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Capital One v. Commissioner: The Power Granted to the IRS Commissioner by the Consent Requirement of Section 446(e)

Bruce H Lubich
Darren Frank

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Darren Frank
Georgetown Law Center
600 New Jersey Avenue NW
Washington, DC  20001
202-248-0642
Dcf32@law.georgetown.edu

Bruce Lubich, Ph.D., CPA
Program Director and Associate Professor
Graduate School of Management and Technology
University of Maryland University College
3501 University Blvd E
Adelphi, MD  20783
301-985-7226
blubich@umuc.edu
Abstract

In Capital One Fin. Corp. v. Commissioner, the United States Tax Court held that Capital One was not permitted to retroactively alter its 1998 and 1999 tax returns to treat late fee income as creating or increasing original issue discount. In its holding, the Tax Court relied primarily on the statutory requirement under section 446(e) that a taxpayer receive the Commissioner’s consent before altering its accounting method. Section 446(e) grants the Commissioner tremendous discretion in granting or denying consent to a request to change accounting method. This paper shows that this broad discretion can be used to shift the time value of money advantage toward the government and away from the taxpayer in what is tantamount to a violation of the takings clause of the U.S. Constitution.
I. Introduction

In *Capital One*, the United States Tax Court held that Capital One was not permitted to retroactively alter its 1998 and 1999 tax returns in order to treat late fee income as creating or increasing original issue discount (hereinafter OID).\(^1\) Allowing Capital One to alter the returns would have lowered its taxable income in those years by $209,143,757 and $216,698,486 respectively.\(^2\) In its ruling, the Tax Court relied primarily on the statutory requirement under section 446(e) that a taxpayer receive the Commissioner’s consent before altering its accounting method.\(^3\)

Although the Tax Court reached the proper result in *Capital One*, the Tax Court’s reliance on section 446(e) should be scrutinized. It is important to ensure that 446(e) is constitutionally permissible, but it is also important explore legislation which drifts away from the founding principles of democracy and free-market capitalism toward the principles of socialism and undue market interference.

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\(^1\)Capital One Fin. Corp. v. Commissioner, 130 T.C. No. 11 (May 22, 2008).
\(^2\)Id. at 2.
\(^3\)Id. at 1; see I.R.C. § 446(e) (“REQUIREMENT RESPECTING CHANGE OF ACCOUNTING METHOD. – Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary.”).
The Commissioner is granted tremendous deference in using their discretion under section 446(e) to grant or deny consent to an individual’s request to change an accounting method. However, the justifications for the requirement set forth in section 446(e) are not as straightforward as previous cases have attempted to convey.

This note proposes that the real reason for giving the Commissioner such broad discretion is to shift the time value of money advantage in favor of the government and away from the individual taxpayer. This broad discretion in turn tips the balance of power all the way in favor of the government.

Part II provides an explanation of OID and time value of money. Part III discusses the specifics of Capital One. Part IV analyzes the Tax Court’s reasoning in Capital One, with an emphasis on the court’s misplaced reliance on section 446(e). The problematic tenets of this section are delved into, both in specific constitutional terms, as well as broader economic and political terms.

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4 Drazen v. Commissioner, 34 T.C. 1070, 1075-76 (1960) ("[Commissioner] is invested with a broad administrative discretion...and it is beyond the authority of this Court to overturn his determination unless the evidence clearly shows that he has abused his discretion.").
II. Critical Underpinnings of the Capital One Decision

A. Original Issue Discount Explained

An understanding of OID is central to the understanding of the decision in Capital One. Showing that OID is the most realistic way to account for the amount of tax liability on late-fee income illustrates the arbitrary nature of the consent requirement this note is arguing against.

