International Lawyer

Volume 49 | Number 2 Article 3

2015

Tax Anti-Avoidance Law in Australia and the United States

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THE INTERNATIONAL LAWYER
A TRIANNUAL PUBLICATION OF THE ABA/SECTION OF INTERNATIONAL LAW

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Introduction

As explained in the body of this Article, in comparison to the United States, it is relatively easy to get legislation passed in the Australian parliamentary system. The U.S. system has a more elaborate set of checks and balances and this means that courts must take up some of the slack when the legislature fails to act. Tax anti-avoidance law provides a good example of the contrast between the two systems.

In Australia, tax anti-avoidance law is found in a self-contained portion of the national tax statute. In the United States, tax anti-avoidance law is a judicially created group of doctrines with a minor statutory gloss. One might expect that the statutory nature of Australian tax anti-avoidance law means that it is more rule-bound, meaning that it provides more answers ex ante, relative to U.S. law.

Not so. Both bodies of law are standards, even though one is found in a statute and the other in case law. Thus, neither body of law provides a comprehensive key to determine whether future transactions violate the prohibition on tax avoidance. Rather, both bodies of law ask future decision makers to determine whether a transaction violates the anti-avoidance standard.[1]

In addition, in both Australia and the United States, the tax anti-avoidance law has evolved to include two common doctrinal components.[2] One component requires evi-

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1. *See, e.g.*, Frederick Schauer, *Formalism*, 97 YALE L.J. 509, 540-42 (1988) (arguing that using rules assigns jurisdiction to past decision makers at the expense of future decision makers).

2. *See, e.g.*, C. John Taylor, *Form and Substance in Tax Law: Australia*, 87 CAHIERS DE DROIT FISCAL INT'L 95, 111-12 (2002) (explaining Part IVA's requirement of dominant purpose of obtaining a tax benefit and the statutory carve-out for transactions "expressly provided for by the tax statute").

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dence of taxpayers' tax avoidance purpose. The other component protects transactions clearly contemplated by the tax statute against charges of tax avoidance.

Finally, in each country, the future decision makers who have the most influence over the development of anti-avoidance law are the same group: tax administrators. In Australia, these administrators work at agency departments including the Australian Taxation Office and the Australian Treasury. In the United States, they work at bureaucratic units including the Internal Revenue Service and U.S. Treasury.

Because both bodies of law are fundamentally standards, they leave the content of the law to be determined in the future. While it is true that guidance from existing case law controls outcomes in certain instances, the nature of tax avoidance is that taxpayers and their advisors constantly develop new transactions for which no precedent exists. The evolution of tax avoidance means that tax anti-avoidance law must operate as an ex post standard in many, if not most, situations of interest. [3] Indeed, it may well be the case that the real advantage of the Australian statutory general anti-avoidance rule (GAAR) is less in the clarity of the words used than in the threatening uncertainty that the words convey.[4] This may apply a fortiori in the case of the United States' case law solution, where there are few statutory words that taxpayers can rely on.

In both Australia[5] and the United States,[6] tax anti-avoidance standards include the test of tax avoidance purpose and an exception for transactions clearly contemplated by the statute. As a result, the two bodies of law usually get to the same answer. Transactions involving loss generators, income assignment to taxpayers with lower rates, straw man intermediaries, and foreign tax credit generators illustrate this similarity.

But the two bodies of law sometimes arrive at different answers. This is because important but subtle doctrinal differences also exist. Australian law conceives of a tax avoidance transaction as a contrived, tax-motivated Plan B departure from the counterfactual of a more normal, Plan A course of action.[7] In contrast, the flagship U.S. economic substance doctrine describes tax avoidance transactions more generally, as transactions with predominant tax, as opposed to business or other nontax, goals.[8] These differences do not result

3. *See, e.g.*, James S. Eustice, *Abusive Corporate Tax Shelters: Old "Brine" in New Bottles*, 55 TAX. L. REV. 135, 147-49, 161 (2002) (emphasizing the role of Treasury and IRS tax administrators in enforcing the law and expressing concern that codification of anti-abuse would be both "overinclusive and underinclusive").

4. *See, e.g.*, Graeme S. Cooper, *International Experience with General Anti-Avoidance Rules*, 54 SMU L. REV. 83, 94 (2001) ("[E]ven though the international experience does not support the view that the GAAR will be applied to unintended targets, no one can have a high degree of confidence in how a GAAR will be applied in practice."); Judith Freedman, *Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle*, 4 BRIT. TAX REV. 332, 346 (2004) (arguing that, with respect to general anti-avoidance law, "lack of certainty is not a defect, since certainty is not the aim of the exercise").

5. *See* Taylor, *supra* note 2, at 111-12.

6. *See, e.g.*, ACM P'ship v. Comm'r, 157 F.3d 231, 254 (3d Cir. 1998) (examining "asserted business purposes and profit motives" to determine whether transactions were "intended to serve . . . non-tax purposes"); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5, 13-15 (2000) (discussing "'exception' for benefits that comport with [statutory] text, intent, and purpose").

7. *See, e.g.*, *Income Tax Assessment Act 1936* (Cth) s 177C(1)(a) (Austl.) [hereinafter *ITAA 1936*] (referring, *inter alia*, to a "scheme" that produces "tax benefits" because of "an amount not being included in the assessable income of the taxpayer . . . where that amount would have been included . . . if the scheme had not been entered into").

8. *See* Internal Revenue Code [I.R.C.], 26 U.S.C. § 7701(o)(1) (2012) ("clarif[ying] economic substance doctrine" as requiring both a "meaningful" change in "taxpayer's economic position" and "a substantial purpose (apart from Federal income tax effects)").

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from systemic analysis about the best structure for tax anti-avoidance law. Instead, they can be traced to the fact patterns Australian[9] and U.S.[10] lawmakers or judges faced when the doctrines first developed.

The best illustration of the differences between Australian and U.S. law is provided when a tax-avoidant transaction is added onto a business transaction. Each body of law has a particular weakness when it comes to identifying these kinds of transactions as tax avoidant. Australian law has had trouble when the degree of importance attached to the tax avoidance add-on is such that the transaction would not have been undertaken at all without the tax-avoidant step.[11] Historically, taxpayers have made "do-nothing counterfactual" arguments that, absent the desired tax benefit, the taxpayer would not have entered into any of the transactions at issue, and thus would have had no tax liability at all.[12] No analogue to the "do-nothing counterfactual" argument exists in U.S. law.[13]

U.S. law has trouble labeling a planning step as tax-avoidant if the larger transaction to which it relates happens to have a particularly strong business purpose. For example, tax planning steps that are part of business-motivated merger and acquisition transactions generally are not vulnerable under U.S. law.[14] In contrast, Australia's Part IVA has been applied to invalidate a planning step that is part of a larger, business-motivated merger transaction. An Australian taxpayer lost in one unwanted assets case, *British American Tobacco*,[15] which surely would have gone the other way in the U.S.

Australian law is also better suited to challenge, for example, "hopscotch loans" designed to circumvent § 956 of the U.S. Internal Revenue Code,[16] which imputes taxable distributions of non-U.S. profits to U.S. parents of multinational groups.[17] Australian law inquires into what would have happened without the tax planning steps. This contrasts

9. *See, e.g.*, Jeffrey Waincymer, *The Australian Tax Avoidance Experience and Responses: A Critical Review*, *in* TAX AVOIDANCE AND THE RULE OF LAW 247, 278-85 (Graeme S. Cooper ed., 1997) (describing cases from which the counterfactual framework emerged).

10. *See, e.g.*, Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 417 (2010) (arguing business purpose doctrine that developed from specific fact and law situations in early cases is ill-suited to the goal of combating abusive transactions and tax avoidance more generally).

11. *See, e.g.*, *RCI Pty Ltd v Comm'r of Taxation* (2011) 84 ATR 785, 834-38, 844, 848 (intercompany round-trip cash transaction served to reduce the value (but not the basis) of an affiliate for tax purposes, and thereby minimized the gain on internal reorganization transaction); *see also* Robert Deutsch, *Part IVA and International Transactions*, 15 TAX SPECIALIST 74, 78-79 (2011) (describing Federal Court decision for government and Full Federal Court decision for taxpayer).

12. Subsequent statutory amendments endeavor to limit the taxpayer's ability to make such a "do-nothing counterfactual" argument. *See infra* note 205 and accompanying text.

13. The question of "framing" a smaller tax-avoidant transaction within a larger business transaction comes up in U.S. law, but for a different reason. *See* David P. Hariton, *The Frame Game: How Defining the "Transaction" Decides the Case*, 63 TAX LAW. 1, 1 (2009) (arguing that the controversies over "tax-motivated structures" are "primarily about 'framing' the transaction as consisting of either the narrower tax-motivated . . . steps" or "the broader business objectives").

14. *See infra* Part II.C.2 (discussing unwanted assets transactions).

15. *British Am Tobacco Austl Servs Ltd v Comm'r of Taxation* (2009) 77 ATR 518, 538-39 (Austl.), *aff'd*, (2010) 189 FCR 151 (Austl.).

16. I.R.C. § 956 (2012).

17. *See, e.g.*, Edward D. Kleinbard, *"Competitiveness" Has Nothing to Do With It*, 144 TAX NOTES 1055, 1068-69 (2014) (discussing "hopscotch loans"); Stephen E. Shay, *Mr. Secretary, Take the Tax Juice Out of Corporate Expatriations*, 144 TAX NOTES 473, 476-77 (2014) (suggesting regulation of same based on several provisions including but not featuring I.R.C. § 7701(o)). *See generally infra* Section II.C.3.

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with the preference of U.S. anti-avoidance law to not make up steps, as the classic U.S. cases *Esmark*[18] and *Cumberland*[19] illustrate.

Government structure provides another point of comparison between Australian and U.S. tax anti-avoidance law. Australia has a parliamentary system that can revise statutory law more easily than in the United States.[20] On the other hand, the United States accepts the delegation of interpretive authority to administrative agencies more readily than Australia.[21] These government structure differences help explain why statutory changes to tax anti-avoidance law happen more regularly under Australia's parliamentary system. For example, in 2013, the Part IVA Australian statute was amended to address emerging case law that appeared to accept taxpayers' "do-nothing counterfactual" arguments.[22] In 2015, Part IVA was amended again; the changed provisions included one that addresses profit-shifting by multinational corporations and allows the Commissioner to tax some supply transactions to Australian customers as if attributable to an Australian permanent establishment.[23] U.S. Treasury regulations offer an avenue for law change that is somewhat comparable to Australian statutory amendment, but U.S. regulations are not used in a similarly frequent or broad manner to shape tax anti-avoidance law.

This Article proceeds in three parts. Part I outlines the history of Australia's GAAR and the history of the U.S. economic substance doctrine and related case law doctrines. Part II explores the similarities and differences in the two jurisdictions' doctrines. Part III considers government structure and notes a similarity—that tax administrators lead the development of tax anti-avoidance law in both jurisdictions. Part III also identifies a key difference—that relatively frequent and broad changes to Australian statutory law have no parallel in U.S. law, including in tax regulation.

