What precisely did he mean when he said we must drop the fiction? As I have already intimated, I believe that he meant we must apply the fiction with a deliberate consciousness of the analogy that gave life to the fiction in the first place.<sup>152</sup> This aspect of Fuller's view of the fiction is an early reflection of the argument he would later develop more fully: that rules must be understood and interpreted in light of the purposes of their creators.<sup>153</sup> "A fiction becomes understandable only when we know why it exists, and we can know that only when we know what actuated its author."<sup>154</sup> Thus, "in simple but loose words, we can only know *what* is said when we know *why* it is said."<sup>155</sup>

### B. Formalism's Rejoinder and a Reply

From a formalist perspective Fuller's "purposive" theory of law is far from self-evident. As discussed previously, the fiction is

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render computation simpler, but which must be dropped from the final reckoning.

*Id.* at 121.

Failure to drop the fiction is dangerous because too much credence is given to the false meaning inherent in it. "The isolation of either a concept or a muscular contraction from its compensatory context is dangerous." *Id.* at 119 (citation omitted). The "isolation of a process of thought from a compensatory context" is what Fuller called "hypostatization." *Id.* at 120. The danger of such isolation in the case of a concept is that context provides meaning. Fuller elaborated on this idea by describing three dangers inherent in concepts; 1) their centripetal force, 2) their capacity for inducing reification, and 3) their metaphorical contamination. *Id.* at 123. Centripetal force relates to the tendency of concepts to exceed their bounds. Reification refers to the tendency of concepts to become isolated from the reasoning process which produced them. Metaphorical contamination refers to the tendency to take fictions literally. *Id.*

151. *Id.* at 118.

152. Samek puts it this way, "A legal fiction must be justified as a means to a social end." Samek, *supra* note 11, at 314.

153. A widely cited explication of this theory is Fuller's article, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630 (1958). Fuller, however, developed this idea in many of his other writings. See SUMMERS, *supra* note 28, ch. 2.

154. FULLER, *supra* note 13, at 49-50. We can see the roots of this idea in Vaihinger, who wrote: "All preoccupation with fictions as such is valueless and harmful because fictions only possess value in their relation to a purpose." VAIHINGER, *supra* note 27, at 123.

155. FULLER, *supra* note 13, at 50 (quoting C.K. OGDEN & I.A. RICHARDS, *THE MEANING OF MEANING* 94 n.1 (2d ed. 1927)).

a formalistic device, especially when it is employed by a legislature.<sup>156</sup> It is because we want to treat the pre-existing rules as having fixed and settled meanings that we are sometimes forced to resort to the use of fictions. Having resorted to a fiction, it would seem contradictory to treat the fiction as having no fixed or certain meaning of its own. Is there some basis to differentiate how we should apply the fiction from how we apply other rules?

To consider that question, let us continue with the disclaimer rules. We could say that the fiction that a disclaimed bequest is no bequest need not be understood on any deeper level in order to be applied. In principle, it is a simple rule after all; if one refuses a bequest, the law treats the bequest as if it was never made. What is there to understand? The answer depends on the context in which the rule is sought to be applied.

Suppose, for instance, a wife disclaims a bequest from her husband in a manner that satisfies section 2518 except that her disclaimer states: "I direct that this bequest shall pass to our children in equal shares." The disclaimer rules provide that the disclaimer is only valid if, "as a result of such [disclaimer], the interest passes without any direction on the part of the person making the disclaimer."<sup>157</sup> Does the language in the wife's disclaimer directing the property to the children violate this rule? On a mechanical level it appears to do so, and we may have no trouble saying that the disclaimer is invalid. But what if the property would have passed to the children in equal shares even without that language in her disclaimer, either by operation of law or because of a contingency clause in the husband's will? If we can give effect to the disclaimer without paying heed to the disclaimer's directive and also without violating her directive, should we treat the disclaimer as valid? It is difficult to see how we can decide that question without looking at the purpose of the disclaimer statute. In this respect, there is an ineluctable connection between what the law is and what the law ought to be.

It would strike many as reasonable to give effect to the disclaimer even though in a technical sense the rule is violated. Since the effect of the directive is the same as if there were no

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156. When a legislature creates a fiction, it does not find a new meaning in the already existing rules in the same way a judge does (if we assume that a judge finds rather than makes law). The judge who creates a fiction is obliged to offer her fiction as an interpretation of an existing rule while the legislature, in its actions, is implicitly conceding that the pre-existing rule did not include the meaning attributed to it now because of the fiction.

