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Remembering Louis Del Cotto

Kenneth F. Joyce
University at Buffalo Law School

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KENNETH F. JOYCE†

Louis A. Del Cotto and I were tax colleagues and friends for over three decades. Our shared experiences were consequently such that it is impossible in this short memorial note to discuss at any length the multitude of his talents and strengths. I will try, however, to give a brief glimpse of him, as a teacher, a scholar, and a friend, in a way that I think he would approve.

As a tax teacher and scholar, Louis Del Cotto was driven by the wisdom of Justice Louis Brandeis' admonition that, "[i]f we would guide by the light of reason, we must let our minds be bold."[1]

To Lou, the Internal Revenue Code was, at least presumptively, a coherent whole and the interrelationship of its provisions was key, to be discovered and revealed, even if only through merciless analysis. To take one of his favorite classroom exercises, "Suppose," he would say, "that a personal injury claimant received from a defendant as damages not cash but property—say Blackacre—worth $100,000. What would the plaintiff's "cost" basis be in Blackacre in light of the fact that § 104(a)(2) of the Code allowed the plaintiff to exclude Blackacre from gross

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† SUNY Distinguished Teaching Professor of Law, University at Buffalo Law School.

1. New State Ice. Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting). The quotation was a favorite of a third Louis, Professor Louis L. Jaffe, who had been a law clerk to Justice Brandeis in 1932. *See* Louis L. Jaffe, *Was Brandeis An Activist? The Search for Intermediate Premises*, 80 Harv. L. Rev. 986, 992 (1967). Lou and I were both students of Prof. Jaffe (Lou—Torts—Buffalo; myself—Administrative Law—Harvard), and Prof. Jaffe, who was the Dean of the Buffalo Law School from 1948 to 1950, was instrumental in my coming to Buffalo in 1964 (I seriously asked him, "Where's Buffalo?"). On arrival, I taught Administrative Law and (at the "suggestion" of Dean Jack Hyman) Gratuitous Transfers (then called Wills and Trusts). Lou, however, had other plans for me and, in a few short years, he had captured my interests and drafted me into tax, which, with Gratuitous Transfers, I have taught ever after.

income? After all," he would say seductively, "if a primary function of basis is to ensure that taxed receipts are not taxed again and that untaxed receipts are eventually taxed once, how could such a plaintiff have any cost basis at all, given the § 104(a)(2) exclusion?"

And as the students would either begin to nod in assent to the zero basis implication of Lou's question, or continue to express their bewilderment, he would deliver the message:

"But, if the plaintiff's basis in Blackacre is zero—indeed—" he would boom, "if it is anything less than its value of $100,000, then if Blackacre is immediately sold, the plaintiff would have gross income on the sale—right? And if that happened what would that do to the Congressional exclusion policy behind §104(a)(2)?"

And so the students would begin to see—first, the specific point that even though there was no statute or regulation which set forth the proper result *in haec verba*, the basis of the plaintiff had to be $100,000 to preserve and carry out the Congressional purpose to forever exclude damages for personal injury. And they also saw, without having it dictated, the larger point that, although the internal coherency of the Code is not always visible, it is discoverable by reasoned analysis, if we "let our minds be bold." And finally, perhaps most importantly, they saw that tax was the proper business of law students, with the power to excite and challenge the mind, and to satisfy its desire to explore and discover.

It was that type of teaching by joint and mutual discovery which endeared Lou to students, which sent many of them off to become successful tax practitioners, and which maintains their gratitude to this day.

In his tax scholarship, Lou exhibited the same striving to analyze and reveal the underlying (albeit sometimes counterintuitive) coherency of the Code. Examples abound, but I pick one where, arguably like the Buffalo Bills (of whom Lou was a devoted but critical fan), although he should have gotten to wear a Super Bowl ring in public, he had to be satisfied with the fact that, for those who know better, he deserved one.

