Winter 2009

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Recommended Citation

William Barker, *The Ideology of Tax Avoidance*, 40 *Loy. U. Chi. L.J.* 229 (2009).

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> Over and over again the courts have said that there is something sinister in so arranging one's affairs so as to keep taxes as low as possible. The rich do so, but they do wrong; for everybody owes a public duty to pay what is fair and equitable. Taxes are exactions for the general welfare; they should not be voluntary contributions for the rich and forced exactions for the poor. To demand less in the name of the people is to recant the values of democracy.[1]

I. INTRODUCTION

Tax avoidance is recognized today by practically all governments as a serious threat to the integrity of tax systems in democratic societies. However, effective deterrence in a manner that comports with the principles of a free society is an awesome task. This task cannot be accomplished without identifying and challenging the ideological basis that fosters tax avoidance in order to begin the process of establishing the democratic core value of equality as an insinuating principle of income tax law.[2]

Tax avoidance is a common term in tax law and scholarship. Though the concept is sometimes explicitly used in statutes,[3] it is more often an underlying premise for legislative, administrative, or judicial action targeting taxpayer conduct that is perceived to undermine fair and equitable taxation.

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* Professor of Law, The Pennsylvania State University Dickinson School of Law. The substance of this paper was presented at the *Loyola University Chicago Law Journal* conference, "Tax Law in a Liberal Democracy: Exploring the Relationship Between Tax and Good Governance." I wish to express special thanks to my co-panelists Lawrence Zelenak and Leo Martinez. Research for this paper was undertaken as part of an ATAX Research Fellowship as a visiting professor at the University of New South Wales.

1. The foregoing intentionally reverses the sentiment found in Judge Learned Hand's statement in Comm'r v. Newman, 159 F.2d 848, 850–51 (2d Cir. 1947) (Hand, J., dissenting). See *infra* text accompanying note 33 for the actual statement.

2. *See generally* William B. Barker, *The Three Faces of Equality: Constitutional Requirements in Taxation*, 57 CASE W. RES. L. REV. 1 (2006) (arguing that the power to tax is naturally circumscribed in constitutional norms between the people and government such as equality).

3. *See, e.g.*, I.R.C. §§ 269, 482 (2000).

The term tax avoidance does not have a limiting and definite meaning. Instead, the term is a label for describing pragmatic decision-making, which by "pricking a line through concrete applications"[4] identifies abusive situations. The results of experience have led to a kind of predictability under U.S. law that supports propositions such as, "[e]xperienced tax professionals can usually readily distinguish tax shelters from real transactions" and "[g]ood tax lawyers know when they are pushing hard at the edge of the envelope."[5]

Sophisticated guesswork is not the same as the legal certainty expected of tax law under the rule of law. The result is that it is difficult to treat tax avoidance as a category, like negligence, that is a normative legal prescription demanding action. Ultimately, even in the case of anti-avoidance legislation, it is the legal profession, and the judge in particular, who determines what really constitutes impermissible avoidance. Dealing with the problems of tax avoidance involves actions traditionally considered outside the conventional role of the judge.[6] This leaves legislatures, administrators, and jurists confronting an ever shifting landscape of taxpayer responses to taxation with a principle that, while found in taxation, is really not part of the law. Consequently, the judicial response to legislative and even judicial anti-avoidance regimes has been that they are dealing with something extraordinary—a remedy that should be used sparingly because of an essential arbitrariness which always borders on opening Pandora's Box.[7]

In the United States, the shift in judicial attitudes toward tax avoidance has been profound. Early in the history of income taxation in America, as the nation was confronting the overwhelming problems resulting from the Great Depression, Congress and the courts faced significant planning by taxpayers that deprived the government of revenue at a time when it could ill afford to lose income.[8] The result was a more substantive, open-ended legal method for tax legislation that

4. Bazley v. Comm'r, 331 U.S. 737, 741 (1974).

5. JOHN BRAITHWAITE, MARKETS IN VICE, MARKETS IN VIRTUE 126 (2005).

6. *See* William B. Barker, *Expanding the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa*, 109 PENN ST. L. REV. 703, 726–27 (2005).

7. See Yuri Grbich, *Does* Spotless *Exorcise* Barwick*'s Ghost?*, *in* TAX CATCH-UPS: A PROSPECT INTELLIGENCE REPORT 88, 105–12 (Robert L. Deutsch ed., 1997) for an excellent account of the judiciary's struggles with implementing Australia's General Anti-Avoidance Rule.

8. President Roosevelt's Message to Congress on Tax Evasion and Avoidance (June 17, 1937), *reprinted in* U.S. REVENUE ACTS 1909–1950, 20 THE LAWS, LEGISLATIVE HISTORIES AND ADMINISTRATIVE DOCUMENTS 2 (Bernard D. Reams ed., 1979).

was a radical departure from previous interpretation methods.[9] This development in tax jurisprudence reached its apex during the years of the Warren court. It should come as no surprise that the court responsible for the highest advancement of the human rights of those who were most traditionally disadvantaged by our system would be the same court that purposefully interpreted tax law restricting its abuse by those who are traditionally advantaged by our system.

Since then, the tide has turned. Literalism in the interpretation of tax legislation now dominates. Though the U.S. Tax Court has recently adopted a more intentionalist approach to tax legislation, it has not met with success on appeal.[10] Tax law is now dominated by the approach of the U.S. district courts, courts of appeal, and the Supreme Court, which have turned increasingly to a plain meaning approach.[11]

A legal method based on strict or literal interpretation is the prop that sustains tax avoidance. It, in turn, is nurtured by the ideology of liberty.[12] The consequence is that in the United States, the federal courts have readopted the ideology that underpins tax avoidance.

This paper takes a small step. As suggested by its beginning quote, this paper shall examine tax avoidance by challenging the traditional starting point. This paper will show that the ideology underpinning tax avoidance is in direct conflict with core democratic values. This ideology leads to a moral perspective that supports a right to avoid over a duty to pay a fair share of taxes. In a democratic society that values taxation in accordance with fairness, that moral perspective is wrong. It exalts individual license over democratic ideas about what income tax law requires of citizens. Freeing tax law from this ideology will

9. *See* William B. Barker, *Statutory Interpretation, Comparative Law, and Economic Theory: Discovering the* Grund *of Income Taxation*, 40 SAN DIEGO L. REV. 821, 830–32, 850–59 (2003) (tracing the change from formalism to intentionalism in the U.S. Supreme Court's approach to interpretation that took place from 1930–1956).

10. *See generally* David F. Shores, *Textualism and Intentionalism in Tax Litigation*, 61 TAX LAW. 53 (2007). Shores' study of the appeals of ten Tax Court cases that used an intentionalist approach showed in every case a reversal by the court of appeals using a plain meaning or textualist approach to statutory interpretation. *Id.* at 62–64.

