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The Tiley trilogy and US anti-avoidance law

Erik M. Jensen*

Abstract

This article considers an influential set of pieces, written by Professor John Tiley in the mid-to-late 1980s, about US anti-avoidance doctrines. The trilogy of articles was written for a British audience, as part of Tiley's efforts to resist importation of those US doctrines ('bleeding chunks of alien doctrine', as he put it) into the UK, but his ideas remain relevant to tax theorists in all countries. The article also examines the work of the Aaronson Committee, of which Tiley was a member, which in 2011 successfully recommended that the UK adopt a general anti-avoidance rule (GAAR). Did Tiley's resistance to anti-avoidance doctrines lessen over the decades, or did the recommendations of the Aaronson Committee avoid the problems that Tiley had seen in the US doctrines? This article concludes, probably not surprisingly, that the latter was the case.

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1 INTRODUCTION

John Tiley first came to Cleveland, Ohio, and Case Western Reserve University for the 1985-1986 academic year. He came with a specific project in mind. The House of Lords had recently decided *Furniss v. Dawson*,¹ which, to some commentators, looked like a significant step toward importing US substance-over-form concepts into the relatively formalistic British tax system.² John wanted to study the American ideas—to get a better idea of what his countrymen and -women might be getting themselves into. He read voraciously, he sat in on tax courses (as well as teaching his own) at the School of Law, and he established contact, in that era before e-mail, with tax professionals across the US.³

John's study led to three important articles in the *British Tax Review*,⁴ a trilogy of articles demonstrating that John had a better grasp of key US tax concepts than most US tax professionals do (the Tiley trilogy). John came away from his study with what, to us colonials, seemed to be a heretical conclusion: the US judicial anti-avoidance doctrines, unless they were quite limited in scope, should stay in the US.

Most US lawyers take the importance of substance for granted. Why (we think) would anyone want to run the risk of being called a formalist, rather than being seen as a keen observer of reality?⁵ As John sarcastically put it in criticizing the 'insidiously attractive' substance-over-form doctrine: 'What could be more attractive than to be freed from the task of living in an unreal world?'⁶

John not only questioned the merits of many judicially imposed US substance-over-form principles; he summarily rejected them for the UK: '[I]mporting bleeding chunks of alien doctrine could prove extremely dangerous.'⁷ If the UK courts do not constrain the scope of any imported doctrines, John wrote, 'they are heading for a quagmire of unprincipled decision making'.⁸ Vivid images indeed.⁹

Particularly interesting to this observer is that the UK has now, by Act of Parliament, adopted a general anti-avoidance rule (GAAR), and the recommendation to do so came

¹ [1984] AC 474.

² *Furniss v Dawson* was not entirely novel. It expanded the so-called 'Ramsay principle,' deriving its name from a case decided two years earlier. See *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300.

³ John already knew many US tax academics, of course, all of whom adored him. The level of adoration increased dramatically during that year.

⁴ See John Tiley, 'Judicial anti-avoidance doctrines: the US alternatives' (1987) *British Tax Review* 180; and 'Judicial anti-avoidance doctrines: the US alternatives—part II' (1987) *British Tax Review* 220 (with a couple of corrections, one quite amusing, noted at 433) [Tiley I]; 'Judicial anti-avoidance doctrines: some problem areas' (1988) *British Tax Review* 63 [Tiley II]; 'Judicial anti-avoidance doctrines: corporations and conclusions' (1988) *British Tax Review* 108 [Tiley III]. See also John Tiley & Erik M Jensen, 'The control of avoidance: the US alternative' (1998) *British Tax Review* 161 (further reflections on US doctrine).

⁵ The substance-over-form doctrine is ordinarily something the government, not taxpayers, may invoke. But see *Zenz v Quinlivan* 213 F2d 914 (6th Cir 1954) (holding that it does not matter whether, if the steps are part of an integrated transaction, a corporate shareholder first sells shares and then has other shares redeemed, or the steps are reversed). *Zenz* gave its name to the bootstrap transaction at issue in the case—'zenzing out'—and taxpayers are as entitled to rely on the substance-over-form result in *Zenz* as is the Internal Revenue Service. See Rev Rul 75-447 1975 2 CB 113 (accepting *Zenz*). See also Tiley I, note 4, 231-34 (critically discussing *Zenz*); Tiley III, note 4, 123-24 (also discussing *Zenz*).

⁶ Tiley I, note 4, 226 (footnote omitted).

⁷ *Ibid* 181.

⁸ *Ibid* 244.

⁹ Phrases like 'bleeding chunks of alien doctrine' do not commonly appear in US tax journals.

out of the Aaronson Committee (named for its chair, Graham Aaronson), of which John Tiley was a member.¹⁰ Did John change his mind over the years, or was the committee's proposal for a new GAAR substantially different from 'the bleeding chunks of alien doctrine' he had condemned a quarter century earlier?

