GLADWELLIAN TAXATION: DETERRING TAX ABUSE THROUGH GENERAL ANTI-AVOIDANCE RULES

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I. INTRODUCTION

> So far [tax] evasion is not a certifiable form of insanity nor are there yet mental hospitals which admit to their wards for kleptomaniacs those convicted of taxation frauds. We segregate those demonstrably and incurably anti-social in a physical sense, such as confirmed criminals, and those anti-social in a mental sense, such as lunatics and idiots, but not yet those anti-social in an economic sense.[1]

Tax avoidance remains a serious problem worldwide.[2] Decreases in compliance reduce a taxation system's legitimacy, meaning those taxpayers who would ordinarily comply may eventually become less inclined to do so.[3] Tax-funded government programs suffer, impacting those who benefit from them.[4] Tax havens cost an estimated $50 billion USD worldwide.[5] The current annual tax gap is estimated to be approximately $345 billion USD[6] and has gone largely unchanged since 1973.[7]

To reduce tax evasion, most nations use common law anti-abuse doctrines, statutes, administrative rules, or a combination of the three.[8] None of these options have worked completely, and given human nature, it is unlikely that anything will ever fully

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1. Assaf Likhovski, *"Training in Citizenship": Tax Compliance and Modernity*, 32 LAW & SOC. INQUIRY 665, 667 (2007) (quoting VICTOR TRANTER, EVASION IN TAXATION 162-63 (1929)).

2. *See* Chris Evans, *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, 37 HONG KONG L.J. 103, 108-16 (2007).

3. *See* Bret Wells, *Voluntary Compliance: This Return* Might be *Correct but* Probably *Isn't*, 29 VA. TAX REV. 645, 648-49 (2010).

4. *See* Evans, *supra* note 2, at 112; Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569, 575 (2006) [hereinafter Raskolnikov, *Crime and Punishment*] (describing the United States as being in the midst of a tax shelter crisis).

5. Evans, *supra* note 2, at 112.

6. Raskolnikov, *Crime and Punishment*, *supra* note 4, at 574.

7. Wells, *supra* note 3, at 648.

8. *See* Evans, *supra* note 2, at 133-35.

work.[9] However, as this article will outline, some solutions are more effective than others. This article proposes a blended solution, using the concept of power-law distributions and their extension into social science. The first section defines tax abuse and avoidance, distinguishing the two terms. The second section addresses the usefulness of imported tax solutions, and more broadly, comparative tax law. The third and fourth sections detail general anti-avoidance rules (GAARs), using one of the world's oldest GAARs, the Canadian GAAR, for illustrative purposes.[10] Finally, this article proposes a new system, arguing that any true attack on tax avoidance or abuse must be aimed at the tax avoidance mentality, not the tax shelter de jure.

II. AVOIDANCE, ABUSE, EVASION AND PLANNING: DISTINCTIONS WITH A DIFFERENCE

Americans are adamant about their "right" to avoid paying taxes, or at the very least, their "right" to pay as little tax as they can get away with.[11] There is an important distinction between these two concepts. Tax avoidance is "[t]he act of taking advantage of legally available tax-planning opportunities in order to minimize one's tax liability."[12] In plain English, avoidance is using the law to one's advantage without actually doing anything illegal. In contrast, tax evasion is reducing one's taxes in a way that is "contrary to the spirit of the law."[13] While avoidance is allowed by the law, evasion is not.[14] This article addresses the problem of tax evasion.

No mix of criminal sanctions, judicial rules, or administrative rulings will entirely eliminate the problem.[15] The solution, therefore, lies in incentivizing paying taxes, disincentivizing tax avoidance, or both.[16] The task of making the payment of taxes desirable is beyond the scope of this article.

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9. *See id.* at 134-35.

10. WILLIAM I. INNES, PATRICK J. BOYLE & JOEL A. NITIKMAN, THE ESSENTIAL GAAR MANUAL: POLICIES, PRINCIPLES, AND PROCEDURES 3, 35 (Carrie Shimkofsky ed., 2006) (noting that the Canadian GAAR was passed in 1988).

11. *See, e.g.*, Helvering v. Gregory, 69 F.2d 809, 810-11 (2d Cir. 1934), *aff'd*, Gregory v. Helvering, 293 U.S. 465 (1934) ("[A] transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose[s], to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible . . . .").

12. BLACK'S LAW DICTIONARY 1500 (8th ed. 2004).

13. William B. Barker, *The Ideology of Tax Avoidance*, 40 LOY. U. CHI. L.J. 229, 232 (2009).

14. *Id.* at 240.

15. *See* Evans, *supra* note 2, at 133-35.

16. *See id.* at 117.

Instead, this article simply notes that such an undertaking requires not only an overhaul of a nation's tax culture, but also its economic and social cultures on both the national and individual levels.[17] Discouraging tax avoidance, to whatever limited degree possible, may be achieved by a proper mix of anti-abuse rules, which act both as a deterrent to tax avoidance and leverage to allow for the punishment of tax avoiders.[18]

Throughout this article, the term "legislative rules" is used to refer to a mixture of judicial barriers, administrative measures, and Congressional legislation or Treasury regulations. Falling into one of two sub-categories, these legislative rules are either specific anti-avoidance rules (SAARs) or general anti-avoidance rules (GAARs).[19] SAARs are targeted at narrow, "specific areas where abuse has been previously identified or revenue leakage is suspected."[20] Often, SAARs are tied to or inserted into a specific section of a nation's revenue code.[21] However, the SAAR's weakness is its specificity.[22] Additionally, the SAAR is further abated by the fact that it is easily avoided and incorporated into new avoidance activities.[23] In contrast, GAAR's strength is its applicability to particular sections or even the entire revenue code.[24] Its broad language has resulted in its labeling as essentially the "carpet bomb" to a SAAR's "smart bomb."[25]

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17. *See generally* Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71, (2003) (discussing a study on changing a nation's tax culture).

18. *See* Evans, *supra* note 2, at 133-35.

19. *See id.* at 117-18.

20. *Id.* at 117. SAARs run rampant throughout the U.S. Internal Revenue Code. *See* Pamela Olson, *Some Thoughts on Anti-Abuse Rules*, 48 TAX LAW 816, 818 (1995). Subchapter K, which deals with partnerships, has a particularly high number of SAARs. *See, e.g.*, I.R.C. §§ 704, 709, 721, 732, 744, 755, 775 (2006).

21. Subchapter K of the American Internal Revenue Code proves illustrative. The following is a list of SAARs either amended or inserted into Subchapter K since 1984: I.R.C. §§ 61(a)(1), 74(a), 704(c)(1)(C), 709(b)(1), 721(c), 732(f)(1), 755(c), 775(c) (2006); Treas. Reg. § 1.704-1(b)(1)(i) (as amended in 1997); *id.* § 1.704-4(d)(1)(iv) (as amended in 2005); *id.* § 1.705-2(b)(2)(i) (as amended in 2003); *id.* § 1.706-1(a)(1),(6)(i) (as amended in 2002); *id.* § 1.708-1(c)(1),(d)(1) (as amended in 2001); *id.* § 1.731-2(a) (as amended in 1997); *id.* § 1.752-2(h)(3) (as amended in 2006); id. § 1.761-2(d)(2)(A)(ii) (as amended in 1995).

22. Evans, *supra* note 2, at 118.

23. *Id.*

24. *See id.*

25. *Id.* at 102.

III. GAAR SPECIFICS

GAARs have three common elements: a trigger, which is usually tax avoidance;[26] a tax benefit, which flows from the trigger;[27] and a reconstruction provision, which provides authority to rewrite the abusive transaction and for tax to be levied against the taxpayer as if the abusive transaction had never occurred.[28]

A. *The Strengths and Weaknesses of GAARs*

GAARs, like so much in the realm of tax law, are imperfect. To this end, many of its perceived strengths are also its weaknesses. For example, GAARs are flexible, broad standards.[29] Such flexibility affords both the ability to keep up with a fast-paced tax shelter industry and decreased certainty in the law for non-abusive taxpayers. This section will explain the strengths and weaknesses of GAARs.

1. GAARs are Broad, Flexible Standards

A GAAR, by definition, is broadly written. Unclear boundaries make it far more difficult for avoidance-minded taxpayers to plan around or right up to its limitations.[30] From this, GAARs are nimble, flexible rules that can easily expand to cover the latest tax shelter.[31] They also eliminate the traditional lag between the introduction of a tax shelter and the promulgation of a SAAR prohibiting it.[32]

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26. *See* Graeme S. Cooper, *International Experience with General Anti-Avoidance Rules*, 54 SMU L. REV. 83, 98 (2001).

27. *Id.* at 102.

28. *Id.* at 103-04. For an alternative analysis of anti-abuse rule structure, *see* generally Nabil Orow & Eu-Jin Teo, *Duties General Anti-Avoidance: Lessons From Income Taxation*, 7(2) J. AUSTL. TAX'N 251 (2004), http://www.austlii.edu.au/au/journals/JIATax/2004/8.html.

29. Dep't of the Treasury, *The Problem of Corporate Tax Shelters: Discussion Analysis and Legislative Proposals*, July 1999, *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/ctswhite.pdf.

30. *See* Evans, *supra* note 2, at 118.

31. John Prebble, *Ectopia, Formalism, and Anti-Avoidance Rules in Income Tax Law*, 1 VUWLRP 27, 372 (2011) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1588358. Prebble notes that "[a] general rule acts as a back-stop to narrow, regime-specific rules," because governments cannot predict the myriad ways in which people will attempt to avoid paying their taxes. *Id.*

32. *See* Richard Lavoie, *Subverting the Rule of Law: The Judiciary's Role in Fostering Unethical Behavior*, 75 U. COL. L. REV. 115, 193-94 (2004) (discussing the wide reach of GAARs).

However, this same flexibility results in a marked decrease in the certainty of tax law.[33] Taxpayers and their advisers may be unsure of whether a new method of structuring a transaction is an illegal tax shelter or a legitimate way to do business. Such uncertainty hits taxpayers, especially those with no interest in avoiding taxes, the hardest. After all, a taxpayer attempting to avoid taxation knows her transaction is illegitimate. Thus, the question is whether she can avoid the GAAR and any applicable SAARs. On the other hand, the question for a taxpayer trying to conduct business is whether the legitimate transaction that may have the effect of reducing the taxpayer's tax burden, or is the lesser taxed choice from a menu of alternative structures, could still be voided under the GAAR, notwithstanding the taxpayer's legitimate goals.

The fact that transactions escaping the reach of SAARs may still be subject to GAARs further decreases certainty in tax law.[34] For example, a transaction deemed legitimate under a SAAR may be prosecutable under a GAAR, or the SAAR could completely trump the GAAR.[35] The question is whether the taxpayer may only be charged with a violation of one or both of the statutes. The answer to this question lay not with GAARs, as they would be overly long or specific, leaving many issues subject to judicial resolution. It should be noted that neither judicial interpretation nor uncertainty in tax law is negative.

Uncertainty prevents taxpayers from creeping too close to the line between abuse and avoidance, allows the GAAR to keep up with new transactions, and allows judges to fill in the gaps of the GAAR in unanticipated situations.[36] Yet certainty is prized in the law, and even more so in tax law.[37] Confidence is necessary in order to structure transactions and conduct business.[38] Therefore, anything that decreases certainty and reduces the incentive to conduct business is undesirable. For

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33. Eugene Trombitas, *The Role for a General Anti-Avoidance Rule in a GST*, 13 N.Z. J. TAX L. & POL'Y 396, 396, 400 (2007); Martin J. McMahon Jr., *Beyond A GAAR: Retrofitting The Code To Rein In 21st Century Tax Shelters*, TAX NOTES, Mar. 17, 2003, at 1736; Prebble, *supra* note 31, at 372.

34. Eugene Trombitas, *Trinity Exposed: Does the Emperor Really Have No Clothes or is He Wearing an Unusual Silver Rugby Jersey? – The Latest News from the GAAR Front*, 13 N.Z. J. TAX L. & POL'Y 583, 602 (2007).

35. Cooper, *supra* note 26, at 106.

36. *See, e.g.*, Barker, *supra* note 13, at 230.

37. *See* Andrea Monroe, *What's in a Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 CASE W. RES. L. REV. 401, 420-21 (2010).

38. *See id.*

such reasons, commentators have referred disparagingly to GAARs as "carpet bombs"[39] or "loose can[n]on[s] [*sic*]."[40]

2. GAARs are Dependent on Judicial Interpretation

While GAARs are legislative anti-abuse rules, their vagueness ties them to a nation's judiciary.[41] Tasked with the duty of interpreting the GAAR and the section of the tax code supposedly being abused, judges must determine the GAAR's applicability, often in the face of SAARs and the looming specter of the right to plan one's taxes.[42] Thus, judicial interpretation can make or break the GAAR. Judges can ignore it, decide cases on other grounds, or use it incorrectly.[43] But judges alone are not to blame. Attorneys are responsible for raising and arguing statutes, regulations, and cases before a court, and are often asked for input when such rules are being drafted.[44] A GAAR, therefore, at its core, is dependent not only on judicial application and understanding, but also on the advocacy of the tax bar.[45]

There are really two tax bars: a legitimate transactional tax bar, which structures "real" deals, or deals that are imbued with economic substance and business purpose, and the tax shelter bar, which trips lightly along the line between legitimacy and tax avoidance, structuring deals for the sole purpose of reducing the overall tax burden of clients.[46] The transactional tax bar and the tax shelter bar advocate for two different types of rules. The tax shelter bar takes literally "the general rule that lawyers are to advance the interests of their clients as vigorously as is permitted by law. . . . [T]his approach is reinforced by the view that no taxpayer is obligated to pay a dollar more in taxes than

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39. Evans, *supra* note 2, at 118.