The effect of treating something as OID is most easily seen by using bonds as an example.\textsuperscript{5} Imagine an individual buys a zero coupon bond from Corporation A at $385,000 with a ten year maturity, which at maturity will be paid back at $1,000,000. Since it is a zero coupon bond, it does not directly pay interest; however, through the $615,000 gain, the individual will receive (assuming the bond is held until maturity) a bond that has appreciated roughly 10\% a year. Under the current-inclusion method of accounting, an individual would be required to report an equal amount of interest as income every year for 10 years, in this case $61,500 \(((1,000,000-385,000)(.1))\). This scenario overstates what an individual would actually receive in the first five years, and understates what an individual would receive in the last five years. Under OID, an individual would report $38,500 the first year, and the next year the individual

\textsuperscript{5}J. Martin Burke & Michael K. Friel, Understanding Federal Income Taxation 672-74 (Matthew Bender & Co., Inc. 2005) (2001) (example is the same one used in this text to easily clarify how OID operates).
would report interest on the principal again, plus interest on the interest earned from year one ($38,500 + $3,850 = $42,350 - interest earns interest). Obviously, in the beginning (in this instance the first five years) an individual’s tax liability under OID would be lower than under the current-inclusion method, but in the end (years six through ten) it would be greater (roughly $91,000 in year ten, nearly a 50% increase over current-inclusion amount of $61,500). Accounting for interest under OID is a better reflection of economic reality than the current-inclusion method, and after ten years the amount on which an individual would pay tax is exactly the same.\textsuperscript{6}

If an individual ends up with exactly the same tax liability in the end, then why does it matter which method an individual uses? It matters simply because the time value of money matters.

\textbf{B. Time Value of Money Explained}

Since the actual worth of money changes over time, the time value of money is extremely important. Most simply, a dollar tomorrow does not buy as much as a dollar today.

In order to calculate the future value of a sum of money, the equation is \textit{“FV = PV(1+i)^n”}. “FV” stands for future value, \textit{PV} for present value, and \textit{i} is the interest rate per period.

\textsuperscript{6}In this example there is roughly a 1,000 discrepancy, due to the simplification of the math for the sake of explanation, i.e. using 10\% as a rough estimate instead of the exact percentage.
“PV” stands for present value, “i” stands for the rate at which the PV will be compounded each period (yearly for the purposes of this note consistent with the tax period), and “n” stands for the number of periods (years in this instance).

This change in value can be due to at least two varying factors. One factor is inflation. As inflation increases, the dollar’s value decreases. For instance, if the rate of yearly inflation is five percent, a good that costs $100 now will cost $105 next year. Thus, at the same rate of inflation, in ten years that same good will cost $163.

The other factor that affects the value of money is interest. Using the same numbers as above, if an individual puts $100 in a savings account which earns five percent yearly, in one year the individual will have $105 and $163 in ten years.

Therefore, if an individual’s money earns the same interest as the pace of inflation, the $100 is worth exactly the same when it is $163 ten years later because at that time it will buy exactly the same amount of goods that $100 did ten years prior. If the rate of interest earned outpaces inflation money will be worth more. If the rate of interest earned falls behind inflation money will be worth less. Therefore, a taxpayer will always want to defer payment of taxes to the Commissioner as long as possible, and the Commissioner will always want to collect taxes from the taxpayer as soon as possible. For each
party the incentive is the same - to possess the money when it is worth the most.

The difference in the time value of money increases as the amount of money increases, as exemplified in Capital One, where the difference in the time value of money was equal to hundreds of millions of dollars. Taking the amount Capital One overpaid in 1998 of $209,143,757 as present value, and assuming a conservative inflation rate of three percent, in just one year the equivalent future value is $215,418,070, in ten years it is $281,071,720.

The time value of money, as well as a reduction in uncertainty of collection, provides a powerful incentive for the Commissioner to do whatever possible to collect more money upfront. Section 446(e) provides the Commissioner with the broad, unchecked, and arbitrary (as discussed infra) power to determine which party reaps the benefits, and which party pays the price.

