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Federal Tax Implications of Administrative Reform: Dealing with Deregulation Law

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FEDERAL TAX IMPLICATIONS OF ADMINISTRATIVE REFORM: DEALING WITH THE DEREGULATION LOSS

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On July, 1980, the Florida legislature repealed Chapter 323 of the Florida Statutes,[1] terminating the state's pervasive regulatory control over motor carrier operations.[2] The implications of this repeal are enormous, especially in light of the trend toward deregulation continuing at all levels of government.[3] The federal tax implications generated by the deregulation process are of particular significance, and should be considered by regulated industries in formulating their strategies to combat deregulation.

Deregulation's chief effect is upon the process of governmental licensing. The process of obtaining and maintaining governmental licenses and permits or otherwise satisfying the administrative requirements of entry into a regulated industry will evaporate. Existing business licenses, permits, and other evidences of governmental sufferance will become valueless, yielding tangible income tax consequences to the deregulated industries.

In accordance with accepted business practices, expenditures made by regulated enterprises to acquire necessary permits or licenses are treated as assets. After deregulation, the loss of that asset should logically give rise to a current deduction.[4] That deduction may represent the taxpayer's only re-

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1. Repeal of this chapter was in accordance with the provisions of the Regulatory Reform Act of 1976, FLA. STAT. §11.61(1979).

2. Chapter 323 of the Florida Statutes represented the legislative mandate for the regulation of motor carriage and shipping in the State of Florida. This chapter granted extremely broad authority to the Florida Public Service Commission to oversee virtually every aspect of that industry's operations, from the setting of rates to the establishing and harboring of mini-monopolies for designated carriers over specified routes or for particular services. See text accompanying notes 5-7 *infra*.

3. The repeal of Chapter 323 is not likely to be an isolated event. The Florida Legislature expressed its desire to systematically deregulate all economic activity. FLA. STAT. §11.61(2)(a) (1979) states it is the intent of the legislature: "[t]hat no profession, occupation, business, industry, or other endeavor shall be subject to the state's regulatory power unless the exercise of such power is necessary to protect the public health, safety or welfare from significant and discernible harm or damage. The exercise of the state's police power shall be done only to the extent necessary for that purpose." Other states and the federal government are becoming increasingly sensitive to the burdens of regulation. To a large extent, such sensitivity was caused by public dissatisfaction with the expense and perceived inefficiency of countless bureaucracies.

4. Reg. §1.165-2(a) provides: "A loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein, *shall be allowed as a deduction* under section 165(a) for the taxable year in which the loss is actually sustained." (emphasis added).

coupment for the often substantial sums spent on administrative permitting. No license resale market remains after deregulation. Consequently, the deregulated taxpayer is faced with a true economic loss which can only be recovered through a reduction of taxable income.

The deductibility of the loss, however, may not be as indisputable as logic might suggest. This article examines the general requirements of deductibility for losses caused by governmental action. Such requirements are synthesized from an analysis of the Internal Revenue Code, an Internal Revenue Service memorandum, and the applicable case law. Finally, the deregulation of Florida motor carriers is used as a case study for analyzing the deductibility of deregulation losses, offering insight into both the tax economics of deregulation and the supporting policies.

THE GENESIS OF ADMINISTRATIVELY CREATED VALUE

Pursuant to Chapter 323, the Public Service Commission (P.S.C.) issued certificates of public necessity and convenience.[5] As a prerequisite to the operation of commercial motor transport within Florida, these certificates created state assured monopolies for the specific route or service. The certificates were not for a term certain but continued in force until amended or cancelled by the P.S.C.[6] Like other business assets, these certificates were transferrable or saleable.[7] Thus, the certificates were clearly intangible assets with a demonstrable and often substantial value. The cost of a certificate was a function either of the expense of its purchase from a prior holder[8] or the capitalized expenses of procuring the certificate directly from the P.S.C. The latter expenses included application costs, legal fees, and associated outlays necessary to generate the franchise.[9] Common carriers properly considered the certificates busi-

5. FLA. STAT. §323.03(5) (1979) (repealed 1980). The P.S.C. was not authorized to issue more than one certificate of public necessity to service a given territory or route unless the existing holder of a certificate failed to provide necessary services and facilities required by the commission. *Id.*

6. The form for certificates issued by the P.S.C. states on its face, "This Certificate shall remain in force and effect until amended, suspended, cancelled or revoked by Order of this Commission."