11. *Id.* at 63; *see also* Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1 (2004); Deborah A. Geier, *Commentary: Textualism and Tax Cases*, 66 TEMP. L. REV. 445 (1993); Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492 (1995); Mary L. Heen, *Plain Meaning, the Tax Code, and Doctrinal Incoherence*, 48 HASTINGS L.J. 771 (1997); Richard Lavoie, *Subverting the Rule of Law: The Judiciary's Role in Fostering Unethical Behavior*, 75 U. COLO. L. REV. 115 (2004); Andre L. Smith, *The Deliberative Stylings of Leading Tax Law Scholars*, 61 TAX LAW. 1 (2007); Lawrence Zelenak, *Thinking About Nonliteral Interpretations of the Internal Revenue Code*, 64 N.C. L. REV. 623 (1986).

12. *See infra* Part II.B.

promote a moral perspective of compliance, thus providing a new starting point for developing a sustainable approach to curbing avoidance.

II. VALUES IN CONFLICT

The nature of tax avoidance can best be understood in terms of the conflicting values that seek their meaning through income tax law. To discover these essences, start with the notion that tax avoidance deals with the incongruence between the intent or object of the statute in taxing a particular situation the way it does or the purpose of the statute in giving a particular benefit to the taxpayer, and the tax outcome advanced by the taxpayer.[13] In most cases, it is said that the tax outcome determined on the basis of the taxpayer's situation is supported by a reading of the statute but not necessarily with the statute's intent or policy.[14] As President Franklin Roosevelt stated in an address to Congress:

> All [methods of avoidance] are alike in that they are definitely contrary to the spirit of the law. All are alike in that they represent a determined effort on the part of those who use them to dodge the payment of taxes which Congress based on ability to pay. All are alike in that failure to pay results in shifting the tax load to the shoulders of those less able to pay.[15]

These taxpayer outcomes achieve tax results that seem to defy the logic of taxation.[16]

These results are in accordance, however, with the logic of another value system. This other value system promotes the individual value of liberty over the individual and collective value of equality. Thus, tax avoidance operates in the limbo created by the antagonism between the ideology underpinning income taxation and the ideology underpinning tax avoidance.

A. The Ideology of Income Taxation

Ideologies are systems of ideas about the goals, values, and

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13. *See* R.W. PARSONS, INCOME TAXATION IN AUSTRALIA: PRINCIPLES OF INCOME, DEDUCTIBILITY AND TAX ACCOUNTING 844–45 (1985).

14. *Id.*; *see also* Heen, *supra* note 11, at 771 (explaining that a literal interpretation ignores "the rich range of contextual and policy considerations that inform" the tax law).

15. President Roosevelt's Message to Congress on Tax Evasion and Avoidance, *supra* note 8, at 2.

16. For example, the Supreme Court, discussing the statutory policy of not allowing double benefits or exclusion from income and inclusion in basis for debt discharge, remarked that "[b]ecause the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern." Gitlitz v. Comm'r, 531 U.S. 206, 220 (2001).

aspirations of a society or of a particular social group. Comprehensive income taxation derives its legitimacy from its democratic ideological values. Income taxation was believed to advance the value of equality in accordance with ability to pay.[17] Taxation in accordance with ability to pay or means is a constitutional requirement in many countries and in several American states.[18] American legislative history singled out the justice of ability to pay as the most important reason for the adoption of the federal income tax system pursuant to the Sixteenth Amendment.[19]

Progressive income taxation in America was the result of a bitter class struggle to reduce the role of regressive consumption taxes and impose larger levels of tax on those with greater means and wealth.[20] History confirms that the income tax law was social legislation that had the strongest claim to democratic legitimacy because it was the result of the demands of public opinion at a time when, in the words of Thomas Jefferson, the "spirit of the people [was] up."[21]

B. The Ideology of Tax Avoidance

Frustrating these social and legislative goals is the fact that many persons with significant means do not pay a fair share of taxes consistent with the values of income taxation.[22] One reason for this is a common judicial antagonism to the values of income taxation. A leading jurist expressed the opinion that tax legislation lacked moral values:

> Law is all about the rules which society imposes upon its members for the regulation of their conduct. Elementary fairness dictates that if rules are to be imposed in an area in which there is *no universal moral imperative to aid understanding*, they shall be clear and unequivocal, so that the subject may know with certainty what he or she may and may not do and what are the legal consequences of any projected course of action.[23]

The concept of tax without a concept of right fosters tax avoidance

17. H.R. REP. NO. 63-5, at XXXVII (1913). *See generally* Barker, *supra* note 9, at 860–61.

18. *See* Barker, *supra* note 2, at 8–10.

19. H.R. REP. NO. 63-5, at XXXVII. *See generally* Barker, *supra* note 9, at 860–61.

20. H.R. REP. NO. 63-5, at XXXVII; *see also* Barker, *supra* note 9, at 860.

21. Thomas Jefferson, Letter to Judge Spencer Roane (Sept. 6, 1819), *in* 10 THE WRITINGS OF THOMAS JEFFERSON 140, 141 (Memorial ed. 1904).

22. *See generally* DEP'T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS (1999) (addressing the "growing level of tax avoidance behavior"); *see also* President Roosevelt's Message to Congress on Tax Evasion and Avoidance, *supra* note 8, at 2.

23. Lord Oliver of Aylemerton, *Judicial Approaches to Revenue Law*, *in* STRIKING THE BALANCE: TAX ADMINISTRATION, ENFORCEMENT AND COMPLIANCE IN THE 1990S, at 174 (Malcolm Gammie & Adrian Shipwright eds., 1996) (emphasis added).

because tax avoidance, in the value system of the legal profession, has a strong ideological basis.

The ideological support for tax avoidance is the right of liberty, that is, the liberty of the subject to be free from an overreaching government, the freedom of property, and the freedom to contract.[24] Liberty in the context of tax is the value system of a particular social group, those with means, who follow the philosophy that "the prosperity of the middle and lower classes depend[s] upon the good fortunes and light taxes of the rich."[25] Liberty here masks the underlying goal of this class to reestablish the incidence of the tax burden on others. Thus, liberty provides the security to pursue an unfettered life as a consumer. Liberty grants to every person who has the wherewithal to pay the right to treat tax savings as a commodity in civil society that can be invented, patented, and purchased just like a new car. In fact, one can obtain insurance that compensates when one does not receive the intended tax benefit.[26]

The differences between the liberal rights ideology of liberty and the ideology of equality are critical. Equality in taxation stands squarely on the shoulders of a progressive movement in taxation that asserts that the political goals of taxation are substantive equality and redistributional justice.[27] Though the modern advocates of ability to pay may have abandoned its class basis[28] and thus robbed the concept of much of its force, the class politics of the Sixteenth Amendment to the Constitution and the Revenue Act of 1913 were clear.[29] In those more truthful times, Dr. T.S. Adams, a former high treasury official, concluded that "[c]lass politics is of the essence of taxation."[30] Henry Simons set forth the political nature of the case for progressive income taxation as follows: "The case for drastic progression in taxation must be rested on the case against inequality—on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely."[31]

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24. *See, e.g.*, Richard A. Epstein, *Taxation in a Lockean World*, 4 SOC. PHIL. & POL'Y 49 (1986). *See generally* GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION (1980).