This article reexamines the Tiley trilogy of articles published after his year in the US. The goals are several: to bring John Tiley's learning about key US doctrines to a new generation of tax professionals; to reevaluate the merits of the Tiley analysis; and to consider whether subsequent developments, including the Aaronson report, require modifying that analysis.

This article first provides a brief summary of the Tiley trilogy. Part II discusses the defects John saw in the US judicial doctrines, and Part III considers the differences between the US and British systems that might justify different methods to attack avoidance behaviour. Finally, Part IV considers the Aaronson Report in light of John Tiley's aversion to US anti-avoidance doctrines, and briefly describes the recent US codification of an anti-avoidance doctrine.

2 THE FORM (AND SUBSTANCE) OF THE TILEY TRILOGY

In the first instalment of the trilogy, published in two parts, John Tiley set out the circumstances that led to his US research; pondered some of the differences between the US and UK legal systems that might reasonably lead to differences in tax jurisprudence;¹¹ described different levels of reasoning that can be involved in resolving a tax dispute (the more ethereal of which, he argued, ought to be avoided by judges);¹² and then comprehensively explained, in often unflattering terms, several of the US judicial anti-avoidance doctrines.

In the second instalment, John considered a number of specific problem areas involving application of the US doctrines outside the corporate tax context. In the final instalment, he extended the discussion to the problem areas in US corporate tax law. At the very end of that last instalment, John reiterated—and embellished—his reservations about the US doctrines.

To say that John had 'reservations' is putting it mildly. To be sure, on the very first page of the trilogy, John had written in measured terms: 'It will be suggested that United Kingdom judges should be extremely wary of importing United States doctrines, since both the intellectual structure of the United States tax system and the administrative structure that underpins it are very different from ours.'¹³ That use of the passive voice has the sound of the typically restrained academic article. The final instalment of the trilogy ends with some passages that have a similar tone, once again urging UK courts to be 'extremely wary' of the US doctrines.¹⁴ But on the second page of the first instalment, there is the reference to 'bleeding chunks of alien doctrine', and examples of similarly biting language can be found throughout the articles. Restrained though the

¹⁰ Report by Graham Aaronson QC, 'GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system' (11 November 2011), available at http://webarchive.nationalarchives.gov.uk/20130321041222/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf [the Aaronson Report].

¹¹ See Part III.

¹² See notes 33-38 and accompanying text.

¹³ Tiley I, note 4, 180.

¹⁴ Tiley III, note 4, 142.

trilogy might have been in some respects, this was not an exercise in dispassionate analysis.¹⁵ This was a subject about which John Tiley had very strong views.

The details of US tax law have of course changed since the trilogy was written, and the trilogy is therefore not a trustworthy guide to today's US black-letter law. Some of the legal doctrine John described has changed dramatically. For example, as John was studying and writing, Congress was interring what had been a key principle of American corporate tax law, the *General Utilities* doctrine.¹⁶ Furthermore, most dividends from corporations are now taxed to individuals at preferential rates, another important change that affects the specifics discussed in the trilogy.¹⁷

The details may have changed, but what John wrote about US anti-avoidance doctrines remains as relevant today as it was back then. This is not to say that John was right in everything he wrote, but the issues he raised are (and always will be) important ones. The trilogy is still a worthwhile, and often wonderful, read.

3 WHAT'S WRONG WITH THE US DOCTRINES?

John Tiley condemned US judges' use of judicially created anti-avoidance doctrines for many reasons. For one thing, he said that US judges underestimate the value of form. Deference to form makes tax law more predictable and administrable (with, to be sure, some losses of revenue). 'If it is objected that tax law must live in the 'real world,' John wrote, one response 'is that the need for certainty is part of the real world.'¹⁸ Relying on form also arguably leads to fairness, with results less dependent on the vagaries of fact-finding.¹⁹ And, as John regularly noted, many statutes, even in the US, intentionally create formalistic rules. According to John an 'indiscriminate adoration of substance' would be totally inappropriate in interpreting and applying such a statute.²⁰ It would be stupid, that is, to interpret a formalistic statute in a non-formalistic way.

A related point is that particular transactions are sometimes clearly governed by a particular set of rules. In that case, John wrote, where:

the court is asked to recharacterise facts which fall clearly within one rule . . . , the court has stumbled into quicksand. . . . The price of uncertainty, although capable of exaggeration, is too great since there is no discernible limit to the areas which are rendered uncertain.²¹

According to John, professing to search for the substance of a transaction can lead to judicial laziness and to the production of opinions that provide little or no legal guidance. John concluded, based on his research, that the typical US judge seemed to think that,

¹⁵ One biting reference that hit this reader particularly hard was about 'basis fixation. United States tax lawyers are obsessed with the problem of determining the basis for assets.' Tiley I, note 4, 190. I regularly tell my students that basis is the most critical concept in the income tax, and that they should be fixated on it.