7. Under the former statute, a certificate could not be transferred or assigned absent an application to the P.S.C. and the opportunity for the public or competitors to file objections and to obtain a hearing before the commission. FLA. STAT. §323.041 (1979) (repealed 1980). Despite the administrative restrictions imposed on transfer, the statutory procedures for assigning the certificates indicate their transferable nature. Thus, the certificates were intangible business assets generally similar to leases, contract rights, patents and other intangibles. The primary distinction, if any, between governmental franchises and other intangibles seems to lie solely in the state's involvement, both as a regulator and monopoly guarantor.

8. In the case of a purchase of a certificate, its cost basis was properly determined under §1012. Often, the certificates are acquired as part of a going business. In the absence of an express allocation of the purchase price, the cost basis attributable to the certificate must be determined by allocation of the total purchase price among all the assets acquired in proportion to their relative fair market values. Reg. §1.61-6. Documenting the cost basis of a certificate previously acquired in a business purchase may, in fact, prove to be a signal difficulty in deducting the "deregulation loss." See note 27 and accompanying text, *infra.*

9. Reg. §1.263(a)-2.

ness assets with a book value reflecting the acquisition expense. As a result of the deregulation legislation, these certificates have become non-assets and must realistically be removed from the books of the corporation.

The elimination of this asset from the corporate records clearly represents an economic loss. This loss is presumably deductible under section 165 of the Internal Revenue Code.[10] If the deduction is permitted, the deregulated carrier would be partially recompensed for its franchise expenses through tax savings.[11]

RECOVERING THE COST OF ADMINISTRATIVE INTERVENTION

The expenses incurred in acquiring or establishing a governmental franchise are generally recovered, in a tax sense, in one of three ways. Current expenses, such as legal or accounting fees incurred to comply with administrative regulations, are deductible as ordinary and necessary business expenses.[12] Although capital expenses may not be recouped through immediate write-off,[13] if the franchise is of limited duration then the capital cost of acquisition may be amortized and deducted over the life of the intangible asset.[14] Most governmental franchises, however, are not so limited, either because of an indefinite period of issue or because the licensing agency renews franchises on a practically automatic basis.[15] The indefiniteness of the term of the intangible's useful life precludes both amortization and current deduction of the acquisition expenses. Consequently, the cost basis is simply carried forward, unreduced by any depreciation or amortization deduction.[16] The license usually represents a continuing asset on the corporate balance sheet. The final method of cost recovery can only occur upon either sale[17] or termination of the license.[18]

The prime cause of license termination is a change in governmental regulation. Deregulation wholly destroys the value of the franchise, leaving a section 165 ordinary loss deduction as the sole means of cost recovery. If the loss is not

10. *Id.* §1.165-2(a).

11. The allowance of a taxable loss does not assure the taxpayer any benefit whatsoever unless there is sufficient current taxable income to be reduced by the allowable deduction. Further, the economic benefit of the taxable loss will fluctuate with the marginal tax bracket of the particular taxpayer involved, granting a proportionately larger benefit to high bracket taxpayers. Thus, a small corporate taxpayer may be said to "recoup" its deregulation expenses only to the extent of 17% if it is in the minimum corporate tax bracket, while a larger corporation may enjoy a recoupment approaching 50%, taking into account the maximum corporate tax rates and potential state income tax savings.

12. I.R.C. §162.

13. I.R.C. §263.

14. *See, e.g.*, Morris Nachman, 12 T.C. 1204 (1949).

15. *See* Rev. Rul. 56-520, 1956-2 C.B. 520; Rev. Rul. 65-228, 1965-2. C.B. 43; Tube Bar, Inc., 15 T.C. 922 (1950).

16. In general, no reduction in a certificate's cost basis will occur under I.R.C. §1001 unless there are adjustments to basis for either depreciation or amortization or for some other recovery of capital. However, the cost basis may well increase under I.R.C. §1016 as the result of capital expenses to protect the certificate.

17. I.R.C. §1001. To the extent that the purchase price for the license is reduced by its cost basis, taxable gain to the taxpayer on the transaction is reduced.

18. Reg. §1.165-2(a). When a license is terminated, the full cost basis should be deductible against ordinary income.

deductible, no tax recovery of money spent in the production of income will occur, distorting the traditional concept of taxing only net profit.[19]

DEREGULATION AND SECTION 165

The statutory provisions and the Treasury's regulations interpreting those provisions set out a number of tests for determining whether a loss is properly deductible. However, these tests are not entirely attuned to the deregulation phenomenon, which destroys the value of intangible assets produced by government sanctioned monopolies or franchises.

A properly deductible loss requires:

(i) An *actual loss* of a business asset...[20]
(ii) Reduced by a reimbursement, recoupment, or insurance,[21] and ...
(iii) The loss is evidenced by a *completed transaction* and *fixed by identifiable events*.[22]

These generalized prerequisites to deduction have been explored at great length in the existing case law, providing some certainty with respect to more common types of loss. Consider, however, the inapplicability of such terms to a program of legislative deregulation.