My reference is to a question that has baffled tax people over the years—the proper way for an income tax system to treat non-recourse debt. It starts with an analysis of why we allow taxpayers to exclude borrowed money to begin with. It continues into the various approaches to dealing with non-payment of previously excluded borrowing. At its apex, it reached the Supreme Court in the *Tufts* case in the form of the following question:

> Over 35 years ago, in *Crane v. Commissioner*, this Court ruled that a taxpayer, who sold property encumbered by a nonrecourse mortgage (the amount of the mortgage being less than the property's value), must include the unpaid balance of the mortgage in the computation of the amount the taxpayer realized on the sale. The case now before us presents the question whether the same rule applies when the unpaid amount of the nonrecourse mortgage exceeds the fair market value of the property sold.[2]

Over a decade earlier, Lou had tackled the *Crane* case, and in his piece had suggested, albeit without substantial elaboration, that the answer to the *Tufts* question was to be found in the tax benefit rule.[3]

Eight years later, still many years before *Tufts*, Lou nailed the point down, as part of his *tour de force* on sales and exchanges in the Buffalo Law Review[4]:

> [Where] the amount of non-recourse debt . . . exceeds the value of the encumbered property. . . . there has been realized a benefit in the amount of such excess, but such benefit arises from past depreciation of cost basis arising from the mortgage or from borrowing on the value of the property. Both the depreciation and the borrowing give the taxpayer untaxed cash that should in some manner be included in his gross income. However, where the mortgage can be satisfied only from the property, the excess amount is not a benefit received because of relief from the mortgage. Therefore the excess should not be part of the amount realized from a sale or other disposition of the property, since it is outside the ambit of section 1001(b). And, absent personal liability for the mortgage, the amount of such excess cannot be taxed as

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2. Commissioner v. Tufts, 461 U.S. 300, 301-02 (1983) (citation omitted).

3. Louis A. Del Cotto, *Basis and Amount Realized Under* Crane*: A Current View of Some Tax Effects of Mortgage Financing*, 118 U. PA. L. REV. 69, 85-86 (1969). The suggestion was not lost on Professor Boris Bittker. *See* Boris I. Bittker, *Tax Shelters, Nonrecourse Debt, and the* Crane *Case*, 33 TAX. L. REV. 277, 285 n.14 (1978).

4. Louis A. Del Cotto, *Sales and Other Dispositions of Property Under Section 1001: The Taxable Event, Amount Realized and Related Problems of Basis*, 26 BUFF. L. REV. 219 (1977).

debt-discharge income.

The appropriate remedy, therefore, would appear to lie in the application of the tax benefit rule. The taxpayer has received the benefit of the mortgage, either as cost basis giving him tax-free cash through depreciation deductions or as a result of tax-free borrowing on the value of the property. Therefore, transfer of the property is the proper occasion to make him account for such past tax benefit by including the excess of debt over property value in his gross income as gain from past depreciation deductions or from past tax free borrowing . . . .

. . .

. . . When the property is disposed of, it becomes clear that the transferor will not pay the amount of the mortgage in excess of his adjusted basis, which amount supported previous depreciation deductions, and therefore the proper tax benefit should be recaptured by the tax benefit rule. Similar reasoning applies if the mortgage secures a borrowing by taxpayer on any appreciation in the property. When on conveyance of the property it becomes clear that the borrowing will not be repaid, the tax benefit received from the prior tax-free borrowing should be recaptured even though it does not arise from the sale of property whose value has fallen below the amount of a non-recourse mortgage.[5]

On March 7, 1983 the Supreme Court decided *Hillsboro National Bank v. Commissioner*,[6] and for the first time, definitively explained and approved the tax-benefit rule in the following language: "The basic purpose of the tax benefit rule is to achieve rough transactional parity in tax . . . and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous."[7]

Less than two months later—on May 2, 1983—the Court decided *Tufts* in favor of the Government, holding that the amount realized on the disposition of the property must include the face amount of the non-recourse mortgage even though it exceeds the value of the mortgaged property. The Court explained:

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5. *Id.* at 322-32.