40. Cooper, *supra* note 26, at 117.

41. *See* discussion *infra* Part III.C.-D.

42. *See infra* Part III.C.-D. *Cf.* Can. Trustco Mortg. Co. v. R., [2005] 2 S.C.R. 643 (Can.) (explaining the three-step application of the GAAR).

43. *See infra* Section III.C.-D. (discussing the fate of Canada's GAAR in the court system). This is strikingly similar to the American experience with Treasury Regulation 1.701-2. Treasury Regulation 1.701-2, which is like a GAAR in many respects, was largely ignored by both practitioners and judges after it was promulgated, and now is effectively a dead regulation. For a discussion of Treasury Regulation 1.701-2, including a history of the Regulation, see Andrea Monroe, *supra* note 37.

44. *See* Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REG. 77, 97 (2006).

45. *See* Barker, *supra* note 13, at 230.

46. Joseph Bankman, *The Business Purpose Doctrine and the Sociology of Tax*, 54 SMU L. REV. 149, 150 (2001) (citing Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. *47*, 55-57 (2001)).

the law requires."[47] At the most obvious level, members of the tax shelter bar prefer bright-line rules.[48] They make their living by going right up to the line. A fuzzy standard makes finding that line, and from that, crafting a transaction that decreases the client's tax burden without landing the client before the IRS or a court, that much harder.[49] Members of the legitimate transactional bar, in contrast, do not mind a world where fuzzy standards coexist, and occasionally, override bright-line rules.[50] Of course, membership in these two tax bars is mutually exclusive.[51] A lawyer may only operate in one or the other. It is more likely that a lawyer moves between the two bars, depending on where she is in her career, her client, her firm, the transaction, state of the law, or a plethora of other factors.[52]

The tax shelter bar's self-interest is troubling. Practitioners are in part responsible for helping to draft and for the characterization of GAARs.[53] These same practitioners argue the favorability of GAARs in court. The issue is not that they should be prevented from arguing points of law relevant to the issues at hand.[54] However, courts and Treasuries should recognize that this "means that drafting tax shelter legislation while seeking the approval of the self-protective professional associations, or allowing them to dodge responsibility for the problem, is a pointless exercise."[55]

If the GAAR depends on judicial interpretation, and judicial interpretation leans too heavily on practitioner characterization, then the GAAR depends on practitioner characterization. If practitioner characterization is, as it is argued, influenced by the tax shelter bar's self-interest in continuing the tax shelter business,[56] then the GAAR is interpreted in light of the tax

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47. Paul R. McDaniel, *Territorial vs Worldwide International Tax Systems: Which Is Better for the U.S.?*, 8 FLA. TAX REV. 283, 299 (2007).

48. *See* Bankman, *supra* note 46, at 150.

49. *See id.*

50. *See id.*

51. *See* Canellos, *supra* note 46, at 55.

52. *See id.*

53. Wells, *supra* note 3, at 665-66 ("In 1985, the American Bar Association released a formal opinion that 'lawyers must maintain their oath to uphold the law and must work to instill public confidence in the tax system,' disavowing the practices of the tax shelter bar. The ABA then released guidelines for giving tax advice based on a 'realistic probability of success' in the matter, meaning that the lawyer must, in good faith, believe that her position is warranted by existing law or can be supported by a change in the law.") (citing ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 85-352 (1985)).

54. *See* Lee A. Sheppard, *Drafting Economic Substance*, 92 TAX NOTES 1262, 1262-63 (2001).

55. *Id.*

56. *See id.*

shelter bar's interest in continuing to purvey tax shelters. If the GAAR is interpreted to continue to allow most tax shelters, then the GAAR's worth is significantly diminished. The judiciary maintains the ability to prevent such an outcome.[57]

B. *GAARs Must Often be Rewritten*

The interplay and tension between the GAAR's strengths and weaknesses often result in GAARs being redrafted at least once after being issued.[58] The need to rewrite is, as with much else with GAARs, a strength and a weakness. Definitions or interpretive practices that seemed to work in theory may not work in practice. A GAAR's dependence on the judiciary only exacerbates this problem. The legislature cannot always predict judicial or practitioner response to a GAAR or any other legislation. Theoretically, a GAAR should be nimble enough not to require redrafting. Yet, protests from practitioners, judicial interpretation, and drafting error from the legislature may lead to revisions of the GAAR. The desire to more explicitly exclude or include transactions or characteristics from consideration in the GAAR may also lead to revisions.

Rewriting a GAAR is difficult. It requires knowledge of the current and projected future status of tax shelters, the nation's tax culture, and the goals of the nation's Revenue Service.[59] Enacting a GAAR is also difficult and often controversial.[60] Thus, amending a GAAR has the potential to be even more controversial, raising the specter of enacting something even worse than the original GAAR, or at the very least, disturbing the status quo. It is likely that legislators may be unwilling to amend a GAAR, having struggled to enact one, leaving the nation with a poorly written, untenable GAAR.

Redrafting a GAAR allows a nation to tailor its laws to fit its experiences. Ideally, this allows for a more effective GAAR. However, it also poses problems. The potential for continual redrafting seriously decreases certainty. The infinite number of revisions available result in taxpayers having no guarantee that the way they structure a transaction today, in compliance with

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57. *See* Rostain, *supra* note 44, at 115 (indicating that the judiciary's revival of the GAAR in times of great need could prevent it from being overused or used in situations where it would be overkill).

58. *See* Dep't of the Treasury, *supra* note 29, at 122; Cooper, *supra* note 26, at 120-22.

59. *See* Michael A. Livingston, *Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax*, 18 CAN. J. L. & JURIS., 119, 131 (2005).

60. Cooper, *supra* note 26, at 85.

their GAAR, will be a legitimate way to structure transactions in the future if and when their GAAR is redrafted.

Redrafting poses other difficulties. The first arises from undefined terms. Commentators often state that GAARs must be tied to a nation's "tax culture," yet they rarely, if ever, define this term.[61] The questions that logically follow are whether tax culture can be defined, what legislators should look for when attempting to tailor a GAAR to a tax culture, and whether there are really at least two tax cultures in any nation. The second difficulty originates with taxpayers. There are those taxpayers who neither avoid nor evade taxes.[62] They intend to complete only legitimate transactions. On the opposite end, however, are those who actively avoid taxes.[63] This is the group at whom GAARs should be targeted. Complicating matters even more are taxpayers who fall somewhere between these two extremes: those who pay taxes depending upon available tax breaks.[64]

IV. THE CANADIAN GAAR

This section will discuss the Canadian GAAR in depth to illustrate both the pitfalls and successes of GAARs. The Canadian GAAR has been chosen due to the length of time that has passed since it was first enacted,[65] the multiple problems it has faced since its enactment,[66] and the fact that it has served as a model for many other nations' GAARs.[67] The first part will

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61. *See* Livingston, *supra* note 59, at 122-124 (analyzing various definitions of "tax culture" and discussing problems inherent in the study of tax culture).

62. *See* Todd Spangler, *Who's Not Paying Federal Income Tax*, USA TODAY, October 12, 2011, http://www.usatoday.com/money/economy/ story/2011-10-06/income-tax-nonpayment/50676912/1.

63. *See id.*

64. *See id.*

65. The Canadian GAAR was introduced in 1987 and enacted in 1988. Dep't of the Treasury, *supra* note 29, at 122.

66. *See* Cooper, *supra* note 26, at 120 (discussing how one of the reasons Canada enacted a second generation GAAR was because the first was "largely left to languish as a dead letter").

67. Many other nations have GAARs, including Australia (*Income Tax Assessment Act 1936* (Cth) pt IVA s 177D, *available at* http://www.comlaw.gov.au/Details/C2011C00758); China (EIT. Article 47, 94, 120, *available at* http://www.fdi.gov.cn/pub/FDI _EN/Laws/law_en_info.jsp?docid=122121); Germany (Abgabenordnung [Fiscal Code of Germany], Oct. 1, 2002, BGBL. I at 3866, § 42 (Ger.), *available at* http://www.gesetze-im-internet.de); Hong Kong (Inland Revenue Ordinance, (2010) Cap. 142, 123, § 61A, *available at* http://www.hklii.org); Malaysia (Income Tax Act 1967, section 140, *available at* http://www.agc.gov.my/Akta/Vol. 2/Act 53.pdf (page 256)); New Zealand (Income Tax Act 2007, Subpart BG1, Subpart GA, *available at* http://www.nzlii.org); Singapore (Income Tax Act, Chapter 134, Section 33, *available at* http://statutes.agc.gov.sg/); South Africa (Income Tax Act 58 of 1962 § 80, *available at* http://www.acts.co.za/).

discuss the factors leading the Canadian Parliament to enact a GAAR. The second part will explain the drafting struggles faced by Parliament. The third part will discuss the initial reaction to the GAAR and outline the two major GAAR cases decided by the Tax Court. The fourth part will discuss the two seminal GAAR cases decided by the Supreme Court of Canada. The fifth part will analyze the state of the GAAR in today's Canada, concluding that while it is unlikely that the GAAR will ever be repealed, the GAAR's future, with regards to use and interpretation, is more uncertain now than ever before.

A. *Why a GAAR?*

"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."[68] This principle, known as the Duke of Westminster principle, has survived into modern Canadian tax law.[69] It has resulted in strict loyalty to form and substance on the part of the Canadian courts, which the Supreme Court of Canada affirmed in *Stubart Investments Ltd. v. Regina.*[70] The *Stubart* case overruled the previous business purpose anti-abuse test because it "disallowed deductions that the [Internal Revenue] Act" expressly permitted, "thereby defeating the social goals of taxation."[71] According to the Court, the goals of taxation expand beyond raising revenue and "include the furthering of equity in raising that revenue, and the indirect promotion of [certain] fiscal and social goals."[72]

The Court also rejected the use of strict rules of statutory interpretation. Under *Stubart*, "[w]here the substance of the Act, when the clause in question is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question."[73] Put another way, *Stubart* required a purposive approach to statutory interpretation instead of a plain-text approach.

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68. Commissioners of Inland Revenue v. Duke of Westminster, [1936] A.C. 1 (P.C.).

69. *See* David G. Duff, *Lipson v. Canada: Whither the Canadian GAAR?*, 2 B.T.R. 161, 166 (2009) (Can.) (discussing how the 2009 *Lipson* case may indicate a willingness of modern Canadian Supreme Court justices to limit the scope of the principle in ways they had not done so before).

70. Stubart Invs. Ltd. v. The Queen, [1984] 1 S.C.R. 536, 575-76 (Can.).

71. *Id.* at 575-76; *see also* David Crerar, Comment, *Interpretations of GAAR: Before and Beyond* McNichol *and* RMM, 23 QUEEN'S L.J. 231, 235 (1997).

72. Crerar, *supra* note 71, at 236.

73. *Stubart*, 1 S.C.R. at 580.

Parliament vehemently objected to *Stubart*.[74] However, tax payers and their advisors favored the case, as it made tax avoidance easier than it had been under the business purpose regime.[75] There was an aggressive spike in avoidance transactions post-*Stubart*, which would have been illegal under the now overturned business purpose test.[76] Exacerbating these revenue losses was the fact that, at the time of the *Stubart* decision, Canada was in the midst of an economic downturn.[77] The "tax overhang," or the difference in the amount of tax owed to the government and the amount of tax actually paid, was approximately $20 billion, and was estimated to increase in the coming years.[78] Additionally, the Ministry lacked the power to make new rulings retroactive. A new code section could be enacted to eliminate one form of abuse, but taxpayers were not grandfathered in.[79] As the deficit reached crisis status, Parliament realized that something had to be done, but was also aware that the taxpayers would not tolerate tax increases, particularly at the voting booth.[80]

Stubart's rejection of the business purpose test was the driving factor in Parliament's decision to enact a GAAR.[81] Another reason for enacting a GAAR was the general culture of Canadian taxation.[82] Canadian courts tend not to use legislative history to aid in statutory interpretation.[83] The courts instead lean heavily on plain-text interpretations of the law.[84] The GAAR forces courts to look at intent and disallow transactions that are consistent with the letter of the law, but not its spirit.[85] This aggressively overturns the usual plain-text based interpretive approach.[86]

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74. INNES ET AL., *supra* note 10, at 3, 27.

75. *Id.* at 28.