157. I.R.C. § 2518(b)(4) (1988).

directive, the analogy underlying section 2518 that a disclaimed bequest is like no bequest is equally applicable to the case.<sup>158</sup> One might contend that the fiction of section 2518 is intended to prevent an injury. Too technical an interpretation of the provision defeats that purpose.<sup>159</sup>

An essential restraint on our tendency to employ fictional rules as formalistically as other rules is the recognition that they are creations of our own minds in a more dramatic sense than non-fiction rules. This understanding may justify our treating fictions with less linguistic respect than other rules. The fiction is a mere form we employ to make other rules work more fairly. When it fails to serve this purpose, why should we honor the empty form? Fuller believed "[n]o theory or dogma can solve the problem of how far we ought to generalize or 'conceptualize' the law. It is a question of balance and judgment . . . The ultimate problem of law is balance."<sup>160</sup> This problem is exemplified by the legal fiction. It is a rule created to do justice, but like any rule, its strict interpretation may, on occasion, interfere with a just outcome. Whether it does so in a particular case is a question of judgment. What course we should pursue when a fiction's strict meaning is not consonant with our ideas of justice is also a question of judgment.

All of this sounds vague and unhelpful. If the key to applying rules well is the exercise of good judgment, one might conclude that the concept of a system ruled by laws rather than by persons is utterly chimerical. If judgment decides legal questions, what happens to the determinacy of law? I will not attempt to resolve this question here.<sup>161</sup> Instead, I wish to conclude by focusing on a context in which dropping the fiction can have, I believe, a clear and definite meaning. I am referring to situations involving mul-

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158. It is not entirely clear what the government's position on this would be. In the regulations, there is a similar example where effect is given to the disclaimer. See Treas. Reg. § 25.2518-2(e)(5) ex. 8 (1954). But in that example, it is specifically stated that under state law, the disclaimer's direction that she intended the property to go to her children was considered merely "precatory," having "no legal effect." *Id.* In my example, I am assuming that the disclaimer's direction would be honored under state law but that this fact is irrelevant because the same consequences would flow from a valid disclaimer.

159. This might be seen as a variation on the maxim set forth by Fuller (quoting Blackstone) that "[n]o fiction shall be allowed to work an injury." FULLER, *supra* note 13, at 50 (*Fictio legis neminem laedit*).

160. *Id.* at 136-37.

161. I have taken a stab at the question of the determinacy of tax law in another article. See John A. Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 WASH. L. REV. (forthcoming, Winter 1992-93).

tiple fictions. I have somewhat arbitrarily divided these situations into three categories. The first is when a fiction, carried to its logical conclusion, gives rise to another fiction. The second is when a fiction affects the application of another fiction. The third is when we attempt to create a fiction by analogy to a fiction. My thesis for all three of these contexts is that the principle of dropping the fiction from the final reckoning can have literal meaning. However, even in these contexts, I suggest that the question of whether to obey the directive to drop the fiction remains a question of judgment.

*C. Dropping the Fiction as a Way to Prevent the Multiplication of Fictions*

Sometimes the creation of a fiction can be seen as having consequences extending beyond its immediate intended effect. This happens when the fictive pattern is carried to its logical extreme. Walter Cliff and Benjamin Cohen point this out in the context of a transfer pricing adjustment under section 482. Section 482 allows the Secretary of the Treasury to reallocate income and deductions among related persons or entities to clearly reflect income. It commonly may have application to sales of goods and services between related corporations where the prices established by the related parties have not been set to comport with similar arm's-length transactions between unrelated third parties.<sup>162</sup> Cliff and Cohen point out that the application of section 482 may tempt us to create "collateral" fictions. To illustrate, if the price charged by Company *A* to its sister Company *B* (both owned by Parent Company) for a sale of goods is increased by \$100 for tax purposes under section 482, how do we then account for the economic reality that no additional cash passes from Company *A* to Company *B* as a result of the reallocation of \$100 of income for tax purposes? If we follow the fictional reallocation of income all the way through, as logic would seem to demand, we may have to create a \$100 constructive dividend from Company *B* to the Parent Company, and a \$100 constructive capital contribution from the Parent Company to Company *A*, in order to account for Company *A*'s retention of the \$100 additional cash it was deemed to have paid to Company *B*.<sup>163</sup> Such a constructive dividend is clearly a legal fiction born of the prior fiction. Cliff and Cohen argue that

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162. Cliff & Cohen, *supra* note 11, at 40.