Actual Loss

The case law under section 165 indicates that a mere paper loss not reflective of actual economic loss will not support a deduction.[23] In the circumstance of deregulation, one wonders whether the elimination of an overseeing governmental bureaucracy constitutes a loss of any sort, actual or not. The change of status from a regulated to an deregulated industry is not the type of transaction which traditionally gives rise to a deductible loss. Thus, the Internal Revenue Service may be reluctant to accept sizable deductions premised on the bare fact of statutory deregulation.

Completed Transaction

Generally a loss is triggered by the sale of an asset or its retirement from economic utility and subsequent loss of value.[24] In both instances, there is a

19. The concept of taxing net income (taxing only profit after proper reduction of gross receipts for the expenses of generating the income) has always presented difficulties when any asset, like the certificates of public convenience, cannot be depreciated or amortized due to a lack of a determinable useful life. The absence of a clear projection of the asset's useful life denies proportionate deductibility for the acquisition expenditure, any tax recovery for the eventual and inevitable valuelessness of that asset must occur in a single shot upon the termination of its use in business. Thus, the nondepreciable or non-amortizable asset distorts the concept of taxable income in any circumstances by lumping into a single taxable year the total recovery of a business expenditure producing income over many years.

20. Reg. §1.165-1(b) (emphasis added).

21. *Id.* §1.165-1(c)(4).

22. *Id.* §1.165-1(d) (emphasis added).

23. The test for "actual loss" was stated in J. G. Boswell Co., 34 T.C. 539 (1960), *aff'd,* 302 F.2d 682 (9th Cir. 1962), *cert. denied,* 371 U.S. 860 (1962): "It is vital to a loss that something of value be parted with, i.e., the petitioner must have suffered a 'loss' in the economic sense. Bookkeeping entries and paper losses are not sufficient." *Id.* at 545.

24. *See, e.g.,* Morris Nachman, 12 T.C. 1204 (1949); Rev. Rul. 70-248, 1970-1 C.B. 172.

clear and distinct transaction which identifies and quantifies the loss. The process of deregulation may not provide unambiguous declarations that specified governmental franchises are, as of a specified date, worthless. Rather, legislative deregulation may subtly modify the jurisdiction of administrative agencies, constrict their rule-making authority, or provide broader exemptions from franchise or registration requirements.[25]

The potential problem with deducting deregulation losses under the actual loss and completed transaction tests is complicated by an additional conceptual issue: to what extent can legislative activity which reduces the value of "governmental assets" be permitted to give rise to a compensating tax benefit. Or, stated another way, is there or should there be some public policy impediment to a tax recovery for the loss of a government sanctioned monopoly. The existing case law provides insufficient guidance for the resolution of the issue.

Loss Through Governmental Action

In the 1939 case of *Consolidated Freight Lines, Inc. v. Commissioner*,[26] the Ninth Circuit established a rationale which may be the focus of future controversies surrounding deregulation losses.[27] A motor carrier held a certificate

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25. The statutory form of deregulation may be of great importance, particularly in light of the Internal Revenue Service's strict interpretation regarding the elimination of an asset from productive life and hence the justification of an identifiable loss. See text accompanying notes 46 & 47 *infra*. For instance, Congress has substantially reduced the regulatory authority of the Interstate Commerce Commission (I.C.C.) over motor carriers under the Motor Carrier Act of 1980. That legislation was intended to eliminate quasi-monopolistic rights arising under the ICC permitting system for authorized carriers. The legislative history supporting that Act states:

> "With respect to operating rights, the Committee intends to oversee the effect of this legislation on their value. Should it become apparent that the effect of this legislation has been to substantially erode the value of operating rights, then appropriate relief for such results should be considered, as early as possible. Preferably it will be considered by the Committee on Ways and Means." H.R. Rep. No. 96-1069, 96th Cong., 2d Sess. 4, *reprinted in* (1980) U.S. Code Cong. & Ad. News 4109, 4112.

Implicit in this language is a recognition that the simple erosion of the value of operating rights will not, without subsequent legislation, result in any recognizable tax loss to the deregulated carriers. In fact, legislation to make such losses deductible has been submitted to the House Committee on Ways and Means although, to date, it has not been acted upon.

26. 101 F.2d 813 (9th Cir. 1939), *cert. denied*, 308 U.S. 562 (1942).