18. Esmark, Inc. v. Comm'r, 90 T.C. 171, 195-197 (1988) (refusing to recharacterize a tender offer followed by an acquirer cash redemption as a corporate-level sale for cash) ("[The Commissioner's proposed] recharacterization does not simply combine steps; it invents new ones. Courts have refused to apply the step-transaction doctrine in this manner."), *aff'd*, 886 F.2d 1318 (7th Cir. 1989).

19. United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 455 (1950) ("[S]ales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes.").

20. *See, e.g.*, Arend Lijphart, *The Case for Power Sharing*, *in* ELECTORAL SYSTEMS AND DEMOCRACY 42, 48 (Larry Diamond & Marc F. Plattner eds., 2006) (noting the consensus political science view that "executive-legislative stalemates" are more common in presidential compared to parliamentary systems).

21. *Compare* Kristin E. Hickman, *Unpacking the Force of Law*, 66 VAND. L. REV. 465 (2013) (surveying IRS administrative practices and judicial review thereof, and indicating that administrative guidance is more common in the U.S.), *with* Richard Vann, *Australia*, *in* COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 9, 10 (Hugh J. Ault & Brian J. Arnold eds., 3d ed. 2010) (noting that "little or nothing [is left] to [tax] regulations" in Australia).

22. *See ITAA 1936*, s 177CB(4) (requiring "disregard" of "any result in relation to the operation of [the Australian Tax] Act" when determining whether "a postulate is . . . a reasonable alternative"); *see also infra* note 205 and accompanying text.

23. *See ITAA 1936*, s 177DA (expanding the definition of "scheme" to include a scheme undertaken by a "significant global entity" which supplies an Australian customer and fails to attribute some or all of the resulting income to an Australian permanent establishment). A "significant global entity" must have "annual global income of $1 billion or more." *Income Tax Assessment Act 1997* (Cth) s 960.555 (Austl.) [hereinafter *ITAA 1997*]. A companion provision requires significant global entities to submit country-by-country reporting. *See id.*, s 815.350 (Austl.). Both measures responded to work done by the OECD's Base Erosion and Profit Shifting project. *See* Explanatory Memorandum, Tax Integrity Multinational Anti-Avoidance Law (2015) 3-4 (Austl.) (explaining that bill emerged from Australian participation in OECD project).

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I. Brief Histories of Tax Anti-avoidance Law

A. Australia

Australia has had a statutory GAAR for a long time. In 1936, the Australian government enacted section 260 of the *Income Tax Assessment Act* (ITAA), which, on its face, seemed to give the Commissioner sweeping authority to set aside tax avoidance transactions.[24] But despite its breadth, section 260 did not, in fact, give the Commissioner sweeping power. This was because the Australian High Court viewed the broad language of section 260 largely through the lens of British common law, which includes the "choice principle" conviction that "every taxpayer is entitled to arrange his affairs so that the tax attaching to them is less than it otherwise would be," while the government is bound to the precise words of its legislation.[25]

In its case law through the end of the 1970s, the High Court held that section 260 did not trump the common law "choice principle," at least in the absence of a clear preexisting plan or agreement that a taxpayer subsequently changed to improve the tax result.[26] The 1977 *Slutzkin* case provides an illustration.[27] *Slutzkin* was an early profit-strip transaction of a kind similar to those that the Australian government would eventually describe as "bottom-of-the-harbour" schemes.[28]

Slutzkin owned a cash-rich company that had wound up operations.[29] Slutzkin could have cashed out of the company by causing it to pay him a dividend.[30] But that would have produced a substantial Australian tax liability.[31] In contrast, at the time, Australian income tax law imposed no tax on capital gain.[32] Slutzkin's solution was to sell his shares in the cash-rich company to a promoter, for a sum somewhat less than the value of the cash, in order to allow the promoter to collect a fee.[33] Slutzkin took the position that he had entered into a capital gain transaction that did not attract income tax.[34] The promoter, who then beneficially owned all of the stock of the cash-rich company, presumably extracted the value of the cash by means of a dividend strip.[35] The dividend strip did not

24. *See ITAA 1936*, s 260(1) (voiding "every contract . . . (a) altering the incidence of any income tax; (b) relieving any person from liability to pay any income tax or make any return; (c) defeating, evading, or avoiding any duty or liability imposed on any person by [the Tax] Act; or (d) preventing the operation of this Act in any respect").

25. Freedman, *supra* note 4, at 350-51 (citing Inland Revenue Comm'rs v. Duke of Westminster [1936] AC 1 (HL) (U.K.) for the principle that a taxpayer is "quite entitled to choose that form of transaction which will not subject him to tax."). *See* Cooper, *supra* note 4, at 118 (describing Commissioner's "residual anti-avoidance power" under ITAA section 260 and noting limitations, including the limitation of the choice principle).

26. *See, e.g.*, Taylor, *supra* note 2, at 111 ("At the height of the 'choice doctrine' . . . [i]n the absence of an antecedent transaction some cases strongly suggested that there could be no alteration in the incidence of tax.").

27. *Slutzkin v Fed Comm'r of Taxation* (1977) 140 CLR 314 (Austl.).

28. *See* Trevor Boucher, Blatant, Artificial and Contrived: Tax Schemes of the 70s and 80s 191, 195-96 (2010).

29. *Slutzkin*, 140 CLR at 316.

30. *Id.* at 315.

31. *See id.*

32. *See id.* at 318.

33. *See id.* at 317.

34. *See id.* at 315.

35. *See ITAA 1936*, s 177E (describing different methods of "stripping of company profits").

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attract tax, and also typically caused the company to become insolvent and unable to pay any liability resulting from the imposition of excess profits tax on retained profits.[36] The company presumably then disappeared, producing the "bottom-of-the-harbour" label.[37]

In *Slutzkin*, the taxpayer won when the High Court held that section 260 did not allow the government to treat the profit-strip transaction as a taxable dividend rather than as a non-taxable capital gain transaction.[38] Chief Judge Barwick relied on the choice principle.[39] That is, he reasoned that the law gave the taxpayer the right to choose between selling the company for a non-taxable gain or liquidating it and producing a taxable dividend. [40]

In the wake of *Slutzkin* and other litigation defeats, Australian tax administrators began to consider an overhaul of Australia's tax anti-avoidance statute.[41] The result was the core of Australia's modern GAAR.[42] An insider account explains that the project of amending section 260 took off in 1978, soon after the *Slutzkin* decision.[43] As is customary in Australia, tax administrators participated in the drafting process.[44] They meant to achieve the goal of "statutorily overcoming the Duke of Westminster doctrine that taxpayers are entitled to order their affairs so that the minimum amount of tax is payable."[45] That is, the amendment project was designed to reverse the courts' interpretation of the common law choice principle.

In May 1981, the behind-the-scenes work was complete, and Treasurer John Howard introduced the bill that would become Part IVA, Australia's current GAAR.[46] Opposition in the House proposed several amendments, but "Howard maintained his position and the opposition amendments were not pressed to a division."[47] The bill became law in June 1981.[48]

The Australian statute includes the two main components common to both Australian and U.S. law.[49] It defines a tax avoidance transaction with primary reference to the tax avoidance purpose of the taxpayer.[50] It also carves out tax effects clearly contemplated by the statute.[51]

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36. *Slutzkin*, 140 CLR at 318-19 (explaining that the case did not consider the promoter).
37. *See id.* at 315-29; *see also* BOUCHER, *supra* note 28, at 195-196 (explaining that the *Slutzkin* decision gave promoters comfort when engaging in similar dividend-stripping schemes).
38. *Slutzkin*, 140 CLR at 320.
39. *Id.* at 319.
40. *Id.* at 318-19 (opinion of Barwick, CJ.) ("By no manner of torture of the language of the decided cases would the sale of shares by appellants . . . fall within the operation of sec. 260 of the Act. . . . [T]he choice of the form of transaction by which a taxpayer obtains the benefit of his assets is a matter for him.").
41. *See* BOUCHER, *supra* note 28, at 153-165.
42. *See id.*
43. *See id.* at 153.
44. *See id.* at 153-165.
45. *See id.* at 156.
46. In his announcement, Howard coined the phrase "blatant, artificial, or contrived" to describe planning targeted by the GAAR. *See* ROBIN WOELLNER ET AL., AUSTRALIAN TAXATION LAW ¶ 25-660 (23d ed. 2013) (citing and quoting John Howard's 1981 speech).
47. *See* BOUCHER, *supra* note 28, at 163.
48. *Id.*
49. *See id.* at 163.
50. *See id.*
51. *See id.*

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Part IVA allows the Australian Commissioner of Taxation to challenge a transaction that (1) is a "scheme,"[52] (2) provides a "tax benefit" that would not have arisen if the scheme had not been carried out,[53] and (3) involves the taxpayer's "dominant purpose" of obtaining the tax benefit.[54] But invalid tax benefits do not include a result "expressly provided for" in the Australian tax statute.[55] The core provisions of Part IVA are excerpted in Appendix A.

Part IVA works within the framework of tax avoidance established by the *Duke of Westminster* choice principle doctrine and applied in *Slutzkin* and other cases.[56] The choice principle is there in the statute, in the articulation of the central "scheme" as an alternative to something else that would have happened "if the scheme had not been carried out."[57] The statute also carefully specifies the consequence of successfully challenging a "scheme."[58] For example, if the tax benefit referred to "an amount not being included" in income, it would be included; if the tax benefit referred to "a deduction . . . being allowable," it would be disallowed.[59] Both Part IVA and the choice principle view tax avoidance as the taxpayer's choice of tax-advantageous Plan B, rather than otherwise advisable Plan A.[60]

In other words, the statute rejected the choice principle only after embracing it.[61] The difference is that the choice principle, as articulated in *Slutzkin*, permitted taxpayers to choose between Plan A and Plan B.[62] Part IVA is designed to require taxpayers to report

52. *See ITAA 1936*, s 177A(1)(a) (defining "scheme"). Under the Australian GAAR, the "scheme" requirement is not a significant obstacle to an effort by the Commissioner to challenge a transaction, under case law that sustains the Commissioner's ability to narrowly frame a scheme even if it is only part of a larger commercial transaction. *See* WOELLNER ET AL., *supra* note 46, ¶ 25-617 (noting that the High Court's endorsement of a narrow understanding of scheme in a split loan case "appears to have considerably strengthened the Commissioner's ability to identify a scheme under Part IVA") (citing *Comm'r v. Hart*, (2004) 206 ALR 207 (Austl.)). *See also* G.T. PAGONE, TAX AVOIDANCE IN AUSTRALIA 44-46 (2010) (challenging notion that a "scheme" must have "commercial" or other "coherence" based in part on language in *Hart*).

53. *See ITAA 1936*, s 177C(1) (defining tax benefit as, for example, an amount not included in income or a deduction claimed, which would not have been included or claimed absent the scheme); *see also id.*, s 177C(2) (explaining that the tax benefit must be based on a comparison with "a postulate" that "comprises . . . events . . . that actually happened" or "is a reasonable alternative").

54. *See id.*, s 177E. An eight-factor test applies to the purpose element of the GAAR. Relevant factors include: "the manner in which the scheme was carried out;" "the form and substance of the scheme;" the timing and duration of the scheme; the result achieved but for Part IVA; the change in the taxpayer's and/or connected persons' financial position; "any other consequence for the relevant taxpayer" and/or a person connected with the taxpayer; and "the nature of any connection . . . between the relevant taxpayer and other persons whose financial position is affected by the scheme. The goal of the test is to ascertain the taxpayer's dominant purpose without necessarily "slavishly tick[ing] off the factors." *Comm'r v Consol Press Holdings Ltd (No. 1)*, (1999) 91 FCR 524, 533, 552 (Austl.).