163. *Id.* at 41-42.

the better approach is to limit the application of section 482 to its immediate purpose of reallocating income and to ignore the collateral fictions it might be thought to raise.<sup>164</sup> They describe this as a "contextual approach" to tax fictions. This contextual approach is also a literal example of dropping the fiction from the final reckoning. By contending that no constructive dividend is generated by the reallocation of income, Cliff and Cohen are directly asserting that the fiction must be abandoned after it has accomplished its immediate purpose.

*D. Dropping the Fiction in the Application of a Fiction to a Fiction*

What happens when we apply a legal fiction to a legal fiction? One author contends that the result is science fiction.<sup>165</sup> The argument Cliff and Cohen make concerning the fictional income produced by section 482 is a more restrained statement of that point of view. In cases where one fiction follows from another, Cliff and Cohen argue that the second fiction should be dropped. But in some cases, the second fiction is inescapable. In such cases, if we are to drop any fiction, it is the first fiction which must be dropped. An impediment to doing so, however, is the formalism typical of tax thinking—that gave rise to the fiction in the first place.

For an illustration, let us return to the disclaimer rules of section 2518 and consider the consequences of successive disclaimers. In general, the disclaimer rules provide that a timely disclaimer must be made within nine months of the event creating the disclaimer's property interest.<sup>166</sup> In our example, assume these facts: Testator leaves property in trust with the income payable to Al for life and also gives Al a testamentary power to appoint the corpus to anyone he chooses, including his own estate. In default of Al's exercise of the general power of appointment, the corpus will pass to Bill upon Al's death.<sup>167</sup> Under these facts, Al has nine months from Testator's date of death to disclaim either the life estate or the general power, or both.<sup>168</sup> The question is, if Al

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164. *Id.* at 53-59.

165. Ziff, *supra* note 11, at 160. Professor Ziff was writing in the context of the Canadian felony-murder rule.

166. I.R.C. § 2518(b)(2)(A) (1988). The statute is tolled if the disclaimer is a minor. I.R.C. § 2518(b)(2)(B) (1988).

167. For estate tax purposes, Al will be deemed the owner of the trust corpus, i.e., the corpus will be included in his gross estate. See I.R.C. § 2041(a)(2) (1988).

168. See Treas. Reg. § 25.2518-3(a)(1) (1954).

disclaims the general power of appointment, how long does Bill have to disclaim the interest passing to him as a result of Al's disclaimer? In considering this question, it is well to take note that had Al exercised the general power of appointment by appointing the property to Bill, Bill would have been allowed nine months from the date of appointment in which to disclaim the property transferred to him by Al's exercise.<sup>169</sup> Under the circumstances, Al's disclaimer is economically equivalent to an exercise in Bill's favor.

In a pragmatic sense, Bill's interest does not come into existence until Al's disclaimer.<sup>170</sup> If this is so, should not Bill's nine month period in which to disclaim begin on the date of Al's disclaimer? The regulations appear to require that Bill also disclaim within nine months of Testator's death.<sup>171</sup> In some circumstances, this could lead to an unfair result, as when Al disclaims on the last possible day and Bill has no opportunity to evaluate his circumstances in light of Al's disclaimer. How do we explain the difference between what seems to be the fair answer and the regulations' answer? It is because the regulations fail to drop the fiction.

It will be recalled that the disclaimer rules are based on the analogy that a disclaimed bequest is more like no bequest than it is like a bequest. Thus, disclaimed bequests are treated as if they had never occurred. In the case of Al and Bill described above, if no bequest had ever been made to Al, then Bill's interest in the

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169. Treas. Reg. § 25.2518-2(c)(3) (1954).

170. Pragmatically speaking, Bill owned nothing of consequence. This is also true from an estate tax perspective. Prior to Al's disclaimer, Bill had nothing more than an expectancy from an estate tax perspective. This is because one who holds a general power of appointment is the owner of the property subject to the power for estate tax purposes. See I.R.C. § 2041 (1988). Thus, prior to Al's disclaimer, Al was the owner of the property for estate tax purposes.