76. *Id.*

77. Jocelyne Bourgon, *Program Review: The Government of Canada's Experience Eliminating the Deficit, 1994-99: A Canadian Case Study*, *in* THE INSTITUTE FOR GOVERNMENT, 13, 1999, http://www.institut eforgovernment.org.uk/pdfs/Canada's_deficit.pdfs.

78. INNES ET AL., *supra* note 10, at 3.

79. Crerar, *supra* note 71, at 239.

80. *Id.*

81. INNES ET AL., *supra* note 10, at 4.

82. Livingston, *supra* note 59, at 130-31.

83. *Id.*

84. *See id.* at 130.

85. *Id.*; *see also* Canada Income Tax Act § 245 (R.S.C., 1985 c.1-4 (5th Supp.)) (Can.), *available at* http://laws.justice.gc.ca/en/ showdoc/cs/i-3.3/bo-ga:l_I_2/20091005/en.

86. Livingston, *supra* note 59, at 130.

The GAAR was also intended to fulfill the taxation goals advanced in *Stubart*.[87] For example, *Stubart* advocated equity in the raising of revenue.[88] One taxpayer's gain through avoidance results in losses to another innocent taxpayer, as the Ministry raises taxes in an attempt to make up lost revenue from avoidance.[89] This burden falls on the average Canadian, who lacks the funds, time, and expertise to engage in the complex tax avoidance transactions favored by larger, wealthier entities.[90] Tax avoidance results in a general net loss to society from the decrease in revenue standing alone.[91] When considering the time, labor, and money spent in attempting to avoid tax and the opportunity costs involved in tax avoidance, this loss is dramatically increased.[92]

B. *Drafting a GAAR: Versions 1, 2, 3 and 4.0*

The Canadian GAAR is an anti-avoidance statute that overlays the entire Internal Revenue Act.[93] It disallows tax benefits unless the transaction resulting in the benefit was reasonably considered to have a bona fide purpose other than obtaining the benefit.[94] The Commissioner of Revenue can recast the transaction and levy tax as if the benefit had never been obtained.[95] However, the current GAAR was not Parliament's first attempt at writing a GAAR; it was its fourth.[96]

The first mention of the GAAR occurred in a speech delivered by the Minister of Finance on February 18, 1987.[97] His speech was followed by a White Paper issued by the Canadian Revenue Agency (CRA).[98] The White Paper concluded that a GAAR was necessary to stave off the increasing revenue losses, and it provided a draft of the GAAR for commentary by tax professionals and scholars.

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87. Crerar, *supra* note 71, at 236-37.
88. *Id.* at 240.
89. *See id.* at 241.
90. *Id.*
91. *Id.* at 245.
92. *Id.*
93. *Id.* at 256-57.
94. Canada Income Tax Act § 245(3)(a).
95. *Id.* § 245(5).
96. *See* INNES ET AL., *supra* note 10, at 34-36 (noting the numerous revisions made to § 245 of the GAAR).
97. *Id.* at 28.
98. *Id.*

The reaction to the GAAR was swift and negative.[99] Some thought that a GAAR, no matter how drafted, was unnecessary.[100] Others thought that the problem lay not with the taxpayers, but with the CRA.[101] Practitioners and commentators alike believed that the CRA should do a better job with the tools at hand, instead of inventing tools to cover up its own bureaucratic inadequacies.[102] Further criticism surrounded what some believed was the GAAR's unconstitutionality and similarity to the business purpose doctrine rejected in *Stubart*.[103] Commentators raised concerns that courts would ignore the proposed GAAR, leaving it to languish as a dead law.[104] Finally, the proposed GAAR, due to its vagueness, could give the CRA an incredible amount of power and discretion.[105] Commentators and practitioners feared the potential abuse of power which could force settlements where taxpayers may have prevailed in court.[106] This problem would be exacerbated due to the newness of the GAAR.[107] Courts might not know exactly how to apply it, or might be unwilling to use it, and taxpayers would be more likely to settle, even when they might not have to or want to.[108]

After this unfavorable reaction, the draft GAAR was sent to the House and Senate for review and revision.[109] The Senate rejected the GAAR outright.[110] The House made several changes to the draft bill.[111] Practitioners and academics were split in terms of support.[112] No matter its form, practitioners remained almost unanimously opposed to the GAAR.[113] Academics, however, took a more tempered view.[114] They felt that the GAAR, as it currently stood, was untenable, but that it was conceptually a useful tool for the CRA.[115] After revisions, the

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99. *Id.* at 4-5.
100. *Id.*
101. *Id.*
102. *Id.* at 31.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 32.
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*

GAAR was released on February 16, 1987.[116] Among other changes, the House eliminated language similar to the business purpose clause in the original draft, which stated that "notwithstanding any other provision . . . the income, taxable income, tax payable or other amounts payable . . . shall be determined as is reasonable in the circumstances ignoring the transaction."[117] This revised regulation, the "GAAR 2.0" exempted transactions that did not abuse a specific provision of the Income Tax Act and authorized the use of Explanatory Notes issued by the Ministry of Finance for the courts as an interpretive aid for the GAAR.[118] Despite its revisions, the "GAAR 2.0" was rejected and sent back for further edits.[119] The "GAAR 3.0" was released on April 13, 1988, but like its predecessors, it was also rejected.[120] In contrast to earlier versions of the GAAR, however, its revisions were mostly minor and technical and included a clause explicitly denying GAAR interference in legitimate commercial and family transactions.[121] The GAAR's final revision was completed on June 30, 1988, and is the current version of the Canadian GAAR.[122]

The Honorable Michael H. Wilson, the Minister of Finance, issued The Explanatory Notes to Legislation Relating to Income Tax ("Explanatory Notes") in 1988 to aid in interpreting the GAAR.[123] The Explanatory Notes stated that the GAAR's purpose was to "prevent abusive tax avoidance transactions or arrangements but at the same time not intended to interfere with legitimate commercial and family transactions."[124] Additionally, the GAAR was also necessary to distinguish between legitimate tax minimization under the Duke of Westminster principle from abusive tax avoidance.[125] This line has proven to be exceedingly fuzzy. Revenue Canada released Circular 88-2 Supplement 1 in 1990, which lists five examples of transactions that would not constitute abuse covered by the GAAR, as well as six examples that would.[126]

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116. *Id.* at 33.
117. *Id.*
118. *Id.* at 34.
119. *Id.*
120. *Id.*
121. *Id.* at 34-35.
122. *Id.* at 35-36.
123. *Id.* at 36.
124. *Id.* at 35.
125. *See id.*
126. Revenue Canada Taxation, Information Circular, 88-2 Supplement 1 para. 3-9 (July 13, 1990), http://www.cra-arc.gc.ca/E/pub/tp/ic88-2sl/ic88-2sl-e.txt.

C. *The Tax Court and the GAAR*

As feared, the GAAR sat virtually unused for almost nine full years after its enactment. The first two cases to utilize the standard were *McNichol v. R*[127] and *RMM Canadian Enters. Inc., v. R.*[128] In the *McNichol* case, two taxpayers set up a partnership and a holding corporation to build and buy an office building.[129] After the partnership dissolution and sale of the holding corporation, they owned the building.[130] From the sale of their holding corporation, the taxpayers received $75,000 over the adjusted cost base of their shares in their holding corporation.[131] This $75,000 surplus was not taxed, however, because the taxpayers characterized it as capital gains under section 110.6 of the Internal Revenue Act.[132]

The *McNichol* court applied the GAAR using a purposive analysis approach. Focusing on the GAAR's "object and spirit," the court gave the GAAR its "full effect" to deny the tax benefits.[133] This reaffirmed then-recent Supreme Court pronouncements, which held that substance, not form, determined the validity of tax avoidance transactions.[134] *McNichol* stood for a "large and liberal" reading of the GAAR, following both a "plain meaning" and "object and spirit" analysis of the GAAR to block tax avoidance transactions that were not otherwise expressly allowed in the Income Revenue Act.[135]

In the *RMM* case, Equilese Corporation, a co-defendant, sold shares in its Canadian subsidiaries to RMM.[136] After the sale, Equilease was "wound up into RMM," and one of its Canadian subsidiaries was "amalgamated with RMM."[137] The Ministry of Finance claimed that under Section 84(2) of the Income Tax Act, "the amounts RMM paid to Equilese Corporation were 'deemed dividends,'" because "they exceeded Equilese Limited's paid-up capital."[138] The court also held that the transaction was abusive under the GAAR.[139] Conceding that it could have reached the

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127. [1997] 97 D.T.C. 111 (T.C.C.) [hereinafter *McNichol*].
128. [1997] 97 D.T.C. 302 (T.C.C.) [hereinafter *RMM*].
129. *McNichol*, 97 D.T.C. para. 1.
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.* para. 23.
134. Crerar, *supra* note 71, at 246-47.
135. *Id.* at 247.
136. *RMM*, 97 D.T.C. para. 6.
137. *Id.*
138. *Id.* para. 10-11.
139. *Id.*

same conclusion without it, the court still endeavored to analyze the transaction under the GAAR.[140] The *RMM* court drew heavily on *McNichol*, as well as another case, *Harris v. Minister of National Revenue*,[141] which was based on Section 137 of the Internal Revenue Act.[142] Section 137 was the precursor provision to the GAAR.[143] As interpreted in *Harris*, this provision allowed for an alternative method to strike down transactions that had as their sole purpose the artificial reduction of income.[144] The court cited *Harris* for this proposition and *McNichol* for the proposition that the GAAR blocked transactions that take "advantage of a divergence between the effect of the transaction, viewed realistically, and what, having regard to the legal form, appears to be the effect."[145] Thus, under *RMM*, the GAAR became a general device to interpret the Internal Revenue Act as a whole Act, as opposed to interpretation of individual provisions of the Internal Revenue Act.[146]

D. *The Supreme Court and the GAAR*

The Supreme Court did not take any GAAR cases until 2005, when it decided *Canada Trustco Mortgage Company v. R.*[147] and its companion case, *Matthew v. R.*[148] Both cases involved tensions between the GAAR and a specific anti-avoidance provision of the Income Tax Act.[149] The *Canada Trustco* Court paid due deference to the Duke of Westminster principle.[150] However, the Court held that the Income Tax Act must be

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140. *Id.* para. 16.

141. [1966] 66 D.T.C. 5189 (T.C.C.).

142. *See RMM,* 97 D.T.C. para. 50.

143. *Id.*

144. *Id.*

145. Crerar, *supra* note 71, at 248 (citing McNichol v. R., [1997] 97 D.T.C. 111 (T.C.C.)).

146. Crerar, *supra* note 71, at 248-49.

147. [2005] 2 S.C.R. 601 (Can.).

148. Mathew v. Canada, [2005] 2 S.C.R. 643 (Can.). During the time between *RMM*, *McNichol* and the Supreme Court cases discussed in this section, many commentators came to believe that the GAAR had become an ineffective law, or, more strongly, a dead letter law. Canadian tax expert Brian Arnold went so far as to propose the revision and re-issue of the GAAR in an article entitled "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule." Brian J. Arnold, *The Long, Slow, Steady Demise of the General Anti-Avoidance Rule*, 52 CAN. TAX J. 488, 489 (2004). However, his proposals, which are discussed at length in his article, while interesting, became moot points once the Supreme Court took up *Mathew* and *Canada Trustco*. As such, they will not be discussed in this article.

149. Can. Trustco Mortg. Co. v. R., [2005] 2 S.C.R. 601, para. 1 (Can.) [hereinafter *Trustco*]; Mathew v. Canada, [2005] 2 S.C.R. 643, para. 1 (Can.) [hereinafter *Mathew*].