¹⁶ See *General Utilities & Operating Co v Helvering* 296 US 200 (1935), under which distributions of property from corporations to shareholders were considered non-taxable events at the corporate level. With one limited exception, the *General Utilities* doctrine is no longer the law. See IRC §§ 311(b), 336 (making distributions of appreciated property taxable to the distributing corporation).

¹⁷ 'Qualified dividends' are taxed at the same maximum rates applicable to most long-term capital gain. See IRC § 1(h)(11).

¹⁸ Tiley III, note 4, 143.

¹⁹ What facts are relevant may well depend on whether the 'substance' of a transaction must be determined. See notes 37-38 and accompanying text.

²⁰ Tiley I, note 4, 234.

²¹ Tiley III, note 4, 143.

by citing an anti-avoidance doctrine, he could avoid the hard work of analysis—as John put it, ‘an invocation of doctrines as if they determined the case without explaining how’.²² It is easier, that is, to say that the substance of a transaction is *X*, and that the tax results should follow from that characterisation, than to have to interpret difficult revenue statutes (and, for that matter, to explain *why* the substance is *X* and not *Y*). John quoted the legendary Judge Learned Hand,²³ who in 1932 described judicial recourse to concepts like ‘form’ and ‘substance’ as ‘anodynes for the pains of reasoning’.²⁴ John added:

It is all too clear from the American authorities that a simple invocation of this doctrine as if it answered the problems presented is an easy a [sic] trap to fall into and frequently deprives a decision of any doctrinal value.²⁵

And it is not as though the US anti-avoidance doctrines are models of clarity: ‘if they operated in isolation, they would produce extreme uncertainty but, worst of all, they can be extremely difficult to grasp and at times lack intellectual credibility.’²⁶ The relationship among the various doctrines is also a source of uncertainty. Are the ‘doctrines’ of a step transaction, a sham transaction, and economic substance distinct from substance-over-form, or do they merely reflect the application of that general doctrine in particular contexts?²⁷ After all, the step transaction doctrine—setting out the circumstances under which a number of formally separate transactions should be collapsed and analysed as a single transaction for purposes of determining the tax consequences—seems to do nothing but disregard form in favor of a newfound substance. If that is so, is anything gained by giving a name to another ‘doctrine’? Similarly, John seemed to think (at times anyway) that the so-called sham transaction doctrine, under which a transaction will be disregarded for tax purposes if its only purpose is tax avoidance, had no independent significance. That doctrine, derived from the 1960 Supreme Court decision in *Knetsch v United States*,²⁸ can also be understood as an application of substance-over-form principles.²⁹

The invocation of judicially created rules would lead to uncertainty under any circumstances, but the uncertainty is compounded by the complex US judicial system. A federal tax dispute can begin its judicial travels in any one of three different sets of trial courts—the Tax Court, the Court of Federal Claims, or a federal district court—at the taxpayer’s option.³⁰ Those courts are not necessarily in doctrinal agreement. Appeals

²² Tiley I, note 4, 188. See also Tiley II, note 4, 103 (noting that his survey of non-corporate cases ‘has been designed to highlight the necessity for clear and intellectually sustainable rules of law and the dangers of vague invocations of ‘substance’ and ‘reality’”).

²³ Hand has often been described as the most important jurist never to have sat on the US Supreme Court.

²⁴ *Commissioner v. Sansome* 60 F2d 931, 933 (2d Cir 1932).

²⁵ Tiley I, note 4, 226-27 (footnote omitted).

²⁶ *Ibid* 180.

²⁷ For that matter, John concluded that judges sometimes used hyperbolic substance-over-form language when all they were doing was reasoning by analogy: see Tiley I, note 4, 228.

²⁸ 364 US 360 (1960).

²⁹ See, eg, Tiley I, note 4, 196-97 (‘It is extraordinarily difficult to work out what a United States lawyer means by a sham transaction. . . . When the United States lawyer concludes that a transaction is a sham he usually means that the form of the transaction is to be disregarded because it is a sham as compared with the underlying substance; the use of the term in this way seems to be nothing more than a rhetorical device of disapprobation to support a conclusion reached on other grounds—usually one of the general doctrines.’). But see 220 (stating that the *Knetsch* approach is ‘intellectually sustainable’).

