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## Net Operating Loss Deductions As They Relate to the Alternative Tax on Capital Gains, *Mutual Assurance Society Corp. v. Commissioner*, 505 F.2d 128 (4th Cir. 1974)

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NET OPERATING LOSS DEDUCTIONS AS THEY RELATE TO THE  
ALTERNATIVE TAX ON CAPITAL GAINS

*Mutual Assurance Society Corp. v. Commissioner,*  
505 F.2d 128 (4th Cir. 1974)

Taxpayer, a corporation, sustained a net operating loss<sup>1</sup> (NOL) in 1969.<sup>2</sup> In 1967, the first year the loss could be deducted,<sup>3</sup> taxpayer's income consisted of ordinary income and long term capital gain. The NOL was greater than 1967 ordinary income, but less than 1967 ordinary income and capital gain together.<sup>4</sup> Taxpayer recomputed its 1967 tax liability under section 1201(a),<sup>5</sup> using a portion of the NOL to offset ordinary income, but took no deduction from its 1967 capital gain.<sup>6</sup> Instead, taxpayer carried over the excess NOL, deducted it from 1968 ordinary income, and redetermined its 1968 tax liability.<sup>7</sup> The Commissioner of Internal Revenue disallowed the 1968 NOL deduction.<sup>8</sup> The Tax Court permitted the 1968 deduction.<sup>9</sup> The Court

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1. See generally Boyle, *Net Operating Losses of Noncorporate Taxpayers (Part 2)*, 4 TAX ADVISOR 667, 670-71 (1973); Branda, *Net Operating Losses and Capital Gains—Some Bizarre Consequences of the Alternative Tax Computation*, 28 TAX LAW. 455 (1975); Hamovit, *Multiple-Year Transactions and Computations: Carryovers and Carrybacks*, N.Y.U. 26TH INST. ON FED. TAX. 583, 583-84, 589-90 (1968); Lee, *Net Operating Losses*, 19 TUL. TAX INST. 143 (1970) (no discussion of effect of alternative tax); Nagel, *Planning to Avoid Wastage of Net Operating Loss Carryovers: A Lesson from Chartier Realty*, 42 J. TAX. 26 (1975); Pratt & Scolnick, *The NOL Deduction: Disagreement Among Circuit Courts Creates Confusion*, 53 TAXES 274 (1975); Note, *Net Operating Losses and the Alternative Tax: Fine-Tuning the Tax Computation Provisions*, 20 VILL. L. REV. 837 (1975); 55 B.U.L. REV. 134 (1975); 12 HOUST. L. REV. 953 (1975); 48 J. URBAN LAW 999 (1971); 8 SAN DIEGO L. REV. 442 (1971).

2. Taxpayer's NOL for 1969 was \$83,059.04. *Mutual Assurance Soc'y Corp. v. Commissioner*, 505 F.2d 128, 129 (4th Cir. 1974).

3. The first available year is the third year before the year in which the loss occurs. INT. REV. CODE OF 1954, § 172(b)(1). The first available year was 1966, but the taxpayer had no taxable income of any kind in that year. Therefore, the entire NOL was carried over to be used as a deduction in 1967. 505 F.2d at 130.

4. Net ordinary income for 1967 was \$72,575.10; long term capital gain was \$209,253.60. The total of the two was \$281,828.70. NOL exceeded net ordinary income by \$10,483.94. 505 F.2d at 131.

5. INT. REV. CODE OF 1954, § 1201(a). See notes 14 & 15 *infra* and accompanying text. Under the regular method, taxpayer's liability would have been \$88,909.44. Under § 1201(a) it was \$52,313.40. 505 F.2d at 131.

6. 505 F.2d at 131. See sources cited note 19 *infra* and accompanying text.

7. 505 F.2d at 131.

8. *Id.* at 132.