III. Capital One

A. Facts

Capital One Financial brought this case against the Commissioner because Capital One was denied the ability to amend its Federal income tax returns for 1998 and 1999 in order to treat its late-fee income from those years as creating or
increasing OID. Treating these amounts as OID would enable Capital One to decrease its tax liability considerably during those years.\(^7\) In order for Capital One to have been permitted to make this change, it was required to file Form 3115, Application for Change in Accounting Method, and await the consent of the Commissioner before actually effectuating the change.\(^8\)

Capital One timely filed Form 3115.\(^9\) Capital One contends that the manner in which it filled out the form was sufficient to amend its treatment of late-fee income from the current-inclusion method it was previously using to the OID method.\(^10\) The Commissioner argued, and the court agreed, that Capital One’s Form 3115 filing lacked specificity necessary to support its claim and therefore was not entitled to treat late-fee income under OID in 1998 or 1999.\(^11\)

\(^7\)Capital One, 130 T.C. No. 11 at 2.
\(^8\)Id. at 7 (citing Reg. § 1.446-1(e)(3)).
\(^9\)Id. at 1.
\(^10\)Id. at 11 (“Question 9 on Form 3115 states: If the applicant is not changing its overall method of accounting, attach a description of each of the following: a. the item being changed. b. the applicant’s present method for the item being changed. In response[Capital One] stated: Question 9a The taxpayer proposes to change its method of accounting for interest and original issue discount that are subject to the provisions of Section 1004 of the Taxpayer Relief Act of 1997 (Pub.L .105-34). Question 9b Credit card obligations are not currently accounted for as required by section 1272(a)(6) of the Internal Revenue Code. The taxpayer's present method of accounting is to take into account the differences between issue price and stated principal amount upon origination in certain cases. Cash advance fees are taken into account as original issue discount.”).
\(^11\)Id. (Court agreed with Commissioner that because Capital One did not explicitly state that it intended to treat late-fee income under the broad title of “interest” the Commissioner was not aware that this item would be subject to the change if permitted and therefore did not give his consent for the treatment to be changed).
The Commissioner contended that since Capital One did not receive the Commissioner’s required consent under section 446(e) prior to filing the 1998 and 1999 returns, it is thereby disallowed from retroactively making such changes. The fact that such consent was later granted and the practice of treating late-fee income as OID is currently acceptable was considered irrelevant by the Tax Court.

Aside from its claim that the filing of Form 3115 was sufficient, Capital One also claimed that the Commissioner abused his discretion; however, it was a weak argument and the court quickly disposed of the claim. Capital One points to the specific language in section 446(e) which states that consent is required only for material items, and claims that the item at issue is interest in general and that late-fee income covered under this umbrella and therefore independent examination is not necessary. Capital One attempted to skirt the issue of consent altogether by disputing the classification of late-fee income itself, claiming it should be considered an “item” as opposed to

12 Id. (Court found that because of the lack of specificity of the answers to Question 9, Capital One did not even seek to receive consent and therefore could not have received it).
13 Id. at 2.
14 Id. at 11 n.12 (“[Capital One] contend[s] that if [Commissioner] did not consent to [Capital One’s] 1999 request to change its method of accounting for late-fee income, then that refusal constituted an abuse of discretion. Because [Capital One] did not make clear to respondent that it was requesting permission to change its method of accounting for late-fee income, petitioners’ contention is unpersuasive.”).
15 Id. at 9.
a “material item.” The Commissioner disagreed, claiming Capital One’s description was too ambiguous to cover late-fee income, and is therefore subject to the Commissioner’s consent under 446(e). Lastly, Capital One claimed it made a mathematical error when it treated late-fee income under the current-inclusion method, and this being a mistake of law, Capital One is entitled to make the requested retroactive changes.