In property law, a general power of appointment is not considered an interest in property. The tax law accepts this idea in principle but then overrides it. Like § 2036(a), § 2041 is a legal fiction born of an analogy to § 2033, that is, § 2041 draws into the gross estate property not held at death (i.e., property over which the decedent held only a general power of appointment). The difference is that there is no question about the general power being held at death, but only whether the power is "property." In effect, § 2041 redesignates a general power as a form of property without saying so directly. See STEPHENS ET AL, *supra* note 84, ¶¶ 4.05[5][c], 4.13[1]. One might reasonably conclude that § 2041 is not the legal fiction involved here. Instead, the true legal fiction may be the property law principle that a general power is not property.

171. The regulations state that "[a] person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than 9 months after the date of the taxable transfer creating the interest in the preceding disclaimant." Treas. Reg. § 25.2518-2(c)(3) (1954).

remainder would have been fixed on Testator's date of death. Continuing with that fiction, the time in which Bill is permitted to disclaim should run from Testator's date of death. But the truth is that a bequest was made to Al, and Bill had no reasonable expectation of receiving the remainder until Al disclaimed. When we apply the disclaimer rules to Bill, we could drop the fiction that Al's disclaimed bequest never occurred. If we did this, we would conclude that the event creating Bill's interest was Al's disclaimer, and that the nine month period for Bill's disclaimer should begin to run from that time.

Should we drop the first fiction when we apply the second in the context described above? I am inclined to think we should. I believe such an interpretation is consistent with the language employed by section 2518 to create the fiction. Moreover, like Fuller, I believe a legal fiction should be employed in light of its purpose. Otherwise, its underlying truth can be lost, and we will be left with only its falsity to guide us.<sup>172</sup> It is instructive to remember Justice Cardozo's advice: "Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it."<sup>173</sup> Having said this, however, I feel constrained to also say that I am enough of a formalist to believe that our power to drop the fiction is not unlimited.

The fiction may be written in such a way as to deny us the freedom to drop the fiction. An example of this is provided by section 7872. Not only does it apply to interest-free "compensation" loans between employers and employees, it also applies to interest-free "gift" loans between family members.<sup>174</sup> It causes us to treat the failure to charge interest as a gift of the interest by the lender to the borrower, followed by a payment of the interest by the borrower to the lender. Thus, the lender has interest income for income tax purposes. But the application of the fiction in section 7872 is not limited to the income tax. It also applies in the gift tax area.<sup>175</sup> Thus, the lender may have a gift tax liability,

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172. When this happens, our legal fiction has been converted into what one writer describes as a "legal myth." Hamilton, *supra* note 11, at 1470-71. "While legal fictions are false propositions that are recognized as false but acted upon as if true, 'legal myth' refers to false propositions that are erroneously taken to be true and acted upon as if true." *Id.* A similar idea has been described as "the meta phenomenon." Samek, *supra* note 11, at 291. "The meta phenomenon is the human propensity to displace 'primary' with 'secondary' concerns, that is concerns about ends with concerns about means. The latter come to be perceived as primary, and distort the former in their own image." *Id.*

173. *Berkey v. Third Ave. Ry.*, 155 N.E. 58, 61 (N.Y. 1926).

174. See I.R.C. § 7872(c)(1)(A) (1988).

175. See I.R.C. § 7872(a)(1) (1988).



as well as an income tax liability, as a result of the interest-free loan. The statute does not give us the option of dropping the fiction after the fiction has served its immediate purpose. Instead, it has chosen to extend the fiction to its logical end.

There is no universally recognizable moment when we should drop the fiction. At times we should drop the fiction as soon as it has performed its immediately intended service. At other times, it may be that we should carry the fiction as far as it will take us. In the particular context of section 7872, for instance, I cannot say that the failure to drop the fiction represents an error. By extending the fiction of section 7872 into the gift tax, it seems fair to say that a greater economic symmetry has been achieved in the operation of the gift tax.<sup>176</sup> Whether or not we should extend a particular fiction beyond its immediate ambit is a function of how much truth underlies the fiction. The truer the underlying concept, the further the fiction may be extended without threat of harm.