25. LOUIS EISENSTEIN, THE IDEOLOGIES OF TAXATION 63 (1961) (quoting Secretary of the Treasury Andrew Mellon).

26. *See* BRAITHWAITE, *supra* note 5, at 113–14.

27. *See* Barker, *supra* note 9, at 864. *See generally* JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA (1985).

28. *See* EISENSTEIN, *supra* note 25, at 12.

29. *See* Barker, *supra* note 9, at 860–61.

30. T.S. Adams, *Ideals and Idealism in Taxation*, 18 AM. ECON. REV. 1, 1 (1928).

31. HENRY C. SIMONS, PERSONAL INCOME TAXATION 18–19 (1938). Henry Simons also

Equality is not simply an ideology; it is the purpose acknowledged by Congress for the adoption of the income tax law.[32] The purpose of the legislation, taxation in accordance with ability to pay, is as much a part of the law as the language of the text itself. In contrast, liberty uses the ideology of formal equality, or equality before the law, as a mask for one class's political goal of shifting the burden of any significant taxes from the few to the many. It is not the democratic political process, but rather the neutral concept of legal certainty that leads to this outcome. The ideology of liberty, however, is not part of the tax law and is derived by the legal profession in accordance with the liberal conception of the rule of law. Thus, liberty is the ideological basis of legal methodology in taxation.

Liberty has prevailed against a strong democratic mandate of substantive equality due to the adoption by the legal profession of the liberal ideology of tax avoidance. Legal methodology is outside legislation yet has the power to negate its essential purpose.

III. THE MORALITY OF TAX AVOIDANCE: TURNING TAX AVOIDANCE UPSIDE DOWN AND INSIDE OUT

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.[33]

Judge Learned Hand's famous lines have been quoted so often that their point of view must clearly be that of the judiciary.[34] The social judgment of the tax professional is that tax avoidance is not bad behavior.[35]

The incidence of tax avoidance is explained and justified as "a market response by the taxpayer to a tax structure that is non-neutral

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believed that the purpose of taxation in accordance with ability to pay, that is mitigating disparities of wealth, was too settled to require further debate. *Id.*; *see also* HENRY C. SIMONS, FEDERAL TAX REFORM 144 (1950).

32. *See supra* Part II.A.

33. Comm'r v. Newman, 159 F.2d 848, 850–51 (2d Cir. 1947) (Hand, J., dissenting).

34. BORIS I. BITTKER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS 1–26 (1988) (noting that Judge Hand's "central message . . . is widely accepted").

35. *See* Pamela F. Olson, Now That You've Caught the Bus, What Are You Going to Do With It? Observations from the Frontlines, the Sidelines and Between the Lines, So to Speak, 2006 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *in* 60 TAX LAW. 567 (2007). Ms. Olson, former Undersecretary for Tax Policy, opined that tax avoidance is not evil. *Id.* at 567.

and discriminatory."[36] Loopholes and tax planning opportunities are seen as safety valves for systems that overtax persons and enterprises. The human proclivity to evade or avoid has been described as follows:

> The attempt to avoid paying taxes is a reaction against the constraints imposed by any tax. It is universal and an inevitable consequence of the very existence of taxes. "Tax and evasion are as inseparable as a man and his shadow." Payment of taxes symbolizes submission. It provokes a feeling of powerlessness by creating a direct bufferless relationship between the isolated, defenceless individual and the state Moloch. It is experienced as a restriction on a person's freedom and interference with his fundamental aspirations for power and prestige. It strikes at the very core of the tax-payer's being, provoking an affective and wholly irrational reaction similar to "a child's reactions to parental domination."[37]

Consequently, failing to gain a tax advantage and having one's taxes increase due to unsuccessful tax avoidance is deemed to be a *penalty*.[38] Though these sentiments may not be publicly shared by all,[39] tax counsel consider themselves morally justified and economically compelled to develop tax savings strategies for the benefit of their clients.[40]

In general, nations recognize a right of tax planning.[41] In some countries this right to choose lesser taxed alternatives is understood as a general exception to constitutional rules that specifically prohibit the strict or literal interpretation of laws.[42] Courts in Belgium state that

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36. Michael Brooks & John Head, *Tax Avoidance: In Economics, Law and Public Choice*, *in* TAX AVOIDANCE AND THE RULE OF LAW 78 (Graeme S. Cooper ed., 1997).

37. G. Trixier, *Definition, Scope and Importance of International Tax Evasion*, *in* COUNCIL OF EUROPE, COLLOQUY ON INTERNATIONAL TAX AVOIDANCE AND EVASION 1, 1 (1980).

38. *See* J.C.L. Huiskamp, *Definition, Scope, and Importance of International Tax Avoidance*, *in* COUNCIL OF EUROPE, *supra* note 37, at 1, 7 (referring to a tax increase as a fiscal law penalty).

39. Former ABA Tax Section President James Holden stated:

> Many of us have been concerned with the recent proliferation of tax shelter products marketed to corporations . . . . The marketing of these products tears at the fabric of the tax law. Many individual tax lawyers with whom I have spoken express a deep sense of personal regret that this level of Code gamesmanship goes on.

James P. Holden, Dealing with the Aggressive Corporate Tax Shelter Problem, 1999 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *in* 52 TAX LAW. 369, 369 (1999).

40. *See* BRAITHWAITE, *supra* note 5, at 117.

41. Sylvain Plasschaert, *Ways and Means to Improve European and Wider International Co-operation Against Tax Evasion and Avoidance, With Particular Reference to Transfer Pricing Within Multinational Enterprises*, *in* COUNCIL OF EUROPE, *supra* note 37, at 1, 9; Frans Vanistendael, *Judicial Interpretation and the Role of Anti-Abuse Provisions in Tax Law*, *in* TAX AVOIDANCE AND THE RULE OF LAW, *supra* note 36, at 131, 132.

42. Graeme Cooper, *Conflicts, Challenges, and Choices – The Rule of Law and Anti-Avoidance Rules*, *in* TAX AVOIDANCE AND THE RULE OF LAW, *supra* note 36, at 13, 27. Belgium

taxpayers are free to choose "*la voie la moins imposée*."[43] This is also known as the "fiscally least burdened" route.[44] Even today in countries like Australia, which statutorily requires that a purposeful interpretation of tax law must be preferred to a literal interpretation,[45] the general right to plan is recognized.[46] Planning to reduce one's tax liability is fully ingrained in the legal and social culture.