B. Opinion

The court began its analysis in Capital One by distinguishing the separate streams of income for a credit card company such as Capital One (i.e., finance charges, annual fees, over-limit fees, cash advance fees, and interchange) and describing how each is to be treated and why it is or is not

16 Id. at 8-9; see infra note 28.
17 Id. at 10.
18 Id. at 13.
19 Id. at 4 (Amount added to any balance carried on the credit card with respect to the interest rate on the card. The treatment of this grace period interest is in dispute).
20 Id. at 5 (Yearly fee cardholder pays the company in order to have use of the card and its credit line. Since this is a compensation for service, it may not be treated as increasing OID).
21 Id. (Penalty that a cardholder pays when the amount charged exceeds the available credit line. Commissioner has conceded that this is properly treated as increasing OID, but disputes the calculated amount).
22 Id. (Fee charged to a cardholder to withdraw cash against the credit limit as opposed to directly purchasing goods. Cash advance fees are properly treated as increasing OID, but like over-limit fees, Commissioner is unclear if amount calculated was proper).
23 Id. at 2, 5 (Percentage of transaction charged as a fee when goods are purchased on credit which is paid to card issuer. Treatment of interchange is currently in dispute. Capital One claims that the burden of interchange is borne by the consumer, while the Commissioner argues the burden is borne by the merchant).
subject to being treated as OID. The court then discussed the codification of section 1272(a)(6)(C)(iii) by the Taxpayer Relief Act of 1997, and whether section 446(e) precludes a retroactive change of accounting methods to a method based on section 1272(a)(6)(C)(iii). The court also uses Treasury Regulation section 1.446-1(e)(2)(ii)(a) to define what constitutes a “change of accounting method.”

In addressing the issue of whether late-fee income is a “material item” or just an “item” not subject to the consent requirement under 446(e), the court clarified that although late-fee income is a stream of income that falls under the umbrella of interest, it produces its own significant portion of income, thus making it a “material item.” The court supports this finding by relying on the fact that Capital One’s largest

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24 Id. at 2-5.
25 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1004, 111 Stat. 911 (codified I.R.C. § 1272(a)(6)(C)(iii) (“In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of…any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in the regulations), by reason of other events”)).
26 Id.; see Reg. § 1.446-1(e)(2)(ii)(a) (“A change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan…A material item is any item that involves the proper time for the inclusion of the item in income or the taking of a deduction.”).
27 Capital One, 130 T.C. No. 11 at 5.
28 Capital One, 130 T.C. No. 11 at 10-12 (citing Wayne Bolt & Nut Co. v. Commissioner, 93 T.C. 500, 510 (1989)(“When an accounting practice merely postpones the reporting of income, rather than permanently avoiding the reporting of income over the taxpayer’s lifetime, it involves the proper time for reporting income.”)).
income producing fee is late-fee income, earning $521,943,513 and $752,010,041 in 1998 and 1999 respectively.\textsuperscript{29}

The court goes on to determine that, “[w]hatever “error” [Capital One] made in treating late-fee income under current-inclusion method in 1998 and 1999, it was not a mathematical error,”\textsuperscript{30} because a mathematical error would involve an error in the actual arithmetic involved in calculating the tax liability.\textsuperscript{31} The court goes on to state that Capital One clearly knew that it was treating late-fee income under the current-inclusion method instead of treating it under OID, and therefore, no posting error occurred in the transfer from the financial books to the tax books.\textsuperscript{32}

In addition to these findings, the court determined that the issue upon which the case hinged was consent, thus revolving around section 446(e).\textsuperscript{33}

The Tax Court proceeded to give five reasons to justify reliance on section 446(e), described generally below.