³⁰ Different jurisdictional rules apply. For example, the Tax Court is available only if the taxpayer does not first pay the contested tax; the taxpayer then petitions to challenge the asserted efficiency. Entrance to the

are heard in twelve different courts spread across the country, and here too doctrinal disagreement is not uncommon. The Supreme Court in theory can impose consistency, but it hears few tax cases (and those only grudgingly).³¹ As a result, a single ‘doctrine’ can take different forms in different fora. As John noted, the step transaction doctrine, described above, had (and probably still has) at least three different formulations in US courts.³²

Perhaps John’s biggest problem with the US judicial doctrines is that he believed they reflected types of thought that are, and should remain, foreign to UK judges. John posited nine levels of reasoning in tax disputes, ranging from the purest questions of fact (level 1) to the most cosmic. One of his goals in the trilogy was to encourage UK judges to continue to avoid levels 8 and 9 and to reach level 7 only on occasion. (Level 7 reasoning arises ‘when the court, having determined the relevant facts and interpreted the relevant legislation, considers invoking some general principle of tax law.’³³)

John classified US anti-avoidance doctrines as level 8 reasoning:

general doctrines which are not of universal application and which are applied spasmodically rather than being constant influences. . . . It is clear that while these doctrines are pervasive they are also unpredictable; they are, or take the form of, rules, but potential rather than actual. They thus resemble comets rather than stars or planets. . . . [I]t is much easier to state such a basic doctrine than to define its limits. . . . [O]nce a doctrine is loose in the law it is extremely difficult to get rid of.³⁴

That sounds bad enough, and level 9 is even worse: ‘At level 9 we move beyond formal legal reasoning into an area in which broad principles float about in the legal ether. These principles are, as much as anything else, gut feelings about what the law should be’,³⁵ and the ‘principles’ at this level inevitably conflict.³⁶

The US doctrines fell within the higher, more suspect levels of reasoning, but John argued that they muddied the waters even at the lowest level, that of basic fact-finding. The world is full of facts, after all, almost all of which should be irrelevant to any particular legal dispute. But if, should a controversy develop, a transaction might be re-characterised into something other than what is suggested by the form, the universe of potentially relevant facts expands exponentially. In short, one needs to know what the law is in order to determine what the salient facts are, and ‘in no area of tax law is this

other two courts requires paying first and then suing for a refund. But it is within the control of the taxpayer as to which court to use, and one important factor in the choice of forum is the relevant precedents in each court.

³¹ For example, Justice William Brennan’s reported ‘normal reaction’ in reviewing petitions for a writ of certiorari was to write ‘This is a tax case. Deny.’ See Bob Woodward & Scott Armstrong, *The Brethren: Inside the Supreme Court* 362 (1980). It is true, however, that, if circuit courts disagree on an issue, the circuit split increases the likelihood that the Supreme Court will agree to hear a case involving that issue, even if it involves taxation.

³² Tiley I, note 4, 235-41. Although John did not discuss this, the economic substance doctrine, under which a transaction may be disregarded for tax purposes if it lacks economic substance, was applied quite differently across the country as well—a defect that was cured only in 2010, and then only prospectively, by legislation. See notes 73-77 and accompanying text.

³³ Tiley I, note 4, 193.

³⁴ *Ibid* 194 (footnotes omitted).

³⁵ *Ibid*. For an amusing mistake, see *ibid* 220 (where ‘level 9 reasoning’ came out, perhaps because of a dictation error, as ‘Lord Freasonine’).

³⁶ *Ibid* 195.

more difficult than in that of general anti-avoidance doctrine.³⁷ Such a doctrine potentially leaves all 'facts' at the risk of being re-characterised.³⁸

4 FUNDAMENTAL DIFFERENCES BETWEEN THE US AND UK TAX REGIMES

Although John Tiley had many uncomplimentary things to say about US doctrines and practices—he really did not like the anti-avoidance doctrines as they operated on US soil—he conceded that the development of the doctrines was understandable in the US. It was understandable because the US governmental and legal systems are very different from their UK counterparts. While that helped to explain the US developments, it also made fighting their transfer to the UK all the more important.

The creaky system of often divided government in the US (it is not the norm for one political party simultaneously to control the presidency and both Houses of Congress) makes quick reaction to tax abuses difficult. Congressional tax enactments generally are of unlimited duration; they become part of the continuing Internal Revenue Code. Unless provision is made for an expiration date, those enactments remain indefinitely on the books for tax professionals to plan around. Congress has the power to amend or repeal provisions that become problematic, of course, but Congress works slowly and inefficiently.³⁹

Under the circumstances, with Congress (and administrators as well) unable to react quickly to the spread of abusive transactions, it may have been necessary for US courts to send the signal, through anti-avoidance doctrines, that claimed tax results which seem too good to be true probably are.⁴⁰ In contrast, the UK parliamentary system, with its strong party discipline, is better suited to quick legislative fixes. If UK taxpayers are behaving badly in a particular way, the party in power is likely to be able to get targeted legislation through Parliament in a clean and quick way. As John wrote,

With the House of Commons . . . little more than a rubber stamp as the annual Finance Bill passes on its stately way, and with the opportunity of an annual Finance Bill for the Revenue to put things right it is suggested that the United Kingdom courts do not need to develop doctrines to protect the Revenue beyond those such as Lord Brightman's step transaction and possibly a business purpose approach; moreover to develop such a doctrine along the lines of substance over form will be to imperil the Revenue just as much to protect it.⁴¹

In the US we do not have the luxury of fast-acting government.