55. *ITAA 1936*, s 177C(2); *see also* PAGONE, *supra* note 52, at 64-66 (acknowledging interpretation difficulties of "expressly provided for" language and arguing that the phrase is meant to be interpreted narrowly).

56. *See Slutzkin*, 140 CLR at 319.

57. *See ITAA 1936* , s 177C(1)-(2).

58. *See id.*, s 177E(1)-(2).

59. *ITAA 1936*, s 177F (describing the consequent "cancellation of tax benefits").

60. *See id.*, s 177C(1)-(2); *see also id.*, s 177E(1)-(2); *Slutzkin*, 140 CLR at 319.

61. *Slutzkin*, 140 CLR at 319.

62. *Id.*

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the transaction as if the more natural and more heavily taxed Plan A route had been followed.[63]

In hindsight, it may have been unnecessary to replace section 260, which was drafted quite broadly, with Part IVA, which specifically engaged the choice principle as its foil.[64] Tax administrators continued to litigate anti-avoidance cases that arose prior to Part IVA's 1981 effective date using the available tool—section 260.[65] And, before a somewhat differently-composed bench, they began to win cases that resembled *Slutzkin*. For example, the full Federal Court held that section 260 voided a profit split transaction in 1987, in the *Gregrhon* case.[66] A successful settlement initiative for "bottom of the harbor" schemes followed.[67]

Despite the government's eventual success in section 260 cases challenging pre-May 1981 transactions, Part IVA remains the anti-avoidance centerpiece of Australian national tax law.[68] Administrators regularly propose, and legislators regularly enact, amendments to the law, for example by expanding the list of "tax benefits" from the original concept of an excluded income item or an overstated deduction to include items such as withholding tax avoidance, capital losses, and foreign tax credits.[69] Through these changes, the "counterfactual" framework molded by the *Duke of Westminster* doctrine lives on.[70]

B. United States

Economic substance, the flagship anti-avoidance doctrine under U.S. law, is one of several judicial doctrines that permit U.S. judges to re-characterize tax avoidance transactions.[71] The other doctrines include the substance-over-form, step transaction, and sham transaction doctrines.[72] They also include the statutory authorization under tax accounting rules for the Commissioner to ensure that amounts reported "clearly reflec[t] income."[73]

63. *See ITAA 1936*, s 177C(1)-(2); *see also id.*, s 177E(1)-(2).

64. *See* Cooper, *supra* note 4, at 118 n.121 (noting the "iron[y] that "Section 260 . . . acquired after its repeal a vigor and potency which the courts denied to it during its currency"). But the resulting confusion in judicial doctrine drew some criticism. *See, e.g.*, Robin Speed, *The High Court and Part IVA*, 15 Austl. Tax Rev. 156, 156 (1986) ("It is difficult to take seriously any reasons given by the High Court on the meaning of [section] 260.").

65. *See* Waincymer, *supra* note 9, at 278-85 (citing *Fed Comm'r Tax'n v Gulland*, (1984) 3 FCR 354 (Austl.) and *Fed Comm'r Tax'n v Gregrhon Invs Pty Ltd*, (1987) 87 ATC 4988 (Austl.)).

66. *See Gregrhon Invs Pty Ltd*, 87 ATC 4988 (full Federal Court decision) (holding vendor shareholders taxable as if they had received a dividend where they transferred continuing active business to a new corporation and sold the old corporation, containing liquid assets, to a promoter).

67. *See* Boucher, *supra* note 28, at 317.

68. *See* Julie Cassidy, *"To GAAR or Not to GAAR—That is the Question:" Canadian and Australian Attempts to Combat Tax Avoidance*, 36 Ottawa L. Rev. 259, 263 (2004).

69. *Id.* at 263 n.11 (reporting the addition of the withholding tax provision effective August 20, 1996, the addition of the capital loss provision effective April 29, 1997, and the addition of the foreign tax credit provision effective August 13, 1998).

70. *See* Graeme S. Cooper, *A Glimpse at Australia's GAAR Bill*, 69 Tax Notes Int'l 759 (2013) (noting that even though 2013 amendments were explicitly intended to rule out the do-nothing counterfactual defense, "the bill's approach leaves the basic speculation-based terminology in place").

71. *See* Bankman, *supra* note 6, at 5.

72. *Id.*

73. I.R.C. § 446(b).

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It has been previously observed that the economic substance doctrine at least partly subsumes the others.[74] If the taxpayer's reporting of a transaction is found to lack economic substance, a court might invoke substance-over-form and state that the real substance of the transaction is other than that described by the taxpayer.[75] Or the court might cite the step transaction doctrine and collapse a transaction into one with fewer and simpler steps.[76] Or the court may state that a purported business deal is a sham,[77] or that reported taxable income fails to clearly reflect income.[78]

There are certainly subtle differences in the logic paths used by the different U.S. judicial anti-avoidance doctrines, and several different examples will be cited below in particular cases. But it is an appropriate generalization for purposes of this Article to collect all of the U.S. anti-avoidance doctrines under the heading of economic substance.[79] The different doctrines' application to future cases is uncertain and therefore it is difficult to distinguish among the doctrines' likely application.[80] And, as to past cases, it is possible to say that a certain case was decided based on a certain strand of anti-avoidance doctrine, but not possible in many cases to say that another doctrine would have reached a different result.[81]

Tax anti-avoidance law arises from case law in the United States, and not from statute. The flagship economic substance doctrine began with *Gregory v. Helvering*, a 1935 Supreme Court case.[82] In 2010, Congress enacted a codification of the economic substance

74. *See* Bankman, *supra* note 6, at 12 (noting that "the 'subjective' leg of the doctrine . . . explicitly incorporates the business purpose doctrine" and that "[t]he objective leg of the doctrine to some extent incorporates sham transaction, economic profit, and substance over form doctrines").

75. *See, e.g.*, Exacto Spring Corp. v. Comm'r, 196 F.3d 833, 839 (7th Cir. 1999) (articulating multifactor and independent investor tests for determining whether a transfer to a shareholder should be treated as a dividend rather than the compensation treatment claimed by the corporation and shareholder).

76. *See, e.g.*, Intermountain Lumber Co., v. Comm'r, 65 T.C. 1025, 1033 (1976) (incorporator lacked section 368(c) "control" due to binding commitment to transfer 50 percent of corporation's outstanding stock immediately after incorporation). *See generally* Stephen S. Bowen, *The End Result Test*, 72 TAXES 722 (Dec. 1994).

77. *See, e.g.*, Rice's Toyota World, Inc. v. Comm'r, 752 F.2d 89, 91 (1985) (holding sale-leaseback transaction "a sham" and simultaneously stating a much-cited version of the economic substance doctrine).

78. *See* Peter C. Canellos & Edward D. Kleinbard, *The Miracle of Compound Interest: Interest Deferral and Discount After 1982*, 38 TAX L. REV. 565, 587 (1983) (describing use of clear reflection of income deficiency to require constant, or economic, accrual of interest expense deduction and suggesting that the "scope and authority" of the guidance would be "matters of substantial controversy") (citing Rev. Rul. 83-84, 1983-23 I.R.B. 12). *See also* Ford Motor Co. v. Comm'r, 71 F.3d 209, 210 (6th Cir. 1995) (disallowing taxpayer's attempt to deduct currently the full future value of tort settlement payments where taxpayer had funded such payments by investing a smaller amount currently in annuity contracts).

79. *See* Bankman, *supra* note 6, at 12.

80. *See id.* ("[T]he doctrines are, in all crucial respects, ambiguous or incomplete.").

81. *See, e.g.*, Hewlett-Packard v. Comm'r, 103 T.C.M. (CCH) 1736 (May 14, 2012) (invalidating a foreign tax credit generator transaction on substance-over-form grounds by re-characterizing equity as debt, and not ruling on economic substance claim).

82. Gregory v. Helvering, 293 U.S. 465 (1935). In the Second Circuit opinion, Judge Learned Hand authored the seminal analysis. *See* Helvering v. Gregory, 69 F.2d 809 (2nd Cir. 1934). *See also* Assaf Likhovski, *The Duke and the Lady:* Helvering v. Gregory *and the History of Tax Avoidance Adjudication*, 25 CARDOZO L. REV. 953, 983-988 (2004) (citing "contradictory trends" in the case law prior to *Gregory* and citing a stamp duty case, United States v. Isham, 84 U.S. 496 (1873), as the "conventional starting point of discussion of the history of federal anti-avoidance doctrines").

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doctrine,[83] but it did not remove interpretive authority from the courts; the statute applies only if the "common law doctrine" is "relevant."[84]

In *Gregory*, the Second Circuit, and then the Supreme Court, considered a transaction in which the United Mortgage Corporation dropped stock of the Monitor Corporation into the Averill Corporation, a wholly-owned subsidiary of United Mortgage; and then the stock of Averill was distributed to Mrs. Gregory, the sole owner of United Mortgage.[85] Mrs. Gregory reported tax-advantaged capital gain when she dissolved Averill and promptly transferred the Monitor shares to a third-party buyer.[86] The taxpayers claimed that there was no taxable dividend because the distribution qualified as a corporate "reorganization."[87] The court held that the transaction would be taxed as a dividend distribution.[88]

The facts of the case and the holding of tax avoidance might fit a number of doctrinal formulations, including the Australian idea of taxing a more natural course of action rather than a contrived scheme. The Second Circuit analysis focused instead on legislative intent. Judge Learned Hand famously expressed the idea that sometimes a statute might intend that a taxpayer would obtain a better tax result if he "arrange[d]his affairs" so as to fit "within an exception of the tax law."[89] Hand's concern was that Mrs. Gregory's transaction did not fit within such an exception, because Congress intended that the tax advantage of a corporate "reorganization" as defined in the statute attach only to transactions that have business purposes.[90]

Hand tied the business purpose requirement in *Gregory* to the underlying purpose of the corporate reorganization provisions.[91] But, as Leandra Lederman has explained, despite this original anchor to statutory intent, later cases have untethered the economic substance test from legislative intent.[92] Taxpayer purpose, not legislative purpose, has come to be the litmus test.[93] Statutory purpose now takes the form of an exception, in

83. *See* I.R.C. § 7701(o).

84. I.R.C. §§ 7701(o)(1), 7701(o)(5)(A); *see* Charlene D. Luke, *The Relevance Games: Congress's Choices for Economic Substance Gamemakers*, 66 TAX LAW. 551, 582-592 (2013) (analyzing the meaning of the "relevance" provision).

85. *See Gregory*, 69 F.2d at 810.

86. *See id.*

87. *Id.* at 810-11 (arguing under the applicable law, Section 112(i)(1)(B) of the Revenue Act of 1928, a tax-deferred corporate reorganization that would produce no corporate-level gain included "a transfer by a corporation of . . . a part of its assets to another corporation" where "the transferor or its stockholders or both are in control of the corporation to which the assets are transferred.").

