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Skunk Works Bill Contains Some Stinky Provisions

To the Editor:

It’s hard not to be sympathetic to the Anti-Skunk Works Corporate Tax Act of 1999, as presented by Professor Calvin Johnson. (See Tax Notes, July 19, 1999, p. 443). Who wants to be seen as defending abusive tax shelters, or, for that matter, who wants to defend that much maligned species, the skunk?

Nevertheless, I have reservations about the attempt to codify already existing anti-avoidance doctrines (Title I of the Act), particularly when that codification is supposed to have effect throughout the Internal Revenue Code. Putting substance-over-form, sham transaction, step transaction doctrines, etc., into statutory form will have little substantive effect, other than to increase confusion and create innumerable new interpretational issues to slow down the enforcement process.

Why codify? Professor Johnson offers several reasons, none of which is persuasive. Since looking to substance has been taken for granted in American jurisprudence for decades, would codification really “absolve the courts from accusations of judicial activism”? Even if it would, what does that have to do with the vast majority of transactions that will never reach the courtroom? Similarly, would codification really affect corporate tax opinion writers? Why are they ignoring time-honored doctrine now?

Professor Johnson notes that many other countries are adopting (or at least are considering) General Anti-Abuse Rules, and that’s true. But in many cases, that’s because there isn’t an arsenal of judicial (or other) weapons already available for tax enforcement officials to use.

One needs to consider an anti-avoidance statute if one is operating in a relatively formalistic system that doesn’t already have a well-developed substance-over-form doctrine. But the United States isn’t in that position. We haven’t had a push for a statutory anti-avoidance rule, in part at least, because we already have anti-avoidance doctrines in place. Maybe the doctrines aren’t being enforced — isn’t that the real problem here? — but they certainly exist.

So — what are the new, often very general rules in Title I of the Anti-Skunk Works Act supposed to add? Professor Johnson writes that “the doctrines have a 70-year history of interpretation in the courts. The history of the doctrines tames the rules and means that they are not monsters or surprises.” True enough if we’re talking about the old rules. But how do old judicial interpretations tame new rules with new, and inevitably ambiguous, language? Or if the new language merely codifies “common law and common sense,” as the report says, what’s the point?

When I look at the proposed statutory language, like any good (or bad) tax lawyer I see interpretational issues. For example:

The determination of any item of gross income, deductions, or credits shall be made according to the substance of a transaction and not its form, except that taxpayers shall be bound by the form chosen.

I think I know, in general, what that’s supposed to do because, in general, I know what the substance-over-form cases do. But I’d be more comfortable with this as a statutory rule if I were sure what “form” is supposed to mean in this context.

Why even propose statutory language that raises interpretational issues like these, and therefore diverts attention from the abuses that need to be addressed?

If I’m a taxpayer, I’m bound by the form of the transaction, but what’s that? The label I put on various documents? (If so, I won’t use labels.) The label someone else puts on my structure? The way I initially report the transaction for tax purposes? Those are different conceptions of “form,” and I can find cases interpreting “form” in each of those ways. Would this new statutory rule mean that transactions where taxpayers have been able to plan on the basis of substance (say, like, variations on the bootstrap transaction blessed in Zenz v. Quintilvan, 213 F.2d 914 (9th Cir. 1954)) are no longer going to work? Surely that shouldn’t happen, but why, given the language of the Anti-Skunk Works Act, wouldn’t it?

Why even propose statutory language that raises interpretational issues like these, and therefore diverts attention from the abuses that need to be addressed?

“Steps undertaken to accomplish a larger goal shall be ignored” is another principle that sounds fine in the abstract, until one stops to wonder what a “step” is and what a “larger goal” would be (making money, avoiding taxes, preparing for the Second Coming?). There’s already some judicial understanding on those
issues, and enforcers are going to look to those cases anyway. What's the statute supposed to add?

The “tax is not a profit center” and “no negative tax” rules, relying on present value computations and such, strike me as unadministrable if taken seriously. They're attempts to give the illusion of precision. I'm skeptical that borderline transactions ought to be struck down on the basis of such suspect computations, and, for the abusive transactions that we should all be concerned about, the flimsiness is obvious without the new statute on the books.

Title I of the Anti-Skunk Works Act is a “There oughta be a law” reaction to a situation where there already is a law.

I'm certainly not going to criticize attempts to discern policy, structure, and intent in interpreting statutes, and I agree with language in the report suggesting that “courts and administration [must] make sense of the system enacted by Congress before being sure of the meaning of separate words.” But I hesitate to try to codify that general principle.

And the language proposed to do that lends itself to ridicule:

The text of the Internal Revenue Code shall be interpreted to reach results consistent with the policy, structure, and intent of Congress at the time that it enacted the provisions. What provisions? What times are we focusing on when a transaction implicates (as will often be the case) provisions enacted at different times, often without congressional thought about how the provisions fit together? Of course we need to try to make sense of the code as a whole, but I'm at a loss as to how that proposed statutory provision is supposed to help us do that.

Title I of the Anti-Skunk Works Act is a “There oughta be a law” reaction to a situation where there already is a law. The basic anti-avoidance doctrines are already on the books. Instead of debating Title I, we should be (1) urging that the already existing principles be used more vigorously in enforcement, and (2) advocating the statutory revisions needed to deal with particular abuses.

Most of the rest of the Anti-Skunk Works Act gets down to the nitty-gritty. That's where the focus should be in statutory change.

Very truly yours,

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