150. *Trustco*, 2 S.C.R. para. 11.

interpreted according to a "textual, contextual, and purposive analysis to find a meaning that is harmonious with the Act as a whole."[151] Generally, the Court's ultimate role was to harmonize the GAAR, the Duke of Westminster principle, and the other provisions of the Income Tax Act.[152] In doing so, the Court employed a three-step analysis.[153] The first step involved determining whether there was a tax benefit arising from a transaction within the meaning of the statute.[154] "The second step [wa]s to determine whether the transaction [wa]s an avoidance transaction under s. 245(3), in the sense of not being arranged primarily for *bona fide* purposes other than to obtain the tax benefit.[155] The final step was to determine if the avoidance transaction was abusive, as defined by the GAAR.[156]

1. Mathew v. Regina

The Court's next case, following *Canada Trustco* was *Mathew v. Canada*.[157] Here, the Court followed the same general principles of law and statutory interpretation[158] as well as the same three-step GAAR analysis as in *Canada Trustco*.[159] The goal, as in *Canada Trustco*, remained to conduct a "unified textual, contextual, and purposive analysis of the provision giving rise to the tax benefit in order to determine why there were put in place and why the benefit was conferred."[160] The court's "goal [wa]s to arrive at a purposive interpretation that [wa]s harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act."[161] However, in this case, the Court failed to mention the impact of the Duke of Westminster principle in its reasoning.[162]

2. The Three Steps of GAAR Analysis

Unlike *Canada Trustco*, the Court did not discuss the first two steps in any detail.[163] The Court instead focused its

151. *Id. para.* 10.
152. *Id. para.* 13 (internal citations omitted).
153. *Id. para.* 17.
154. *Id.*
155. *Id.* (internal citations omitted).
156. *Id.*
157. [2005] 2 S.C.R. 643 (Can.).
158. *Id. para.* 31.
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.*
163. *Id.*

attention on whether or not the claimed tax benefits, which were $10 million in losses, were abusive.[164] The Court noted that as in *Canada Trustco*, the burden was on the taxpayer to refute the presence of a tax benefit and the avoidance transaction.[165] However, the Minister of Finance had the burden of establishing the existence of abusive tax avoidance.[166] Doubts as to the existence of an abusive tax avoidance transaction were resolved in favor of the taxpayer.[167]

As in *Canada Trustco*, the Court rejected a narrow textual analysis of the Income Tax Act, and instead relied on a "unified textual, contextual, and purposive approach to interpretation."[168] The Court noted that these three concepts did not necessarily warrant three separate considerations because they were inexorably intertwined in the search for legislative purpose.[169]

The Court then applied that principle to the facts at hand.[170] In *Mathew*, the allegedly abusive losses were claimed under sections 18(13) and 96(1) of the Income Tax Act.[171] Section 96(1), on its face, did not place any restrictions on loss sharing between partners, except for foreign partners.[172] Accumulated losses would be divided among all partners who entered the partnership before the end of the tax year.[173] Section 18(13) required that the partnership not deal at arm's length with the taxpayer.[174]

The Income Tax Act generally did not allow for the transfer of losses between taxpayers.[175] Subject to specific exceptions, each serves a particular Parliamentary purpose. This did not automatically mean that the partners in the present case could not transfer losses under section 18(13); rather, their transfer just could not be abusive.[176] "The purpose of [s]ection 18(13) [wa]s to prevent taxpayers who [we]re in the business of lending money from claiming a loss upon the superficial disposition of a mortgage or similar non-capital property."[177]

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164. *Id. para.* 32, 35.
165. *Id. para.* 31.
166. *Id.*
167. *Id.*
168. *Id. para.* 42.
169. *Id. para.* 43.
170. *See Id. para.* 42-54.
171. *See Id. para.* 3, 8-9, 44.
172. *Id. para.* 45.
173. *Id.*
174. *Id. para.* 46.
175. *See Id. para.* 58.
176. *See id.*
177. *Id. para.* 53.

3. Were the Transactions Abusive, In Light of the GAAR?

If the tax benefit claimed is within the object, spirit, or purposes of sections 18(13) and 96(1), then the tax benefit will be allowed under the GAAR.[178] The Court did not allow this tax benefit rule in *Mathew*.[179] Sections 18(13) and 96 disallow arm's length parties from accepting 18(13) tax losses and claiming them as their own.[180] The two sections together are intended to "allow the preservation and sharing of losses on the basis of shared control of the assets in a common business activity."[181]

The *Mathew* court concluded that the taxpayers formed the subsequent partnership simply to realize and allocate tax losses.[182] Neither partnership in *Mathew* ever dealt in real property, except for the original mortgage portfolio sold to the partnerships by the Standard Trust Company (STC).[183] STC was never in a partnership relationship with either entity.[184] To allow the transaction in the case at bar would be to circumvent the spirit and purpose of 96(1) and 18(13).[185] The series of transactions went against Parliament's purpose of "confining the transfer of losses such as these to a non-arm's length partnership."[186]

E. *Reaction to Canada Trustco and Mathew*

A question raised after *Canada Trustco* and *Mathew* was whether the GAAR was necessary to the corpus of Canadian tax law.[187] *Canada Trustco* and *Mathew* held that courts must follow a "textual, contextual, purposive approach to statutory interpretation" for all provisions of the Act.[188] The GAAR's redundancy initiates from its provisions that courts to do the same.[189] Some argued that the Court did not mean for the textual, contextual, purposive interpretation to be used in all GAAR cases and that courts should use the Duke of Westminster

178. *See Id. para.* 57.
179. *See Id. para.* 63-64.
180. *See Id. para.* 55.
181. *Id. para.* 62.
182. *Id. para.* 61.
183. *Id. para.* 62.
184. *Id.*
185. *Id. para.* 63.
186. *Id. para.* 62.
187. *See* Benjamin Alarie et al., *Symposium on Tax Avoidance After Canada Trustco and Mathew: Summary of Proceedings*, 53 CANADIAN T.J. 2010, 1024 (2005).
188. *Id.*
189. *See id.*

approach in all other cases.[190] This approach is consistent with the Court's attempts to harmonize the GAAR with the Duke of Westminster principle.[191]

Brian Arnold, a noted tax commentator, maintains his conclusion that the GAAR is not necessary.[192] In *Mathew*, the Court clearly held that all statutes, including the Income Tax Act, must be interpreted under the purposive/contextual rule, and that literal interpretation is not appropriate.[193] Therefore, the Act, both at the individual provisionary level and as an entire Act, must be interpreted textually, contextually, and purposively. *Canada Trustco* contradicted this, stating that the Act should be interpreted literally until the GAAR is reached.[194] Arnold argues that there is simply no justification for using a literal interpretation.[195] However, if courts use the modern standard, then transactions that abuse the provision's purpose will fail and the tax benefit will be unavailable without any need to analyze the transaction under the GAAR.[196] Therefore, the GAAR is unnecessary.[197] Due to the glaring inconsistencies from the Court as to the proper method of statutory interpretation, though, the GAAR may continue to be necessary until such time as those inconsistencies are resolved.

Other commentators see a role for the GAAR, particularly because after these two Supreme Court cases, the "GAAR itself . . . [became] an interpretive device for the entire Income Tax Act."[198] The "dead letter" nature of the GAAR, combined with its vagueness, is its saving grace.[199] Because taxpayers may be more inclined to be more conservative when planning transactions, there is no legislative bull's-eye to manipulate or avoid, unlike more specific anti-avoidance rules.[200] Due to these factors, the GAAR "infuses an anti-avoidance purpose throughout the Act," perhaps evolving anti-avoidance into one of the principles of taxation discussed in *Stubart*.[201] The GAAR, as a

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190. *See id.*

191. *See id.* at 1014.

192. Brian J. Arnold, *Policy Forum: Confusion Worse Confounded- The Supreme Court's GAAR Decisions*, 54 CAN. TAX J. 167, 182 (2006).

193. *Id.* at 181.

194. *Id.*

195. *See id.* at 176-78, 182.

196. *Id.*

197. *Id.* at 182.

198. Crerar, *supra* note 71, at 249.

199. *See id.* at 250-51.

200. *Id.* at 250.

201. *Id.* at 251.

legislative pronouncement of a large principle of taxation, could then shore up faltering specific anti-avoidance rules.

The Act has specific anti-avoidance provisions outside of the GAAR.[202] If a taxpayer survives one of those specific anti-avoidance transactions, it is not clear if they still must run the gamut of the GAAR.[203] *Canada Trustco* implies that transactions are not cleansed of GAAR-able taint if deemed non-abusive under a more specific transaction.[204] GAAR cases are very fact-specific, leaving the Tax Court with a great deal of leeway and discretion.[205] However, the Supreme Court did require that Revenue Canada ground its case in specific sections of the Act.[206] It is not enough to make a GAAR claim by stating that a transaction is generally abusive.[207]

Yet, this leads back to the original question: if an abusive transaction must be grounded in a specific provision of the Act to gain GAAR standing, and that abusive transaction is cleansed by the provision's specific anti-avoidance rule, is there still GAAR standing, or has it been erased? Arguably, standing is erased as the Supreme Court has referred to the GAAR as a provision of last resort.[208] Therefore, the GAAR should only exist as a claim when other anti-avoidance rules have been satisfied, if there is some sort of ambiguity as to the purpose and context of the provision. This allows Revenue Canada to take the entire Act into account while still meeting the rule that abuse of a specific provision must be alleged. This also falls within the broad swath of discretion granted to Tax Court judges who have greater latitude to examine context and purpose, instead of plain text, when there is ambiguity in the provision.[209]

Another issue plaguing the necessity of the GAAR is the Supreme Court itself, which appears reluctant to hear GAAR cases.[210] The responsibility seems to have been placed on the Tax Court. The Supreme Court explicitly stated that the Federal Court of Appeal should not interfere with Tax Court judgments in *Canada Trustco*.[211] According to Brian Arnold, this is

202. *Id.*
203. Alarie et al., *supra* note 187, at 1029.
204. *Id.*
205. *Id.* at 1022, 1029.
206. *Id.* 1029.
207. *Id.*
208. Can. Trustco Mortg. Co. [2005] 2 S.C.R., para. 21 (Can.).
209. Alarie et al., *supra* note 187, at 1029.
210. Arnold, *supra* note 192, at 209.
211. *Trustco*, 2 S.C.R. para. 46.

unwise.[212] Tax Court judges are not tax experts. They are no better suited to "judge whether the Minister, in denying the tax benefit, has established abusive tax avoidance under s. 245(4)[]"[213] than is the Federal Court of Appeal. According to Arnold, it ought to be the Supreme Court's role to make a final decision on these issues; the Court should not limit the appeals process on such a significant issue.[214]

F. *The 2009 Supreme Court GAAR Decision*

In January 2009, the Supreme Court handed down its third GAAR decision in *Lipson v. Canada.*[215] *Lipson* is notable, not only for its reliance on the GAAR, but for the fact that, unlike the only two other GAAR cases decided by the Court, it was not a unanimous decision.[216] The taxpayer in *Lipson* wanted to get an interest deduction for borrowed funds.[217] Since he used the funds to buy a personal residence, he should not have been able to get the deduction.[218] Under the relevant statute, trying to finance his purchase directly in a family investment corporation triggered an additional tax.[219] He entered into a series of transactions with his wife to get the interest deduction.[220] The Ministry denied the deduction, relying on a Tax Court case called *Singleton v. Canada.*[221] Specifically, according to the Ministry, the deduction was denied because "the true economic purpose for which the borrowed money was used was to purchase a principle residence not to earn income" as required by the specific statutory provision.[222] Unfortunately for the Ministry, the Federal Court of Appeal reversed *Singleton* right after they denied Lipson's deduction.[223] The Supreme Court upheld the Federal Court of Appeal's reversal before Lipson's appeal of the Ministry's denial went to trial.[224] The Ministry had to find a new

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212. Arnold, *supra* note 192, at 209.
213. *Trustco*, 2 S.C.R. para. 46.
214. Arnold, *supra* note 192, at 209.
215. *See generally* Lipson v. R., [2009] 1 S.C.R. 3 (Can.).
216. *Id.; see generally Can. Trustco Mortg. Co.*, [2005] 2 S.C.R. 601 (Can.) (deciding the case unanimously); *Matthew*, [2005] 2 S.C.R. 643 (Can.) (same).
217. Lipson, 1 S.C.R. para. 4, 9.
218. *Id. para.* 4, 10.
219. *Id. para.* 4, 6.
220. *Id.*
221. *Id. para.* 10.
222. *Id.*
223. *Id.*
224. *Id. para.* 13.

ground for denying the interest deduction. That new ground was the GAAR.[225]

The Ministry's argument was as follows: the transaction resulted in a tax benefit, reasonably could be considered to have been motivated by tax reduction, and resulted in a misuse of specific provision of the Income Tax Act.[226] Under the GAAR, the transaction was void.[227] The Ministry won in the Tax Court of Canada.[228] Lipson appealed, arguing to the Federal Court of Appeal that the GAAR could not be used, and that instead, each transaction in the series had to be considered individually.[229] The Federal Court of Appeal rejected this argument and upheld the Tax Court of Canada's decision.[230] Lipson appealed to the Supreme Court.[231]

The Court upheld the Federal Court of Appeals, but only by a narrow majority.[232] Four Justices dismissed the taxpayer's appeal.[233] Two Justices argued that the GAAR did not apply.[234] The final Justice argued that the appeal should be dismissed, but on the basis of a specific anti-avoidance rule, not the GAAR.[235]

One expert has already called this "probably the most significant tax decision in the last 70 years."[236] Another commentator was not so bold, noting that the case seemed instead to show that the Supreme Court may be more willing to use the GAAR, or at least to limit the Duke of Westminster principle's scope.[237] However, it is unclear if this is actually true. *Lipson*, after all, was not decided by the full panel of Supreme Court Justices, nor was it a unanimous decision like the previous two decisions.[238] The disagreement on the Court may actually signal the Supreme Court's unwillingness to adjudicate future

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225. *Id. para.* 45.

226. Duff, *supra* note 69, at 163.

227. *Id.*

228. *Id.* at 163-64.

229. *Id.* at 164.

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.*

234. *Id.*

235. *Id.* Astute readers will note that two Justices' positions are missing from this analysis. *See generally* Lipson v. R., [2009] 1 S.C.R. 3 (Can.). While nine Justices usually sit on the Supreme Court, the *Lipson* Court sat as a reduced panel of seven Justices. *Id.* This, along with the fact that the seven Justices did not issue a unanimous opinion, increases the uncertainty of the outcomes of future GAAR cases.