6. 460 U.S. 370 (1983)

7. *Id.* at 383.

> The rationale for this treatment is that the original inclusion of the amount of the mortgage in basis rested on the assumption that the mortgagor incurred an obligation to repay. Moreover, this treatment balances the fact that the mortgagor originally received the proceeds of the nonrecourse loan tax-free on the same assumption. Unless the outstanding amount of the mortgage is deemed to be realized, the mortgagor effectively will have received untaxed income at the time the loan was extended and will have received an unwarranted increase in the basis of his property.[8]

Now, I ask you, does that not sound just like the tax-benefit rule? And, more relevantly, does it not sound to you just like Lou Del Cotto in the *Buffalo Law Review* in 1977, especially in light of the above-quoted basic rationale of the tax-benefit rule given in *Hillsboro*? Would you not, therefore, expect from the *Tufts* court a citation somewhat like "*See* Del Cotto, etc., etc."? What followed immediately however, was not such a citation, but a begrudging footnote 8:

> "Although the *Crane* rule has some affinity with the tax benefit rule, see Bittker, *supra*, at 283; Del Cotto, Sales and Other Dispositions of Property Under Section 1001: The Taxable Event, Amount Realized and Related Problems of Basis, 26 Buffalo L. Rev. 219, 323-324 (1977), the analysis we adopt is different *[sic]*. Our analysis applies even in the situation to which no deductions are taken. [*Does the* Hillsboro *formulation distinguish between the tax benefit of a deduction and that of an exclusion?*] It focuses on the obligation to repay and its subsequent extinguishment, not on the taking and recovers of deductions. [*Did you not just say that the focus was on an "assumption"?*] See generally Note, 82 Colum. L. Rev., at 1526-1529."[9]

Well, Lou, you had to be satisfied with "some affinity." You did not get the consanguinity you deserved. And, like Scott Norwood after Super Bowl XXV, you took it without whining. But "we" all know that you were not wide right—that you were right down the middle, and that footnote 8 in *Tufts* will eventually suffer the same fate as footnote 37 in *Crane*. Until then, of course, the whole episode will continue to serve the overriding purpose of your teaching and scholarship—to challenge, to discover, to reveal.

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8. 461 U.S. 300, 309 (1983).

9. *Id.* at 310 n.8 (bracketed italics added.)

I conclude on the upbeat: I thank my esteemed colleague publicly for the intellectual ride we had together, both in class and on paper.[10] It began with that first summer before I started teaching tax, when he spent countless hours giving unselfishly of the insights he had gained over many years of thinking and teaching. It continued until the end, and although my debt to him may be non-recourse, it is—as he taught us that *Crane* taught—every bit as real as is the debt my wife Rita and I owe Lou's wife Bea for, *inter multa alia*, the meat ball recipe, and as are the debts my children Mary and Michael owe "Aunt Bea" and "Uncle Lou" for being their proxy Godparents and for being a loving part of their Buffalo family.

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10. *See generally* Louis A. Del Cotto & Kenneth F. Joyce, *Taxation of the Trust Annuity: The Unitrust Under the Constitution and the Internal Revenue Code*, 23 TAX L. REV. 257 (1968); Kenneth F. Joyce & Louis A. Del Cotto, *The* AB (ABC) *and* BA *Transactions: An Economic and Tax Analysis of Reserved and Carved Out Income Interests*, 31 TAX L. REV. 121 (1976); Louis A. Del Cotto & Kenneth F. Joyce, *Inherited Excess Mortgage Property: Death and the Inherited Tax Shelter*, 34 TAX L. REV. 569 (1979); Louis A. Del Cotto & Kenneth F. Joyce, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 TAX L. REV. 459 (1980); Louis A. Del Cotto & Kenneth F. Joyce, *Interest-Free Loans and* Dickman v. Commissioner*: A Letter to the Supreme Court*, 32 BUFF. L. REV. 589 (1984), *reprinted in* TAX NOTES, June 4, 1984.