88. *See id.* at 811 (requiring dividend treatment).

89. *Id.* at 810.

90. *Gregory*, 69 F.2d at 810-11. A somewhat narrower reading of Hand's opinion is that it disregarded the existence of a transitory corporation for purposes of the corporate reorganization provisions. *See* Marvin A. Chirelstein, *Learned Hand's Contribution to the Law of Tax Avoidance*, 77 YALE L.J. 440, 446 (1968) (reporting that Hand later said that the newly formed corporation lacked a business purpose).

91. *See Gregory*, 69 F.2d at 810-11.

92. *See* Lederman, *supra* note 10, at 425-428 (arguing that a focus on "business purpose" misses the possibility of a non-tax, non-business purpose and can validate tax planning simply because it is closely integrated with a business transaction).

93. *See* Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, 2009 U. ILL. L. REV. 697, 709-710 (arguing that the focus on pre-tax profit and subjective nontax purpose "obviously fail[s] to directly address the question of whether the results of transactions fall outside the purposes of the tax laws").

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that the economic substance doctrine does not defeat a transaction clearly intended by a statute.[94]

In 1978, the Supreme Court offered a formulation of the economic substance doctrine in *Frank Lyon Co. v. United States.*[95] The case involved a sale-leaseback transaction in which Worthen, a bank that did not need depreciation deductions to minimize tax, financed its new bank building by selling the building to Frank Lyon, which could use the deductions.[96] The transaction gave Worthen an option to buy back the building from Frank Lyon.[97] Because of the low exercise price of the option, Worthen was sure to exercise it.[98]

The Supreme Court upheld the transaction and allowed the depreciation deductions claimed by Frank Lyon. The Court reasoned that the overall transaction had both objective economic substance and subjective business purpose.[99] The multiparty nature of the transaction provided evidence of objective economic substance.[100] The goal of building a new bank building while remaining compliant with banking regulations provided evidence of business purpose.[101]

The *Frank Lyon* decision illustrates a weakness of a holistic analysis that focuses on business, or non-tax, purpose: such an analysis can validate tax avoidance that happens to occur in the course of a transaction otherwise motivated by nontax goals.[102] Some have recommended the cure of returning to the Learned Hand legislative purpose roots of the economic substance doctrine, rather than embracing the concept of overall business, or nontax, purpose.[103] Others have pointed out that cases like *Frank Lyon* vividly illustrate that the economic substance doctrine must decide how to "frame" a transaction to be

94. *See* Bankman, *supra* note 6, at 13-15 (discussing carveout "for benefits that comport with [statutory] text, intent, and purpose"); *see also* Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. REV. 131, 136 (2001) (emphasizing the importance of practitioners' understanding of underlying law) ("Good tax lawyers know when they are pushing hard at the edge of the envelope.").

95. *See* Frank Lyon v. United States, 435 U.S. 561, 583-84 (1978).

96. *Id.* at 563-72.

97. *Id.*

98. *See* Bernard Wolfman, *The Supreme Court in the Lyon's Den: A Failure of Judicial Process*, 66 CORNELL L. REV. 1075, 1089-90, 1095-98 (1981) (explaining the repurchase option and the low tax rates generally applicable to banks like Worthen).

99. *See Frank Lyon*, 435 U.S. at 580-81, 584.

100. *See id.* at 580 (noting that the depreciation deductions would have been available to one of the parties and that the parties were not related).

101. *Id.* at 576, 580 (noting that Worthen "needed a bank building" and acknowledging "that the tax laws affect the shape of nearly every business transaction").

102. *See, e.g.*, Gergen, *supra* note 94, at 140 ("The message is that you can pick up tax gold if you find it in the street while going about your business, but you cannot go hunting for it."); *see also* George K. Yin, *The Problem of Corporate Tax Shelters: Uncertain Dimensions, Unwise Approaches*, 55 TAX L. REV. 405, 424 (arguing that the court in UPS, Inc. v. Comm'r, 254 F.3d 1014 (11th Cir. 2001) "concluded that a 'business purpose' can include a tax minimization purpose so long as a transaction involves a going concern engaged in a bona fide profit-seeking business").

103. *See, e.g.*, Lederman, *supra* note 10, at 417 (arguing that business purpose doctrine developed from specific fact and law situations in early cases is ill-suited to the goal of combating tax avoidance more generally); *see also* McCormack, *supra* note 93, at 725-27 (arguing that the general "traditional tests" of economic substance doctrine do not adequately consider the specific statutory purpose of provisions underlying contemporary shelters).

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tested for economic substance, whether as a larger overall transaction or a narrower tax planning step.[104]

Despite these critiques, the economic substance doctrine's interest in taxpayer purpose continues unabated. Subsequent U.S. cases framed the economic substance doctrine as a two-part test for (1) "subjective" non-tax purpose and (2) "objective" economic substance, or opportunity for profit.[105] The best reading of this two-part test is that both prongs are trying to get at why the taxpayer undertook the transaction, or whether the transaction was tax-motivated.[106] The goal of discerning motive is clearly stated in the "subjective" non-tax purpose prong.[107] It is also present in the objective prong, as this analysis similarly focuses on whether the transaction would happen without the tax savings, or whether "it alters the taxpayer's economic position in a meaningful way (apart from its tax consequences)."[108]

Prior to a recent statutory amendment, some courts said that a transaction had to satisfy both the "subjective" and "objective" tests to have economic substance.[109] Others held that a transaction that satisfied only one test or the other could have economic substance.[110] The doctrine, particularly when applied in its disjunctive form, failed to consistently support government success in the late 1990s and early 2000s.[111]

Compaq v. Commissioner, a 2001 foreign tax credit generator case, illustrates the potential weaknesses of the judicial economic substance doctrine when courts apply a disjunctive

104. *Compare* Karen C. Burke, *Reframing Economic Substance*, 31 VA. TAX REV. 271, 273 (2011) ("[C]ourts need a measure of flexibility in framing economic substance cases to accomplish the intended purpose of section 7701(o)."), *with* Hariton, *supra* note 13, at 38 ("[T]he essence of a tax shelter is the fact that it is extraneous to the taxpayer's business . . . ."). There is a parallel in Australian law's concept of the "scheme" that will be tested under Part IVA. *See supra* notes 57-60 (explaining statutory "scheme" concept); *infra* note 219 (explaining that the strategy of framing the scheme is not generally thought to be a powerful tool for the taxpayer).

105. *See Rice's Toyota World*, 752 F.2d at 91 (holding sale-leaseback transaction "a sham" because "the taxpayer was motivated by no business purpose" . . . and "no reasonable possibility of a profit exists"). As a matter of logic, this holding does not explain what should happen if the taxpayer has business purpose but no reasonable profit prospect, or no business purpose but a reasonable profit prospect. But the court used a conjunctive statement that proved, unfortunately, attractive in future cases.

106. The test is analogous in function to the Australian 8-factor test that undertakes to determine taxpayer purpose. *See supra* note 54 and accompanying text.

107. David Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW 235, 235 (1999).

108. *Id.* This formulation is very similar to that adopted in I.R.C. § 7701(o).

109. For example, in *ACM*, a partnership purchased corporate debt and then sold it for technically contingent payments, taxed under the installment sale rules. The contingent payments were front-loaded, but under the rules then in effect, the basis in the installment notes was recovered ratably. This produced front-loaded gain, which was allocated under the partnership rules not to Colgate-Palmolive, the corporation that had purchased the shelter, but to a zero-bracket taxpayer that was also a partner in the partnership. The partnership redeemed the zero-bracket taxpayer after most of the gain was recognized, leaving Colgate-Palmolive to reap the back-loaded tax losses. *See ACM P'ship*, 157 F.3d at 239-43; Bankman, *supra* note 6, at 8-9. The *ACM* court applied the "related" but "distinct" elements of "objective economic substance" and "subjective business motivation" to disallow the tax benefits claimed by Colgate-Palmolive in *ACM*. *See ACM P'ship*, 157 F.3d at 260.

110. *See e.g.*, Wells Fargo v. United States, No. 09-cv-02764-PJS-TNL, 2014 U.S. Dist. LEXIS 99111, at *35 (D. Minn. July 21, 2014), *available at* https://www.gpo.gov/fdsys/pkg/USCOURTS-mnd-0_09-cv-02764/pdf/USCOURTS-mnd-0_09-cv-02764-9.pdf.

111. *See, e.g.*, Hariton, *supra* note 13, at 6-10 (discussing subjective business purpose analysis in Countryside Ltd. P'ship v. Comm'r, 95 T.C.M. (CCH) 1006 (2008)).

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test.[112] Compaq purchased stock in a non-U.S. corporation prior to a dividend record date and sold it shortly after the record date for little or no economic profit.[113] The dividend payment attracted foreign withholding taxes, which provided foreign tax credits, which Compaq used to offset tax due on unrelated income.[114] The Fifth Circuit refused to treat the foreign withholding taxes as costs for purposes of determining whether Compaq had an "objective" profit motive.[115] The court concluded that the transaction had economic substance because of the possibility for profit prior to the subtraction of the foreign withholding tax costs, even if the taxpayers had a "subjective" tax avoidance purpose.[116]

At the time of *Compaq*, the United States faced a moment of reckoning similar to the moment faced by Australia at the time of *Slutzkin*. Court decisions, including *Compaq*, suggested that judicial doctrines were not up to the task of invalidating clearly tax-avoidant transactions.[117] Thus, the questions arose of whether and how to enact a statute that would provide a course correction.[118] The result was I.R.C. § 7701(o), enacted in 2010, and excerpted in Appendix B.[119]

The enactment process, which took ten years, featured proposals from the administration, the bipartisan Congressional Joint Committee on Taxation, individual legislators, and others.[120] The core of the resulting statute provides that when "the economic substance doctrine is relevant," a transaction has economic substance only if it both (i) "changes in a meaningful way . . . the taxpayer's [pre-tax] economic position," and (ii) "the taxpayer has a substantial [non-tax] purpose for entering into such transaction."[121] The statute only applies when the common law economic substance doctrine is "relevant" or, in other words, when a judge deems the doctrine "relevant."[122]

112. *See* Compaq v. Comm'r, 277 F.3d 778 (5th Cir. 2001).

113. *Id.* at 779-80.

114. *Id.*

115. *Id.* at 788.

116. *Id.*; *see also* IES Indus., Inc. v. United States, 253 F.3d 350 (8th Cir. 2001), *rev'g* 1999 WL 973538 (N.D. Iowa Sept. 22, 1999) (reaching a similar conclusion).

117. *Cf.* Cooper, *supra* note 4, at 86 (noting that the possibility of a statutory anti-avoidance law arises when there is "a failure of the usual legal process").

118. A consensus of commentators objected to the result in *Compaq*, and many suggested a legislative countermeasure. *See, e.g.*, Daniel N. Shaviro & David A. Weisbach, *The Fifth Circuit Gets It Wrong in Compaq v. Commissioner*, 94 TAX NOTES 511, 517 (2002) at 511, 517 (criticizing appellate decisions in *Compaq* and *IES* and proposing "legislation enacting strong substantive antiabuse rules" as a countermeasure). *See also* Calvin H. Johnson, *The Anti-Skunk Works Corporate Tax Shelter Act of 1999*, 84 TAX NOTES 443, 445-48 (1999) (explaining that codification of judicial doctrines could serve to "absolve the courts from accusations of judicial activism" and emphasize the doctrines' existence to taxpayers, and offering statutory language to codify not only economic substance, but also other judicial anti-avoidance doctrines); Bret Wells, *The Foreign Tax Credit War*, 2016 BYU L. REV. ___ (forthcoming 2016) (manuscript at n. 162) (listing sixteen publications criticizing the *Compaq* decision).