236. C. Schmitz, *Top Court Boosts Tax Avoidance Rule*, THE LAWYER'S WEEKLY, Jan. 23, 2009, *available at* www.lawyersweekly.ca/index.php?section=article&articleid-840.

237. Duff, *supra* note 69, at 166-67.

238. *See Lipson v. R.*, [2009] 1 S.C.R. 3 (Can.).

GAAR cases. In the alternative, the Court may continue to hear GAAR cases, and the two Justices who did not participate in *Lipson* may be persuaded by the dissenters, which would then form a majority. This would drive use of the GAAR back to a pre-*McNichols/RMM* era, with the GAAR hardly ever being used, if at all. However, a lack of Supreme Court cases does not prevent the Ministry from raising the GAAR against taxpayers, or from the lower courts using the GAAR. Indeed, the Supreme Court has already stated its desire that the Tax Court be the primary court issuing GAAR judgments, to which the higher courts of Appeal should defer.[239]

What the Ministry and lower courts in Canada should be concerned about is whether the Supreme Court will *continue* to hear GAAR cases. It is difficult, if not impossible, to predict what the next GAAR case might bring. The GAAR could be gutted almost completely, for example. Dissenting Justice Binnie's approach, according to the majority in *Lipson*, would do just that.[240] If Justice Binnie, who was joined by a second Justice, were able to persuade the third dissenting Justice and at least one of the two Justices not sitting in *Lipson*, his dissent would be a majority opinion.

For now, it seems that the Duke of Westminster principle has been limited, while the GAAR is somewhat strengthened. This is a clear and welcome departure from the previous two cases, which attempted, without much success, to harmonize the GAAR and the Duke of Westminster principle.[241] The *Lipson* case also lowers the threshold of proving an abuse or abuse to a "balance of probabilities test," a lower bar than the previous "clear and unambiguous" abuse test.[242] This may make the GAAR easier to apply in the future. As such, while it seems at first blush that the GAAR may have been not only revived, but strengthened with the result that the Ministry and courts would have an easier time applying the GAAR against taxpayers, the makeup of the Court and its split in the *Lipson* decision make this conclusion, like the GAAR itself, vague and uncertain. While the GAAR is certainly here to stay, its interpretation and the degree to which it is successfully raised against transactions is anything but clear.

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239. Can. Trustco Mortg. Co., [2005] 2 S.C.R. 601, para. 46 (Can.).

240. Lipson, 1 S.C.R. para. 52.

241. *Id.*

242. Duff, *supra* note 69, 166-167 (2009).

V. CHRONIC TAX-AVOIDANCE: A PROPOSED SOLUTION

Just as there are chronically homeless people, there are chronic tax avoiders.[243] Tax avoidance statutes, including GAARs, may deter those in the median, but they will never reach the chronic tax avoider. This section discusses the chronic tax avoider and her place in the tax avoidance spectrum using Malcolm Gladwell's account of a chronically homeless man named Murray Barr.[244] It explains why GAARs fail to reach the chronic tax avoider, and why this failure is a serious problem. Finally, this section proposes a solution to reach and rehabilitate chronic tax avoiders and respond to some anticipated criticisms of the proposal.

A. *Million Dollar Murray*

Murray Barr faced an incoming tide of problems throughout his life in Reno, Nevada.[245] He was an alcoholic, and although he would initially respond well to treatment, once removed from a treatment program, he would inevitably relapse.[246] Murray accumulated hospital bills seemingly as large as anyone else's in Nevada. According to a Reno police officer, "[i]t cost [them] one million dollars not to do something about Murray."[247]

The problem with homelessness, as with many other social ills, is that it does not follow a normal bell curve distribution, with a small number of offenders at either end of the curve, and the bulk of the problem in the middle.[248] Instead, homelessness follows a power-law distribution, with the bulk of the activity at the extreme end. For example, a Philadelphia study indicates that 80% of all homeless persons are only homeless for one to two days and are never homeless again.[249] Another 10% are termed "episodic" homeless, meaning that they are homeless for three weeks at a time on average, usually during the winter.[250] These individuals are usually youths, drug users, or both.[251] However,

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243. *See, e.g.*, Alex Raskolnikov, *Crime and Punishment*, *supra* note 4, at 575-78 (analyzing different groups of taxpayers by evasion rates).

244. Malcolm Gladwell, *Million-Dollar Murray*, The New Yorker, Feb. 13, 2006, para. 1-3.

245. *Id. para.* 1.

246. *Id. para.* 2.

247. *Id. para.* 3.

248. *Id. para.* 2.

249. Gladwell, *supra* note 244, para. 16; *see also* Aaron Clauset, Cosma Rohilla Shalizi & M.E.J. Newman, *Power-Law Distributions in Empirical Data*, 51 SIAM REV. 661, 661 (2009), *available at* http://arxiv.org/abs/0706.1062v2.

250. Gladwell, *supra* note 244, para. 17.

251. *Id.*

the final 10%, the chronically homeless, cost the system the most money.[252] They lived in shelters for years on end, were older, and had other mental or physical disabilities.[253] In New York City, there are approximately 2,500 chronically homeless.[254] These 2,500 people cost the city $62 million annually.[255] With these kinds of costs, it would almost be cheaper to provide each person with her own apartment than to support them without a stable living environment.[256]

Cities like Denver and Saint Louis have done just that, realizing that soup kitchens and shelters allow the chronically homeless to remain as such.[257] Enrollees in these radical programs are given an efficiency apartment, contingent on their working within a set of rules.[258] Caseworkers are assigned to work with the homeless individually and monitor the status of everyone enrolled in the program.[259] In Denver, this program costs $15,000 per person annually, or one-third of what it would cost to care for the person were she still living on the streets.[260] While this program cannot and does not work for everyone and often encourages irresponsible behavior,[261] its efficiencies and successful rehabilitations cannot be ignored.

The focus on efficiencies and the moral discomforts presented by power-law solutions is troubling. It seems wrong to give a homeless person an apartment when there are people who work two or three jobs and may seem more deserving of help, but get none. "Social benefits are supposed to have some kind of moral justification," and power-law solutions are about cold, long-term efficiencies.[262] However, as Gladwell concludes, being fair does not always provide solutions, meaning that society's "usual moral intuitions are [of] little use, then, when it comes to a few hard cases. Power-law problems leave us with an unpleasant choice. We can be true to our principles or we can fix the problem. We cannot do both."[263]

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252. *Id.* para. 17-18.
253. *Id.* para. 17.
254. *Id.* para. 18.
255. *Id.*
256. *See id.* para. 20.
257. *See id.* para. 22-27.
258. *Id.* para. 27.
259. *Id.*
260. *Id.* para. 28.
261. *Id.* para. 30.
262. *Id.* para. 31.
263. *Id.* para. 32.

B. *Chronic Tax Avoiders*

Illegal tax avoidance is ultimately a social problem. Revenue losses impact the legitimacy of the taxation system and hurt taxpayer-funded government programs, depriving citizens of the full measure of their government benefits.[264] Tax avoidance follows a power-law distribution.[265] Currently, most tax shelters, or rather, those that cost the government the most, occur at the partnership or small business level.[266] Therefore, most tax evasion also occurs at the small business level.[267] This is not to say that other taxpayers do not avoid taxes;[268] rather, the avoidance has shifted up and out, concentrated at a higher level with fewer participants. In other words, tax avoidance has become a classic power-law distribution.[269] For example, a single partnership may claim capital losses of $84,997,111 from one avoidance scheme.[270] In contrast, tax sheltering used to be a far more common activity, taking place at lower levels with middle class taxpayers.[271] Modern tax shelters cost more and are undertaken by fewer individuals.[272]

There is no single conclusion on why people attempt to minimize their taxes other than the fact that they "like keeping as much of [their] money as possible."[273] Generally, tax avoidance is a function of the size of the penalty and the likelihood that a penalty will be imposed.[274] Different people accept different levels of risk for an almost infinite number of reasons and factors.

Tax avoiders can be classified into three groups.[275] There are individual taxpayers who avoid taxes on a very small, almost

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264. *See* Wells, *supra* note 3, at 648-49.

265. Richard Lavoie, *Flying Above the Law and Below the Radar: Instilling a Taxpaying Ethos in Those Playing by Their Own Skills*, 29 PACE L. REV. 637, 637 (2009) [hereinafter Lavoie, *Flying Above the Law*].

266. *See id.* at 672-73.

267. Raskolnikov, *Crime and Punishment*, *supra* note 4, at 575.

268. *See id.*

269. *See id.* A recent report puts group three taxpayer's evasion at 67% percent of the $345 billion tax gap. *Id.* at 574-575.

270. *See* Scott A. Schumacher, *MacNiven v. Westmoreland and Tax Advice: Using "Purposive Textualism" to Deal with Tax Shelters and Promote Legitimate Tax Advice*, 92 MARQ. L. REV. 33, 55 (2008).

271. *Id.*

272. *Id.* at 54-55.

273. *See* Raskolnikov, *Crime and Punishment*, *supra* note 4, at 578.

274. *Id.* at 576.

275. Lavoie, *Flying Above the Law*, *supra* note 265, at 639. For an excellent discussion on why certain taxpayers are more likely than others to comply with the tax law, see generally *id.* at 650.

insignificant scale.[276] Their avoidance may be legitimate or not, but it is not continued once the Internal Revenue Service catches and punishes it.[277] These taxpayers' behavior can be managed with SAARs.[278] Put another way, the usual rules and procedures work for them. SAARs, for example, target a specific transaction, and the taxpayer's mentality is such that this discipline works: she will not go out and continue the transaction or try to find another way to short the tax system. This group constitutes the largest of the three groups of taxpayers.[279]

The second group includes median taxpayers, who fall in the middle of the power-law distribution.[280] This group may continue illegitimate avoidance measures after IRS sanction, but only at fairly low levels.[281] Punishment may not work the first or second time for them, or rather, it operates at a lower success rate than with the first group, but it eventually works at satisfactory level.[282]

The third group, the most problematic, is the focus of the remainder of this article. The third group is comprised of chronic tax avoiders.[283] These taxpayers are usually small businesses or partnerships claiming tax losses in the millions of dollars.[284] They have a tax avoidance mentality in that they purchase new tax shelters to stay ahead of the SAAR promulgation curve and are not deterred by SAARs or judicial rulings.[285] Instead, this group perceives such rules and regulations as problems to be solved by expensive accountants and attorneys, and the solution

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276. *Id.*

277. *See id.* at 647.

278. *Id.* at 648.

279. Lavoie, *Flying Above the Law*, *supra* note 265, at 638.

280. *See id.* at 672.

281. *See id.* at 675-76.

282. *See id.*

283. *See* Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Avoidance*, 109 COLUM. L. REV. 689, 708 (2009) [hereinafter Raskolnikov, *Revealing Choices*]. Professor Raskolnikov groups taxpayers similarly in his article, *Revealing Choices*. *Id.* However, Professor Raskolnikov groups taxpayers into two groups: gamers and non-gamers. *Id.* at 707. He advocates separating the gamers from the non-gamers through some sort of price discrimination scheme, and then using deterrence based methods for the gamers and cooperative enforcement based methods for the non-gamers. See *id.* As will be discussed *infra*, this article advocates a form of cooperative enforcement mechanisms against the chronic tax avoiders, who are parallel to Raskolnikov's gamers. However, a key distinction between Raskolnikov's proposal and the proposal in this article is the timing of enforcement. Raskolnikov's work targets post-transaction, not before or during transactions, as this article does. *See id.* at 707-708.

284. Lavoie, *Flying Above the Law*, *supra* note 265, at 672.

285. *Id.* at 674-75.

as the structure resulting in the least amount of tax while still just barely within the boundaries of the applicable laws.[286]

The concern with preventing chronic tax avoidance is more about eliminating the avoidance mentality that is so prevalent and less about eliminating the shelter itself. The shelter is a tool. Tax shelters come and go, and they do so because the mentality of avoidance is so deeply ingrained in individuals attempting to avoid paying taxes that punishment under SAARs and GAARs is ineffective.[287]

Social science has reached no real conclusions about why taxpayers fall into different groups.[288] Some argue that taxpayers comply with tax law "to avoid feelings of guilt, shame, and peer condemnation, because they value cooperation and believe that others are law-abiding citizens, and because they feel pride in fulfilling their civic duty."[289] From another perspective, some taxpayers avoid taxes because they disagree with the administration of the tax law, with how tax revenue is spent, or because they feel that everyone else is avoiding taxes, so they might as well too—a perception of permission to avoid, so to speak, in light of others' avoidance.[290]

C. *Can a GAAR Help?*

GAARs are considered tools of last resort for the most stubborn forms of tax abuse. This notion is incorrect, as proven by the continuance of tax avoidance in countries with GAARs.[291] Even if a GAAR is merely intended to reduce the incidence of tax avoidance, instead of eliminating it all together, GAARs result in long, drawn-out controversies, encounter numerous drafting problems, and often languish as dead letter laws.[292] Even the United States has a GAAR, which is more commonly known as "PAAR."[293] "The PAAR . . . authorizes the Internal Revenue

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286. *See* Richard Lavoie, *Deputizing the Gunslingers: Co-opting the Tax Bar into Dissuading Corporate Tax Shelters*, 21 VA. TAX REV. 43, 48-49 (2009) ("In recent years, however, many practitioners have come to view these judicially created anti-abuse doctrines as so vague that they can effectively be ignored. Downplaying the relevance of the common law anti-abuse doctrines and relying on a literalist approach to statutory and regulatory interpretation has allowed many tax practitioners to give favorable opinions regarding highly questionable transactions.") [hereinafter Lavoie, *Deputizing the Gunslingers*].