Judges around the world have proclaimed that tax planning to reduce one's liability to pay tax is an entitlement.[47] No one has a moral duty to pay any more than the law requires;[48] taxpayers consequently pay less than they would otherwise owe.[49] Indeed, transactions that have no apparent purpose other than to avoid tax are justified because "there is nothing wrong in companies or shareholders entering, if they can, into transactions for the purpose of avoiding or relieving them from taxation."[50] Tax planning is accomplished through the freedom to choose the *form* of the transaction that the taxpayer enters into.[51] The most illuminating description of this process was provided by Judge Barwick of the Australian High Court when he stated, "[T]he [taxpayer] has every right to *mould* the transaction into which he is about to enter into a *form* which satisfies the requirements of the statute."[52]

Thus, tax avoidance accomplished by gaming the system is not only acceptable, but legitimate. In the words of Judge Learned Hand, tax avoiders "do right."[53] Case law at times even suggests a kind of admiration for the clever scheme.[54] This is because the traditional view is that the duty to pay tax is perceived in a most limited way because tax legislation is mere pragmatism lacking any "universal moral

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and France are examples. *Id.*

43. The lesser taxed way. *See* Plasschaert, *supra* note 41, at 9; Vanistendael, *supra* note 41, at 136. This standard led Belgium to enact a GAAR in 1993. *Id.*

44. Plasschaert, *supra* note 41, at 9.

45. Acts Interpretation Act of 1901, 1984, ss. 15AA (Austl.) (requiring courts to interpret federal legislation to prefer an interpretation that promotes the purpose or object of the Act to one that does not).

46. Jeffrey Waincymer, *The Australian Tax Avoidance Experience and Responses: A Critical Review*, *in* TAX AVOIDANCE AND THE RULE OF LAW, *supra* note 36, at 247, 250.

47. Comm'r of Taxation of Austl. v. Westraders Proprietary Ltd., (1980) 144 C.L.R. 55 (Austl.).

48. Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

49. Inland Revenue Comm'rs v. Westminster, [1935] A.C. 1 (H.L.).

50. Jacques v. Comm'r of Taxation of Austl., (1924) 34 C.L.R. 328, 362 (Austl.).

51. *Westraders*, 144 C.L.R. at 60.

52. *Id.* (emphasis added).

53. Comm'r v. Newman, 159 F.2d 848, 850–51 (2d Cir. 1947) (Hand, J., dissenting).

54. Lord Tomlin spoke of the "ingenuity" of the taxpayer. *Westminster*, [1935] A.C. 1.

imperative."[55] Many perceive legislation in general, and tax legislation even more so, as being the result of political compromise without any claim to universal truth.[56] Tax avoidance, to the contrary, is rooted in a core individual right. The right can be seen in the light of two principles: "the freedom to engage in contractual arrangements and the rule that only laws, adopted by [the legislature], legitimate the levying of taxes."[57] The first principle recognizes a taxpayer's right to choose the form of the transaction. The second principle contains the implicit assumption that tax statutes must be certain of scope and that they are subject to strict or literal interpretation.[58] The underlying moral principles that support tax avoidance restrict the value of argumentation based on intent and purpose of the act. Even where legislative purpose in the interpretation of tax statutes is required, it is still viewed with skepticism.[59]

The twin objects of literal interpretation, certainty and continuity—that is, that the status quo should not be disturbed—support the view that a tax savings generated by a legal form is a property right. A rights theory of avoidance treats the tax statute as "a value-neutral tool to be used by lawyers, administrators, or judges for particular ends of their choosing."[60] In addition, all debate is fairly well contained in a setting dominated by the legal profession and sequestered from the public, who are largely ignorant of the particulars.

The benign attitude towards avoidance and aggressive tax planning is widespread and exerts a powerful influence on societies.[61] Phillip Jans suggested, *"[l]a fraude est contraire aux droit aux fisc, l'evasion s'oppose seulement à ses interests."*[62] Whereas evasion deprives governments of what is legally theirs, avoidance merely raises the state's concern that taxes may not be imposed properly.

The moral posturing of tax avoidance relies on a deception. Tax law in the modern democratic world is based on each citizen's duty *as a*

55. *See* Lord Oliver, *supra* note 23, at 174.

56. This is what leads textualists today to favor literal interpretation of statutes. *See, e.g.*, ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 17 (Amy Gutmann ed., 1997).

57. Plasschaert, *supra* note 41, at 9.

58. For a general history of interpretation of tax statutes in the U.S. and the U.K., see Barker, *supra* note 9, at 826–32.

59. Grbich, *supra* note 7, at 105–12.

60. JAMES W. HURST, DEALING WITH STATUTES 39 (1982).

61. *See* BRAITHWAITE, *supra* note 5, at 13–14, 142–43.

62. English translation: "Evasion runs counter to the rights of the state, avoidance harms its interests." Plasschaert, *supra* note 41, at 9. Les transtats indirects des benefies entre sociétés interdependentes, 118 Bruylant, Brussels 1976 (translated in Plasschaert, *supra* note 41, at 9).

citizen to pay a fair share of the burden of government without privilege or exemption from tax.[63] Democracies are founded upon the critically important principles of fairness and equality in tax. These principles were inextricably linked to representative government.[64] Indeed, the public duty to pay taxes is established in many constitutional provisions that provide that each person is bound to contribute his proportion, or that each person is bound to contribute in proportion to his means.[65]

The importance of these norms of taxation to the contribution of the sometimes painful birth of democracies, in cases like the United States and the French Republic, and the importance of the principle of ability to pay leading to the income tax system cannot be understated.[66] These core values of democratic societies are in direct contrast with the lack of moral censure of the traditional, accepted view of tax avoidance.

Most people recognize their duty to file the most accurate return possible and to pay their appropriate share to the government.[67] A sizeable minority, however, state that their primary goal is to minimize their taxes,[68] and these attempts at minimization sometimes take the form of evasion or avoidance. For those who primarily derive income from wages and who therefore bear the brunt of taxes, tax avoidance is not a victimless crime. A legal rule that views tax savings in accordance with formal compliance with the statute establishes a right for one group that raises at the same time a corresponding obligation for another group.[69] The majority of dutiful taxpayers end up assuming a larger portion of the costs of government than do the avoiders and evaders. This outcome mocks the social values of the income tax in a democratic society.

The problem with tax avoidance is the problem of a moral perspective that leads to an equality of tax opportunity for only a few. The liberal tradition of law guarantees the same possibilities to avoid for

63. For example, the Bolivian Constitution declared, "[t]he Taxes shall be fairly imposed, without either exception or privilege." Const. of the Bolivian Republic of 1826, tit. XI, cl. III, *reprinted in* CONSTITUTIONS THAT MADE HISTORY 180 (Albert P. Blaustein & Jay A. Sigler eds., 1988).

64. *See* JOHN LOCKE, TWO TREATISES OF GOVERNMENT 193 (Thomas I. Cook ed., Haffner 1947).

65. *See generally* Barker, *supra* note 2, at 8–9 (discussing the notion of equality and the Constitution).

66. *See generally id.* at 9. *See also* Barker, *supra* note 9, at 860–61.