The US federal system, with the separate state governments operating within the national system, introduces other complications not found in the UK. Legal rules in many areas, including property law, are almost entirely created by state governments; the national tax laws must then classify the transactions carried out pursuant to those substantive rules, which can vary substantially across the fifty states. In the UK, in contrast,

³⁷ Ibid 191.

³⁸ Ibid.

³⁹ That statement is meant to be a description rather than an editorial comment. Many would say that the US Constitution was intended to create a creaky system, so as to protect the populace from a potentially abusive government.

⁴⁰ US legislative and regulatory responses to tax avoidance are discussed in Erik M Jensen, 'The US legislative and regulatory approach to tax avoidance,' in *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley* 99 (2008).

⁴¹ Tiley III, note 4, 144-45.

Parliament establishes both the substantive rules and the governing tax doctrine.⁴² That reduces doctrinal complexity and lessens the need for judicial development of anti-avoidance doctrines.

The form that tax legislation takes in the two countries provides another reason for judicial participation in the US lawmaking process in a way frowned upon in the UK. In John's words, in the US, '[t]he legislation which the courts have to apply contains many provisions of a complexity equal to the worst of the United Kingdom legislation but it is much more prone to introduce relatively woolly concepts and leave matters to the courts to resolve'.⁴³ It was because of these 'woolly concepts' that US judges were forced to develop 'level 7 reasoning'⁴⁴ (and sometimes much worse): 'Level 7 reasoning comes much more naturally to United States lawyers than to their United Kingdom colleagues not least because they recognise that their statute provides a framework for the judges to develop doctrine, a premise which United Kingdom lawyers do not share.'⁴⁵

John may have exaggerated some of the differences he saw between the US and the UK, however. US judges think it necessary to determine the reality, the substance, underlying behaviour, but John argued that there are profound differences

between the real world of the United States and the real world of the United Kingdom. The United States is content to live in an atmosphere of *in terrorem* provisions and considerable uncertainty because of the system of quasi-law which underpins the state. This quasi-law consists of Regulations . . . and Letter Rulings. . . . The result of all this is that the taxpayer has a reasonable awareness of when he will be straying into dangerous territory and when not and that such information is reasonably accessible.⁴⁶

In this passage John seemed to be suggesting both that those in the US are willing to deal with 'considerable uncertainty' and that, because of this 'quasi-law', there is really not much uncertainty at all, particularly if a taxpayer stays away from the borders of 'dangerous territory'. Doctrines with somewhat fuzzy boundaries may be regarded as '*in terrorem* provisions', but the terrified are only going to be those who engage in aggressive tax planning. And, despite the disparaging reference to 'quasi-law', no US tax lawyer thinks of Treasury regulations, which do indeed help in providing certainty, as anything but *real* law. They are generally promulgated pursuant to elaborate rules of administrative law and are subject to potentially rigorous public comment during the promulgation process.⁴⁷

⁴² Tiley I, note 4, 186.

⁴³ Ibid 187. John conceded that Americans do occasionally act like Her Majesty's subjects: 'Where subsequent legislation has been meticulous in its detail the United States courts have indicated a willingness to approach the problems of construction in a thoroughly English way and to reject arguments based on form and substance' Tiley III, note 4, 144.

⁴⁴ See text accompanying note 34.

⁴⁵ Tiley II, note 4, 64.

⁴⁶ Tiley III, note 4, 143.

⁴⁷ On this point it is impossible for those in the US to imagine the practice of tax law without the extremely comprehensive body of regulations that flesh out statutory language and provide examples of the operation of the statute. (To the extent a regulation conflicts with a congressional enactment, the regulation must fall, but that is a relatively unusual situation.) The status of private letter rulings is different in that, for most purposes, they are not to be treated as precedent. Nevertheless, although they might be 'quasi-law', it is invaluable to know what sorts of transactions the Internal Revenue Service is blessing. And the letter rulings are publicly available, with identifying information redacted.

John may also have overstated the extent to which the US Constitution, which imposes limitations on the national taxing power, contributes to the enactment of fuzzy statutes that invite, or even demand, judicial intervention. In particular, John emphasised the significance of the Sixteenth Amendment to the Constitution, ratified in 1913. Without the Amendment, a tax that reached income from property would (the Supreme Court had held in 1895⁴⁸) be a direct tax that would have to be apportioned among the States on the basis of population.⁴⁹ Apportionment would have made the income tax absurd.⁵⁰ By exempting 'taxes on incomes' from the apportionment requirement, the Amendment made the modern income tax possible—but only insofar as the tax is really on 'incomes'. Hence the uncertainty, or so John argued.