27. The loss occasioned by the deregulation process will hereinafter be referred to as a "deregulation loss." Needless to say, that term has no import other than as a shorthand for the alleged or real reduction in value of governmental licenses and other franchises by virtue of statutory revision. It is at least possible to have "deregulation gains"; that is, an increase in the economic value of a business's governmental licenses by the reduction of certain restrictions on their scope. For instance, the elimination of territorial restrictions of a regulated business could significantly increase the value of existing certificates to larger businesses suddenly freed from limited markets. Interestingly, there is no mechanism within the Internal Revenue Code for triggering a realized *gain* to the industry so benefited, while there is, at least in certain circumstances, a deductible loss to those industries whose certificates are rendered worthless.

of public convenience and necessity from the state of Washington to engage in the business of transporting persons and property on specified routes within that state. Although the certificate simply authorized the carrier to engage the transportation business, state statutes prohibited issuance of more than one cerificate to competing motor carriers. Thus, the certificates had value not only as a prerequisite to the operation of a transportation business within the state, but also as a state-provided monopoly. The taxpayer had, in fact, paid a very substantial premium for the monopoly. Soon after Consolidated purchased the certificate, the Washington legislature amended the applicable statutes to remove the limitation on the issuance of certificates for any given route. Thus, the monopolistic element which represented the bulk of the certificate's value was destroyed.

In the year of the statutory amendment Consolidated deducted the certificate's full cost basis, arguing that it had suffered a recognizable loss in the value of the certificates. The Commissioner of Internal Revenue disallowed the deduction. The Ninth Circuit held that the destruction of the monopoly granted by statute did not constitute a deductible loss, but only a diminution in value not recognizable for tax purposes. The court reasoned that because the certificate was still a requirement of doing business, it remained in use by the taxpayer. Even though the certificate's true value had been substantially eliminated by statutory amendment, this was insufficient to justify a loss deduction because the certificates were neither totally obsolete nor completely valueless.

If the *Consolidated Freight Lines* court held that the continuing vitality of the certificates of public convenience negated a complete and recognizable loss, the case would not represent an unusual extension of the general law underlying section 165. However, after noting that the reduction of value caused by the loss of the monopolistic portion of the certificate was neither a complete loss nor a completed transaction the court also noted that

> Destruction of the statute which put an end to the monopoly did not destroy the certificates, nor their value. The thing destroyed was the right of monopoly conferred by the statute, not by the certificate. What interest did petitioner have in the rule of law, declared by statute? "No person has a vested interest in any rule of law, entitling him to insist that it shall remain unchanged for his benefit". . . . Whatever right the statute conferred upon petitioner was subject to the right of the state to change it. When petitioner purchased the certificates, it did not purchase a monopoly, but the means by which it might take advantage of a monopoly conferred by statute. It now has had no loss of such means, for they exist now as before. We think petitioner suffered no loss on the certificates, for the thing destroyed was not a part thereof.[28]

The court adopted a mechanical test: so long as the certificates remain in use there is, by definition, no completed loss deductible under section 165. The opinion also intimates that public policy justifies denying deductibility to taxpayers based on a reluctance to create fiscal impediments to necessary statutory amendment.[29] If, as a matter of public policy, an additional hurdle to section

28. 101 F.2d at 814 (citations omitted).

29. Whether or not a taxpayer has a vested right in the statutory status quo is not relevant

165 deduction exists, then the burden of proving a closed transaction and actual loss may be heavier than would be the case with other assets.

Such a judicial extension of the statutory language of section 165 may find some support in the series of cases following prohibition. In those cases the United States Supreme Court enunciated the general proposition that where the state legislatures or Congress finds the conduct of a business "noxious" to public policy, there is no right to a deduction for the loss of goodwill or similar intangibles of businesses closed down by the prohibitory legislation.[30] While there are very clear differences between seeking a tax deduction for losses incurred from the legislative process of deregulation and the constitutional prohibition of a noxious industry, there are parallels between the two. In both circumstances a tax deduction constitutes the sole means of recouping money spent for an intangible asset after it is destroyed by legislation. In both cases the allowance of such a deduction in a single year is an indirect form of compensation for the legislative activity generating the loss, creating a financial burden on the federal government for the implementation of reform. Arguably, permitting sizable deductions or other tax benefits to deregulated businesses in effect recognizes a "vested right in the legislative status quo."[31]