First, section 446(e) provides the Commissioner with the authority to permit or deny requests for retroactive changes to accounting method.\textsuperscript{34}

\textsuperscript{29}Id.
\textsuperscript{30}Id. at 13.
\textsuperscript{31}Id.
\textsuperscript{32}Id. at 13-14.
\textsuperscript{33}Id. at 1, 5.
\textsuperscript{34}Capital One, 130 T.C. No. 11 at 6 (citing Barber v. Commissioner, 64 T.C. 314, 319-20 (1975) (Taxpayer wanted to make a retroactive change in its accounting method, which the Commissioner denied. The taxpayer challenged
Second, in determining whether to grant consent under 446(e) “the Commissioner is invested with wide discretion.”

Third, if the Commissioner denies consent and the taxpayer subsequently challenges this denial, the Commissioner’s action is “reviewed under an abuse of discretion standard.”

Fourth, in order for a taxpayer to be eligible to alter its method of accounting it must submit Form 3115 during the year it wishes to make the change. Filing Form 3115 is basically a request from the applicant for a ruling, which the Commissioner is not obligated to provide.

Fifth, if the taxpayer did not obtain the consent of the Commissioner prior to changing its method of accounting the Commissioner has the authority to force the taxpayer to abandon its new method and revert to its old method of reporting income, and the Commissioner may do so without considering the

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that Commissioner could deny this change if the requested change was correct under the law. The court found for the Commissioner). 

35 Capital One, 130 T.C. No. 11 at 6 (citing Capitol Fed. Sav. & Loan Ass’n v. Commissioner, 96 T.C. 204, 213 (1991) (Taxpayer had applied to Commissioner seeking consent to alter its method of accounting. The Commissioner refused to consider the application, and in doing so did not abuse his discretion); see also Commissioner v. O. Liquidating Corp., 292 F.2d 225 (3rd Cir. 1961) (appeal from a Tax Court decision finding that the Commissioner had violated the abuse of discretion standard. The Tax Court’s decision was overturned based on a deference to the broad discretion of the Commissioner); see also Drazen, 34 T.C. at 1075-76 (1960) (Taxpayer changed from the cash basis of reporting income to an accrual basis before receiving consent from the Commissioner to make such a change. The court held that the burden to show the method used was correct falls on the taxpayer and the taxpayer here did not meet this burden)).

36 Capital One, 130 T.C. No. 11 at 6 (citing Capitol Fed. Sav. & Loan, 96 T.C. at 213).

37 Capital One, 130 T.C. No. 11 at 6-7 (citing Capitol Fed. Sav. & Loan, 96 T.C. at 213).
correctness of the new method.\textsuperscript{38} Even if a taxpayer can show the correctness of the new method; that fact alone cannot justify a change without the Commissioner's consent.\textsuperscript{39}

In order to justify its reliance on section 446(e) the court provided the following policy reasons for the section’s existence: "(1) to protect against the loss of revenues;"\textsuperscript{40} "(2) to prevent administrative burdens and inconvenience in administering the tax laws;"\textsuperscript{41} and "(3) to promote consistent accounting practice thereby securing uniformity in collection of the revenue."\textsuperscript{42}

The Tax Court found for the Commissioner, holding that Capital One was required under section 446(e), but failed to obtain, prior consent from the Commissioner to alter its methods

\textsuperscript{38}Capital One, 130 T.C. No. 11 at 6-7 (citing O. Liquidating Corp., 292 F.2d at 225); see also Drazen, 34 T.C. at 1075-76.

\textsuperscript{39}Capital One, 130 T.C. No. 11 at 6-7 (citing Pac. Transp. Co. v. Commissioner, 75 T.C. 497, 680-82 (1980) (Long and involved case with litigation that lasted three years, and disputed sixteen separate tax issues with regard to its accounting and income reporting practices. In relevant part, the ninth issue dealt with the taxpayer having altered the way it treated certain capitalized items as current deductions and the court held that the alteration was impermissible because the taxpayer did not obtain the prior consent of the Commissioner) ("[I]t is not sufficient for a taxpayer merely to show the correctness of the new method; that fact alone cannot justify a change without the Commissioner's consent.")); see also Wright Contracting Co v. Commissioner, 316 F.2d 249 (5th Cir. 1963), affg. 36 T.C. 620 (1961) ("[E]ven where a taxpayer's new method of accounting would be more correct than his prior method, the consent of the Commissioner is essential in order to effect a change." (citing H F Campbell Co v. Commissioner, 53 T.C. 439, 448 (1969), affd. 443 F.2d 965 (6th Cir. 1971))).