67. Karl A. Kinsey, *Measurement Bias or Honest Disagreement? Problems of Validating Measures of Tax Evasion* 6 (Am. B. Found., Working Paper No. 8811, 1988).

68. *Id.*

69. *See* Wesley Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913).

all taxpayers. This, however, is formal equality only, or equality before the law, and only the well-to-do and well-informed can realize this advantage. The law thus protects the strong. With due regard to Learned Hand, he got it wrong. Democratic society will never be able to effectively tax income according to a taxpayer's means without turning the perceived morality of tax avoidance upside down and inside out.

IV. THE DISTINCTION BETWEEN TAX EVASION AND TAX AVOIDANCE

The liberal rights view of law also biases the way avoidance and evasion are perceived. It does this by misconceiving the problem of avoidance—making avoidance separate from and unrelated to evasion. Examining avoidance without the lens of liberal moral ideology will show its underlying affinity to evasion.

Tax avoidance can be approached by determining what it is not—that is, criminal tax fraud or evasion. In examining the approach different nations take to distinguish between tax avoidance and evasion, care must be taken with vocabulary because certain terms are used differently. It is safe to say that there are three different categories of conduct involved. The first is tax evasion, *fraud fiscal* in France and *Steuerhinterziehung* in Germany, which describes criminal behavior. The second is tax avoidance, called simply tax avoidance in the U.K. and called illegitimate, impermissible tax avoidance in the U.S., *evasion fiscale* in France and *Stearumaehung* in Germany.[70] Tax avoidance describes "legal" but unsuccessful tax planning.[71] Last, there is permissible or legitimate tax avoidance, tax planning, or tax minimization, which denotes fully appropriate, successful tax planning. In order to keep the discussion intelligible, I shall refer to criminal conduct as evasion, to unsuccessful tax planning as avoidance, and to successful tax planning as minimization.

National laws on tax evasion are commonplace. In the United States, the tax code criminalizes the "willful" violation of the tax law. Section 7201[72] imposes criminal sanctions on "any person who willfully attempts . . . in any manner to evade or defeat any tax."[73] Criminal sanctions can be imposed for the willful failure to collect or pay tax

70. *See* Vanistendael, *supra* note 41, at 131 n.1.

71. *See id.* at 131; Plasschaert, *supra* note 41, at 9; CHRIS WHITEHOUSE, REVENUE LAWS: PRINCIPLES AND PRACTICE (Tolley 2001) (1983).

72. I.R.C. § 7201 (2006).

73. I.R.C. § 7201.

under Section 7202[74] or for the willful failure to pay an estimated tax, file a return or supply information under Section 7203.[75] Section 7206 prohibits the willful making or aiding in the preparation of a false or fraudulent statement or return.[76]

In a criminal prosecution under Section 7201, the government must prove beyond a reasonable doubt that the taxpayer voluntarily failed to report transactions that he was engaged in truthfully and accurately, that the taxpayer's conduct was intentional and willful, and that this led to an understatement of tax or a tax deficiency.[77] In a criminal prosecution under Section 7206, the government must prove the defendants made or aided in filling a return that was false or fraudulent as to a material matter.[78]

The unifying principle of criminal liability is the willfulness requirement.[79] Though at one time willfulness was understood in terms of "an act done with a bad or evil purpose,"[80] the modern judicial standard is phrased in terms of "a voluntary, intentional violation of a known legal duty."[81] Three elements are clearly required in order to establish willfulness: (1) a voluntary action, (2) intentional conduct, and (3) knowledge of that which is required by law.[82]

The traditional approach to distinguishing tax avoidance and tax minimization on the one hand from tax evasion on the other hand, is to recognize that tax avoidance and tax minimization are attempts to reduce one's taxes by "lawful" means. Whether or not the conduct is successful, the view is that the "behavior is perfectly legal."[83] Thus, tax avoidance, as contrasted with tax effective minimization, is a lawful activity that is simply not effective (does not accomplish the expected result) for tax purposes.

These confident assertions are simply not a complete and accurate

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74. I.R.C. § 7202 (2006).

75. I.R.C. § 7203 (2006).

76. I.R.C. § 7206(a) (2006).

77. Sansone v. United States, 380 U.S. 343, 351 (1965).

78. I.R.C. § 7206(1), (2). *See* United States v. Dahlstrom, 713 F.2d 1423, 1426–27 (9th Cir. 1983).

79. United States v. Murdock, 290 U.S. 389, 397–98 (1933), *overruled on other grounds by* Murphy v. Waterfront Comm'n of N.Y. Harbor, 378 U.S. 52 (1964).

80. *See* United States v. Bishop, 412 U.S. 346, 359–61 (1973).

81. United States v. Pomponio, 429 U.S. 10, 12 (1976). *See also Bishop*, 412 U.S. at 359–61. Though *Pomponio* dealt with a prosecution under Section 7206, the same standard for willfulness has been applied under Section 7701. *See* United States v. Kinig, 616 F.2d 1034, 1039 (8th Cir. 1980).

82. *See* MICHAEL I. SALZMAN, IRS PRACTICE AND PROCEDURE ch. 7 (rev. 2d ed. 2002).

83. Vanistendael, *supra* note 41, at 132.

reflection of the nature of tax avoidance, however. To say that evasion is illegal whereas illegitimate avoidance that does not work is legal is terribly misleading. Where a taxpayer is not entitled to the fruits of his plan, it can hardly be said that the taxpayer's position is "legal," that it conforms to the law, is according to the law, is not forbidden or discountenanced by the law, is good and effectual in law.[84] It is instead "illegal," that is, not authorized by law, contrary to the law, contrary to the principles of the law.[85] The difference between avoidance and evasion is not about the legal outcome but is about the characterization of the taxpayer's conduct, that is, a description of the legal consequences of having engaged in tax avoidance. Tax avoidance is properly described as noncriminal behavior, not as legal behavior.[86]

Doctrine recognizes a clear line between noncriminal avoidance and criminal evasion. The *Internal Revenue Service Manual* provides that the distinction between evasion and avoidance is fine, but definite.[87] The line, however, cannot be drawn in respect to the first requirement of a voluntary and intentional action that leads to an understatement of tax liability since that standard is easily satisfied by the avoider.[88] The line must be drawn in regard to the truthfulness or accuracy of the taxpayer's representations and in regard to the question of whether the conduct results in a violation of a known legal duty.

A legal conclusion that the proper tax treatment is not in accord with the taxpayer's representation of the transaction is, in a sense, a finding that the taxpayer's representations were not true. Doctrine, however, tends to mix the notion of truthfulness with that of knowledge; these notions are often depicted indirectly as questions of openness and disclosure versus secrecy and concealment. "[T]he term 'tax evasion' can be reserved for conduct that entails deception, concealment, destruction of records and the like, while 'tax avoidance' refers to behavior that the taxpayer hopes will serve to reduce his tax liability but

84. BLACK'S LAW DICTIONARY 1038 (4th ed. 1968).

85. *Id.* at 882.