Despite the breadth of the dictum in *Consolidated Freight Lines,* subsequent cases have focused on its narrower holding that a simple reduction in the value of an intangible right neither extinguishes the right nor generates a recognizable loss.[32] For example, in *Reporter Publishing Co. v. Commissioner,*[33] the Tenth Circuit decided whether a newspaper could deduct the reduction in value of a franchise granted by the Associated Press to the taxpayer. The taxpayer had purchased a newspaper in Kansas, including its franchise with the Associated Press. That franchise was accorded considerable value in purchase negotiations, because it assured the newspaper that no direct competitors would be permitted to subscribe to the service.[34] As in *Consolidated Freight Lines,* the taxpayer attempted to deduct approximately $30,000.00 of the $80,000.00 it had allocated to the Associated Press franchise in its purchase of the newspaper as a

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to the question of whether he sustains a recognizable loss upon statutory amendment. Section 165 permits the deduction for "losses," not just for the destruction of "vested" property rights. There is, however, an irrebuttable economic loss upon the statutory change, whether or not an enforceable property right was destroyed thereby.

30. *See, e.g.,* Clarke v. Haberle Crystal Springs Brewing Co., 280 U.S. 384 (1930).

31. *Id.* at 386.

32. It is important to note that many cases support loss deductions for brewery equipment, trademarks and similar assets which became valueless upon the adoption of prohibition. *See, e.g.,* Gambrinus Brewery Co. v. Anderson, 282 U.S. 638 (1931); Elston Co. v. United States, 21 F. Supp. 267 (Ct. Cl. 1937); William Zakon, 7 B.T.A. 687 (1927). These cases indicate that, where proper substantiation of cost basis is available, a deductible loss caused by dramatic statutory change has historically been deemed deductible despite any real or imagined impediment to statutory reform.

33. 201 F.2d 743 (10th Cir. 1953).

34. The Associated Press (A.P.) had established bylaws which prevented the service from being made available to locally competing newspapers. The United States Supreme Court subsequently ruled these bylaws illegal as violative of the Sherman Antitrust Act, eliminating the competitive edge previously accorded A.P. subscribers.

loss of a business asset. The court, strictly following *Consolidated Freight Lines,* held that the continued use of the Associated Press membership by the newspaper nullified any contention that it was valueless and therefore no deduction was permissible. The loss of the monopolistic benefit concededly reduced the value of the certificate but did not *destroy* it. In the language of the then existing Treasury regulations, the franchise had not been so degraded in value that "the taxpayer discontinues the business or discards such assets permanently from use in such business."[35]

Thus, in *Reporter Publishing,* as in *Consolidated Freight Lines,* the continued use of the asset belies any contention that it has been rendered totally valueless for purposes of affording a loss deduction. The Tenth Circuit did not address the policy question, gratuitously raised in *Consolidated Freight Lines,* of whether a *complete* loss would have been deductible where it was a product of government deregulation which obliterated the previously sanctioned monopoly.

In 1954, the *Consolidated Freight Lines* decision was given an expansive interpretation by the Court of Claims. In *Chase Candy Co. v. United States,*[36] that court reviewed an attempted deduction by a candy company for a loss occasioned by the worthlessness of certain purchased intangible commodity rights. During the Second World War both sugar and chocolate were rationed to industrial users by the government, which utilized a formula based primarily on consumption prior to rationing. Chase Candy, faced with an inadequate supply of these materials, purchased a division of the National Candy Company which had, due to its prior production, the right to receive a large allocation of the commodities. The taxpayer allegedly paid a substantial premium above the true value of the company. It sought to deduct this premium as a loss in the year that sugar rationing ceased.

The taxpayer opposed the government's motion for summary judgment, arguing that at trial it could establish the amount paid for the intangible rights to acquire rationed sugar and chocolate were severable assets purchased in the business acquisition, and that their obsolescence represented a properly deductible loss. The Court of Claims granted the government's motion reasoning, as in the *Consolidated Freight Lines* case, that the purchase of the National Candy Company did not automatically create a vested right to acquire the rationed commodities, but merely represented an opportunity provided by statute to participate in the governmentally sanctioned monopoly on the sale of the commodities involved.[37] Because a taxpayer cannot have a vested right in a statutory enactment, the court held that no loss could be deducted upon a provision's repeal.[38]

35. 201 F.2d at 744.

36. 126 F. Supp. 521 (Ct. Cl. 1954).

37. *Id.* at 523.