9. *Mutual Assurance Soc'y Corp.*, 32 CCH Tax Ct. Mem. 839 (1973).

of Appeals for the Fourth Circuit reversed and *held*: A corporation's net operating loss deduction is used fully in the earliest deduction year that taxable income, including capital gain, is greater than the available net operating loss deduction, even if the operation of section 1201(a) prevents use of the net operating loss deduction to reduce taxable capital gain in that year.<sup>10</sup>

Both the alternative capital gain and NOL provisions of the Internal Revenue Code were enacted to benefit taxpayers. Section 1202, the general capital gain provision, provides a deduction from gross income of fifty percent of long-term capital gain.<sup>11</sup> Tax liability on the remaining amount is computed according to standard graduated rates.<sup>12</sup> The section 1202 deduction is not available to corporations.<sup>13</sup> Section 1201 provides a mandatory alternative tax on the capital gains of both corporate and noncorporate taxpayers, if the tax computed under the section 1201 formula is lower than the standard tax.<sup>14</sup> Instead of a deduction, section 1201 provides for a separate computation of the tax on capital gain at a special flat rate.<sup>15</sup>

10. *Mutual Assurance Soc'y Corp. v. Commissioner*, 505 F.2d 128 (4th Cir. 1974).

11. INT. REV. CODE OF 1954, § 1202:

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. . . .

12. *See id.* §§ 1, 62(3), 63, 1202.

13. *Id.* § 1202.

14. *Id.* § 1201(a) (emphasis added):

If for any taxable year a corporation has a net section 1201 gain [excess of net long term capital gain over net short term capital loss], then, in lieu of the tax imposed by [section 11] there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of [the ordinary tax on ordinary income, and a tax at a special rate on capital gain].

The courts have respected the mandatory language of section 1201. *See Arc Realty Co. v. Commissioner*, 295 F.2d 98, 106 n.7 (8th Cir. 1961); *Naegele v. United States*, 383 F. Supp. 1041 (D. Minn.), *appeal docketed*, No. 73-1921, (8th Cir., Dec. 26, 1973), *stayed pending decision in Foster Lumber Co. v. United States*, 500 F.2d 1230 (8th Cir. 1974), *cert. granted*, 420 U.S. 1003 (1975) (No. 74-799); *Lone Manor Farms, Inc.*, 61 T.C. 436, 439 (1974); *Amelia J. Taylor*, 27 T.C. 361, 372 (1956); *Clarence Co.*, 21 T.C. 615, 617 (1954); 48 J. URBAN LAW 999, 1006 (1971).

15. Compare INT. REV. CODE OF 1954, § 1202, with *id.* § 1201(a); see notes 11 & 14 *supra*. For example, the present standard tax for most corporations is 22% on the first \$25,000, and 48% on income above \$25,000. INT. REV. CODE OF 1954, § 11. The present alternative tax on corporate long term capital gains is 30%. *Id.*, § 1201 (a)(2). The variables of ordinary income and capital gain determine the point at which the effective rate on capital gain exceeds 30% and § 1201 preempts the standard tax.

For noncorporate taxpayers the § 1202 deduction results in a capital gain tax rate of one-half the taxpayer's marginal standard tax rate on ordinary gain. Until the changes of the Tax Reform Act of 1969 went into effect, § 1201(b) provided for an alternative

Section 172, the NOL provision, was enacted to lessen the hardship of the annual tax accounting period on taxpayers with fluctuating profits and losses.<sup>16</sup> If qualifying deductions exceed gross income in any year, the taxpayer may use the excess deductions (NOL) to offset income of up to eight other years.<sup>17</sup> NOL is deducted first from income of the earliest possible year. NOL in excess of that year's income is deducted from income of the next available year, and so on, until the NOL is exhausted.<sup>18</sup>

The courts and the Commissioner agree that most ordinary deductions, including the NOL deduction, may not be deducted from capital gain taxed at the favorable section 1201 rates.<sup>19</sup> They have disagreed

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tax of 25% on noncorporate taxpayers' entire long term capital gain, with the result that noncorporate capital gain taxpayers whose marginal standard tax rate was higher than 50% benefitted from § 1201. The changes wrought by the Tax Reform Act of 1969 are discussed at note 48 *infra*.