US courts, John wrote, have to construe legislation

not only in terms of what Congress intended but also in terms of what the Sixteenth Amendment allowed. The legislation in the early years was broad and many of those broad principles have remained in place. Broad legislation is sensibly construed in a broad way. Issues of form and substance first emerged in this era and the preference for substance over form, being concerned with fact classification rather than re-characterisation, is a natural and correct way to determine the facts of the case.⁵¹

It is true that Supreme Court cases from the 1920s and 1930s regularly contained discussions as to whether a particular item constituted 'income' within the meaning of the Sixteenth Amendment.⁵² But such discussions have almost completely disappeared from modern jurisprudence. The old cases may help explain the origins of anti-avoidance doctrines, I suppose, but they cannot explain their continued importance in the US system. Modern US courts give almost no consideration to constitutional limitations on the national taxing power.⁵³

Some of what John Tiley wrote about the differences between the systems of the US and the UK may thus be questioned, but he certainly provided a lot to think about.

5 THE AARONSON REPORT AND THE US CODIFICATION OF THE ECONOMIC SUBSTANCE DOCTRINE

As noted earlier, it was a surprise to many US observers that John Tiley, eminent sceptic about anti-avoidance doctrines, particularly of the US variety, was a member of the Aaronson Committee that recommended a general anti-avoidance rule (GAAR) for the

⁴⁸ See *Pollock v Farmers' Loan & Trust Co* 157 US 429, 158 US 601 (1895).

⁴⁹ See US Constitution, Art I, § 2 and Art I, § 9, cl 4 (both requiring that direct taxes be apportioned).

⁵⁰ Suppose two states have identical populations, but the average income in state A is twice that in state B. If an income tax is a direct tax that has to be apportioned, the amount of income tax to be paid by the two states would have to be the same, presumably meaning that the tax rates in state B, the poorer state, would have to be twice as high as those in state A. The mechanics of that system could be made to work, but the result would be preposterous. No self-respecting Congress would ever enact such a tax.

⁵¹ Tiley III, note 4, 144.

⁵² See, eg, *Eisner v Macomber* 252 US 189 (1920) (holding that the receipt of a totally proportionate stock dividend, one that did not change the recipient's proportionate interest in the corporation's assets and earnings, was not income within the meaning of the Sixteenth Amendment).

⁵³ But see *National Federation of Independent Business v Sebelius* 132 S Ct 2566 (2012) (holding that a 'penalty' for failure to acquire suitable health insurance under the so-called 'Obamacare' legislation is really a tax authorised by the Taxing Clause in the Constitution and that the penalty would not be affected by the Sixteenth Amendment).

UK.⁵⁴ But the Report issued by Graham Aaronson contains little that the author of the Tiley trilogy might have objected to. The recommendations were quite limited in their scope, and intentionally so. The Committee did not recommend anything like the importation of US substance-over-form doctrines, and, in any event, the Committee recommended *legislative*, not judicial, action. (Doing this legislatively was characterised in the report as being consistent with the rule of law.⁵⁵)

The GAAR recommended by the Aaronson Committee was to apply only to transactions of a clearly abusive sort. The goal was to have ‘a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements’.⁵⁶ The Report posited two main requirements for an acceptable GAAR: ‘The first is that the GAAR applies only to abnormal arrangements’, and ‘[t]he second is that the GAAR will operate only if the arrangement cannot reasonably be regarded as a reasonable exercise of choices of conduct afforded by the legislation.’⁵⁷

Determining whether an arrangement is ‘abnormal’ is not necessarily easy, of course, but the difficulty is lessened if the category is limited to those transactions that might otherwise seem to lead to preposterously good results.⁵⁸ If there is a colourable claim that a transaction, as structured, achieves the desired results, the GAAR is not to apply. When there is doubt about whether ‘an arrangement can be regarded as a reasonable exercise of choices made available by the tax rules[,] the appropriate principle is to give the taxpayer the benefit of the doubt.’⁵⁹ And the Report recommended that there be ‘an automatic exclusion from the operation of the GAAR for any arrangement which is entered into entirely for non-tax reasons.’⁶⁰

Furthermore, the Aaronson Report emphasised that, unlike the case with other GAARs, there should be no negative presumption merely because one of the objects of the arrangement is a tax advantage:

I do not consider this to be the right approach for a GAAR that is suitable for the UK tax regime. The insuperable problem is that the UK tax rules offer, and indeed in many instances positively encourage, the opportunity for taxpayers to reduce their tax liability. Taking advantage of this can be described as a form of tax avoidance, but clearly it is not something to be criticised and therefore it should not be counteracted by a GAAR.⁶¹

Limited though it was, the recommended GAAR was not to be a paper tiger. It could be invoked to strike down the desired tax consequences in transactions that otherwise seemed to meet statutory requirements:

[I]t should be made clear that the GAAR is not to be regarded as a rule of construction, or interpretation, of statutory language. Rather, it operates on the hypothesis that the particular tax rules engaged by the arrangement would, on

⁵⁴ See Aaronson Report, note 10.