38. *Id.* at 525-26. "[T]he assets purchased by plaintiff from National did not include the thing which was destroyed, and which was of value for a time to plaintiff, i.e., the monopoly." *Id.* at 526. With respect to the *Chase Candy* case it is essential to keep in mind that the taxpayer was arguing its position on a motion for summary judgment. Chase Candy may have been able to establish, as is conceded by the court, that it separately negotiated its purchase

Significantly, the *Chase Candy* court granted the Commissioner's motion for summary judgment even though the monopolistic right could have been properly treated as an independent asset and may have had a clearly demonstrable cost basis, and even though it was indisputably worthless following the repeal of the rationing statute and regulations.[39] The court did not address the question of where the value of those intangibles went. An asset was purchased by the taxpayer, presumably accounted for as an asset with an identifiable value, and later was removed from the corporate records following the end of rationing. The court offered no guidance as to whether the amounts paid for the intangibles should be treated as goodwill, reallocated among the other assets acquired in the purchase, or simply ignored. Rather, the court merely quoted from the United States Supreme Court decision in *Weiss v. Wiener*[40] that "[t]he income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer."[41] Certainly this statement is of limited comfort to the taxpayer who paid a premium for an asset subsequently rendered valueless by a change of statute, and for which no recoupment can be made, either by sale to a third party or through tax recovery.[42]

Finally in 1966 the Tax Court, again relying on *Consolidated Freight Lines* and *Reporter Publishing Company*,[43] ruled that a reduction in the value of a governmental franchise which did not totally destroy its utility in the business could not represent a closed transaction and therefore was not a deductible loss under section 165.[44] In *Monroe W. Beatty*[45] that court reviewed a proposed deduction by the taxpayer for the reduction in value of liquor licenses issued by the state of Arizona. Prior to 1961 Arizona had strictly limited the number of liquor licenses available and, therefore, the licenses could be held as investments. The licenses had historically appreciated steadily in value, primarily

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of the business from its purchase price of the intangible right to acquire rationed commodities.

39. The fact that the court was unwilling to permit the taxpayer to prove these assertions indicates that it apparently believed, *as a matter of law*, that the loss of a monopolistic right cannot constitute an asset giving rise to a deductible loss under the Internal Revenue Code.

40. 279 U.S. 333 (1929).

41. *Id.* at 335.

42. 126 F. Supp. at 526. Of particular interest in the *Chase Candy* decision is the brief dissenting opinion of Judge Madden, who noted: "The case of Consolidated Freight Lines v. Commissioner, discussed in the opinion of the court, does not seem to me to have been rightly decided by the Circuit Court of Appeals. If, in fact, one has paid for a license or franchise, whether he has paid for it to a city or state, or to an owner of a business to which the right is appurtenant because of some "grandfather" provision in the applicable laws, *he is out the money*, and if, by reason of a change in the laws, he loses the monopoly granted by the licensor franchise, I see no reason why his true status should not be recognized by the tax authority." *Id.* (emphasis added).

43. The court did not cite *Chase Candy*; in fact the rationale of that case has not yet been adopted by any court.

44. Monroe W. Beatty, 46 T.C. 835 (1966).

45. *Id.*

because the licenses were freely transferrable. In 1961 the state amended its regulations, greatly increasing the availability of liquor licenses and limiting their transferrability. Both of these changes severely decreased the value of the liquor licenses.

The taxpayer sought to deduct a portion of his liquor license's purchase price on the theory that the licenses actually represented a bundle of rights independently purchased. Because some of those rights had been rendered totally valueless by the change in legislation, the taxpayer argued that their loss was separately deductible.[46] The government, however, contended that the liquor license was an inseparable asset which was still being used in the taxpayer's business. Therefore, the license was not valueless and, hence, there was no identifiable and recognizable loss to support any deduction.[47] Denying the deduction to the taxpayer, the court held that the monopolistic benefit of a governmental franchise was not an asset independent of the right to carry on business, that the taxpayer continued to use its certificate in the business, and therefore no closed transaction had occurred to generate any tax loss.[48]

Like its predecessors, the *Beatty* decision holds that for a deductible loss to occur due to changes in statutes or regulations, the intangible asset must be totally destroyed and absolutely eliminated from continuing vitality in the business. Furthermore, to constitute a deductible loss, the worthlessness cannot be a product of a mere change in governmental policy or police power activity, regardless of the actual economic loss occasioned by the change. The Internal Revenue Service has fully adopted this interpretation of section 165.

In a technical advice memorandum[49] issued in 1977, the Service considered the deductibility of a loss in value of selling time used in the marketing of tobacco in North Carolina. In a situation very similar to that in *Chase Candy*, tobacco warehouses were permitted time to sell their tobacco at state run auctions based on a formula which took into account the floor space owned and

46. The argument that an asset can be divided into innumerable individual rights, any one of which may independently become valueless and give rise to a deductible loss, is obviously antagonistic to the concept of requiring total worthlessness before permitting a loss deduction under §165. The *Beatty* court, while supporting the service's contention that an asset must become worthless in its totality, may, on the other hand, have accepted an overbroad statement of the law. If, for instance, what appears to be a single asset was purchased as a composite of rights with a provable cost basis allocated to each component, then there appears to be no reason to prohibit the deduction of a loss of one of the components. *See* Parmelee Transp. Co. v. United States, 351 F.2d 619 (Ct. Cl. 1965), for the proposition that an intangible such as the business good will, need not necessarily be an indivisible asset as long as a proper cost allocation can be proven. This may represent the very bundle of separate rights conceptually rejected by the *Beatty* court.