16. See, e.g., *Lewyt Corp. v. Commissioner*, 349 U.S. 237, 243-44 (1955) (Frankfurter, J., dissenting) (construing INT. REV. CODE OF 1939, § 122, a predecessor of INT. REV. CODE OF 1954, § 172); *Mutual Assurance Soc'y Corp. v. Commissioner*, 505 F.2d 128, 137 (4th Cir. 1974); *Foster Lumber Co. v. United States*, 500 F.2d 1230, 1231 (8th Cir. 1974), cert. granted, 420 U.S. 1003 (1975) (No. 74-799); *Sidney Axelrod*, 2 CCH Tax Ct. Mem. 885, 886 (1973), rev'd on other grounds, 507 F.2d 884 (6th Cir. 1974); *Chartier Real Estate Co.*, 52 T.C. 346, 357 (1969), aff'd, 428 F.2d 474 (1st Cir. 1970); H.R. REP. No. 8557, 76th Cong., 1st Sess., 9-10 (1939); Note, *Net Operating Loss Carryover and Corporate Adjustments: Retaining an Advantageous Tax History Under Sections 269, 381, and 382*, 69 YALE L.J. 1201, 1205 (1960).

For example, without the NOL provision a taxpayer who lost \$50,000 in one year and earned \$100,000 in the next year would be taxed at standard rates on the \$100,000 in the one taxable year in which it was earned. A taxpayer who earned \$25,000 in each of the same two years would be taxed each year at a lower standard rate for each year's income. This difference in tax consequences is especially striking for noncorporate taxpayers, who are taxed at marginally increasing rates, but it is also true for corporations. The NOL provisions allow tax payers to deduct losses in one year from income of other years, reducing both the marginal rate of tax and the dollar amount subject to tax. In this example, the NOL provision would permit the first taxpayer to deduct the \$50,000 loss of the first year from the \$100,000 profit of the second year and pay tax on only \$50,000.

17. INT. REV. CODE OF 1954, §§ 172(b)(1)(A)(i), 172(b)(1)(B).

18. *Id.* § 172(b)(2).

19. See *Little v. Commissioner*, 294 F.2d 661 (9th Cir. 1961); *Pope & Talbot, Inc.*, 60 T.C. 74 (1973); *Horace Drew*, 31 CCH Tax Ct. Mem. 143 (1972); *Chartier Real Estate Co.*, 52 T.C. 346 (1969), aff'd, 428 F.2d 474 (1st Cir. 1970); *Walter M. Weil*, 23 T.C. 424 (1954), aff'd, 229 F.2d 593 (6th Cir. 1956); Rev. Rul. 247, 1956-1 CUM. BULL. 383. See generally Halperin, *Capital Gains and Ordinary Deductions: Negative Income Tax for the Wealthy*, 12 B.C. IND. & COM. L. REV. 387 (1971); 48 J. URBAN LAW 999 (1971). But see *Statler Trust v. Commissioner*, 361 F.2d 128 (2d Cir. 1966) (trust computing tax by § 1201 method allowed to deduct capital gain charitable deduction from capital gain income in the year of the gift, since trust was a mere conduit);

whether such nondeductible NOL may be carried over and deducted from ordinary income of the next available deduction year. The Commissioner has consistently maintained that when a portion of NOL may not be deducted from capital gain in a deduction year because of the operation of section 1201, the taxpayer may not carry that portion forward to offset ordinary income of the next available deduction year.<sup>20</sup> From 1969 to 1974, courts allowed the carryover.<sup>21</sup>

In *Chartier Real Estate Co.*,<sup>22</sup> the leading case, the Tax Court found

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Read v. United States, 320 F.2d 550 (5th Cir. 1963) (estate tax deductible from capital gain reported as income in respect of decedent); United States v. Memorial Corp., 244 F.2d 641 (6th Cir. 1957) (corporation may deduct expense of selling issue of bonds from capital account); Meissner v. United States, 364 F.2d 409 (Ct. Cl. 1966) (estate tax deductible from capital gain reported as income in respect of decedent).