287. *See id.*

288. *See* Lavoie, *Flying Above the Law*, *supra* note 265, at 642.

289. Raskolnikov, *Crime and Punishment*, *supra* note 4, at 578.

290. *Id.*

291. Dep't of the Treasury, *supra* note 29, at 119.

292. *Id.*

293. Treas. Reg. § 1.701-2 (as amended in 1995).

Service . . . to recast a partnership transaction if the transaction has a principal purpose of substantially reducing the partners' federal income tax liability in a manner inconsistent with the intent of subchapter K."[294] As detailed extensively in Professor Andrea Monroe's article on the PAAR, practitioners initially resisted the rule and as such, it was rewritten, and, ultimately killed through neglect.[295]

GAARs are inefficient, in that it is unnecessary for those taxpayers who are covered by existing structures. Thus, GAARs are intended to cover only the chronic tax avoiders. However, chronic tax avoiders will never respond favorably to a GAAR at a level high enough to classify it as successful. After all, a GAAR is just a SAAR that casts a wider shadow. It does nothing to change the underlying problem: the deeply-rooted tax avoidance mentality. Chronic tax avoiders inevitably discover how to push the envelope with more and better avoidance transactions.[296]

This is not to completely denigrate GAARs. GAARs almost work, and they certainly work better against tax avoidance as a whole rather than the current regime. The major downfall is that they are statutory measures whose punitive elements are solely monetary.[297] To find an appreciable level of success, GAARs must include a mechanism that creates the same dependencies and incentives to return inside the system and rebuild the taxpayer's mentality. As is currently the case, however, the GAAR fails because it lacks rehabilitative supports.[298] Perhaps a GAAR with such an enhancement tool will allow incentives to line up to change the mentality of the chronic tax avoiders seeking out the latest forms of illegitimate tax avoidance. The goal is to reduce, if not eliminate, levels of tax avoidance. Put another way, the IRS must first understand the GAAR's lessons, respecting the spirit and the letter of the law.

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294. Monroe, *supra* note 37, at 406.

295. *See generally* Monroe, *supra* note 37, at 408-443 (detailing the history of the PAAR, analyzing reasons for the PAAR's failure, and proposing a new, re-written PAAR for partnership consumption).

296. *See* Lawrence Zelenak, *Codifying Anti-Avoidance Doctrines and Controlling Corporate Tax Shelters*, 64 SMU L. Rev. 177, 186 (2001) ("'Every stick crafted to beat on the head of a taxpayer will, sooner or later, metamorphose into a large green snake and bite the Commissioner on the hind part.'") (quoting Martin Ginsburg, *The National Office Mission*, 27 TAX NOTES 99, 100 (1985)).

297. Zelenak, supra note 296, at 187; *see also* Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. CHI. L. REV. 601, 649 (2007) [hereinafter Raskolnikov, *The Cost of Norms*] (generalizing negative consequences of insufficiently precise "substantive tax laws").

298. *See* Lavoie, *Flying Above the Law*, *supra* note 265, at 663.

VI. A PROPOSED SOLUTION: GAAR-PLUS

The solution to the pervasive issue of chronic tax avoidance lay with the Internal Revenue Service's implementation of a prevention mechanism. This mechanism is the GAAR-plus, a civil system containing a statutory, traditional GAAR with additional support and oversight to shift the illegitimate avoidance mentality of chronic tax avoiders. The GAAR-plus would only apply to chronic tax avoiders in a civil context, as opposed to the criminal context. It must also clearly, consistently, and predictably distinguish between qualifying tax avoiders and non-qualifying tax avoiders. It must then act upon taxpayers in a fair, manageable way that provides punishment, rehabilitation, and incentives for chronic taxpayers avoiders to rejoin the ranks of those taxpayers who pay their fair share of taxes.[299] Finally, the GAAR-plus must provide for recidivism as well as reward successful rehabilitation. While many of its features are analogous to the criminal system of punishment, the GAAR-plus would be strictly a civil system.

A. *To Whom Does the GAAR-plus Apply?*

The experiences of other countries with traditional GAARs are enlightening. For example, most GAARs exempt transactions with a legitimate business purpose or economic substance.[300] Written like a traditional GAAR, the GAAR-plus would do the same.[301] The GAAR-plus would establish similar categories of excepted transactions, such as family transactions, but would also include a monetary threshold that would override the exempted transaction categories. For example, assume that the monetary threshold is $10,000. A transaction that would ordinarily be exempted under the family transaction exemption

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299. Richard Lavoie, *Analyzing the Schizoid Agency: Achieving the Proper Balance in Enforcing the Internal Revenue Code*, 23 AKRON TAX J. 1, 12 (2008) [hereinafter Lavoie, *Analyzing the Schizoid Agency*] ("No one relishes paying taxes, but if the laws are perceived as fair, then the burden is less onerous. Conversely, if taxpayers read Service guidance as being slanted in the government's favor, they lose respect for the law and are less likely to obey it."); *see also id.* at 13 ("If taxpayers feel they are being dealt with unfairly, then their discontent is likely to spread to others and ultimately impair faith in the self-assessment system throughout society.").

300. *See supra* notes 20-23 and accompanying text.

301. *See* Jerome B. Liben, *Should the Internal Revenue Code Include a GAAR?*, TAX ANALYSTS, para. 13 (2009) (arguing that a GAAR in the United States would not apply to the vast number of business transactions undertaken because "it would be obvious that the transaction was undertaken in the normal course of business operations for a legitimate business reason and not primarily for tax avoidance"); Raskolnikov, *The Cost of Norms*, *supra* note 297, at 605 (discussing a proposed reform, one strength of which is that it is flexible and need not apply to all transactions).

of the GAAR-plus that was worth $11,000 would be potentially subject to the GAAR-plus. This recognizes that chronic tax avoiders can work within even the exempted categories.[302] It also allows the IRS to focus its resources most efficiently on the major tax avoiders, not harming those taxpayers whose avoidance is not worth the enormous cost it would take to punish them under the GAAR-plus.

However, a monetary threshold is easily avoided. Taxpayers attempting to avoid the GAAR-plus could easily structure transactions that are one dollar less than the threshold.[303] Thus, there must be additional provisions to override this threshold. For example, assume that an individual had been punished under another statute or regulation a number of times in the past. The individual undertakes another transaction that falls a dollar under of the GAAR-plus' monetary threshold, but otherwise is in violation of the GAAR. Since she has been punished under other laws and regulations in the past, the GAAR's monetary threshold no longer applies to her, and her short-shifted transaction falls under the GAAR's shadow.[304]

B. *Applying the GAAR-plus*

This section assumes that for any transaction discussed, none of the above preliminary exemptions apply to the taxpayer in question. The issue is how the GAAR-plus applies at the civil sentencing, penal, and post-punishment phases. This sees each phase individually and provides various options for drafting a GAAR-plus in the United States. This section will also focus on the prevention of recidivism, as the widespread prevention of future avoidance is the reason for enacting such a system.

1. Sentencing

Determining the applicable punishment under the GAAR-plus is analogous to using the Federal Sentencing Guidelines.[305]

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302. *See, e.g.*, I.R.C. § 1091(a)-(d)(2002). This section of the Code prohibits sales preceded or followed by a purchase within a 30 day period of substantially identical stock, securities or options to either buy or sell stock or securities. Section 1091 has no teeth, because individuals can simply wait 31 days to make their purchase, and not incur the loss disallowances of the section. *Id.*

303. *See id.*

304. *See id.*

305. *See* U.S. SENTENCING GUIDELINES MANUAL (2009), *available at* www.ussc.gov/Guidelines/2009_guidelines/2009_manual.cfm. The Sentencing Guidelines are intended to "further the basic purposes of criminal punishment: deterrence, incapacitation, just punishment, and rehabilitation." *Id.* ch. 1, pt. A, subpart 1(2) ("The Statutory Mission"). The Guidelines are composed like a grid, with categories of offender

Assessing punishment under the GAAR-plus is completed using a system of points, with the number of points given varying, depending on factors such as the magnitude of the transaction or the individual's punishment history. The abusive taxpayer must then earn that number of points during the punishment phase of the GAAR-plus. For example, if Taxpayer A's avoidance transaction is worth 1500 to 2500 points under the GAAR-plus Guidelines, the judge has the discretion to give any sentence corresponding to that point range.[306] The judge can issue a sentence above or below the GAAR-plus guidelines, but must provide a detailed explanation of his reasoning.[307] The judge's discretion is reviewed on appeal under an abuse of discretion standard.[308]

The IRS agents assigned to monitor the taxpayer's case can add or deduct points from the taxpayer after sentencing. The taxpayer receives points for "good behaviors" such as correctly executed, non-avoidance transactions and completion of ethics trainings and tax seminars. However, the taxpayer can lose points for "bad behaviors" such as acting in bad faith to encourage an anti-avoidance culture in the workplace, not attending ethics trainings, or willfully ignoring advice or instructions from IRS agents. Definitions or standards for granting and deducting points should be determined by Congress or the IRS.

However, the GAAR-plus will not use mandatory minimum sentences. This is for two reasons. First, mandatory minimum sentences give prosecutors a high degree of power in the plea-bargaining and charging contexts.[309] A prosecutor can threaten to add charges to a defendant's crimes that would exponentially

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behavior on one side of the grid, and offender characteristics on the other. *See id.* There is a Guideline range of appropriate sentences "for each class of convicted persons determined by coordinate the offense behavior categories with the offender characteristics categories." *Id.* The Guidelines are advisory, but include features that underscore "Congressional objectives, including providing certainty and fairness in meeting the purposes of sentencing, avoiding unwarranted sentencing disparities, and maintaining sufficient flexibility to permit individualized sentences when warranted." *Id.* at subpart 2. Indeed, a judge who departs from the Guidelines must provide her reasons for doing so, 18 U.S.C. § 3553(b), and is reviewable on appeal. 18 U.S.C. § 3742.

306. *See* United States v. Rosenberg, 195 F.2d 583 (2d Cir.), *cert. denied*, 344 U.S. 838 (1952) (holding that if a trial judge's sentence is within statutorily defined guidelines, it cannot be challenged on appeal).

307. *See* Kimbrough v. United States, 552 U.S. 85, 110-11 (2007) (holding that the district court did not abuse its discretion in ordering a prison sentence outside the Guidelines after properly calculating the appropriate range in the context of § 3553(a) factors regarding a drug-trafficking offense).

308. *See id.*

309. *See* Michael A. Simons, *Prosecutorial Discretion in the Shadow of Advisory Guidelines and Mandatory Minimums*, 19 TEMP. POL. & CIV. RTS. L. REV. 377, 385 (2010).

increase that defendant's total mandatory imprisonment term.[310] The prosecutor can use this charging threat as leverage during plea bargaining to encourage a guilty plea.[311]

Further, the GAAR-plus will be a weapon of last resort and likely used with highly complex, cutting-edge transactions.[312] While a civil system of mandatory minimums may seem to be helpful for judges who may not be very familiar with such transactions, the newness and complexity of these transactions are what require elimination of such mandatory minimums.[313] The Guidelines must be slightly general so that they can encompass new transactions. Further, the punishments envisioned should allow for sufficient judicial flexibility to allow for new transactions, varying levels of complexity within known transactions, and varying degrees of culpability or avoidance within a transaction.[314]

As stated above, a judge uses the GAAR-plus Guidelines to figure out how many points the avoidance transaction is worth. The taxpayer must accumulate these points during her punishment under the GAAR-plus to overcome her punishment. A team of IRS officials assigned to the taxpayer's case account for points. The IRS can also return to the judge at intervals, established by the point level, to petition for deceases in the taxpayer's sentence. The taxpayer can also petition for sentence decreases at the same set time intervals.

While it seems obvious that no taxpayer would ever want to petition for increases, the GAAR-plus system would still explicitly prohibit such a practice by any party. Not only does such a mechanism present constitutional issues,[315] but allowing taxpayers to increase their sentences would also present issues similar to those faced in India regarding to affirmative action benefits for scheduled or otherwise backward classes.[316] In

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310. *See id.*

311. *See id.*

312. *See* Canada Trustco Mortg. Co. v. R., [2005] 2 S.C.R. 601, para. 21 (Can.); Alarie et al., *supra* note 187, at 1029.

313. *See* Lavoie, *Deputizing the Gunslingers*, *supra* note 286, at 64 n.56 (2001). "While a strict view of statutory interpretation may be currently in vogue, there has traditionally been a looser application of such canons in the area of tax legislation. More judges need to recognize and apply this more relaxed approach to statutory interpretation when considering tax-shelter cases." *Id.* at 82.