### *E. Dropping the Fiction in Creating Fictions*

There is another circumstance involving multiple fictions where the need to drop the fiction may be more obvious than has thus far been demonstrated. Here I refer to the creation of a fiction by analogy to another fiction. If we fail to drop the first fiction when we engraft a second fiction onto an existing fiction, our second fiction is likely to suffer from a lack of conformity to basic principles. This will be illustrated with two examples. The first example is a simple generic one, and the second is a more complex one concerning the tax law.

#### 1. A Generic Example

It is readily apparent that an analogy to an analogy is likely to become attenuated with respect to the original source of analogy. For instance, if we say a bicycle is like a motorcycle and a motorcycle is like a car, does it follow that a bicycle is like a car? Though we may say that they have some characteristics in common, we would be cautious about extending the comparison too far. Suppose that a law were enacted which stated that motorcycles are

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176. It might be noted that the idea of imputing interest to interest-free loans received its most important judicial approval in the gift tax context. *See Dickman v. Commissioner*, 465 U.S. 330 (1984) (interest-free loan is a gift of the foregone interest by the lender to the borrower). The *Dickman* decision was the immediate stimulus for the enactment of § 7872. *See BITTKER & McMAHON, supra* note 21, ¶ 31.4.

defined to include bicycles for licensing and other purposes. This would be a legal fiction since bicycles are not motorcycles in common parlance. Suppose that a few years later, a law was enacted saying that motorcycles are automobiles for licensing and other purposes. This would be a second legal fiction since motorcycles are not in fact automobiles in the common sense. The two rules, when read together, may have the effect of denominating bicycles as automobiles for regulatory purposes.<sup>177</sup> If this was not the intended result, the error would be the result of failing to drop the first fiction when the second fiction was created. Put differently, the second fiction failed to take account of the earlier fiction and operated more broadly than was intended. "A liar should have a good memory."<sup>178</sup>

## 2. Section 2036(c)

A tax case study involving failure to drop the fiction in creating a fiction is provided by recently repealed section 2036(c).<sup>179</sup> Some readers will recall that this controversial provision was so widely despised that when it was repealed in 1990, that repeal was made retroactive to its date of enactment.<sup>180</sup> Section 2036(c) was enacted in 1987<sup>181</sup> to put an end to the tax planning devices broadly described as estate freezes.<sup>182</sup> The classic estate freeze is the corporate recapitalization in which the shareholder/owner receives two classes of stock. The more valuable of the two classes is preferred stock with dividend and liquidation preferences approximating the

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177. For example, bicyclists might be required to have driver's licenses and to carry liability insurance.

178. JOHN BARTLETT, *FAMILIAR QUOTATIONS* 117 (quoting MARCUS FABIUS QUINTILIANUS, *DE INSTITUTIONE ORATORIOA*, bk. IV, 2, 91).

179. See Revenue Reconciliation Act of 1990, P.L. 101-508, § 11,601, 104 Stat. 1388-490. Section 2036(c) was replaced with I.R.C. §§ 2701-04 (1988 & Supp. II 1990).

180. *Id.* Section 2036(c), however, was not without its defenders. See, e.g., John A. Bogdanski & Lawrence R. Brown, *Farewell To Freezes: Section 2036(c)*, 42 *TAX NOTES* 1633 (1989). Dozens of articles were written about § 2036(c) during the three years it was on the books. I was one of the many who wrote about some aspect of the provision. See John A. Miller, *Gift (W)rapping the Estate Freeze*, 41 *TAX NOTES* 1335 (1988).

181. Omnibus Budget Reconciliation Act, Pub. L. No. 203, § 10,402(a), 101 Stat. 1330-431 (1987) (Titles IX and X of the Act, where the tax provisions are found, are sometimes referred to as the Revenue Act of 1987).