86. The distinction can be important. Even though tax avoidance may not be subject to criminal sanctions, it may well be subject to civil penalties. For example, a bill is before Congress to codify the economic substance test. The bill would add Section 6662B, which would add a substantial penalty where transactions lacked economic substance. Export Products Not Jobs Act, S. 96, 110th Cong. §§ 201–02 (2007), *available at* http://www.govtrack.us/data/us/bills.text/110/s/s96.pdf.

87. INTERNAL REVENUE SERVICE MANUAL § 9.1.3.3.2.1 (1997).

88. Tax avoidance is sometimes defined as an activity purposefully entered into to avoid taxes. *See* Cooper, *supra* note 42, at 28. The presence or absence of this particular motive is not relevant to the issue of whether the taxpayer engaged in voluntary and intentional acts.

that he is prepared to disclose fully to the IRS."[89]

Others make this point as to the different nature of tax avoidance even more forcefully: In engaging in tax avoidance, the taxpayer has no reason to worry about possible detection; quite the contrary, it is often imperative that he makes a detailed statement about his transactions in order to ensure that he gets the tax reduction he desires.[90]

This assessment is only valid from a very limited perspective. Dissimulation is the handmaiden of avoidance. Whereas the "tax avoider" may have nothing to worry about in terms of criminal prosecution, he is still concerned about detection because undiscovered tax avoidance is successful tax avoidance. Taxpayers have substantial incentives to conceal. After all, the taxpayer's goal in tax planning is tax savings, and these savings are not only an important factor to ensure the profitability of the transaction but, in many cases, may have been the only reason for entering into the transaction in the first place.[91] Additionally, in many cases, in order to achieve significant tax savings, taxpayers incur substantial transactional costs that would not have been incurred but for the tax savings.[92] For example, in a recent case, a taxpayer incurred $24,783,800 in transaction costs to carry out a prearranged purchase-sale transaction that was planned to yield tax savings of $93,500,000.[93] These costs amounted to 26.5% of the expected tax savings.

What is really meant when it is said that taxpayers disclose? Taxpayers do report the results of the transactions on their tax returns in accordance with their construction of the applicable tax results. Returns may not disclose, however, the details about the transactions that the administration and courts may consider critical elements for understanding the "true" nature of the activity in terms of the statutory provisions. Relevant information may also be presented in different parts of the return, thus making it difficult for administrators to comprehensively grasp the plan.

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89. BITTKER & MCMAHON, *supra* note 34, at 1–25.

90. Agnar Sandmo, *The Theory of Tax Evasion: A Retrospective Review*, 58 NAT'L TAX J. 643, 645 (2005).

91. *See, e.g.*, Compaq Computer Corp. v. Comm'r, 277 F.3d 778 (5th Cir. 2001) (analyzing a prearranged transaction to buy shares before the declaration of a dividend and sell those shares immediately after in order to obtain the dividend and increase the taxpayer's foreign tax credits).

92. *See* U.S. DEP'T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS 23 (1999), *available at* http://www.treas.gov/offices/tax-policy/library/ctswhite.pdf.

93. *See* ASA Investerings P'ship v. Comm'r, 76 T.C.M. (CCH) 325 (1998).

To illustrate, take the case of captive insurance companies.[94] In *Carnation Co. v. Commissioner*,[95] the company entered into casualty and property insurance contracts with American Home, a recognized independent insurance company.[96] As part of a prearranged deal, American Home reinsured ninety percent of the risks with Three Flowers, Carnation's wholly-owned Bermuda subsidiary.[97] Due to American Home's concerns about Three Flowers' ability to meet its commitments, Carnation undertook to provide $3 million in additional capital to Three Flowers on demand.[98]

Carnation reported the tax results of the transactions to the Internal Revenue Service (IRS) according to its claimed construction of the transaction. Thus, Carnation's return disclosed deductible insurance premiums. Any examination of Carnation's accounts would have revealed that these payments had been made to an unrelated insurance company. Three Flowers' accounts would have disclosed insurance income and expenses, which, if ever repatriated, would have been included in Carnation's consolidated income as foreign source dividend income and increased Carnation's foreign tax credit limitation.[99] The information provided at the time would not likely have included the facts that Three Flowers "insured" its parent's risk or that Carnation had provided a guarantee of additional capitalization in order to ensure that Three Flowers could cover its parent's risks.[100]

The court found that Carnation's contract with American Home was not insurance and that the premiums received by Three Flowers were not income derived from insurance.[101] The critical facts necessary to that conclusion were the parent-subsidiary relationship and the capitalization guarantee. Though the taxpayer was willing to disclose this information upon audit, it certainly would have benefitted from the government's ignorance because assessment of Carnation's situation for tax purposes without these facts was misleading and would have made the assessment of Carnation's proper liability for tax impossible. Discovery by the Internal Revenue Service without careful auditing was

94. For an account of captive insurance and tax avoidance, see William B. Barker, *Federal Income Taxation and Captive Insurance*, 6 VA. TAX REV. 267 (1986).

95. 640 F.2d 1010 (9th Cir. 1981).

96. *Id.* at 1012.

97. *Id.*

98. *Id.*

99. *See* I.R.C. § 904 (2006).

100. *See infra* note 102.

101. *Carnation Co.*, 640 F.2d at 1013–14.

not possible.[102] Yet, there is no duty to disclose unless required by statute.[103]

One reason Carnation's tax plan went awry was because the accommodation party, American Home, insisted that Carnation guarantee the losses of its captive insurance company. It was that guarantee that labeled the transaction a sham. A guarantee by Carnation of its own losses establishes a lack of relation between the legal form of the transaction, insurance, and its obvious consequences. In other words, no one could honestly believe that he had "insured" himself if he were responsible for his own losses. However, there was never any hint of wrongdoing in this case.

The absence of disapproval is even more remarkable in even more questionable tax avoidance planning. An illuminating example comes from *E.I. Du Pont de Nemours & Co. v. United States*,[104] a case that involved the proper application of the transfer pricing regime of the Code. Section 482 empowers the Secretary of the Treasury to reallocate income and deductions among related entities in order to prevent evasion or to clearly reflect the income of the entities.[105] Du Pont's plan, which was subsequently executed, was to set up a wholly-owned subsidiary [DISA] in Switzerland to purchase U.S. manufactured goods from the parent company and to sell these goods to related European distributors.

In the process of developing the strategy, those promoting it faced substantial opposition from Du Pont's operating divisions due to their view that the scheme conflicted with the appropriate allocation of profits among the divisions of Du Pont.[106] Consensus was achieved only because all were convinced that the plan would achieve significant tax savings and because it was agreed that the profits of the various divisions would be recalculated ignoring the role of DISA, showing the economic contributions of the various divisions for performance evaluation and compensation purposes.[107]

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102. Section 6038 requires that taxpayers who are in control of a foreign corporation report certain information with respect to the activities of that corporation to the IRS. I.R.C. § 6038 (2006). This includes information on related party transactions. In the early days of captive insurance companies, taxpayers assumed that the use of intermediary unrelated insurance companies shielded them from this reporting requirement. [Author's experience.]