20. Treas. Reg. § 1.172-4(a)(3) (1960) provides:

The amount which is carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the taxable (or net) income for other taxable years, preceding such taxable year, to which it may be carried back or carried over . . . .

Treas. Reg. § 1.172-4(b)(1)(ii) (1960) provides:

The portion of the loss which shall be carried to any of such several taxable years subsequent to the earliest taxable year is the excess of such net operating loss over the sum of the aggregate of the taxable incomes (computed as provided in § 1.172-5) for all of such several taxable years preceding such subsequent taxable year . . . .

Treas. Reg. § 1.172-5 (1970) lists the adjustments required by INT. REV. CODE OF 1954, § 172(d). No adjustment is provided for § 1201 capital gain.

21. In the leading case, *Chartier Real Estate Co. v. Commissioner*, 428 F.2d 474 (1st Cir. 1970), *aff'g* 52 T.C. 346 (1969), the principal issue was whether NOL could be deducted from § 1201 gain in a deduction year. The Tax Court held against the taxpayer, applying the rule announced in *Walter M. Weil*, 23 T.C. 424 (1954), *aff'd*, 229 F.2d 593 (6th Cir. 1956). In *Weil*, the taxpayer had sought to use a charitable deduction to set off § 1201 capital gain. In *Chartier*, the taxpayer sought unsuccessfully to distinguish the NOL deduction by its special purpose. *Accord*, *Foster Lumber Co. v. United States*, 500 F.2d 1230 (8th Cir. 1974), *cert. granted*, 420 U.S. 1003 (1975) (No. 74-799); *Olympic Foundry Co. v. United States*, 493 F.2d 1247 (9th Cir. 1974), *aff'g* 29 Am. Fed. Tax R.2d 72-759 (D. Wash. 1972); *Data Prods. Corp. v. United States*, 74-2 U.S. Tax Cas. 85,495 (C.D. Cal., Sept. 23), *aff'd in an unpublished opinion*, (9th Cir., Dec. 27, 1974), *petition for cert. dismissed*, 95 S. Ct. 1364 (1975); *Naegele v. United States*, 383 F. Supp. 1041 (D. Minn.), *appeal docketed*, No. 73-1921, (8th Cir., Dec. 26, 1973), *stayed pending decision in Foster Lumber Co. v. United States*, *supra*; *Lone Manor Farms, Inc.*, 61 T.C. 436 (1974), *noted in Branda*, *supra* note 1, at 456 (Tax Court followed *Chartier* construction of § 172(b) to determine effect of § 1201 on amount of carryover, but not to determine effect of statute of limitations); *see Continental Equities, Inc.*, 33 CCH Tax Ct. Mem. 812 (1974). *But see Axelrod v. Commissioner*, 507 F.2d 884 (6th Cir. 1974), *rev'g* 32 CCH Tax Ct. Mem. 885 (1973) (decided against noncorporate taxpayer after *Mutual Assurance Soc'y*); *Mutual Assurance Soc'y Corp. v. Commissioner*, 505 F.2d 128 (4th Cir. 1974).