\textsuperscript{40}Barber, 64 T.C. at 319-20 (citing Camiel Thorrez v. Commissioner, 31 T.C. 655, 688 (1958), affd. Per curiam 272 F.2d 945 (6th Cir. 1959)).

\textsuperscript{41}Capital One, 130 T.C. No. 11 at 6 (citing Barber, 64 T.C. at 320 (citing Estate of Cyrus H.K. Curtis v. Commissioner, 36 B.T.A. 899, 906-907 (1937))).

\textsuperscript{42}Capital One, 130 T.C. No. 11 at 5 (citing Barber, 64 T.C. at 320 (citing Pacific Vegetable Oil Corp. v. Commissioner, 26 T.C. 1, 16 (1956), revd. on another issue 251 F.2d 682 (9th Cir. 1957))).
of accounting for late-fee income, and also that Capital One may
not amend its Federal income tax returns because it would be
amending a “material item,” as well as being prohibited by
section 446(e).

IV. Analysis

A. Section 446(e) as an Arbitrary and Capricious Measure

This note concedes that the Tax Court in Capital One came
to the proper conclusion, but deems the court’s primary reliance
on section 446(e) in reaching its conclusion improper. As
discussed in Part II(B), the court provides several viable
points as to why Capital One should not be permitted to
retroactively alter its returns. This finding includes the fact
that Capital One did not make a mathematical or posting error,
but rather wanted to change to a more advantageous method after
realizing the method it used was inferior for its own time value
of money purposes.

In deciding which method of accounting for late-fee income
is superior, Capital One can be analogized to the bond example
given in Part I(A). The bond example illustrates that by using
calculations that take into consideration the fact that interest
earns interest over time, using OID as a more realistic method

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43Capital One, 130 T.C. No. 11 at 1, 15.
of accounting, a more realistic amount of includable income can be ascertained.

Even assuming, for the sake of argument, that treating Capital One’s late-fee income in 1998 and 1999 as increasing OID would have been a more accurate method than the current-inclusion method, this would not entitle Capital One to use this method after it knowingly and willingly used another.

In examining the five reasons that the Tax Court provides for relying on section 446(e), stating that the Commissioner has authority to permit or deny requests for retroactive changes justifies the first of the court’s reasons for relying on section 446(e). The second of the court’s reasons is simply that the Commissioner is invested with broad discretion. This ideal has

44 See supra note 35.
45 See supra note 36.
been consistently upheld for several policy reasons,\textsuperscript{46} and is furthered by the other reasons provided by the court.

Third, the courts examine the Commissioner’s decision under the abuse of discretion standard.\textsuperscript{47} Compared to other standards of review from de novo to clearly erroneous to substantial evidence, abuse of discretion is, “the most limited in scope, and the standard that most binds the hands of the courts reviewing an agency’s determination.”\textsuperscript{48}

Fourth, requiring a filing of Form 3115 which the Commissioner is entitled to disregard\textsuperscript{49} can only be challenged under the abuse of discretion standard, a difficult standard to overcome. This arbitrary enforcement leads to the fifth reason, which points to the irrelevancy of the correctness of the taxpayer’s new method in seeking to obtain the Commissioner’s consent.\textsuperscript{50}