⁵⁵ *Ibid* 15.

⁵⁶ *Ibid* 4.

⁵⁷ *Ibid* 40.

⁵⁸ See *ibid* 32 (‘I have reached the conclusion that the better approach is to identify what it is that makes the centre ground of responsible tax planning unobjectionable, and to use this as the way to exclude from the shortlist of abnormal transactions those which come within that centre ground.’).

⁵⁹ *Ibid* 33.

⁶⁰ *Ibid* 35.

⁶¹ *Ibid* 30-31.

conventional purposive interpretation, succeed in achieving the advantageous tax result which it set out to obtain. The GAAR then provides an overriding statutory principle to which other tax legislation is subject.⁶²

The GAAR would help avoid the ‘fiscal chess game’—laws are enacted, taxpayers work around those laws, and then new laws are enacted to deal with the changed behaviour.⁶³ And it would make it unnecessary for judges and administrators to ‘stretch’ the interpretation of a statute to come to the right result in a case involving an abnormal arrangement.⁶⁴ No stretching would be necessary; the GAAR would provide the authority to disallow the claimed tax benefits.

The ultimate goal was ‘to avoid the application of [the substantive tax] rules, or exploit their application, in a way that Parliament could not rationally have contemplated.’⁶⁵ This seems to require something like a ‘too good to be true’ standard—that is, if the tax results, although they seem to be justified by statutory provisions, purposively interpreted, are too good to be true—the GAAR may be applicable.⁶⁶

Graham Aaronson recognised the danger of ‘mission creep’—that a GAAR could be pushed over time by Her Majesty’s Revenue and Customs (HMRC) into something far different from what was originally intended⁶⁷—and the Committee’s proposal had built into it a protection against mission creep: the creation of an Advisory Panel not made up only of HMRC personnel. The Advisory Panel would, among other things, regularly review the application of the GAAR; make sure that an independent person who has expertise about the transaction under review be involved;⁶⁸ publish decisions in redacted form, so that systemisation would develop;⁶⁹ and guard against HMRC’s discretionary powers by having the Advisory Panel do periodic updating of guidance about the types of cases to which the GAAR should apply.⁷⁰

The Aaronson Report is full of other goodies as well, but those are many of the highlights. It is understandable that John Tiley could have supported such a GAAR, even though those redacted documents might contain the seeds of ‘quasi-law’.⁷¹

It is worth noting that the US has recently had its own codification, in a limited way, of an anti-avoidance doctrine that had been judicially created. (If the US action had not taken place in 2010, slightly before the enactment of the UK GAAR, I might have suggested that a ‘bleeding chunk of alien doctrine’ must have crossed the Atlantic from east to west.)

⁶² Ibid 28.

⁶³ Ibid 15.

⁶⁴ Ibid 5.

⁶⁵ Ibid.

⁶⁶ This is like a standard suggested by Professor Alan Gunn to interpret a US anti-abuse rule in a regulation promulgated under the partnership tax regime. A transaction is abusive even if it seems to satisfy all statutory requirements if one concludes that, had Congress thought about the transaction, Congress would have deemed the transaction objectionable: Alan Gunn, ‘The use and misuse of anti-abuse rules: lessons from the partnership antiabuse regulations’ (2001) 54 *SMU Law Review* 159, 174.

⁶⁷ See Aaronson Report, note 10, 24 (‘Without exception the representative bodies were concerned about the possibility that some HMRC officials would use a GAAR in cases for which it was not designed.’).

⁶⁸ Ibid 26.

⁶⁹ Ibid.

⁷⁰ Ibid 29 (‘provide for an authoritative source of guidance as to the sort of cases to which the GAAR should apply’).

⁷¹ See notes 46-47 and accompanying text.

The US for years had resisted codification of any general anti-avoidance rule. Although the Internal Revenue Code includes many provisions that contain authority for application of substance-over-form principles, those provisions are targeted at specific transactions.⁷² The George W Bush administration did not support codification of a general anti-avoidance rule largely on the ground that doing so would fossilise doctrines that need to be fluid, to be able to adjust quickly to the never-ending imagination of tax planners.