22. 52 T.C. 346 (1969), *aff'd*, 428 F.2d 474 (1st Cir. 1970).

that allowing the subsequent deduction effectuated the purpose of the NOL provisions to help taxpayers with uneven earnings;<sup>23</sup> that it did not violate the section 1201 policy disallowing ordinary deductions from capital gain (the purpose of which was to prevent the double advantage of ordinary deductions and favorable rates); and that the language of the NOL provision could be construed to support this interpretation. Section 172(b)(2) provides that, after NOL is carried to the earliest deduction year, the amount available for deduction in subsequent years is "the excess, if any, of the amount of such loss [NOL] over the sum of the *taxable income* for each of the prior taxable years *to which such loss may be carried*. . . ."<sup>24</sup> The Tax Court construed the phrase "to which such loss may be carried" to modify the words "taxable income" as well as the words "each of the prior taxable years." Since NOL may not be carried to capital gain,<sup>25</sup> "taxable income . . . to which such loss may be carried" includes only ordinary income.

In *Mutual Assurance Society Corp. v. Commissioner*,<sup>26</sup> the Fourth Circuit rejected the *Chartier* construction. Giving section 172(b)(2) a "natural reading," the court reasoned that the language "to which such loss may be carried" was intended only to identify the deduction years available, not to restrict the meaning of "taxable income."<sup>27</sup> Since the phrase "taxable income" is not defined in section 172(b)(2), the court applied its general meaning—gross income, including capital gain, minus allowable deductions. From this definition the court deduced that "taxable income" in section 172(b)(2) was meant to include capital gains. Therefore, the taxpayer's NOL deduction was exhausted in the first deduction year in which it was smaller than the sum of ordinary income and capital gain.<sup>28</sup>

The court also found the *Chartier* construction inconsistent with the way section 172 treats the standard capital gain deduction of noncorporate taxpayers.<sup>29</sup> Section 172(d)(2)(B) prevents noncorporate NOL

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23. See Note, *Net Operating Losses and the Alternative Tax: Fine-Tuning the Tax Computation Provisions*, 20 VILL. L. REV. 837, 852-66 (1975), for a proposed revision of the Internal Revenue Code of 1954 to accommodate perfectly the goal of equal tax treatment of ordinary loss-capital gain taxpayers in carryover years and other taxpayers. The author of the Note assumes that Congress intended precisely equal treatment.

24. INT. REV. CODE OF 1954, § 172(b)(2) (emphasis added).

25. See note 21 *supra*.

26. 505 F.2d 128 (4th Cir. 1974).

27. *Id.* at 134.

28. *Id.*

29. *Id.* at 134-35.

taxpayers from taking the section 1202 deduction from capital gain in loss and deduction years.<sup>30</sup> If “taxable income” in section 172(d)(2)(B) did not include capital gain, the provision would be meaningless because it would disallow a deduction that had not been taken. Since section 172(b)(2) doesn’t specifically define “taxable income,” the court applied the general definition, clearly intended to be applied in section 172(d)(2)(B), to section 172(b)(2). Although section 172(d)(2)(B) applies only to noncorporate taxpayers, the court reasoned that the inference drawn from section 172(d)(2)(B) was equally applicable to corporations.<sup>31</sup>

The court found its interpretation consistent with the history of the capital gain and NOL provisions.<sup>32</sup> From 1924 to 1934, ordinary losses in excess of ordinary income were fully deductible from that year’s capital gain.<sup>33</sup> The absence of such a provision in later code revisions<sup>34</sup> led to the judicial determination<sup>35</sup> that Congress no longer intended that all ordinary losses be fully applied to reduce actual tax liability. The court found nothing in the legislative history of the NOL section showing an intent to place taxpayers with fluctuating earnings in precisely the same position as those with steady earnings; the goal was simply to improve their position. Therefore, the court reasoned, the ameliorative purpose did not require allowance of the subsequent deduction.<sup>36</sup> The dissenting judge thought the majority opinion con-

30. INT. REV. CODE OF 1954, § 172(d)(2)(B):

In the case of a taxpayer other than a corporation—

. . . .

. . . the deduction for long-term capital gains provided by section 1202 shall not be allowed.

31. 505 F.2d at 135.

32. *Id.* at 136-37.

33. Revenue Act of 1924, ch. 234, § 208(a)(5), 43 Stat. 262:

The term “capital net gain” means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain.