182. H.R. REP. NO. 391, 100th Cong., 1st Sess. 1043 (1987). As will be discussed in the text, earlier that same year the Tax Court had rejected the Service's argument that the gifted growth stock in a corporate recapitalization freeze is includable in a decedent's gross estate under § 2036(a). *Estate of Boykin v. Commissioner*, 53 T.C.M. (CCH) 345 (1987). For a brief discussion of the nature of an estate freeze and for citations to more detailed treatments, see STEPHENS ET AL., *supra* note 84, ¶ 4.08[9][b].

business's present income stream and present fair market value. The taxpayer also receives common stock which will only have value if the business grows. By giving away the common stock to his children, the taxpayer excluded (before enactment of section 2036(c)) any appreciation in the value of the business from his gross estate, and did so at a low gift tax cost.<sup>183</sup>

Prior to the enactment of section 2036(c), the Internal Revenue Service had sought to curtail the effectiveness of the estate freeze as a tax saving device by arguing in *Estate of John G. Boykin* that section 2036(a) applied to estate freezes.<sup>184</sup> The reader will recall that section 2036(a) draws back into the gross estate remainders given away during life in which the grantor retained a life estate. The Service argued that a recapitalization, like the one just described in which a person gives away common stock while retaining preferred stock, is the legal equivalent of a gift of a remainder while retaining a life estate. One can readily understand this position. In particular, one might say that like the remainder, the common stock has only a future value. Similarly, like the life estate, the preferred stock provides the ability to presently enjoy the benefits of ownership of the business. However, the tax court rejected the Service's argument that the gifted growth stock in a corporate recapitalization freeze was includable in a decedent's gross estate under section 2036(a). The court reasoned that the recapitalization had created two distinct property interests and that with the gift of the growth interest, the taxpayer had effectively parted with all interest in it.<sup>185</sup> Thus, section 2036(a) could not apply because the growth stock had been given away with no strings attached.

Having unsuccessfully attempted to apply section 2036(a) to estate freezes, the government apparently saw the estate freeze

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183. Typically, for gift tax purposes, the taxpayer would place a very low value on the common stock given away. He could support this valuation by reference to the liquidation value of the interest, that is, if the business were liquidated today it would have no value because of the liquidation preference of the preferred stock.

There are a variety of possible freeze maneuvers. In general, an estate freeze involved division of ownership of a business into two parts, a frozen interest and a growth interest. Ideally, the frozen interest was worth the present value of the business and the growth interest held only the potential for becoming valuable if the business prospered. By giving away (at a low gift tax cost) the growth interest, a taxpayer could maintain control of the business and continue to enjoy the income from the business while excluding any future appreciation in its value from her gross estate. For descriptions of the various forms of estate freezes, see Byrle M. Abbin, *The Value Capping Cafeteria—Selecting the Appropriate Freeze Technique*, 15 U. MIAMI INST. ON EST. PLAN. ch. 20 (1981).

184. *Estate of Boykin v. Commissioner*, 53 T.C.M. (CCH) 345 (1987).

185. *Id.* at 348.

problem as uncovering a flaw in section 2036 rather than as a problem outside the scope of that section.<sup>186</sup> Thus, the perceived solution to the estate freeze problem was to amend that section by adding section 2036(c). Section 2036(c) eliminated the estate tax benefits of freezes by treating the retained frozen interest in an estate freeze (the preferred stock in the example above) as the equivalent of a retained life estate in the given-up growth interest (the common stock) for purposes of the application of section 2036(a).<sup>187</sup> In short, section 2036(c) was the legislative overturning of the tax court's decision in *Boykin*.<sup>188</sup>

I have previously described section 2036(a) as a legal fiction in the sense that it rests upon an analogy to the principle embodied in section 2033: that the estate tax is levied upon property owned and transferred at death. Section 2036(a) creates the fiction that a decedent owned and transferred a remainder at death when, in fact, the remainder was typically given away years earlier. Thus, section 2036(c) was a legal fiction grafted onto a legal fiction; that is, it drew an analogy to an analogy. Consequently, the analogy in section 2036(c), that the preferred stock is to the common stock as the life estate is to the remainder, is attenuated from the ultimate source of the analogy, section 2033. In attacking estate freezes, the drafters of section 2036(c) failed to drop the fiction.

It is arguable that section 2036(c) did not comport with the central premise of the estate tax of taxing the transfer of property at death. In this sense, section 2036(c) was an altogether different order of fiction from the fiction established by section 2036(a). That section involves property arrangements where there is retention of some present interest while transferring a future interest in the same property. Retention of a life estate makes for a reasonable

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186. See H.R. REP. NO. 391, 100th Cong., 1st Sess. 1043 (1987) ("The Committee believes that keeping a preferred stock interest in an enterprise while giving away the common stock resembles a retained life estate, and should be treated as such.").