314. *See id.* at 61-62 (noting that courts may feel constrained by the literal statutory language if guidelines are codified).

315. *See id.*

316. *See* MARC GALANTER, LAW AND SOCIETY IN MODERN INDIA 117-18 (Rajeev Dhavan ed., 1997); *see, e.g.*, Jasani v. Parashram, (1954) 1954 S.C.R. 817, 838, 841-42 (India) (determining through a three-pronged test that although candidate had joined a

India, many members of the scheduled or backward classes actually try to remain members of their disadvantaged class to continue receiving government benefits, including reserved seats in legislative bodies.[317] In addition, some individuals who may not necessarily qualify for affirmative action benefits manipulate the system in order to get these benefits.[318] The GAAR-plus system, by explicitly disallowing sentence increases, will minimize these concerns. As an additional safeguard, each point range will be tied to a range of years. The judge will be required to pick a number of years from that range, reviewable under an abuse of discretion standard, after which the taxpayer will no longer receive GAAR-plus benefits. She will instead be deemed to have served her punishment and will be out of the system.

2. Civil Punishment

The civil punishment phase of the GAAR-plus is focused on monitoring and guiding the offending taxpayer. The taxpayer is assigned a team of IRS agents who will monitor her transactions. The number of assigned agents will depend on the taxpayer's needs. For example, a corporation would require more agents than a single individual. The agents will rotate out after previously determined intervals, so as to prevent the assigned IRS agents from getting too close to their assigned taxpayer. If the agents are too close, they will be less likely to spot potential abuse or provide unbiased advice, thus defeating the purpose of having monitoring agents at all.[319] Put another way, rotating IRS agents will act as checks against the emergence of common cognitive biases, such as political bias or status quo bias.[320]

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different caste, he continued to be eligible for the reserved seat for the "Scheduled Caste" he was born into).

317. *See, e.g.*, Jasami v. Parashram, (1954) 1954 S.C.R. 817, 819-20 (India) (discussing the conversion of an individual to another caste by changing his religion so he could run for a political seat reserved for a member of that caste); Oraon v. Munzi, 1964 A.I.R. 201 (1763) (Patna H.C.) (analyzing the conversion of an individual to Christianity and its impact on that individual's ability to run for a seat reserved for a member of a "Scheduled Tribe"); *see* VICKI C. JACKSON & MARK TUSHNET, COMPARATIVE CONSTITUTIONAL LAW 1310-11 (Robert C. Clark et al. eds., 2nd ed. 2006) (citing MARC GALANTER, LAW AND SOCIETY IN MODERN INDIA 117-18 (Rajeev Dhavan ed., 1997)). "Scheduled Class" and "Backward Class" are modern terms for members of the lowest castes in Hindu society, and "Scheduled Caste" members were formerly referred to as the "untouchables." *See, e.g.*, Nirmala Ganapathy, *India brings back caste in census; Data will help set govt's affirmative action policy but may divide society*, THE STRAITS TIMES, Aug. 14, 2010.

318. *See* GALANTER, *supra* note 317, at 116-18.

319. *See* Raskolnikov, *Revealing Choices*, *supra* note 283, at 736-38.

320. *See id.* at 725 & n.154 (discussing the similar effect of privileges for tax preparers because clients are able to discuss avoidance tactics).

Assigned agents provide advice and assist with transactions. Their precise duties should be left relatively vague to fulfill the vague nature of the GAARs that this system is based off of and to allow maximum flexibility in tailoring advice and help to the needs of individual taxpayers. Agents will be required to review transactions of a certain magnitude, determined by the taxpayer's point status, both before the transaction occurs and throughout the duration of the transaction. However, certain transactions will be exempted from the review process, including any transaction to which the GAAR-plus system would not apply.[321] The goal of monitoring is to strike a balance between providing support to the taxpayer and not unreasonably impeding the regular course of business.

3. Recidivism and Rehabilitation

As noted earlier, there are many incentives for a taxpayer to stay within the GAAR-plus system after accumulating the number of points needed to end punishment. Taxpayers may want to continue receiving IRS advice or may have a large, complex transaction and want to ensure she is in compliance with the law. Taxpayers will have the option to voluntarily stay within the GAAR-plus system for a limited time period as determined by the judge at sentencing.

The mechanism for remaining in the GAAR-plus is based on points, just as all else is in the system. The retention mechanism is similar to gift card usage. An individual needs a set number of points, barring any sentence reductions, to leave the system. If the taxpayer received a reduced sentence at any point during her punishment, her extension of time to stay in the GAAR-plus system voluntarily will be proportionately reduced as well. Assume that number is 10,000 points. The taxpayer can "cash in" her points, capped at a limit determined by the Guidelines, for activities such as extra trainings, extension of IRS oversight, and increased oversight on complex transactions. Each of these activities or rewards would "cost" a certain number of points. For example, an extra ethics training might cost 5,000 points. The taxpayer who has accumulated 8,000 points and needs 10,000 points to get out of the system can "cash in" 5,000 of her points on the training. She would then have 3,000 points, but would still need 10,000 points to leave the system.

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321. For example, the transaction may be exempted as within the ordinary course of business or under the pre-determined monetary threshold. Additionally, if the GAAR is not cast over the entire Internal Revenue Code, it would, obviously, only apply to those transactions within the Code section it covers.

There are limits to cashing in points. After a pre-determined number of years by the judge at sentencing using the GAAR-plus Guidelines, the taxpayer can exit the system even if she has not yet accumulated the necessary number of points. This will prevent taxpayers from using the IRS to get free tax advice or to add the color of legitimacy to their transactions from the IRS guidance provided.

A system that provides incentives to remain and thrive in the system can create dependencies on the system necessary to ensure its success.[322] The GAAR-plus system has the positive or affirmative goal of changing the avoidance mentality of chronic taxpayers. However, it will also have the duty of actively preventing taxpayers from trying to return to the system. An easy solution would seem to be that any individual who successfully completes the GAAR-plus program, but recidivates, will face increased time under the system. However, this is self-defeating, as it gives taxpayers exactly what they want, which is to return to the GAAR-plus system. As such, repeat offenders will be barred from participating in the points segment of the system. Instead, their transactions will be recast and tax levied as appropriate, just as with first time offenders, and then face an additional monetary fine above and beyond the taxes levied on the recast transactions. The IRS could determine other alternative punishments as appropriate in place of a return to the GAAR-plus system.[323]

C. *Criticisms*

The GAAR-plus is, like any anti-avoidance measure, imperfect and subject to criticisms. This Part will attempt to identify and address criticisms of the GAAR-plus.

1. Redundancy: PAARs, GAARs and SAARs

The United States already has two GAARs.[324] Therefore, the question is whether another is necessary. As discussed *infra*, Subchapter K, the partnership section of the Tax Code, is covered by the PAAR.[325] The PAAR lets the Treasury recast partnership transactions with a principle purpose of substantially reducing the partners' federal income tax liability in a manner

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322. *See* Raskolnikov, *The Cost of Norms*, *supra* note 297, at 605-07 (listing the benefits of social norms and the incentives to follow such norms).

323. *See* Raskolnikov, *Crime and Punishment*, *supra* note 4, at 607.

324. *See* I.R.C. § 7701(o) (West Supp. 2010); I.R.C. § 269.

325. *See* note 296 and accompanying text.

inconsistent with the intent of subchapter K.[326] This regulation is still technically alive.[327] It has never been removed from the Regulations, and the IRS has even used it on rare occasions.[328] It is now universally ignored.[329] In its 16-year history, it has only been raised by the IRS in under thirty published rulings and determinations, of which only six contain any real analysis or guidance for taxpayers.[330] The courts treat the PAAR in much the same way.[331] In short, the PAAR has also been killed through neglect.

Yet, the PAAR is not alone. Buried in the Health Care Reform Actis a GAAR.[332] This new GAAR, found in section 7701(o), codifies the judicial economic substance doctrine. It states:

> [I]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.[333]

Two points are to be derived from this new GAAR. First, parallel to Professor Monroe's discussion of this GAAR's impact on the PAAR,

> if a court determines that the application of the economic substance doctrine is appropriate, then this proposal would require the court to use a uniform, statutory definition of economic

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326. Treas. Reg. § 1.701-2 (as amended in 1995).

327. *See* Monroe, *supra* note 37, at 407.

328. *See id.*; *see also id.* at 429, 431 nn.141-43 (listing situations where the IRS has considered the applicability of Treas. Reg. § 1.701-2).

329. *See id.*

330. *See id.* at 432.

331. *See id.* at 433-34.

332. I.R.C. § 7701(o) (West Supp. 2010). New Section 7701(o) is estimated to raise $4.2 billion over the next ten years. Jerome B. Libin, *Congress Should Address Tax Avoidance Head-On: The Internal Revenue Code Needs a GAAR*, 30 VA. TAX. REV. 339, 346 (2010) (citing Dep't. of the Treasury, General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals 151 (Feb. 2010)). Libin notes that section 269 of the Internal Revenue Code also operates as a "mini-GAAR." *Id.* at 351.

333. I.R.C. § 7701(o)(1) (West Supp. 2010). For a detailed discussion of new Section 7701(o), see John Prebble, *The US GAAR*, TAX PROF BLOG (2010), http://taxprof.typepad.com/prebbleus-gaar-for-txpfblog.pdf.

> substance. Under this codified version of economic substance, a court would still have to engage in a fact-intensive analysis of the underlying transaction in order to determine whether the economic substance doctrine is applicable. Yet it is this analysis that has proven so unpredictable in litigating partnership tax shelters. Additional problems emerge if we further assume that a codified economic substance doctrine would exclude various transactions from its application. The codified doctrine would become more complex, and its exceptions would likely provide a roadmap to future abusive transactions. Third, the recent success of various anti-tax shelter tools does not eliminate the need to revise the PAAR. For instance, the judicial doctrines remain unpredictable, experiencing periods of both robust and limited application by the courts. Different views of judicial role may affect a court's willingness to extend these doctrines into novel contexts where a taxpayer technically complies with subchapter K, but violates its intent. . . . [T]his may mean becoming more efficient in disclosing transactions, thereby freeing up additional time to focus on tax planning.[334]

Second, Section 7701(o) is a new, recently enacted provision.[335] As such, it does not yet have the breadth of court cases, Treasury determinations, rulings and written guidance, or scholarly articles that other nation's GAARs, our own PAAR, or even any other section of the Code has. However, an educated prediction can be made, based on the history of the economic substance doctrine, and other nation's GAARs. The new GAAR will fail, but it will not likely fail in the same way as the PAAR. The whole point of section 7701(o) was to codify an existing judicial doctrine – the perennially popular economic substance doctrine.[336] It will, like any new law, raise a multitude of concerns and issues.[337] It may deny legitimate tax benefits.[338] However, the more

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334. Monroe, *supra* note 37, at 463-65.

335. *See* Interim Guidance Under the Codification of the Economic Substance Doctrine and Related Provisions in the Health Care and Education Reconciliation Act of 2010, I.R.S. (Oct. 4, 2010), http://www.irs.gov/irb/2010-40_IRB/ar09.html.

336. Libin, *supra* note 332, at 346-348.

337. *Id.* at 350.

338. *Id. But see* STAFF OF JOINT COMM. ON TAXATION, 111TH CONG., TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE "RECONCILIATION ACT OF 2010," AS

immediate issue with new section 7701(o) has already been established in this article: that GAARs are well intentioned but improperly aimed. They will not impact the chronic tax avoiders at whom Section 7701(o) is aimed. The economic substance doctrine, as a judicial doctrine, was too broad to conclusively prevent chronic tax avoiders from abusing the tax code.[339] The PAAR did not stop chronic tax avoiders from abusing the tax code.[340] GAARs in other nations were unsuccessful in doing so.[341] There is no real reason to believe that somehow section 7701(o) is special and that its mere existence will suddenly halt chronic tax avoiders in their paths. Simply put, it is highly likely that this new GAAR will not solve the tax abuse problem.[342]

The United States actually already has a successful system very similar to the GAAR-plus with Notice 2000-12.[343] Under Notice 2000-12, large taxpayers can request examination and resolution of specific tax issues before the return is filed.[344] A similar program, the Compliance Assurance Program (CAP), allows taxpayers and the IRS to exchange information about completed transactions or taxable events before filing returns.[345] These programs are admittedly very similar to the GAAR-plus. However, one crucial distinction is that the GAAR-plus begins to act before a transaction or taxable event occurs, not afterwards. The other two systems, Notice 2000-12 and CAP, operate after the transaction has already occurred.[346] These two systems show two things: that post-transaction cooperative enforcement can succeed in the United States, and that IRS agents are more than capable of working in a cooperative fashion to help, not just prosecute, taxpayers. These two fundamental lessons show that

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AMENDED, IN COMBINATION WITH THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT" 142-156 (Comm. Print 2010) (addressing concerns with new Section 7701(o)).

339. *See* Libin, *supra* note 332, at 345.

340. Monroe, *supra* note 37, at 407.

341. *Id.* at 452-453.