47. *Id.* at 838-39. The court reiterated that a governmental franchise "is merely a permit granted by the sovereign to carry on business subject to regulation and modification under its police power." *Id.* at 839.

48. *Id.* at 840-42.

49. A technical advice memorandum is merely one interpretation of the Internal Revenue laws as adopted by the National Office of the Internal Revenue Service at the request of a district office. The memorandum is not entitled to precendential weight, but it is indicative of national IRS policy, and as such, represents a position from which the service would have some difficulty in receding therefrom. Reg. §601.106(f).

operated by each warehouseman. Selling time was considered a valuable commodity to be exchanged by warehousemen through the purchase or lease of warehouse space. In 1974, the United States Department of Agriculture promulgated regulations which established a new method of allocating selling time, effectively eliminating the value of warehouse floor space as a factor in obtaining selling time. A taxpayer had a substantial investment in warehouse space purchased to obtain selling time, and sought to deduct the premium paid for the space as a loss in 1974.

The technical advice memorandum reviewed the *Consolidated Freight Lines, Reporter Publishing Company,* and *Beatty* cases and determined that no deduction was permissible for the alleged loss. The Internal Revenue Service noted that in each of those cases although governmental action diminished the value of a severable asset, it nonetheless retained some utility in the business following the supposed loss. Thus, as in those cases, the technical advice finally determined that

> As long as [the warehouseman] continues to own or hold leaseholds on warehouses in its business of operating tobacco warehouses, [the warehouseman], like the taxpayers in the cases discussed above, will be using in its business the larger asset of which the purportedly severable asset is a part.
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> In each of the cases discussed above, the courts determined that the asset for which taxpayer had claimed a loss was not severable from the larger asset of which it is a part. From the discussion of the cases, it can be seen that selling time possesses the same qualities as the monopolistic rights in *Consolidated Freight Lines* and *Reporter Pub. Co.* and the intangible rights attached to the liquor license in *Beatty*. Likewise, the selling time acquired by [the warehouseman] in the 1970 transaction is not severable from [the warehouseman's] feehold or leasehold interest in warehouses. Since the selling time is not severable, there will be no closed and completed transaction within the Section 1.165-1 of the regulations for as long as [the warehouseman] continues to own or hold leases on warehouses in its business of operating tobacco auction warehouses.[50]

A SYNTHESIS

Synthesis of the cases and the technical advice memorandum discussed above initially appears simple. For a business to be able to enjoy a tax recoupment for its deregulation losses, the burden is on the taxpayer[51] to establish that the process of deregulation not only caused an actual economic loss[52] but also a

50. Private Letter Ruling 7744008 (July 28, 1977).

51. As with all matters pertaining to tax computation, other than fraud, the taxpayer carries the burden of proof in establishing his right to deductible loss under §165. However, the stringency of the regulations concerning proof of a total loss as a condition precedent to any deduction seems to have pushed that burden of proof further than is necessarily required by the language of the statute itself. A similar extension by the service in the area of losses of governmental sanctions through deregulation could effect a similar increase in the taxpayers' burden, resulting in administrative amendment to §165.

52. See text accompanying note 20, *supra*.

recognizable tax loss.[53] The devaluation will not generate a taxable loss unless it is total. So long as the asset remains either a legal prerequisite to continuing the business of the taxpayer as in *Consolidated Freight Lines,* or remains a functioning asset of any economic value whatsoever to the business, as in *Reporter Publishing Company,* the loss will not be deemed to have been generated by a closed transaction[54] and may not be recognized. To the extent the taxpayer can establish the complete loss of a governmental franchise, whether a product of legislative action or not, strong authority exists for the deduction.

Unfortunately, dictum suggests that the obsolescence of an intangible asset granted by a governmental entity is different from other intangibles. This proposition is based on the theory that the public policy against shackling legislatures to a statutory status quo prevents an intangible asset from being considered a vested property interest of a taxpayer. Although the Internal Revenue Service in its technical advice memorandum does not cite such dicta, that the loss to the tobacco warehouseman was a function of governmental activity seemed to be of special significance.[55] Nevertheless, after noting that fact, the memorandum proceeds to analyze the law strictly within the traditional terms of section 165 and, in particular, on the basis of the requirement of a closed transaction without further averting to the governmental cause of the loss.