119. *See* I.R.C. § 7701(o).

120. *See* ROBERT MCMECHAN, ECONOMIC SUBSTANCE AND TAX AVOIDANCE: AN INTERNATIONAL PERSPECTIVE 202-218 (2013) (discussing the saga of the enactment of § 7701(o)).

121. *See* I.R.C. § 7701(o)(1).

122. I.R.C. § 7701(o)(5)(A), (C).

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Section 7701(o) is but a gloss on the U.S. judicial economic substance doctrine.[123] It continues to share with Australian tax anti-avoidance law the component of requiring taxpayer anti-avoidance purpose. This is because the judicial objective and subjective prongs, with their different approaches to illuminating taxpayer purpose, remain the law, though the statute requires them to be applied conjunctively.[124] The U.S. law also continues to share with Australian law the component of protecting transactions clearly contemplated by the tax statute against charges of tax avoidance.[125] Legislative history explicitly states that the section was not intended to apply to tax benefits "clearly contemplated" by the statute. [126] Most importantly, U.S. tax anti-avoidance law remains a standard after the enactment of § 7701(o). The statute retains judges' final power to determine when a transaction lacks economic substance.[127]

II. Comparing Australian and U.S. Tax Anti-Avoidance Law

A. Both Standards, With Same Core Substance

Tax anti-avoidance law developed in context in both Australia and the United States.[128] Yet, the two bodies of law are fundamentally similar.[129] Both take the form of a legal standard.[130] And both include two core components: the presence of taxpayers' tax-avoidance purpose and an exception for claimed tax benefits clearly contemplated by the statute.[131]

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123. This is so despite commentators' calls for more sweeping changes. *See, e.g.*, Lederman, *supra* note 10, at 434 (arguing that the "business purpose" should be relevant only if the purpose of the statute makes it relevant); McCormack, *supra* note 93, at 709-10 (advocating an inquiry into "the purposes of the tax laws"). Section 7701(o) does feature some additional tweaks, but these are not central to the core of anti-avoidance doctrine. For example, it confirms that fees and foreign taxes should be treated as expenses in determining the taxpayer's pre-tax economic position. *See* I.R.C. § 7701(o)(2)(B) (requiring the Secretary issue regulations specifying that foreign taxes as expenses for purposes of calculating pre-tax profit). And Congress imposed strict liability penalties of 20 percent and 40 percent for underpayments of taxes stemming from transactions that lack economic substance. *See* I.R.C. § 6662(b)(6) (applying accuracy-related penalty to tax benefits disallowed for a transaction lacking economic substance); *see also* I.R.C. § 6676 ("reasonable basis" defense not available for return position on transaction that lacks economic substance).

124. *See* I.R.C. § 7701(o)(1) (providing that economic substance requires that "the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position" and that "the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction").

125. *See id.*

126. Committee reports and other items of legislative history include this idea of statutory purpose. *See* Luke, *supra* note 84, at 566-67 (citing 2010 JCT report, 2009 House Ways & Means report, and six earlier committee reports on other economic substance bills that were proposed but did not become law).

127. Charlene Luke persuasively argues that if a Treasury regulation, promulgated under Section 7701(o), provided that a specific transaction failed economic substance, the regulation would not be entitled to *Chevron* deference. This is because the statute explicitly defines economic substance as a "common law doctrine" and preserves a court's power to decide whether the economic substance doctrine is "relevant." *See* Luke, *supra* note 84, at 607 (citing Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, 467 U.S. 837, 865 (1984)).

128. *See* Likhovski, *supra* note 82, at 960-63 (contrasting the formal interpretation of "the Duke" with the purposive interpretation of *Gregory*, 293 U.S. 465).

129. *See*, *ITAA 1936*, s 177; *see also* I.R.C. § 7701(o).

130. *See*, *ITAA 1936*, s 177; *see also* I.R.C. § 7701(o).

131. The formulation is similar to that proposed by the OECD in that the principal purpose test intended to elude tax-avoidance transactions that take advantage of treaty provisions. That provision would withhold treaty benefits if "obtaining the benefit was one of the main purposes of any arrangement or transaction that

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The Australian GAAR uses the formal *Duke of Westminster* choice principle as a foil.[132] The GAAR pushes against the formal choice principle of "the Duke" and invalidates transactions where a taxpayer chooses a contrived "Plan B" approach over a more natural "Plan A" course of action.[133]

The U.S. economic substance doctrine stands on a foundation of purposive case law, rather than reacting against a formal common law tradition. The U.S. law emphasizes objective opportunity for pre-tax profit and subjective non-tax purpose.[134] In this way, like the Australian GAAR, the U.S. law investigates tax avoidance purpose.[135] Also, like the Australian GAAR, the U.S. case law reflects an exception for transactions clearly contemplated by the statute.[136]

The substantial similarities between the two bodies of law suggest that where the underlying purpose of a law is the same in both jurisdictions, and the type of transaction is the same, we should expect the law to reach approximately the same result in both Australia and the United States. Several case studies discussed below in Part II.B support this hypothesis. Yet, in some cases, the Plan A/Plan B Australian framework produces different results when compared to the more general U.S. focus on the tax avoidance qualities of a transaction. Section II.C, *infra*, gives some examples of divergence.

B. Examples of Doctrinal Convergence

1. *Loss Generators, Income Assignment, and Intermediaries*

Australian and U.S. tax anti-avoidance law converges in a variety of situations.[137] Both bodies of law capably shut down large categories of purely tax-motivated transactions, including transactions that produce stand-alone losses to shelter unrelated income.[138] In the Australian case, the natural counterfactual is that such a transaction would not take place, and the government has won numerous cases related to tax shelters wholly unrelated to the businesses of Australian taxpayers.[139] For example, Part IVA has invalidated a transaction in which the taxpayer attempts to deduct prepaid fees and interest expenses with the proceeds of a "round robin" loan from a related party.[140] In the U.S. case, similar

resulted . . . in that benefit, unless it is established that granting that benefit . . . would be in accordance with the object and purpose of the relevant provisions of this Convention." *See* OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances 6 (2014) (providing "PPT rule" Article X final recommendation on BEPS project Item 6).

132. *See* Likhovski, *supra* note 82, at 994.

133. *See ITAA 1936*, s 177C(1)(a).

134. *See* I.R.C. § 7701.

135. *See id.*

136. *See id.*

137. Other examples in addition to the case studies in the text also exist. Dividend stripping provides one example of similar results. *See* Cooper, *supra* note 4, at 125 (explaining that both Australian (through specific statutory GAAR provisions) and U.S. law (through I.R.C. § 306) address dividend-stripping transactions).

138. *See id.* at 97.

139. *See, e.g.*, Taylor, *supra* note 2, at 111-12 (describing a "sham" "round robin" transaction involving the generation of artificial tax losses through purchases and shares of shares in a related Norfolk Island company") (citing *Lecos Pty Ltd v. Fed. Comm'r Tax'n* (1986) 17 ATR 1107).

140. *See, e.g.*, *Fed. Comm'r of Taxation v. Calder* [2005] ATC 5050 (holding Part IVA applicable to excessive deductions for advance fee and interest payments made out of borrowed round-robin funds; *see also Fed. Comm'r of Taxation v. Hart & Anor* [2004] ATC 4599 (involving a split loan scheme in which taxpayer acceler-

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"loss generating" tax shelters "will almost always fail in litigation" through the application of one or more doctrines under the economic substance umbrella.[141] For instance, a taxpayer who attempts to deduct prepaid 4 percent interest on borrowed funds invested at a guaranteed return of 1 percent will quickly run into sham transaction precedent.[142]

As another example, both Australian and U.S. law sometimes disregard an individual's assignment of income to an entity.[143] Part IVA reaches mixed results on this income-splitting issue, depending on whether "tax advantages are subordinate to other commercial reasons for channeling personal services income through an intermediary."[144] U.S. law also reaches mixed results under case law that similarly considers whether the individual fully controls the corporation or other entity and whether third parties have recognized the corporate form.[145]

Another example of a strategy common to both Australian and U.S. law is the use of a tax-indifferent intermediary to improve the tax results of selling a company. Australian "bottom of the harbor" schemes like those in *Slutzkin* and *Greghorn* attempted to avoid the tax that would result from a dividend distribution by selling stock to a promoter. The 1981 Australian GAAR targeted these "bottom of the harbor" schemes from the beginning.[146] In the U.S. case, the IRS has said that it "may recharacterize" a similar U.S. intermediary transaction that involves a tax-indifferent party who purchases (presumably high-basis) target stock from a seller and sells (presumably low-basis) target assets to a buyer who wanted to buy the assets and not the stock.[147]

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ated interest deductions by allocating them to commercial loan rather than home residence loan to avoid capitalization requirement for interest on home residence loan).

141. Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 69 (2001) (citing ACM P'ship v. Comm'r, 73 T.C.M. (CCH) 2189 (1997)).

142. *See* Goldstein v. Comm'r, 364 F.2d 734, 737 (2d Cir. 1966) (holding such a transaction a sham).

143. *See, e.g.*, Cooper, *supra* note 4 at 122-23, 122 n. 135 (explaining application of section 260 and Part IVA "to counter the practice of . . . using an intermediary to conduct a business that consists predominantly of providing the services of the former employee").

144. Scott Pennicott, *Resolving the Personal Services Income Dilemma in Australia: An Evaluation of Alternative Anti-Avoidance Measures*, 10 J. AUSTL. TAX'N 53, 76 (2007) (citing *Fed Comm'r of Tax'n v Mochkin* (2003) 127 FCR 185 and Robert Deutsch, *Today's Part IVA: A Report Card*, (paper presented at NSW Annual Intensive Retreat, Nov. 6, 2004) (manuscript at 16)).

145. *See* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, ¶ 75.2.5, ¶ 75.2.5 nn. 69-77 (3d ed. 2003 & 2015 supp.) (giving examples of income "deflect[ed] to entities by "services performers"). U.S. law reaches these results under the substance-over-form doctrine of assignment of income, despite other cases that insist on respect for the corporate form in other situations. The U.S. approach is to disregard the income assignment, not the corporation or other entity. *Cf.* Moline Prop. Inc. v. Comm'r, 319 U.S. 436, 438-441 (1943) (insisting on respect for corporate form).

146. *See supra* Section I.A.

147. The IRS has listed a particularly egregious intermediary transaction as an invalid tax avoidance transaction. This version, dubbed the "Midco" transaction, involves a U.S. corporate intermediary who harvests foreign tax credits attributable to gain on the sale, which, due to an arbitrage built into the shelter, is taxable only for non-U.S. purposes. I.R.S. Notice 2001-16, 2001-9 I.R.B. 730. Thanks to a Section 338 election that deems the sale of the assets in a fashion that is not taxable for U.S. purposes, the underlying asset sale brings only foreign tax credits, not taxable income, to the U.S. intermediary. I.R.S. Notice 2004-20, 2004-11 I.R.B. 608.