187. Section 2036(c) was structured to piggyback on § 2036(a). "For purposes of subsection [2036](a), if—(A) any person holds a substantial interest in an enterprise, and, (B) such person . . . transfers [a growth interest] while retaining [a frozen interest] then the retention shall be considered to be a retention of [a life estate]." I.R.C. § 2036(c)(1) (1988 & Supp. II 1990). For discussions of the 1987 version of § 2036(c), see Dennis I. Belcher & Michele A. Wood, *Section 2036(c): Has the Ice Age Arrived for Estate Freezes?* 13 TAX MGMT. EST. GIFTS AND TR. J. 63 (1988); James C. Magner & Zenon Z. Tencza, *The Freeze Gets Iced: Section 2036 After OBRA*, 39 TAX NOTES 505 (1988).

188. The impact of § 2036(c) was much broader than the mere overturning of *Boykin*, however. See, e.g., Richard L. Dees, *Section 2036(c): The Monster That Ate Estate Planning and Installment Sales, Buy-Sells, Options, Employment Contracts, and Leases*, 66 TAXES 876 (1988).

analogy between a remainder (which passes into possession on the transferor's death) and other property actually owned and transmitted at death. In both situations, the property does not fully pass from the transferor to the beneficiary until the transferor dies. Moreover, the extinguishment of the life estate is a necessary condition precedent to the enjoyment of the remainder. In contradistinction, unlike the life estate, the preferred stock in an estate freeze is not extinguished by the death of its holder. Nor is any possessory interest retained until death in the common stock. In a formal sense, the property transactions attacked by section 2036(c) did not involve a division of property between present and future interests. Instead, they involved division of the property into two or more distinct present interests. Thus, the fiction in section 2036(c) that the common stock was transmitted at death was much more attenuated than the fiction in section 2036(a) that the remainder was transferred at death.

Does this prove that section 2036(c) was badly conceived? Not by itself. The argument can still be made that section 2036(c), or something like it, was a necessary response to the estate planners's legerdemain.<sup>189</sup> One could even argue that some estate freezes functioned as divisions of property into present and future interests even if both interests appeared to be present interests. However, this argument runs counter to our formalist tendencies in tax law. Or, if formalism is to fall by the wayside, such cases, if they exist, should be winnable by the government under section 2036(a) by virtue of a substance-over-form analysis.

Under the precept that the fiction should be dropped from the final reckoning, section 2036(a) was not the proper source of analogy for section 2036(c). If the drafters of section 2036(c) had followed that precept, they would have been obliged to create a fiction that was a direct analogy to the transfer at death principle of section 2033. Had they attempted to do this, they might have seen more clearly how tenuous the analogical connection was between an estate freeze and a transfer at death. They might have concluded, as was later done, that the problem posed by the estate freeze was essentially a valuation problem. In other words, the real issue was whether the growth interest was being undervalued for gift tax purposes at the time of its transfer. The provisions replacing section 2036(c), sections 2701 through 2704, approach

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189. See, e.g., Bogdanski, *supra* note 180, at 1654.

the matter of the estate freeze more directly as a valuation problem<sup>190</sup> by establishing some mechanisms for valuing growth interests to insure that they are not undervalued.

Although sections 2701 through 2704 are quite arbitrary and irksome,<sup>191</sup> they have not yet aroused anything approaching the outcry that arose after the enactment of section 2036(c). This is evidence that the firestorm of controversy section 2036(c) aroused, and which ultimately led to its retroactive repeal, was due to its lack of a sound analogical foundation and not simply to the fact that it closed down some favored estate planning schemes. Its drafters failed to adequately consider its source of analogy. The price paid for this failure to drop the fiction was a significant one. The statute's lack of a sound analogical connection to the rest of the estate tax made it difficult to integrate into the existing analytical framework. For three years following its enactment, practitioners and their clients hesitated over how to plan the clients' estates while the government vacillated over how to apply the statute. In the end, those persons who were bold or ignorant enough to disregard section 2036(c) were left unscathed while everyone else spent time and money in a wasted effort to come to grips with it.