103. For example, under U.S. law, information with respect to certain "reportable and listed" transactions is required to be reported. I.R.C. § 6407 (2006). *See also* I.R.C. § 6662A (2006) (accuracy-related penalty).

104. 608 F.2d 445 (Ct. Cl. 1979).

105. I.R.C. § 482 (2006).

106. *E.I. Du Pont de Nemours & Co.*, 608 F.2d at 447.

107. *Id.*

It was openly acknowledged that the resulting price to DISA was "artificially low"[108] or "fictitious."[109] There was also concern that these prices were significantly lower than those charged to other related entities.[110] Du Pont's Treasury Department, however, argued as follows:

> It would seem to be desirable to bill the tax haven subsidiary at less than an "arm's length" price because: (1) the pricing might not be challenged by the revenue agent; (2) if the pricing is challenged, we might sustain such transfer prices; (3) if we cannot sustain the prices used, a transfer price will be negotiated which should not be more than an "arm's length" price and might well be less; thus we would be no worse off than we would have been had we billed at the higher price.[111]

At trial, the key Treasury Department officer, instead of being a little embarrassed over the terms of the scheme, nonchalantly admitted that Du Pont would have transferred ninety-nine percent of the profit to DISA if they could have gotten it by the Internal Revenue Service.[112]

The conduct in *Du Pont* suggests a close affinity between tax avoidance and evasion. How close to the line did Du Pont go? Apparently, not even close. The court reported that the reason it described "the special status of DISA as a subsidiary intended and operated to accumulate profits without much regard to the function it performed or their real worth" was simply to show how difficult it was to show comparable arm's length prices.[113] The court explained that "[i]t was not that there was anything 'illegal' or immoral in Du Pont's plan; it is simply that the plan made it very difficult, perhaps impossible, to satisfy the controlling Treasury regulations under Section 482."[114] In one sense, it was completely proper to ignore the taxpayer's motivation because Section 482 is concerned with the economic substance of intergroup transfers and not with the taxpayer's intent or purpose. The court's gratuitous remarks on the taxpayer's morality, however, illuminate the moral perspective of the judge. The liberal moral perspective evidenced in *Du Pont* goes to the very heart of the avoidance/evasion question. In order to be evasion, the taxpayer's

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108. *Id.*

109. E.I. Du Pont de Nemours & Co. v. United States, 42 A.F.T.R.2d 78-5081, 78-5089 (Ct. Cl. 1978).

110. *E.I. Du Pont de Nemours & Co.*, 608 F.2d at 447.

111. *Id.* at 447 n.4.

112. *Id.* at 448 n.7.

113. *Id.* at 449.

114. *Id.*

conduct must be willful. Willfulness depends on whether the taxpayer intentionally violated a known legal duty. Though the court in *Du Pont* extensively quoted the somewhat brazen comments on gaming the tax system which analyzed the risks of failure and the likelihood of success,[115] and those that acknowledged that one would have done more if one thought one could get away with it, or cited the fact that Du Pont kept two sets of books—one for tax purposes and one for economic purposes, these factors were irrelevant to the question of whether Du Pont violated a known legal duty. The morality of tax avoidance has made this kind of subjective intent irrelevant. Even more surprising is the irrelevance of the taxpayer's expression of the opinion that the resulting price was "artificially low" or "fictitious" where the essence of the issue under Section 482 is whether the taxpayer had transferred at an arm's length price. The reason is that these statements are only the subjective views of taxpayers. It is only the objective characterization of taxpayers' conduct that matters. This objective characterization is from the point of view of the legal characterization of a taxpayer's representation of his situation.

The Supreme Court stated in *United States v. Bishop* that the reason Congress provided a willfulness requirement for criminal tax evasion was to "construct penalties that separate the purposeful tax violator from the well-meaning, but easily confused, mass of taxpayers."[116] Sophisticated tax planners who intentionally game the system hardly fit into this category of "the well-meaning, but easily confused, mass of taxpayers." Yet sophisticated taxpayers receive the equal protection of this doctrine. That is because an actual bona fide misconception of the law is a defense if "the ignorance or mistake negatives the purpose, knowledge, belief, recklessness or negligence, required to establish a material element of the offense."[117]

Du Pont illustrates the breadth of protection that a misconception of law can afford. When one reviews the rationale behind the plan, one cannot help but see expressed an unbridled optimism that this plan will work. Tax avoiders bolstered by a certain moral perspective are confident that they are on the side of right. Practically any argument will establish a bona fide misconception and save them from a charge of fraud. Their confidence is not unrealistic, for they employ attorneys

115. Indeed, books on tax planning recommend that one must consider the odds of success just as a businessman considers them on making normal business decisions every day. 1 MICHIE'S FEDERAL TAX HANDBOOK 451 (Joseph E. Gibson ed., 1970).

116. 412 U.S. 346, 361 (1973).

117. MODEL PENAL CODE § 2.04 (1985). *See* Battjes v. United States, 172 F.2d 1, 4 (6th Cir. 1949).

who have been trained to argue any side in an adversarial system. President Roosevelt's cynical remarks are close to the mark: "'[t]ax avoidance' . . . means that you hire a $250,000-fee lawyer, and he changes the word 'evasion' into the word 'avoidance.'"[118] According to the court in *Du Pont*, there is not even the slightest moral duty to try to get the transfer price right.[119]

The captive insurance company issue demonstrates a quite different aspect of the misconception of law defense. The tax law, then and now, distinguishes provisions for self-insurance reserves, not deductible by taxpayers, and insurance premium payments, which are deductible.[120] The captive insurance industry represented a high degree of tax sophistication. At the time when captive insurance companies started to become popular, those involved with setting up these corporations were aware of captive insurance's essential nature. For example, in *Mobil Oil Corp. v. United States*,[121] the employee responsible for planning explained:

> *Outside insurance*, of course, refers to covering insurable risks by paying a premium to a non-affiliated insurance company in return for an agreement that the insurance company would indemnify the insured for losses suffered. *Self insurance* is usually handled by setting aside premiums out of current earnings into a reserve for self-insurance; losses are charged against this reserve. Self-insurance can also be worked through an *insurance affiliate.* Under this system, operating subsidiaries pay premiums to an affiliated insurance company.[122]

From the point of view of those in the industry, captive insurance arrangements were unequivocally self insurance, not insurance. But lawyers know that that understanding is immaterial to the question of willfulness because these statements only represent the *truth* of captive arrangements from the point of view of economics, finance, commercial dealings, or even just plain common sense. It is only, however, from the point of view of the legal characterization of a taxpayer's

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118. ARTHUR M. SCHLESINGER, JR., THE POLITICS OF UPHEAVAL 333 (1960).