\textsuperscript{46}See supra note 41-43.
\textsuperscript{47}See supra note 37.
\textsuperscript{48}Jennifer Root, \textit{The Commissioner’s Clear Reflection of Income Power Under §446(B) and the Abuse of Discretion Standard of Review: Where Has the Rule of Law Gone and Can We Get it Back?}, 15 AKRON TAX J. 69, 99-100 (According to Maurice Rosenberg, under the abuse of discretion standard of review, the agency's decision is protected by: “a kevlar shield, theoretically all but impregnable to the reviewing court's prodding, provided that the agency's decision has been forged in a process in which it considered all relevant factors and balanced those factors in a rational fashion. In short, an agency operating under this standard is granted an uncommon privilege in the American legal system--‘a limited right to be wrong … without being reversed.’” (citing Maurice Rosenberg, \textit{Judicial Discretion of the Trial Court: Viewed from Above}, 22 SYRACUSE L. REV. 635, 649 (1971))).
\textsuperscript{49}See supra note 38.
\textsuperscript{50}See supra note 39-40.
The policy reasons given for the use of section 446(e) could all be accomplished with the less unfair and less arbitrary measure of simply requiring the taxpayer to notify the Commissioner that it is changing its methods of accounting. This protocol would allow the Commissioner to keep watch on the taxpayer to ensure that no abuse is taking place. It would also not burden the individual by forcing him to wait for a decision the Commissioner may or may not decide to give, and then being forced to administer a method of accounting which may be less beneficial and more onerous.

B. Constitutional Argument

Noting that the true underlying motive to grant the Commissioner such deference in decisions made under section 446(e) is for the advantage of the time value of money, the Commissioner’s exercise of authority under section 446(e) amounts to a taking of private property without due process or just compensation under the Fifth Amendment.\textsuperscript{51} The Commissioner taking more tax than Capital One, strictly speaking,\textsuperscript{52} owes is equivalent to a possessory taking, as is taking away Capital One’s ability to make its own decision between two legally

\textsuperscript{51}U.S. CONST. amend. V ("No person shall be...deprived of...property, without due process of law; nor shall private property be taken for public use, without just compensation.").

\textsuperscript{52}The difference between the current-inclusion method and the OID method.
permissible forms of accounting. This possessory taking goes hand in hand with the regulatory taking that occurred when the government took away Capital One’s right to use its own property as it wishes.\textsuperscript{53}

If government is seen to be inherently coercive, such as when it exercises its power of eminent domain, it must incorporate restitution principles so that the coerced party gets a benefit of equal value.\textsuperscript{54} Without this equal exchange, there is no net gain, and the action should not have been taken in the first place.\textsuperscript{55}

When the government gives certain things to individuals “[a]t root, these ostensible gifts are gifts of property that has [sic] been taken from other [individuals], so these transfers necessarily implicate important questions of takings theory and practice.”\textsuperscript{56} Applied to government actions like taxes, the government must show that the taking of the property was legitimate in order to be able to justify the redistribution of such property.\textsuperscript{57} “Otherwise it is little better than the thief who attempts to convey good title to a third person, especially to a purchaser in bad faith, that is, one who knows

\begin{footnotes}
\textsuperscript{53}Obviously, one cannot use as one wishes something that one no longer possesses.
\textsuperscript{55}Id.
\textsuperscript{56}Richard Epstein, Bargaining With the State 4 (Princeton University Press 1993).
\textsuperscript{57}Id.
\end{footnotes}
or who has reason to know the defect in the [government]’s title.”

The main purpose of the takings clause is “to bar the Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”

However, before the takings clause can be considered, a court must conclude that the government has taken property, which spawns the question of what exactly constitutes “property” for this purpose.

The Supreme Court defined “property” for the purposes of the takings clause to include all the rights surrounding the individual’s ownership, which is not limited to the “vulgar and untechnical sense of the physical thing with respect to which the citizen exercises rights recognized by the law,” but encompasses, “the group of rights inhering in the citizen’s relation to the physical thing, as the right to possess, use and dispose of it...every sort of interest the citizen may possess.”