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2. *Foreign Tax Credit Generators*

As a final example of similar results under Australian and U.S. law, consider the story of foreign tax credit generators. These transactions became attractive in the 1990s when the low taxation of foreign income for a domestic-parented multinational[148] produced a tantalizing asset—excess capacity on the part of the domestic parent to absorb additional foreign tax credits.[149] Multinational corporations could use FTC generators to take advantage of this asset by, in effect, using generated foreign tax credits to reduce tax on unrelated income.[150]

One early version of a foreign tax credit generator transaction was a dividend- or interest-stripping transaction designed to harvest withholding taxes.[151] It involved the purchase and then sale back of an investment asset. The purchase and sale price approximately offset, and the goal was to produce a foreign withholding tax during a short and risk-free holding period.[152] "Splitter" transactions made up a second category.[153] These transactions were used by U.S. taxpayers to arbitrage certain technical U.S. rules, like "check-the-box" rules, and certain non-U.S. combined corporation rules to claim foreign tax credits separated from any obligation to include related foreign income in a U.S. tax base.[154] A third category of foreign tax credit generator transactions, called "structured passive investment arrangements" by the U.S. government, involved structures that typically wrapped around a borrowing or lending transaction and took advantage of partnership allocation rules.[155] For example, foreign taxes paid on income from safe investments made by a partnership might be allocated to the U.S. joint venture partner for purposes of

148. In the 1980s and 1990s, multinational businesses began to pay less income tax on the foreign components of their business. Domestic corporate tax burdens also declined, but generally remained higher. *See* Rosanne Altshuler & Harry Grubert, *The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational Companies*, 7 FLA. TAX REV. 153, 174 (2005) (reporting steadily declining rate of tax for manufacturing MNCs from 1982 to 2000).

149. For example, the U.S. has a foreign tax credit limitation structure designed to ensure that the foreign tax credit might reduce domestic taxes on foreign income on a dollar-for-dollar basis but would not reduce domestic taxes on domestic income. In effect, the maximum foreign tax credit taken may not exceed the applicable domestic tax rate multiplied by the foreign source income earned by the enterprise. I.R.C. §§901(a), 904. Dividends from non-U.S. subsidiaries pull up a proportional amount of foreign taxes paid by those subsidiaries. I.R.C. § 902. A similar style credit applied in Australia prior to 2004. In that year, a participation exemption system displaced the foreign tax credit system for taxes paid by foreign subsidiaries of Australian corporations. Vann, *supra* note 21, at 451-52. An offset system applies when Australian residents and resident companies directly pay foreign income tax. *See* FRANK GILDERS ET AL., UNDERSTANDING TAXATION LAW ¶¶ 18.12-18.19 (6th ed. 2013).

150. *See* Lee Sheppard, *Can the FTC Generator Transactions Be Reconciled?*, 141 TAX NOTES 451, 451 (Nov. 4, 2013) (noting that "the basic transaction" is "a sale of tax credits").

151. *See, e.g.*, *infra* text accompanying note 164 (noting similarity of interest- and dividend-stripping transactions encountered in Australia and U.S.).

152. *See id.*

153. *See id.*

154. *See, e.g.*, Guardian Indus. Corp. v. United States, 477 F.3d 1368, 1375 (2007) (providing example of arbitrage of check-the-box rules); I.R.S. Notice 2004-20, 2004-11 I.R.B. 608 (providing example of arbitrage of Section 338 election rules).

155. *See, e.g.*, Treas. Reg. § 1.901–2(e)(5)(iv) (2015).

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its ability to claim the U.S. foreign tax credit, but also be available to the non-U.S. joint venture partner for purposes of claiming that it had paid tax in a foreign jurisdiction.[156]

Foreign tax credit generator transactions were a global phenomenon. Both the ATO and the IRS encountered these transactions.[157] In fact, the collaborative efforts of the Joint International Tax Shelter Information Centre (JITSIC), of which Australia and the United States were both members,[158] helped identify the problem of foreign tax credit generators.[159]

The Australian response to foreign tax credit generators was characteristically straightforward. It involved two steps. First, it was necessary[160] to add foreign tax credits to the Part IVA definition of "tax benefit"[161] to enable Australian tax administrators to challenge foreign tax credit generator transactions. This was accomplished in 1999,[162] effective retroactively to the 1998 announcement date of the legislation.[163] The explanatory memorandum accompanying the legislation described a first-generation interest- or dividend-stripping generator transaction like those considered in the U.S. cases *Compaq* and *IES*.[164]

156. *See, e.g,* Treas. Reg. § 1.901–2(e)(5)(iv)(B) (2015) (listing six conditions for the existence of a "structured passive investment arrangement," including the existence of a special purpose vehicle, a greater allocation of foreign taxes to the U.S. party than would be expected with a direct investment, the expectation of a foreign tax benefit for the counterparty, and inconsistent treatment by the U.S. and foreign jurisdictions).

157. *See, e.g., Fed Comm'r of Tax'n v Citigroup Pty Ltd* (2011) 193 FCR 380, 384-86 (Austl.) (describing interest-stripping transaction); *Guardian Indus.*, 477 F.3d at 1369 (describing splitter transaction).

158. *See JITSIC Network*, OECD, http://www.oecd.org/tax/forum-on-tax-administration/ftajitsicnetwork.htm (last visited Mar. 4, 2016) (reporting JITSIC creation in 2004 and subsequent expansion).

159. *See* Robert Goulder, *Government Learned of Foreign Tax Credit Abuse Through International Information Exchanges*, 93-5 TAX NOTES TODAY, Doc 2007-11594 (May 11, 2007).

160. A 1996 High Court case, *Spotless Services*, had confirmed that GAAR-based disallowance of tax benefits could apply to investment transactions designed to arbitrage cross-border benefits, but *Spotless Services* involved the reduction of withholding tax, which was listed as a possible tax benefit under Part IVA. *See Fed Comm'r of Tax'n v Spotless Servs Ltd* (1996) 186 CLR 404, 424 (Austl.) (applying Part IVA to recharacterize interest subject to a 5 percent Cook Islands tax as Australian source income rather than exempt foreign source income on which tax was due); *see also* PAGONE, *supra* note 52, at 57-59 (arguing that the taxable Australian income that the taxpayer would have included but for the transaction was greater than the interest actually earned, since the Cook Islands deposit paid interest at a lower rate than an Australian deposit would have).

161. The question of amending the definition of tax benefit arises under Australian law in part because of the schedular approach taken to drafting that section of the statute. *See* Robert Deutsch, *Improving the Operation of the Anti-Avoidance Provisions*, 13 CCH TAX WEEK 1 (2011). In contrast, the Canadian GAAR broadly defines a tax benefit as "a reduction, avoidance, or deferral of tax or other amount payable under this Act." Income Tax Act, R.S.C. 1985, c 1 s 245(1) (Can.). *See* Graeme S. Cooper, *Conflicts, Challenges and Choices – the Rule of Law and Anti-Avoidance Rules*, *in* TAX AVOIDANCE AND THE RULE OF LAW 34 (Graeme S. Cooper ed., 1997) (contrasting Canadian and Australian approaches).

162. *ITAA 1936*, s 177(C)(1)(bb) (this section was amended in 2007 by No. 143, s 3 and Sch. 1 item 71 to substitute "foreign income tax offset" for "foreign tax credit" in connection with other amendments to Australia's foreign tax credit system); *Amendment No. 11 to Income Tax Assessment Act 1936* (Austl.).

163. *See* Vann, *supra* note 21, at 9 ("[T]ax legislation is routinely made retrospective to its announcement date, a practice that does not create any constitutional issues in Australia. . . . Initially this was confined to tax avoidance measures but now the same applies even where the legislation concerns systemic issues.").

164. Explanatory Memorandum, Taxation Laws Amendment Bill (No. 5) 1998 (Cth) 1899 (Austl.) ("A scheme is entered into whereby a foreign income stream is acquired. Where the acquisition cost of the income stream is deductible, those deductions largely cancel out the foreign income received. The major portion of the foreign tax credits which relate to that foreign income stream are then available to offset tax payable on the taxpayer's other foreign income of the same class or to carry forward any excess to future years.").

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Second, the ATO pursued and won a case, *Citigroup Pty*, challenging a foreign tax credit generator transaction.[165] In *Citigroup Pty*, an Australian subsidiary of Citigroup Inc. acted as an accommodation party.[166] Its ability to absorb a sizable Hong Kong income tax because of its excess foreign tax credit capacity for Australian tax purposes was one of the keys to the design of the transaction.[167] In the case, the Federal Court held that the transaction violated the Australian GAAR and upheld the Commissioner's cancellation of the Australian foreign tax credit benefits.[168] Since the *Citygroup Pty* interpretation of the 1998 change adding foreign tax credits to the list of possible tax benefits, no other foreign tax credit generator case has made it to the courts in Australia.

In contrast, the U.S. approach to foreign tax credit generators involved a tedious, multifaceted ten-year effort.[169] In 1998, the IRS published a Notice signaling its intent to challenge foreign tax credit generators, but the Notice encountered political pushback from legislators[170] and was revoked in 2004.[171] The IRS and Justice Department also audited, litigated, and lost cases, including the 2001 *Compaq*[172] and *IES*[173] cases, which involved first-generation dividend-stripping transactions; and the 2005 *Guardian Industries* case,[174] which involved a splitter transaction that arbitraged so-called "check-the-box" and "technical taxpayer" regulations.

After these losses, the government regrouped. In 2006, the government targeted the *Guardian Industries* precedent with proposed modifications to regulations that sought, roughly speaking, to allocate foreign tax liability in accordance with different combined group members' income.[175] In 2007, the government released proposed regulations that disallowed the claiming of duplicate foreign tax credits resulting from "structured passive investment" arrangements, such as joint ventures that allocated foreign taxes paid by a

165. *See* Vanda Carson, *Citigroup Takes on ATO over Tax Credits*, SYDNEY MORNING HERALD (Jan. 21, 2009), *available at* http://www.smh.com.au/business/citigroup-takes-on-ato-over-tax-credits-20090120-7ln1.html.

166. *Citigroup Pty Ltd*, 193 FCR at 391 (explaining the importance of Australian foreign tax credit to profitability of transaction).

167. *Id.* at 399 (emphasizing that "the money comes from the Australian revenue" and that "the existence of other foreign income against which to set that credit off . . . made the transactions . . . viable").

168. *Id.* at 405-06 (holding that the interest-stripping scheme at issue violated Part IVA).

169. *See generally* Philip R. West & Amanda P. Varma, *The Past and the Future of the Foreign Tax Credit*, TAXES—THE TAX MAG., Mar. 2012, at 27, 38.

170. I.R.S. Notice 98-5, 1998-1 C.B. 334 (Jan. 20, 1998).

171. I.R.S. Notice 2004-19 (Mar. 15, 2004).

172. *Compaq*, 277 F.3d at 779. Commentators broadly objected to the result in *Compaq*. *See, e.g.*, Daniel N. Shaviro & David A. Weisbach, *supra* note 118, at 511, 517 (criticizing appellate decisions in *Compaq* and *IES* and proposing "legislation enacting strong substantive anti-abuse rules" as a countermeasure); *see also* Bryan Camp, *Form Over Substance in Fifth Circuit Tax Cases*, 34 TEXAS TECH L. REV. 733 (2003) (criticizing *Compaq* and other Fifth Circuit tax decisions); Wells, *supra* note 118 (listing publications criticizing the *Compaq* decision).