34. Revenue Act of 1938, ch. 289, § 117(a)(4), 52 Stat. 501, defined long term capital gain as

. . . gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income.

35. Walter M. Weil, 23 T.C. 424 (1954), *aff’d*, 229 F.2d 593 (6th Cir. 1956). The legislative history of the section made no mention of the omission of the ordinary loss deduction in computing the amount of long term capital gain. H.R. REP. NO. 1860, 75th Cong., 3d Sess. 7-9 (1938); S. REP. NO. 1567, 75th Cong., 3d Sess. 5-7 (1938).

36. 505 F.2d at 137-38. The *Chartier* rule would allow a taxpayer to apply the

trary to the legislative intent expressed in the NOL provisions, as construed by the courts and confirmed by Congress' acquiescence.<sup>37</sup> The majority found Congress' failure to change the statute after *Chartier* inconclusive.<sup>38</sup> Noting that "it strains the usual canons of construction to read significance into Congressional inaction, because so little time has elapsed," the majority opined that congressional inaction might show acceptance of the interpretation the Commissioner announced in 1960.<sup>39</sup>

The majority opinion, although logical, was incomplete. Its definition of "taxable income" does not defeat the *Chartier* construction of section 172(b)(2). "To which such loss may be carried" reasonably can modify "taxable income," whatever the meaning of "taxable income." Since ordinary deductions cannot be applied to section 1201 capital gain, the section 1201 capital gain of a deduction year is not "taxable income . . . to which such loss may be carried." The legislative history cited by the court<sup>40</sup> was also inconclusive. The lack of clear legislative intent to place NOL taxpayers in precisely the same position of taxpayers with steady earnings does not compel a restrictive construction of the section.

Nonetheless, the court's understanding of the operation of the section was correct.<sup>41</sup> Its interpretation of section 172(b)(2) is confirmed by

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NOL to ordinary income taxed at progressive rates in as many as eight profit years. Under the old statutory provision, the NOL taxpayer had to deduct current ordinary losses from capital gain taxed at fixed lower rates in the year of the loss before carrying any excess loss to other tax years. He could then deduct any excess loss from both ordinary income and capital gain in the one or two deduction years available under the statute.

Congress abolished the 1924 NOL benefit in 1933. National Industrial Recovery Act, ch. 90, § 218(a), 48 Stat. 209 (1933); S. REP. No. 114, 73d Cong., 1st Sess. 7 (1933) (incorrectly citing the provision as § 217a).

37. 505 F.2d at 138 (Russell, J., dissenting).

38. *Id.* at 138 n.21.

39. *Id.* The majority also reasoned that Congress might have simply disregarded the *Chartier* decision:

Even *Chartier Real Estate* would not likely have prodded a prompt Congressional response if Congress thought that the statutes were interpreted wrongly. It was a decision by a single Court of Appeals which characterized the question presented as "unimportant" and "seldom occurring." . . . [Congress may have viewed] *Chartier Real Estate* as a single, nonrecurring aberrant decision.

*Id.*, quoting *Chartier Real Estate Co. v. Commissioner*, 428 F.2d 474, 475 (1st Cir. 1970).

40. 505 F.2d at 136-37.

41. See Note, *supra* note 23, at 846-47 (supporting analogy to the operation of insurance company loss carryover provisions and the minimum tax for tax preferences).

section 172(c), by other portions of the legislative history of the alternative tax on capital gains and the NOL deduction, and by the 1969 revision of section 1201.

First, section 172(c) defines NOL as “the excess of [ordinary loss] over the gross income.”<sup>42</sup> Therefore, in the actual loss year, the portion of ordinary loss which exceeds ordinary income but is less than ordinary income and capital gain together never qualifies as a NOL deduction. If the corresponding portion of a carried loss were preserved for subsequent deduction, the tax benefit of the loss would be greater in the profit years to which it is carried than it could be in the year in which it is sustained, when the loss has its greatest economic impact on the taxpayer.