Nevertheless, as part of the healthcare legislation enacted in 2010, popularly and unpopularity known as ‘Obamacare’, Congress did codify an economic substance doctrine (or what the statute characterised as a ‘clarification’ of that doctrine),⁷³ with consequences that we are not yet in a position to understand.⁷⁴ In brief, that doctrine would honour a transaction for tax purposes only if it has economic substance. One of the salutary results of the new statute, by almost everyone’s standards, was clarifying the relationship in application of the test between an objective criterion (to what extent did a transaction in fact have possibly beneficial tax consequences apart from the tax effects?) and a subjective criterion (to what extent did a taxpayer participating in a transaction need to have non-tax motivations for that participation?). US courts had taken inconsistent positions as to whether a transaction, to be honoured, had to satisfy both criteria, or only one, effectively leading to the doctrine’s being applied in different ways in different parts of the country. As a result of codification, it is now clear (for transactions subject to the codified doctrine) that a transaction will be treated as having economic substance only if it satisfies both tests.⁷⁵

I do not know for sure, of course, but I suspect that this US ‘clarification’ is a change that John Tiley would accept, and maybe even endorse. It was done legislatively; it eliminated inconsistencies that existed in judicial doctrines; and it was not meant to apply to all aspects of tax law. It was not a bad first effort by the US.

The ‘clarification’ did not, however, make the judicial anti-avoidance doctrines irrelevant; indeed, the statute defines the ‘economic substance doctrine’ in terms of the

⁷² For example, a Code provision sets out the standards governing when a contribution of property to a partnership (generally a non-taxable event) followed by a distribution of cash to the contributing partner (distributions also generally being non-taxable) will be treated as a disguised sale of the property: see IRC § 707(a)(2)(B).

⁷³ See IRC § 7701(o). Congress also provided for a strict-liability penalty to enforce the ‘clarification’: 40 percent of the understatement of tax attributable to any ‘nondisclosed noneconomic substance transaction’: IRC § 6662(b)(6) (i). A penalty of that magnitude should be enough to get the attention of most aggressive tax planners.

⁷⁴ The codification of the economic substance doctrine had nothing to do with the healthcare legislation, except that codification was scored as a revenue raiser and the Obama administration and Congress were looking everywhere for revenue to support the legislation. Disallowing hoped for tax benefits on the ground that a transaction lacked economic substance, coupled with a strict liability penalty, see note 73, was expected to raise \$4.2 billion in 2016—a pittance by US budgetary standards, but something.

⁷⁵ The application of the ‘clarification’ has lots of other ambiguities. For example, one must determine whether a transaction is one to which the economic substance doctrine is relevant, and that determination is to be made ‘in the same manner as if this subsection had never been enacted’: IRC § 7701(o)(5)(C). Pretend, that is, that what you in fact know happened did not. See Erik M Jensen, ‘Legislative and regulatory responses to tax avoidance: explicating and evaluating the alternatives’ (2012) 57 *St Louis University Law Journal* 26-37 (discussing codification of economic substance doctrine).

‘common law doctrine’.⁷⁶ On that front, John’s criticisms of US judicial anti-avoidance doctrines are as timely today as they were in the 1980s.

6 CONCLUSION

Twenty-six years ago, John Tiley concluded that, even though he did not like the US anti-avoidance doctrines, he was not averse to importing a couple of limited, ‘alien’ principles into the UK:

Of these a version of the step transaction doctrine . . . , combining a preordained series of transactions with an absence of a business purpose, can be seen to be intellectually sustainable and reasonably workable. The same is true of the business purpose doctrine in the sense that where the taxpayer invokes a particular provision it is open to the courts to hold that the particular provision is not a mechanical rule but requires a particular purpose other than the saving of tax to be shown by the taxpayer; such a doctrine would have the advantage of being inapplicable whenever the relevant purpose can be shown. Such a test would be predictable . . . and reasonably workable.⁷⁷

John Tiley’s scepticism about broader US judicial anti-avoidance doctrines was intended as a warning to his countrymen and –women; the trilogy was written for a largely UK audience. But for those not part of the primary audience, in particular those of us across the Atlantic, the trilogy was worth reading when it first appeared, and it is worth reading now. The US can be very provincial in matters of tax policy. Most US tax professionals do not study the tax law of other countries, even though there is much that could dramatically improve our laws. John’s work suggests another reason that the US should broaden its horizons: the Tiley trilogy was an extraordinary effort to question the merits of doctrines that most in the US take for granted. As we continue evaluating anti-avoidance doctrines, a never-ending process, the Tiley trilogy should be must reading in the US and elsewhere.

Indeed, everything John Tiley wrote is worth reading and rereading. It is a matter of great sadness that this wonderful man has left us. We have lost the pleasure of his presence—his ready smile, his quick wit, his graciousness—but at least his written work, his intellectual legacy, will be with us forever. For that we can be thankful.

⁷⁶ See IRC § 7701(o)(5)(A). In addition, the judicial doctrine remains in full force to analyse transactions consummated before the effective date of the ‘clarification’.

⁷⁷ Tiley III, note 4, 142.