173. *IES Indus.*, 253 F.3d at 351.

174. *See Guardian Indus.*, 477 F.3d at 1369. This foreign tax credit "splitter" case used check-the-box planning to create a structure that separated an intermediate foreign entity, treated as a disregarded entity for U.S. purposes, from a lower-tier foreign entity, treated as a corporation for U.S. purposes. The intermediate entity had the legal liability for tax under 1.901-1(f) and so was eligible to claim direct foreign tax credits, even though those credits were "split" from the income on which the tax was imposed, which remained beyond the reach of the U.S. tax system in the lower-tier foreign corporate subsidiary.

175. These "technical taxpayer" regulations appear in final form at Treas. Regs. §§ 1.901-2(f)(2) (2015). They were finalized in modified form in 2012.

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combined foreign group to a U.S. partner.[176] Also in 2007, the government released a chief counsel advice that denied claimed foreign tax credits in connection with the audit of a certain taxpayer.[177] Finally, in 2008, the government listed foreign tax credit generators as a "Tier One" coordinated audit issue and released specific field advice designed to collect and prioritize all transactions that turned up on audit.[178]

The government's efforts also included some tax administrator support for statutory amendments, though U.S. tax administrators were less central to the process of legislative change in comparison to Australian tax administrators. Section 7701(o), the U.S. statutory gloss on the judicial economic substance doctrine, became law in 2010.[179] If the law had applied to *Compaq* and *IES*, it should have produced government wins.[180] Section 909 also became law in 2010.[181] Section 909 features a "matching rule" that aims to disallow foreign tax credits when they are claimed before income associated with the foreign tax credits is taken into account, similar to the "splitter" transactions in *Guardian Industries*.[182]

After 2010, the government's carefully plotted litigation strategy began to bear fruit in a series of cases involving structured passive investments and prior law. None of § 909, § 7701(o), or administrative guidance directly applied to any of the cases. Instead, the government won them based on classic economic substance precedent. For example, in 2011, a U.S. district court handed the government a victory in the *Pritired* case on three alternative grounds: debt-equity recharacterization, lack of economic substance, and application of special partnership anti-avoidance rules.[183] In 2012, the government won the *Hewlett-Packard* case in Tax Court,[184] and in 2013, courts generally held for the government with respect to a structured passive investment known as the "STARS" transaction.[185]

BNY Mellon, a STARS case, was the most remarkable of these cases for the development of the economic substance doctrine.[186] The case involved a foreign tax credit generator wrapped around a "U.S. borrower" transaction in which a non-U.S. bank loaned money to

176. These "structured passive investment arrangement" regulations appear in final form at Treas. Reg. § 1.901-2(e)(5)(iv) (2015). They were mostly finalized in 2011. T.D. 9535 (July 13, 2011).
177. *See* I.R.S. Tech. Adv. Mem. 200807015 (Nov. 7, 2007) (denying claimed foreign tax credits in a "U.S. Lender Transaction" involving a UK counterparty).
178. *See* Memorandum from Walter L. Harris, Industry Director on Tier I Issue Foreign Tax Credit Generator Directive to Industry Directors et al. (Mar. 11, 2008) (*available at* Tax Notes Today 55-10) (identifying foreign tax credit generators as a tier 1 audit issue and directing field auditors with respect to "issue identification," "examination risk analysis," and "audit techniques").
179. *See* I.R.C. § 7701(o); *see supra* notes 117-122 (sketching enactment process).
180. We say "should" rather than "would" because of the facial requirement in the statute that the Commissioner promulgate guidance to specify how to account for foreign taxes in determining pre-tax economic effect. *See* I.R.C. § 7701(o)(2)(B).
181. *See* I.R.C. § 909.
182. *See* I.R.C. § 909(b); West & Varma, *supra* note 169, at 36-37 (describing Section 909 proposal and enactment).
183. Pritired 1, LLC v. United States, 816 F. Supp. 2d 693, 732 (S.D. Iowa 2011). The Transaction was structured as a U.S. lender transaction; both Pritired's U.S. partner and counterparty French banks claimed credit for the same taxes paid.
184. The Hewlett-Packard transaction, also structured as a U.S. lender transaction, was disallowed on grounds that an investment claimed as equity should instead be treated as debt. *See Hewlett-Packard*, 103 T.C.M. (CCH) 1736, at *30.
185. *See* Wells, *supra* note 118, at 39-44 (describing the government's assault on STARS transactions).
186. *See generally* Bank of N.Y. Mellon v. Comm'r, 140 T.C. 15 (2013).

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a U.S. taxpayer. The U.S. taxpayer (BNY) contributed $8 billion in portfolio investment assets, and its British counterpart, Barclays, contributed $1.5 billion to a special-purpose entity (SPE).[187] The SPE transferred $1.5 billion to BNY in redemption of some units it held in the SPE and paid Barclays an above-market interest rate on the $1.5 billion, thus, in effect, creating a loan from Barclays to BNY.[188] Because both BNY and Barclays were considered under their respective countries' laws to own the SPE, both claimed tax benefits, including foreign tax credits, in the case of BNY, for the payment of the U.K. taxes on the investment income earned by the assets in the SPE.[189] The taxpayers accelerated payment of these income taxes in order to front-load the foreign tax credit benefits.[190]

The taxpayer in *BNY Mellon* had carefully structured the transaction to pass muster under the economic substance doctrine, but Judge Diane Kroupa's decision countered at every step.[191] First, the taxpayer wrapped the foreign tax credit generator structure around a bona fide business transaction—borrowing money.[192] The Court framed the transaction to be tested as the tax-motivated "circular cash flows."[193] Second, the taxpayer ensured that there was pre-tax profit so that the objective prong of the economic substance doctrine would be satisfied.[194] But the court held that the pre-tax profit requirement of the economic substance doctrine meant an adequate profit in relation to available transactions—not just any non-zero positive profit.[195] Third, Judge Kroupa also applied the subjective prong of the economic test, implying that the conjunctive version of the test should apply, and explained that even if the loan was a bona fide business transaction, the use of a special-purpose entity lacked subjective business purpose.[196] Fourth, she reached back to the purposive roots of the economic substance doctrine and concluded that "Congress did not intend to provide foreign tax credits for transactions such as STARS."[197]

It takes longer to tell the story of U.S. tax administrators' efforts to crack down on foreign tax credit generators than it does to tell the story of Australian tax administrators' efforts. The U.S. story features many years of drawn-out litigation and multifaceted administrative guidance.[198] The Australian story involves a neat statutory amendment and a single confirming case. Yet the two bodies of law do essentially the same work: they apply anti-tax avoidance standards to reach the conclusion that benefits from foreign tax credit generator transactions will not be allowed.

187. *Id.* at 20-21.

188. *Id.*

189. *Id.* at 28-30.

190. *See id.* at 18; *see also* Bank of N.Y. Mellon v. Comm'r, 106 T.C.M. (CCH) 367 (Sept. 23, 2013) (holding on motion for reconsideration that interest on debt was deductible).

191. The Tax Court was able to adopt a flexible interpretation of the economic substance doctrine in part because of the more flexible view adopted by the Second Circuit, to which *BNY Mellon* would have been appealed. In other words, the Tax Court might have been more constrained if the case had been appealable to, for example, the Fifth Circuit (especially because Section 7701(o) technically did not apply).

192. *See Bank of N.Y. Mellon*, 140 T.C. at 17.

193. *Id.* at 35-36.

194. *See id.* at 34-35.

195. *See id.* at 36-37 ("[E]conomic benefits that would result independent of a transaction do not constitute a non-tax benefit for purposes of testing its economic substance.").

196. *Id.* at 38-40.

197. *Id.* at 46-47.

198. *See supra* text accompanying notes 117-122 (sketching statutory enactment process).

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C. Examples of Doctrinal Divergence

Is there any question on which different answers would be reached under Australian and U.S. tax anti-avoidance law? Above, we argued that the two laws should usually reach the same result when faced with similar transactions. This is because both laws are standards, and both include the same two basic doctrinal components: the requirement of tax avoidance purpose, subject to an exception for transactions clearly contemplated by the statute.

Yet the standards do contain some different content. As outlined in Part I, the Australian concept of tax avoidance features a natural "Plan A" course of action that is replaced by a "Plan B" tax avoidance scheme.[199] Plan A constitutes the counterfactual transaction upon which the remedial tax treatment is based.[200]

U.S. law does not explicitly envision the comparison of the tax avoidance transaction to some other, more natural course of action. Of course, once invalidated, a tax avoidance transaction must be replaced with something under U.S. law in order to figure out what taxes are due. But the content of this alternative is not the focus at the outset.

Here we describe three cases where Australian and U.S. tax anti-avoidance law would provide different answers to similar questions. First, we consider Australian "do-nothing counterfactual" cases in which Australian courts have held against the government under the theory that the taxpayer would have done nothing absent the important tax savings offered by a scheme, and thus obtained no "tax benefit" within the meaning of the statute.[201] Next, we discuss tax planning for the disposition of unwanted assets in connection with an acquisition transaction, which is more vulnerable to challenge under anti-avoidance law in Australia.[202] Finally, we analyze a hypothetical tax avoidance challenge to certain "hopscotch loans" designed to avoid the deemed repatriation provisions of § 956 of the U.S. statute as an example of a case where Australian law would more easily impute steps.[203]

1. *The "Do-Nothing Counterfactual"*

Australian law had, prior to a recent law change, a feature that made it more difficult for the government to challenge a tax avoidance transaction added onto a business transaction if the taxpayer could argue that the tax savings were essential to the completion of the business transaction.[204] This "do-nothing counterfactual" argument was addressed by statutory amendment in 2013.[205] Nevertheless, the law in place prior to the amendment highlights a doctrinal difference.