Second, the absence of an express provision to prevent simultaneous use of sections 1201 and 172 by corporations or individuals, corresponding to section 172(d)(2)(B),<sup>43</sup> is almost certainly an accident. The predecessor of section 172(d)(2)(B) was restricted to noncorporate taxpayers because the general capital gain deduction was similarly restricted.<sup>44</sup> No such provision was needed for the alternative capital

42. INT. REV. CODE OF 1954, § 172(c) (emphasis added):

For purposes of this section, the term “net operating loss” means . . . the excess of the deductions allowed by this chapter over the *gross income*. Such excess shall be computed with the modifications specified in subsection (d).

The modifications specified in subsection (d), which also affect the computation of taxable income in the deduction year under § 172(b)(2)(A), demonstrate a congressional intent that NOL represent accurately the true excess of deductions over total income. Section 172(d) disallows NOL carryback and carryover deductions; noncorporate taxpayers' deduction of capital loss in excess of capital gain and the § 1202 capital gain deduction; personal exemptions; noncorporate taxpayers' nonbusiness losses in excess of nonbusiness income; corporations' tax-exempt interest deductions; and Western hemisphere trade corporations' deductions. INT. REV. CODE OF 1954, § 172(d)(1)-(5). Corporations may deduct 100% of dividends received from related corporations, preferred stocks of public utilities, and foreign corporations, without the usual restriction that such deductions be limited to 85% of taxable income. INT. REV. CODE OF 1954, § 172(d)(6). Corporations get no capital gain deduction, and § 172(d)(2)(B) disallows other taxpayers' § 1202 deductions in computing NOL in the loss and deduction years. See notes 11 & 30 *supra* and accompanying text. Since § 1201 provides an alternative rate rather than a deduction from income, see note 15 *supra* and accompanying text, it is not a factor in determining the existence or size of NOL in the year of the loss. See also 55 B.U.L. REV. 134, 144-45 (1975).

43. See note 30 *supra* and accompanying text.

44. The purpose of § 172(d)(2)(B)'s predecessor was

to reach a truer figure representing the individual's economic income . . . . Since corporations are not subject to the percentage provisions regarding capital gain the provision in no way affects them.

84 CONG. REC. 7497 (1939) (remarks of Representative Cooper).

gain tax, either before or after it was extended to corporations,<sup>45</sup> because the language of the 1939 Code did not permit simultaneous use of the benefits.<sup>46</sup> The phrase "taxable income of each of the prior taxable years to which such loss may be carried" was introduced in the comprehensive Code revision of 1954 to simplify the statutory language rather than to add the *Chartier* benefit.<sup>47</sup>

Finally, revised section 1201(b) and new sections 1201(c) and (d), enacted in 1969, limited the alternative tax after 1974 to the first \$50,000 of the capital gain of noncorporate taxpayers<sup>48</sup> and nullified the *Chartier* benefit for them.<sup>49</sup> If Congress had recognized the benefit

45. Revenue Act of 1942, ch. 619, § 150(c), 56 Stat. 843, amending INT. REV. CODE OF 1939, § 117.

46. Section 122(b) of the Internal Revenue Code of 1939 originally described the NOL deduction for any taxable year as the sum of

(1) the amount if any of the net operating loss for the first preceding taxable year; and

(2) the amount of the net operating loss, if any, for the second preceding taxable year, reduced by the excess, if any, of the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3) and (4) for the first preceding taxable year over the net operating loss for the third preceding taxable year.

Revenue Act of 1939, ch. 247, § 122(b), 53 Stat. 867. "Net income" of corporations included 100% of capital gains. See INT. REV. CODE OF 1939, §§ 21-23, 53 Stat. 9-16.

The section was revised in 1942, but the statutory language precluded the *Chartier* construction. See Revenue Act of 1950, ch. 995, § 215(a), 64 Stat. 937-39; Revenue Act of 1942, ch. 619, § 153(a), 56 Stat. 847-48.

