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Murphy: It's Not Just About Basis

To the Editor:

I am writing about Prof. Deborah A. Geier's recent article, ''*Murphy* and the Evolution of 'Basis,'" *Tax Notes*, Nov. 6, 2006, p. 576. I am reluctant to comment, since Deborah has done a masterful job of making her case that basis: (1) is a be-all and end-all concept; and (2) is not static and deserves to be given a modern interpretation after its substantial evolution in the case law. However, I am bothered by at least one aspect of her argument that requires focus not on the trees of basis but on the forest of fairness.

Of course, I agree with Prof. Geier that the *Murphy* court's phraseology on the (un)constitutionality of section 104(a)(2) is not, as she puts it, a correct way of speaking. As she says, given section 104's exclusionary role, the court's opinion must be read as constitutional censure of section 61, not section 104. I also agree (it is hard as a tax lawyer *not* to) that section 61 has enormously broad reach.

By the way, the same issue of *Tax Notes* that contains Prof. Geier's thorough article reports on the D.C. Bar Association's November 2 presentation about *Murphy*, at which your own Lee Sheppard was a panelist. I disagree with Lee's characteristic hyperbole that ''Congress can tax whatever it wants.'' See Sheryl Stratton, ''Lawyers Debate Effect of *Murphy* Case'' (*Tax Notes*, Nov. 6, 2006, p. 521). Surely, what Lee meant was that *if* it is constitutional to do so, then Congress can tax it. That, of course, is the question.

I expect Prof. Geier is smarter than I am, and I know she has made a convincing case that an amount cannot be excludable from income (absent a statute excluding it) if there are no previously taxed dollars to create basis and to offset cash received. Yet, I am still not 100 percent convinced. Although I recognize that Prof. Geier and other notable tax minds have taken potshots at the nontax lawyers litigating *Murphy* (and at the nontax judges on the D.C. Circuit), stepping back and looking at the forest is clearly appropriate.

Not only that, but I am not convinced that one can justify *Murphy only* by locking oneself in the time warp of 1913 and failing to consider the historical basis developments Prof. Geier so ably describes. In fact, for all its careful vetting, Prof. Geier's argument may prove too much when she says that Murphy must be taxed because ''[s]he made no nondeductible capital expenditures that created bodily integrity, emotional well-being, and professional reputation.'' Geier, p. 580.

From an academic and technician's viewpoint (and I certainly give a technician's nod to Prof. Geier's article), maybe she is right that ''*Murphy* can be understood only as a basis case.'' Geier, p. 581. Yet I do not think that is all it is. We all seem to agree that the court and *Murphy* got it wrong when it referred to the (un)constitutionality of section 104(a)(2) in permitting taxation on an award of damages for mental distress and loss of reputation, since plainly section 61 is a taxing weapon, while section 104 is an excluding shield. Maybe some other parts of the court's verbiage are similarly imprecise. We may not see the tax lingua franca that all of us as tax lawyers expect, but that doesn't mean the concepts are wrong.

I have rarely looked at the constitution in my career, and I don't consider myself competent to say what is or is not within the constitutional scope of section 61. Yet, I still believe there is more to the *Murphy* court's statements than many tax technicians are willing to admit. Although Prof. Geier may be right — and she has done a masterful job of making her argument — she gives a whiff of bias at the end of her article, particularly in her closing footnote.

If I am reading her correctly, she expresses difficulty in articulating a satisfactory rationale for the section 104(a)(2) exclusion. In a lengthy footnote to her article (footnote 25) she seems to argue stridently that section 104(a)(2) makes no sense. I think she steps outside of her carefully crafted basis argument and tries to cross a bridge too far. It is worth quoting part of what she says:

> Moreover, it is hard to see why the most fortunate subset of injured parties — those fortunate enough to receive a recovery of some sort — should be the ones blessed with a tax benefit. If they are going to deviate from gross income principles on ''policy'' grounds, why not let those who are unlucky enough to be injured by a natural disaster or by individuals without insurance deduct their loss of human capital, even though they have no basis to deduct and even though it would be a personal loss? While that result seems absurd on its face, exclusion and deduction are equally problematic in this context as a matter of tax theory. Geier, p. 582.

I know many who are knowledgeable in the tax world find a kind of Lewis Carroll quality about the *Murphy* case. Yet from my point of view, there is still much to commend it. If Prof. Geier really means that it is hard to defend the tax theory of section 104(a)(2), I can well see why *Murphy* would be anathema to her. I admit that I am not sure I can reconcile the convincing and seemingly immutable Napoleonic-like march of basis law Prof. Geier has laid out, and to somehow square that with the *Murphy* court's Waterloo.

Yet, unlike Prof. Geier, I am still wondering whether, as a matter of tax policy, the nontax lawyers and judges facing the *Murphy* facts may not have been right.

Very truly yours,

Robert W. Wood
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