119. Section 482 is a mixture of several important principles and policies of income tax law including tax avoidance principles, the assignment of income doctrine, general deduction theories, and clear reflection of net income under the parties accounting method. BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 13.20(1)(b) (7th ed. 2006). Though the use of Section 482 is only available to the government (Treas. Reg. § 1.482-1A(b)(3) (1968)), it does not follow that the taxpayer can disregard general tax principles and policies in setting its prices. Indeed, Treas. Reg. § 1.482-1A(a)(3) permits taxpayers to report a price different from those actually charged on a timely filed return if necessary to reflect an arm's length result.

120. *See* Barker, *supra* note 94, at 274–76.

121. 8 Cl. Ct. 555 (1985).

122. *See* Barker, *supra* note 94, at 284.

representation of his situation that willfulness for criminal purposes is determined.

Tax avoidance, as defined in this paper, is the unsuccessful attempt to reduce one's taxes.[123] Though taxpayers are proven wrong in their conclusion, it is obvious that taxpayers do not engage in tax fraud under current doctrine. This is true because, even though taxpayers engage in voluntary tax planning, even though taxpayers intentionally engage in artificial and manipulative conduct in an attempt to reduce their taxes, and even though taxpayers may report strained versions of the facts or little fact at all, taxpayers lack the knowledge of the legal requirements of the tax laws and believe, even though sometimes foolishly, that the plan they have created could work.

Though tax planners might be wrong, their defense to tax fraud is predicated on "an actual, bona fide misconception of the law."[124] Such a misconception is a defense to tax fraud if it negates "the purpose, knowledge, belief, recklessness or negligence required to establish a material element of the offense."[125] In *United States v. Critizer*, the court concluded that "[i]t is settled that when the law is vague or highly debatable, a defendant—actually or impliedly—lacks the requisite intent to violate it."[126] There, even though the defendant was told by the Internal Revenue Service that rent from Indian lands was income, the Bureau of Indian Affairs had informed her that in their opinion it was tax exempt. The result of this intra-governmental disagreement was that the taxpayer did not report the income and, thus, concealed the facts necessary for any IRS determination. According to *Critizer*, this was not fraud.[127] Similarly, novel questions of tax law[128] or unique legal questions have been held as a matter of law to negate fraud.

Yet tax planners by necessity often knowingly operate close to the line. Just as obviously, those who do not succeed have crossed the line, whether they are detected or not. The Supreme Court once concluded that in criminal matters it is not unfair "to require that one who deliberately goes perilously close to an area of prescribed conduct shall take the risk that he may cross the line."[129] This doctrine has not been applied to tax avoidance, however.

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123. *See supra* Part III.

124. *See* Battjes v. United States, 172 F.2d 1, 4 (6th Cir. 1949).

125. MODEL PENAL CODE § 2.04 (1985).

126. United States v. Critzer, 498 F.2d 1160, 1162 (4th Cir. 1974).

127. *Id.*

128. *See* United States v. Mallas, 762 F.2d 361 (4th Cir. 1985) (describing a coal mining tax shelter).

129. Boyce Motor Lines, Inc. v. United States, 342 U.S. 337, 340 (1952).

Thus, whereas the tax evader solely exploits the uncertainty of detection and not the law, the tax avoider exploits both the uncertainty of the tax law and of detection. As long as a case for uncertainty of the law can be established in tax, the case is one of avoidance. The liberal tradition's ideological insistence on certainty in the application of tax laws is also the basis for distinguishing tax avoidance from evasion. For many, this result is obvious. It relies, however, on a one-sided or incomplete view of tax legislation.

Tax law's domain is not simply the domain of the finite words of the statute. The tax law is a totality of language, purposes and intent that aims to achieve certain social goals. Tax avoidance's domain is the shadow world that results from the incongruence between statutory language and the context, intent or purpose of the legislation.[130] Words separated from their context and divorced from their purposes are words without a point of view. Or, to put it another way, they are words that the interpreter can choose any point of view from which to interpret them. Conscious tax avoidance exploits this discontinuity. The tax avoider's art may be described as the discovery either before or after the fact of formal or subjectively possible interpretations creating a veritable twilight zone of ambiguity outside the real possibilities of the statute that accord with the legislature's intent and purpose. The accepted ideology of tax avoidance conditions the judge to accept these other constructions at face value, thus formally rendering the statute vague. Consequently, there can be no fraud.

V. CONCLUSION

In America, the liberal ideology of individual liberty has been rejuvenated. Strict or literal interpretation of tax statutes is now the norm. This has two consequences for tax avoidance. The first is that courts are much more likely to reach a decision based on the "plain meaning" of the statute. In such cases, taxpayers are free to exploit interpretations that contradict the context, intent and purpose of the act. The second involves the situation where there is no plain meaning. Literalism is only a preferred mode of interpretation. Where the statute is ambiguous, the context, intent and purpose of the legislation may be considered.

In these cases, courts recognize the mandate to make the norm actual in terms of the legislation's intent and purpose.[131] When the law uses

130. *See supra* note 9 and accompanying text.

131. *See* Johnson v. United States, 163 F. 30, 32 (1st Cir. 1908). *See also* Corn Prods. Ref. Co. v. Comm'r, 350 U.S. 46, 52 (1955) (gains from hedging transactions held analogous to

concepts like arm's length pricing, the interpreters, including the taxpayer, are directed to report their transactions in accordance with legislative values. Whether these values are described in terms of legislative intent, purpose or the spirit of the law, they are generally acknowledged to be part of the law. Yet the liberal ideology of individual rights robs these values of their full normative force. A taxpayer may safely disregard these values without being accused of fraud.

Rethinking tax evasion can change the incidence of avoidance in our society because some avoiders clearly cross the line. Putting avoiders in jail is not the point of this essay, however. Instead, the purpose of this essay is to expose the ideology that underpins tax avoidance. It is also to confront a system that tolerates aggressive game playing. Exposing this ideology to the forces of democracy is the first step to dealing with tax avoidance. A focus on this ideology can make it the object of a struggle that can produce considerable advances in applying tax law in a fair and equitable manner. Because this ideology encourages taxpayers to try to avoid taxation, and discourages the government from dealing effectively with avoidance, its demise can change the power of avoidance to undermine taxation.

Democratic societies recognize that individual freedom is only possible under the rule of law, but individual freedom means more than the rights of private autonomy. Real liberty's truest expression can only be found in a democratic society; it depends on the social rights of citizens, acting together, to determine the content of the law under which all individuals are to exercise their freedom. The American people acting through Congress have mandated taxation under a principle of equality. The task of jurists is to make both aspects of freedom real through their decisions. The principle thrust of this paper's critique is that jurists have failed to advance through tax a society that is committed to maintaining and enforcing substantive equality for its entire people.

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inventory sales in order to achieve Congress' purpose).