342. Of course, the GAAR-plus will not solve the tax abuse problem completely, because "tax minimization is part of our taxpayer culture." Libin, *supra* 332, at 352. The difference between Section 7701(o) and the GAAR-plus is two-fold. One, "tax minimization within the boundaries of the law" is not problematic. *Id.* Two, the GAAR-plus is aimed at changing tax norms and the mentality of the chronic tax avoider, as opposed to punishing the behavior post-hoc. As such, it may be more likely to decrease, although not eliminate, the problem.

343. *See generally* I.R.S. Notice 2000-12, 2001-1 C.B. 727-732 (creating a way for potential tax avoiders to resolve tax return issues before tax returns are due); *see also* Wells, *supra* note 3, at 679 (discussing the history and success of Notice 2000-12).

344. I.R.S. Notice 2000-12, 2000-1 C.B. 727.

345. *See* I.R.S., Announcement 2005-87, 2005-2 C.B. 1144, Corporate returns—Compliance Assurance Process (2005); *see also* Wells, *supra* note 3, at 680 (explaining the Compliance Assurance Program).

346. *See* Wells, supra note 3, at 680; I.R.S. Notice 2000-12, 2000-1 C.B. 728.

the GAAR-plus, at its most basic conceptual level, has a strong chance of success. It has already succeeded in other forms.[347] It need only succeed earlier now.

2. Implementation and Enforcement Costs

The GAAR-plus will potentially be very difficult to implement. It will possibly take a lot of time and require trained IRS agents to oversee taxpayers and their transactions. However, this is not logistically difficult with the proliferation of video conferencing, email, and secure online file sharing. IRS agents need not be on-site to advise taxpayers; they can do so from anywhere.

The GAAR-plus would require is vast amounts of capital, both monetary and human, which will be hugely problematic.[348] Obviously, money must be spent to plan, create, debate, pass, and initiate this system. Once the system is in place, there will be both the fixed costs associated with its day-to-day running, as well as the variable costs associated with activities such as litigation, training, monitoring, and enforcement. Further, assigning IRS agents to monitor taxpayers means that those IRS agents will be diverted from other tasks. Other agents must be hired and paid, which may become difficult at a time when the American economy continues to falter. Monitoring transactions will slow down transaction completion times. However, in the long run, it may be that the GAAR-plus program is cheaper than litigating complex avoidance cases over and over for years. Further, Congressional studies will be necessary to determine the long-term costs, both monetary and non-monetary, of fighting tax avoidance cases. Such costs should be used to determine an appropriate level of resources, including the determination of monetary thresholds or other exemptions, to fuel the GAAR-plus system.

With regard to human capital, it will be difficult to improve audit and oversight effectiveness in any meaningful way.[349] These costs will be exceptionally high, particularly with regard to hiring and training agents to preemptively spot cutting edge, highly sophisticated avoidance transactions.[350] "Given the highly

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347. *See* I.R.S., Notice 2000-12, 2000-1 C.B. at 727, Pre-Filing Agreements Pilot Program (2000) (inviting large business taxpayers to participate in a pilot program providing I.R.S. consultation for post-transaction tax issues before filing tax returns).

348. *See, e.g.*, Lavoie, *Deputizing the Gunslinger*, *supra* note 286, at 63 (describing the downside in increasing auditing frequencies such as the demand for more auditors. However, governments may lack the resources to meet this demand.).

349. *See* Raskolnikov, *Crime and Punishment*, *supra* note 4, at 595-96.

350. *See id.*; Lavoie, *Deputizing the Gunslinger*, *supra* note 286, at 65-66.

technical nature of these transactions, it is very probable that only a few hundred tax specialists in the country could effectively deal with the issues involved on a timely basis."[351] Even more problematic is the risk of ineffective monitoring. Agents who are improperly trained will miss transactions or compensate for their inability to do their jobs by labeling any complex transaction that they do not understand as abusive.[352] This will chill the undertaking of complex transactions, incentivize hiding such transactions from one's monitoring agents, and waste the government's already highly limited resources.[353]

All of this will come at the cost of a steep learning curve. One solution is to follow the Australian approach. The Australian revenue service attempted to implement a "responsive regulation approach to tax enforcement,"[354] meaning a cooperative approach. The Australian examiners encountered a great deal of difficulty working under a cooperative regime because they had been trained to be highly adversarial towards taxpayers.[355] Professor Raskolnikov suggests separate audit teams when undertaking cooperative regimes, so that agents need not switch between techniques and to make it easier to develop a holistic approach to cooperative tax enforcement.[356] Once agents can spot and work with the GAAR-plus system, implementation costs decrease. There will be no need for outside experts, agents will be able to work more efficiently with their assigned taxpayers, and there will be less lag as agents struggle to keep up with sophisticated tax shelters.[357] Additionally, this system is rule-based, is clear with regard to what punishment will be imposed, and allows for very little government discretion, meaning the costs of implementation from the IRS side will be lower than with a traditional GAAR.[358] From the taxpayer's

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351. Lavoie, *Deputizing the Gunslinger*, *supra* note 286, at 65.

352. *See id.* at 65-66.

353. *See id.* at 66.

354. Raskolnikov, *Revealing Choices*, *supra* note 283, at 737.

355. *See id.*

356. *See id.*

357. The tax agent's independence must remain paramount. *See* Lavoie, *Analyzing the Schizoid Agency*, *supra* note 399, at 10. The potential for a conflict of interest between the relationship they will develop with their assigned taxpayers and their work as IRS employees is real. *Id.* Changing agents, or even oversight of agents' work, may help manage this risk. *See id.* (identifying agents or examining officers' role in raising "meritorious issues" even if they personally side with the taxpayer's legal position).

358. *See* Raskolnikov, *Crime and Punishment*, *supra* note 4, at 597, 605 (eliminating government discretion is crucial, given the incentives for certainty provided by "[t]housands of years of history with corrupt tax collectors") (internal citation omitted); Lavoie, *Deputizing the Gunslinger*, *supra* note 286, at 65-67 (contrasting the GAAR system, which has Service agents who lack the sophistication and adequate training

perspective, she might not know exactly what punishment a transaction would receive, but she would have a decent estimate of its order and magnitude.[359] "Hence, it will be cheaper for the government to administer and less susceptible to abuse by enforcement agents compared to a vague standard-based sanction."[360] Further, the easier it is for a taxpayer to interpret and apply the tax code to her own transactions, the more efficiently any system of taxation, including anti-abuse measures, operates.[361]

3. Uncertainty

The GAAR-plus system will create uncertainty. The last thing most people want in a tax law is uncertainty.[362] After all, one of the primary objections to the existing American mini-GAAR, the PAAR, is that it is uncertain.[363] All GAARs create uncertainty, but is uncertainty a bad thing? Not necessarily. There is, like all things, an optimum level of uncertainty in the law.[364] Uncertainty prevents individuals from undertaking potentially illegal transactions just because they are not sure if they are illegal.[365] In the world of tax law, where there are an unusually high number of people trying to avoid the law, as compared to other areas of law, this uncertainty allows the government to catch a greater number of people.[366] It allows the government the flexibility to keep up with new tax shelters without having to promulgate new SAARs.[367] Furthermore, uncertainty in GAARs is tempered by both Service rulings and

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necessary to identify "tax shelter transactions"). To mitigate this lack of sophistication, Lavoie proposes various costly measures such as hiring private attorneys to serve as agents or having these attorneys train Service agents. *Id.*

359. Raskolnikov, *Crime and Punishment*, *supra* note 4, at 605.

360. *Id.*

361. *See* Lavoie, *Analyzing the Schizoid Agency*, *supra* note 299, at 4-5 ("[T]he tax system relies heavily on taxpayers correctly reporting their tax burden in the first instance. Preparing tax returns requires taxpayers to understand the relevant provisions of the Code and apply them to their particular factual circumstances.").

362. *See, e.g.*, Monroe, *supra* note 37, at 420-21 (detailing practitioners' criticisms of the PAAR based on the PAAR's uncertainty).

363. *Id.*

364. *See generally* Nicholas H. Stern, *Optimum Taxation and Tax Policy* 31 STAFF PAPERS–INTERNATIONAL MONETARY FUND, 339 (1984) (defining and explaining theories of optimum taxation).

365. *See supra* part II.B.

366. *See* Richard Lavoie, *Subverting the Rule of Law: The Judiciary's Role in Fostering Unethical Behavior*, 75 U. Col. L. Rev. 115, 193-94 (2004) (discussing the wide reach of GAARs).

367. *Id.* at 194-95.

published guidance and by judicial rulings.[368] Indeed, in nations where GAARs have been ineffective, "it is because the judiciary does not know what to make of them."[369] As discussed above, the judiciary can make or break a GAAR.[370] However, the Service should provide some structure so that the judiciary knows how to do that. With the GAAR-plus system, taxpayers will know what kinds of transactions are preliminarily exempted from the GAAR because the transactions will be listed in the first section of the statute. Additionally, all GAAR-plus language will track traditional GAARs and the language of the already familiar economic substance doctrine.

Indeed, the GAAR-plus is, at some level, intended to be doubtful. As John Prebble wrote,

> [a] general anti-avoidance rule is in essence anti-formalist and substantive. But its role is to extend the coverage of an income tax regime to areas that, almost by definition, an income tax regime cannot reach, being areas that elude the law because of the impossibility of ever fitting the naturally occurring phenomena of business and profits into a regime that can operate only within the boundaries of artificial constructs: national frontiers and the calendar.[371]

The chronic tax avoider's concern about certainty in the law exists not so that he is knowledgeable of its existence and whether or not his legitimate transactions will be caught in the fuzzy corners of the law. Rather, the chronic tax avoider is concerned about certainty in the law so that she can find a bright line and avoid taxes.[372] Put another way, the chronic tax avoider cares about certainty in the law so that she can manipulate it to her illegitimate advantage. The law is not, and should not be, concerned with making the life of the chronic tax avoider easier. If anything, its goal is to make her life difficult.

Uncertainty is valuable in GAARs specifically because they are GAARs. If a GAAR is too specific, it is a SAAR, and the whole point of having a GAAR is lost. "This characteristic,

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368. *Id.*

369. Rebecca Prebble & John Prebble, *Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law?*, CRITICAL TAX CONFERENCE SAINT LOUIS UNIVERSITY SCHOOL OF LAW CENTER FOR INTERNATIONAL AND COMPARATIVE LAW 16 (2010), *available at* http://www.ssrn.com/abstract=1523043.

370. *See supra* part II.C.

371. Prebble, *supra* note 31, at 382.

372. *Id.* at 372.

together with the fundamental problems of tax law plus what many see as the dubious moral standing of tax avoiders, prompts some commentators to argue that certainty is simply an inappropriate value for general anti-avoidance rules to strive for."[373]

4. The Power of the IRS

Some may argue that the GAAR-plus system increases the IRS's power at the plea-bargaining stage. To remedy this concern, the GAAR-plus Guidelines will be written broadly enough that the IRS can charge different "sub-crimes" within the Guidelines, allowing for various advisory ranges of sentences. Once a charging decision has been made, the IRS can then recommend a sentence length. Arguably, this places the IRS in the role as "sentencer." This role is patterned after the prosecution's role in the criminal context because prosecutors have the discretion to add or drop charges with mandatory minimum sentences, giving them effective control over the defendant's sentence.[374] Prosecutorial control of sentencing means that defendants will almost be forced to take plea bargains, mostly in cases where they are doubtful regarding their chances before a jury.

The GAAR-plus eliminates many of the "IRS as sentencer" problems due to its lack of mandatory minimum sentences. The presiding judge will always act as a check over the IRS. Further, there is an opportunity for what, in the criminal context, Professor Douglas Berman has proposed as "second look sentencing," which allows a prosecutor to reevaluate a case to decide whether the defendant is one society believes should be imprisoned for as long as she has been sentenced.[375] In other words, it allow for the readjustment of sentences based on changing societal values, new evidence, or good behavior during incarceration.[376] While this has not been implemented, it is worth studying for the GAAR-plus context.

VII. CONCLUSION

The Internal Revenue Code is replete with revenue leaks. The Treasury can keep hiring people, it can promulgate new

373. Prebble & Prebble, *supra* note 369, at 41.

374. *See* Wayne R. LaFave, Jerold H. Israel, Nancy J. King, & Orin S. Kerr, CRIMINAL PROCEDURE, § 13.2(a) (3d ed. 2011).

375. Douglas Berman, *Encouraging (And Even Requiring) Prosecutors to be Second-Look Sentencers*, 19 TEMP. POL. & CIV. RTS. L. REV. 429, 437 (2010).

376. *Id.*

regulations, and it can pass new laws. But none of these actions work completely. The PAAR is evidence of that, as it flopped around within Subchapter K before wheezing its way to dead-letter status.

Yet, enacting the PAAR was a good try. After all, numerous countries, from Canada, to Hong Kong, Australia and South Africa, all have had at least some success with GAARs. The GAAR-plus, on the other hand, is about oversight. The point of the system is to get chronic taxpayers dependent, provide incentives to change their avoidance mentalities, and gradually provide a structure for them to no longer need the system. Certainly, this is paternalistic, but given the failure of other anti-avoidance measures thus far, it may be exactly what is required.