A problem in the application of tax fictions, as with the application of law generally, lies in deciding how far we ought to generalize concerning the application of rules to facts. That is, we are always faced with questions of interpretation. In the end, this question is one of judgment. But recollecting and understanding our premises is a necessary first step to arriving at fair conclusions.

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190. For some preliminary analyses of these rules, see STEPHENS ET AL., *supra* note 84, ch. 4A (1991 Supp.); Lloyd L. Plaine & Pam H. Schneider, *Proposed Valuation Regulations Flesh Out Operation of the Subtraction Method*, 75 J. TAX'N 82 (1991); Lloyd L. Plaine & Pam H. Schneider, *Proposed Valuation Regulations Provide Workable Exceptions for Transfers in Trust*, 75 J. TAX'N 142 (1991); Lewis D. Solomon & Lewis J. Saret, *Tax Planning for Closely Held Corporations Under the New Estate Freeze Rules*, 16 REV. TAX'N OF IND. 3 (1992).

191. In general, these complex provisions utilize the legal fiction that the retained interest in an estate freeze has a zero value. Thus, in effect, the transferor is treated as if he gave the entire underlying asset away. This assures that the growth interest is not undervalued for gift tax purposes. These provisions raise a number of issues concerning multiple fictions. For example, if the transferor is deemed to give away during life the entire asset even though he retains an income interest in it, should § 2036(a) still apply when he dies? The statutory answer is that § 2036(a) will still apply. See, e.g., I.R.C. § 2702(a)(1) (1988 & Supp. II 1990) (§ 2702 applies solely for purposes of the gift tax). But it should be noted that in this particular context, credit will be given for the gift tax paid in computing the estate tax. See I.R.C. § 2001(b) (1988). It is tempting to go on at some length concerning these new provisions and their treatment of the multiple fictions they raise. However, such detailed analysis is beyond the scope of the present article.

When we see the analogy from which our fiction derives, we have greater assurance that we can apply it properly. This is because rules are applied best when applied with a consciousness of their purposes. When we draw an analogy, we should seek to draw as direct a connection as possible between the case sought to be addressed and the guiding paradigm sought to be applied. Dropping any fiction that may intervene between those two things is a way of doing this.

## VI. CONCLUSION

A fiction is only worthy of use if it embodies a truth on a non-literal plane. Its underlying truth, then, is its chief virtue. But it is its literal falsity that makes it useful. By twisting the facts, the *worthy* fiction brings some new circumstance within the operation of pre-existing rules in a fashion that leads to a more equitable result than would otherwise be obtained. Like the two sides of a coin, the two aspects of the fiction, its truth and its falsity, are inextricably bound. Like the two sides of a coin, those dual aspects are difficult to observe at the same moment. To see a fiction is to choose a perspective. With a tilt of the head the perspective can change, and the fiction can disappear. This fickle quality of the fiction is fundamental to its strange melding of truth and falsity. It is also the key to its utility. Metaphor often captures truth in ways that mere cold prose can never achieve.

Though the tax fiction partakes of metaphor, it is often simply a more striking version of the analogical thinking that tax lawyers employ every day. In that sense, fictions are an essential element of tax law. In tax law, legal fictions are relatively benign tools for effectuating positive changes in an incremental fashion. By converting comparative statements into absolute rules, tax fictions serve to render the operation of law consistent with its underlying economic premises. The danger of employing them is that the falsehood in the fiction can take on the appearance of truth. It is necessary to remember that a good fiction is a matter of context. Moreover, since fictions result from analogy, we can only judge the fiction if we first recognize the analogy underlying it. A bad fiction, then, is often based upon a bad analogy or a wrong analogy. Unsound analogies are a natural result of drawing an analogy by reference to a rule which itself rests upon an analogy. This tendency toward unsoundness of the second analogy derives from its more tenuous connection to the legal principle or paradigm that serves as the ultimate source of analogy.

In the end, no analysis of the legal fiction can fairly reduce its operation to a mechanical formula. No evaluation of the merits of a particular fiction can escape the need to exercise balance and judgment in its employment. A tax fiction is like any tax rule: its merit rests in questions of tax policy and tax theory as they are raised by particular cases. The justification for most tax fictions is their utility in achieving the general tax policy goal of economic symmetry. We use the fiction to treat cases that are substantively alike in a consistent manner though they may differ in form. But sometimes the very idea that we can distinguish between substance and form seems itself a fiction.