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Given the status of the law with respect to deregulation losses and the necessity for an absolute loss of the value of the governmental franchise under section 165, the effect of Florida's repeal of Chapter 323 on the taxable incomes of deregulated industries appears to be relatively clear. The deregulation resulting from sunset legislation, which simply excises the statutory authority for regulatory bodies,[56] fits squarely within the cases and regulations discussed

53. See text accompanying note 22, *supra.*

54. The legislative history to the Motor Carriers Act of 1980 acknowledges the need for additional legislation to permit recognition of partial losses through deregulation, indicating the breadth of the role that the closed transaction requirement has assumed. See note 25 *supra.* As a condition to deductibility, it is one thing to require a transaction be closed so as to identify a completed loss, but quite another to require that an integrated asset be totally eliminated from any function, however minor, in the business operations of a taxpayer. In both *Consolidated Freight Lines* and *Reporter Publishing Co.,* an allegedly indivisible asset remained in nominal use in business operations and hence no deductible loss was permitted. The *Parmelee* case implies that there may be a single asset which is still divisible for loss purposes, drawing into some suspicion the categorical stance assumed by the IRS in this regard. See note 46 *supra.*

55. The technical advice memorandum initially noted concern with cases dealing primarily with losses engendered by governmental activity, but failed to return to that theme in its analysis. This is somewhat puzzling, the same result could have been supported by numerous cases dealing with losses outside the governmental context. Thus, the memorandum leaves open the issue of whether or not deregulation losses may, in fact, constitute a special subclass of losses under §165.

56. The Sunset law repeals the subject statutes in their entirety rather than merely modifying or amending them. Compare this with the less drastic deregulation occasioned by the Motor Carrier Act of 1980. See note 25 *supra.* Under the rationale espoused by the IRS and

above. The certificates of public convenience and necessity formerly required of common carriers are now not only valueless as economic assets, but are totally meaningless as legal documents. Unlike the situation in *Consolidated Freight Lines* where the certificates were merely reduced in value by the loss of some monopolistic benefit, the repeal of Chapter 323 renders the certificates nothing more than legal anachronisms.

In order to deny the deductibility of any remaining cost basis the carriers had in those certificates, the Service must argue that either public policy denies any loss generated by legislative or administrative change, or that the monies expended in creating and maintaining governmental franchises during a period of deregulation continue to benefit the business after deregulation. The first assertion, while arguably supported by weak dictum in the cases cited above, is inimical to economic reality and existing law. The second contention also appears untenable: after complete deregulation those expenditures cannot be logically recharacterized as having been made for the creation of general business goodwill or to enhance "going concern" value.

CONCLUSION

The apparent clarity of the deductibility of deregulation losses in the context of the repeal of Chapter 323 does not necessarily assure the same for other forms of deregulation. In fact, administrative reform of any sort, short of absolute repeal of the statutory underpinnings for a regulatory agency, is virtually certain to raise the issues confronted in *Consolidated Freight Lines*. The Service's position has been consistent: as long as any vestige of a governmental franchise remains, however denuded of value it may have been by deregulation, no loss will be recognized. Thus, the elimination of all barriers to the entry into a regulated business, other than simple registration, may even be a sufficient continuation of the necessity for a governmental franchise to deny deductibility due to a lack of a closed transaction.

Regulated industries may now face a Hobson's choice. The desire of regulated industries to maintain at least some portion of the mini-monopolies granted them by regulatory structure, is tempered by the fact that partial deregulation will generate a sizable economic loss without economic or tax recoupment. Deregulation lobbyists should be cognizant that a compromise which removes some of the entry barriers into regulated industries while simultaneously preserving aspects of the regulatory structure presents the risk of losing a real and valuable asset, a protected marketplace, without an offset for recoupment of loss.

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its technical advice memorandum, it appears unquestionable that the cost basis to Florida motor carriers for their certificates of public convenience and necessity from the FPSC can be deducted as losses in 1980. Logically, though somewhat inconsistent, those same carriers who suffered significant devaluation of their certificates from the Interstate Commerce Commission by virtue of the Motor Carrier Act of 1980 do not appear to qualify for any lost deduction absent remedial legislation. For instance, one carrier had assets of $46 million prior to the deregulation, it suffered an $18 million loss upon enactment of the Motor Carrier Act of 1980 through devaluation of its certificates. NATION'S BUSINESS, Oct. 1980, at 46. One may well wonder whether that $18 million loss was any more real in the context of "creeping" federal deregulation as opposed to the Florida legislature's more heavy-handed approach.