47. The NOL provisions were "rewritten both for the purpose of clarity and also to incorporate several major substantive changes." H.R. REP. No. 1337, 83d Cong., 2d Sess. A-56 (1954). By 1954, the section had become long and complicated. See Revenue Act of 1950, ch. 995, § 215, 64 Stat. 937-39. The *Chartier* benefit was not among the "substantive changes" explained in the House and Senate reports. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A-56 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 32-33 (1954). The language "the earliest year to which such loss may be carried" appeared in the House report explanation of the addition of a carryback year, with no reference to "taxable income." H.R. REP. No. 1337, 83d Cong., 2d Sess. A-56 (1954). The *Mutual Assurance Soc'y* court suggested that "to which such loss may be carried" was used to make clear which years were intended. 505 F.2d at 134, n.10. More precisely, the phrase may have been used to mean "deduction year" in a simplifying revision treating carryback and carryforward years together, since all deduction years are treated alike except for sequence. In the 1939 Code, carryover and carryback years were treated separately. See, e.g., Revenue Act of 1950, ch. 994, 215, 64 Stat. 937-39.

48. INT. REV. CODE OF 1954, §§ 1201(b), (c), (d).

49. See Boyle, *supra* note 1; Branda, *supra* note 1, at 456. Only the first \$50,000 of net long term capital gain is taxable at the § 1201 flat rate of 25%. INT. REV. CODE OF 1954, §§ 1201(b)(2), (d)(3). Ordinary losses cannot be used to reduce capital gain taxed at the § 1201 rate. See cases cited note 19 *supra* and accompanying text; note 21 *supra*. The NOL taxpayer has no taxable ordinary income in the loss year. Therefore, he would never owe less tax under § 1201 (\$12,500) than he would owe at the

and intended to extinguish it for noncorporate taxpayers but not for corporations, it would likely have noted its existence, explained the purpose of the difference in treatment, and made statutory provision in section 172 for the corporate benefit.<sup>50</sup>

The Supreme Court will soon consider the issue presented in *Mutual Assurance Society*.<sup>51</sup> The Court should adopt the *Mutual Assurance Society* rule. The *Chartier* benefit can be derived from the language of section 172(b)(2), and is consistent with the general policy of NOLs. But the language relied on was adopted by Congress without the understanding that it created the benefit, and the benefit is inconsistent with the operation of the NOL provisions as a whole.

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standard graduated rate on the first \$50,000 with the § 1202 deduction of 50% (at most, \$8,330 for married individuals filing separate returns, estates, and trusts). INT. REV. CODE OF 1954, § 1(d).

50. Congress made no mention of the *Chartier* benefit when it revised § 1201. H.R. REP. NO. 91-41(3), 91st Cong., 1st Sess. 144-46 (1969); S. REP. NO. 91-552, 91st Cong., 1st Sess. 194-95 (1969). While this silence is not conclusive evidence that the *Chartier* benefit should not exist for corporations, it is difficult to justify treating them differently from other taxpayers without express provision. Under § 172, except to the extent that § 172(d) provides particular allowance or disallowance of other corporate and noncorporate deductions in the Code to reflect true economic income, only very narrow classes of corporations receive treatment different from noncorporate taxpayers. INT. REV. CODE OF 1954, §§ 172(b)(1)(C) and 172(j) treat regulated transportation corporations. Sections 172(b)(1)(D)-(E) and 172(b)(3)(E) (the American Motors provisions) treat manufacturers of a single class of products who are members of a class of three or fewer United States manufacturers of the product with loss year losses greater than the income of the two immediately prior years. Sections 172(b)(3)(B) and 172(h) treat subchapter S corporations.

51. *Foster Lumber Co. v. United States*, 500 F.2d 1230 (8th Cir. 1974), cert. granted, 420 U.S. 1003 (1975) (No. 74-799).