As applied to Capital One and section 446(e), money (i.e., the tax liability owed by a taxpayer) is clearly within the Supreme Court’s broad definition of property. Paying taxes is:

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58 Id.
61 United States v. General Motors Corp., 323 U.S. 373, 378 (1945)
an interest in disposing of the property. The method of accounting for taxable income is a right surrounding this disposition of property.

A possessory taking has usually been found when the government either physically occupies or confiscates the property.\textsuperscript{62} Denying Capital One money to which it is entitled and retaining possession of it satisfies this as confiscation. Also, affirmatively requiring a company to maintain its books in a certain way amounts to a confiscation of company resources.\textsuperscript{63} This conclusion illustrates the overreaching power of section 446(e) in that the correctness of the method is irrelevant, and the taxpayer showing his method to be superior to the Commissioner’s is ineffectual.\textsuperscript{64}

The court carved out another category, regulatory takings, in Pennsylvania Coal v. Mahon, where the Court found that a law that prevented a mining company from exercising certain rights went too far in restricting liberty.\textsuperscript{65} Here the government did not actually directly “take” the property itself but made it, “commercially impracticable to mine certain coal has nearly the

\textsuperscript{62}Chemerinsky, supra note 61 at 641.
\textsuperscript{63}Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982) (Supreme Court determined that ordinance compelling apartment building owners to accommodate cable television facilities by making space available for the equipment was an prohibited taking of that company’s resources).
\textsuperscript{64}See supra note 52.
\textsuperscript{65}260 U.S. 393 (1922).
same effect for constitutional purposes as appropriating or nearly destroying it.”

In attempting to devise a method to evaluate whether a law has gone “too far” in restricting liberty, the Supreme Court has come up with factors that should carry the greatest weight: “(1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with investment-backed expectations; and (3) the character of the government action.”

If Capital One had been allowed to keep the money, it would have directly increased usable capital. Section 446(e) interferes with investment-backed expectations by likewise reducing the amount of workable capital and giving ownership of it to the government. The power given to the Commissioner under section 446(e) goes “too far” by taking away a taxpayer’s right to make decisions and giving it to the Commissioner. Abuse of discretion is an extremely difficult standard to overcome for the individual and the decisions of the Commissioner are almost always upheld as a result. This also addresses the due process requirement. If the taxpayer has no viable option to seek redress, then he has not been afforded the protection of due process.

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66 Id. at 414.  
68 See supra note 35-44.
Furthermore, the government is only authorized to exercise its power of eminent domain if the taking is for a "public use." 69 "Public use" has been "expansively defined...so that virtually any taking will meet the requirement." 70

An affirmative defense which would uphold a takings regulation is that, "there is not a regulatory taking when the government’s action leaves reasonable economically viable use of the property." 71 This defense is not available in Capital One since the taking of both the money and of the right to choose its own method of accounting is total and complete.

Lastly, the taking is allowed as long as "just compensation" is provided. 72 The Supreme Court has held that just compensation is "measured in terms of the loss to the owner; the gain to the taker is irrelevant." 73 Assuming the extra money taken from Capital One by using section 446(e) is used to provide more social benefit, the question, in terms of Capital One’s loss, is whether the additional amount of benefit it receives is equivalent to the increase of personal benefit by keeping the money.

69See supra note 52.
70Chemerinsky, supra note 61 at 662.
71Id. at 648.
72See supra note 52.
73Chemerinsky, supra note 61 at 664.
V. Conclusion

In *Capital One*, treating late-fee income as increasing OID would have been a more correct method of calculating taxable income than the current-inclusion method required by the Commissioner. The Tax Court had other avenues which it could have taken in order to reach the same conclusion, that the Commissioner was correct in disallowing Capital One from retroactively changing its returns from 1998 and 1999. However, the court did not take any of these avenues and instead, placed unacceptable weight on section 446(e). The result is an unconstitutional violation of the takings clause exemplified by the intertemporal shift in the time value of money caused by the denial of the use of OID.