199. *See id.*
200. *See id.*
201. *See generally* Deutsch, *supra* note 11.
202. *See, e.g., British Am. Tobacco*, 77 ATR at 538-39.
203. Kleinbard, *supra* note 17, at 14-15; Shay, *supra* note 17, at 4.
204. *See* Deutsch, *supra* note 11, at 83 (noting that the "do nothing counterfactual" is readily available in "internal reconstructions" more than in third-party transactions and citing *News Australia* and *RCI* as examples of cases where taxpayers raised a do-nothing counterfactual).
205. A statutory amendment intended to fix the "do-nothing counterfactual" problem was described in a November 2012 Treasury exposure draft and officially proposed in Parliament in March 2013. It passed in June 2013, without opposition. The statute, as enacted, refers to the two ways of using the counterfactual or "alternative postulate" idea. One possibility constructs a counterfactual by extinguishing the problematic tax benefit-producing "scheme" from the facts. The second possibility reconstructs an alternative transaction

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The *RCI Pty* case illustrates the do-nothing counterfactual or "alternative postulate" argument.[206] In *RCI Pty*, an Australian taxpayer corporation, RCI Pty. Limited (RCI), wholly owned a U.S. subsidiary, James Hardie Holdings (Holdings).[207] In March 1998, Holdings borrowed about $300 million from another group company and declared and paid a dividend of about $300 million to RCI.[208] This reduced the value, but not the basis, of the Holdings stock held by RCI.[209] In October 1998, RCI transferred the Holdings shares to a different group member, RCI Malta, in exchange for shares in RCI Malta.[210] This transaction was taxable under Australian law to RCI as a formal matter.[211] But, because of RCI's tax losses and the reduced value of Holdings as a result of the March 1998 dividend, the transfer of Holdings to RCI Malta did not result in RCI reporting any significant gain for Australian tax purposes.[212] These transactions took place as part of an internal restructuring intended, among other goals, to establish a central group finance company in the Netherlands.[213]

The Australian Commissioner contended that the capital gain that RCI would have paid on the October 1998 Holdings share transfer in the absence of the March 1998 Holdings dividend was a "tax benefit" within the meaning of Part IVA and so subject to government adjustment, producing an additional tax liability of about AUS $172 million.[214] But the taxpayer successfully argued that no tax benefit existed because, if the taxpayer had faced a tax liability of AUS $172 million, it would not have entered into the internal restructuring transaction in the first place.[215]

This curious weakness, under which a transaction's larger and more important tax benefits create (up to a point) a defense against GAAR application, has no parallel in U.S. law. To be sure, U.S. law grapples with the "framing" question of how to analyze a tax-avoidant step in the context of a larger business transaction.[216] But it does so in order to consider

that may differ more significantly from the actual facts. The key provision, requiring disregard for tax results, applies to the latter, alternative-transaction analysis. *ITAA 1936*, s 177CB(4). Academic commentators identify a lack of clarity in the law and an uncertainty about the extent to which the counterfactual requirement has been modified. *See* Cooper, *supra* note 70. But the explanatory memorandum and other materials are clear about the goal of eliminating taxpayer access to a do-nothing counterfactual, and practitioners seem to have absorbed the message. *See, e.g.*, Karen Payne, *Australia Reforms GAAR*, BNA TRANSFER PRICING INT'L J. (Aug. 2013) ("In extreme cases where the tax costs of a functionally substitutable scheme are otherwise prohibitive, a private ruling from the ATO may be the only 'responsible' way to manage Part IVA tax risks, since tax cost must now be disregarded in determining the reasonable alternative postulate.").

206. *RCI Pty*, 84 ATR at 788.
207. *See id.* at 789.
208. *See id.* at 834.
209. *See id.* at 789.
210. *See id.* at 792.
211. *See id.* at 840, 844.
212. *See* Deutsch, *supra* note 11, at 78-79.
213. *See RCI Pty*, 84 ATR at 789.
214. *See id.* at 844.
215. *See id.* at 847-48. It is not clear whether the result in the case arose from poor briefing as well as diligent statutory interpretation. *See* PAGONE, *supra* note 52, at 53 (arguing that prior GAAR case law supports the view that an investigation into other possibilities available to the taxpayer relates to the purpose of the transaction rather than to the existence of a tax benefit) (citing and quoting High Court judgment of Gummow and Hayne JJ. in *Fed Comm'r of Taxation v Hart* (2004) 217 CLR 216 (Austl.)).
216. *See* Burke, *supra* note 104, at 273 ("[C]ourts need a measure of flexibility in framing economic substance cases to accomplish the intended purpose of section 7701(o)."); Hariton, *supra* note 13, at 38 ("[T]he essence of a tax shelter is the fact that it is extraneous to the taxpayer's business.").

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which portions of a transaction may support the taxpayer's assertion of a non-tax purpose. If the *RCI Pty* case had arisen under U.S. law, and the government had successfully defined the tax avoidance transaction narrowly, as the cash round-trip internal restructuring, the government might have won the case. To give a parallel example, in a case like *Gregory*, a U.S. taxpayer could not have raised the defense that the company desired to sell the assets distributed to Mrs. Gregory, but would only have done so if the advantageous tax result obtained by the spin-off planning was available.

2. *Unwanted Assets*

The story of the "do-nothing counterfactual" should not suggest that tax avoidance steps embedded in business transactions are generally easier for the government to challenge under U.S. law. In fact, such challenges are generally more difficult for the government under U.S. law. If a transaction has so much business purpose that it will certainly happen with or without a tax-savings add-on, then it is possible to challenge a portion of the transaction under Australian law, in part because case law recognizes that "scheme" may be interpreted narrowly by the government.[217] U.S. tax administrators do not have this advantage.

Consider an unwanted asset situation. A target corporation plans to merge with an acquiring corporation. The acquiring corporation does not want all of the target corporation's assets or, perhaps, is prohibited from owning all of them under non-tax law. The target corporation will of course try to divest the unwanted assets in the most tax-efficient way possible.

In Australia, at least one court has held that Part IVA permits the Commissioner to recast tax planning in connection with an unwanted assets transfer and treat the transaction instead as if the unwanted assets had been sold in a fully-taxable transaction, and without the benefit of tax assets that the seller attempted to shift within the group.[218] In contrast, U.S. law does not typically apply tax anti-avoidance law to disregard planning designed to minimize tax on the disposition of unwanted assets in connection with a business transaction.

The Australian case, *British American Tobacco*, involved the merger of British American Tobacco Group (BAT) with the Rothmans Group (Rothmans). Rothmans transferred certain unwanted assets—nine brands—among Rothmans members, and then to a third-party buyer, Imperial Tobacco Group (Imperial), to comply with an agreement struck with the Australian Competition and Consumer Commission.[219] The intercompany transfer allowed Rothmans to use the otherwise unavailable losses of one group member to shelter

217. Under the Australian GAAR, the "scheme" requirement is not a significant obstacle to an effort by the Commissioner to challenge a transaction, under case law that sustains the Commissioner's ability to narrowly frame a scheme even if it is only part of a larger commercial transaction. *See* WOELLNER ET AL., *supra* note 46, ¶ 25-617 (noting that the High Court's endorsement of a narrow understanding of scheme in a split loan case "appears to have considerably strengthened the Commissioner's ability to identify a scheme under Part IVA") (citing Comm'r v *Hart*, 217 CLR 216); PAGONE, *supra* note 52, at 44-46 (challenging notion that a "scheme" must have "commercial" or other "coherence" based in part on language in *Hart*). *But see Macquarie Bank Ltd v Fed Comm'r Tax'n*, [2013] FCA 1076 (focusing on overall business transaction of brokering stock sale in Part IVA analysis).
218. *See British Am Tobacco*, 77 ATR at 538-39.
219. *See id.* at 523.

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gain on the sale of the unwanted assets to the third-party buyer. After the sale of the nine brands to Imperial, British American Tobacco Group and Rothmans merged.[220] The tax decision favored the government and held that the group would be taxed as if it had transferred the brands directly to Imperial.[221] One important factor in the analysis was the counterfactual, which was that the unwanted assets transfer and the merger would have happened, but without the tax-saving intercompany transfer.[222]

In contrast, U.S. law often permits taxpayers to dispose of unwanted assets in a tax-efficient manner in connection with an acquisition transaction. One example is the "mirror subsidiary technique," which, in its original form, permitted an acquiring corporation to purchase a target by using two acquiring corporations to buy stock in two target subsidiaries: one with wanted assets and one with unwanted; liquidate the target subsidiary owning the unwanted assets into the unwanted asset acquisition subsidiary; and sell the stock of the unwanted asset subsidiary for little or no gain.[223] U.S. anti-avoidance law generally has not applied to the mirror subsidiary technique, although statutory amendments limit it.[224]

Another example is the *Esmark* case, where the Tax Court refused to recharacterize a cash tender offer for some of a corporation's stock, followed by the distribution of the stock of a subsidiary of the corporation in redemption, as a sale of the stock of the subsidiary for cash followed by a cash distribution.[225] A third example is provided by *Morris Trust*, where a target corporation divested its insurance business prior to merging its bank business with an acquiring bank.[226] The target distributed insurance company stock in a claimed tax-deferred spin-off.[227] The court acknowledged that the active business and other components of the spin-off statute meant to embrace anti-avoidance principles, but held that the taxpayer had successfully obtained the desired tax-deferred result for the spin-off of the unwanted insurance business.[228]

U.S. courts have invalidated unwanted asset planning in some cases, but these have involved relatively narrow facts.[229] *Gregory*, which involved the distribution of a subsidiary company to Mrs. Gregory, is one example.[230] *Elkhorn Coal*, which invalidated a "C"

220. *See id.* at 522-25.
221. *See id.* at 538-39; *see also* Deutsch, *supra* note 11, at 76-78.
222. *See British Am Tobacco*, 77 ATR at 538 ("Precisely the same commercial and legal object could have been achieved without the transfer, sale or disposal by the taxpayer to Rothmans followed by the transfer, sale or disposal by Rothmans to the Imperial subsidiaries.").
223. *See* LEANDRA LEDERMAN, UNDERSTANDING CORPORATE TAXATION 202 (2d ed. 2006) (describing mirror techniques).
224. *See* BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, at ¶ 10.22[3] (7th ed. 2000) (describing statutory amendments).
225. *Esmark*, 90 T.C. at 195-97 (refusing to recharacterize a tender offer followed by an acquirer redemption as a corporate-level sale for cash; tax planning motivated by General Utilities doctrine though limited by statute); *see also* Eustice, *supra* note 2, at 155 ("Esmark selected the low-tax path to a given end in a situation where two other equally plausible, though higher taxed, alternative routes also were available; the Service was not allowed to resequence Esmark's transaction into high-tax channels.") (footnote omitted).
226. Comm'r. v. Morris Trust, 367 F.2d 794, 795 (4th Cir. 1966).
227. *Id.*
228. *Id.* at 802 (respecting taxpayer's tax-deferred spin-off in advance of a merger); Rev. Rul. 68-603, 1968-2 C.B. 148 (stating that the government would follow *Morris Trust*); *but see* I.R.C. §§ 355(d)-(e) (limiting ability to spin off unwanted assets in connection with a merger).
229. *See, e.g.*, Helvering v. Elkhorn Coal Co., 95 F.2d 732 (4th Cir. 1937); *Gregory*, 69 F.2d 809.
230. *Gregory*, 69 F.2d at 810.

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reorganization because of the transfer of unwanted assets, is another example.[231] But, in *Gregory*, the subsidiary whose shares were transferred to Mrs. Gregory owned liquid investment assets, and the distribution did not relate to a business-motivated merger transaction but rather anticipated the prompt sale of the distributed subsidiary by Mrs. Gregory to a prearranged buyer.[232] In *Elkhorn Coal*, the result followed from a specific statutory requirement that the corporation transfer "substantially all" of its assets in order to qualify for a "C" reorganization.[233] Despite cases such as *Gregory* and *Elkhorn Coal*, U.S. taxpayers are generally able to embed tax planning within a bona fide business transaction.

3. *Hopscotch Loans*

A "hopscotch" loan may arise when a non-U.S. parent owns a first-tier U.S. subsidiary, which, in turn, owns a second-tier non-U.S. subsidiary; and when the second-tier non-U.S. subsidiary holds retained profits that have not been subject to significant non-U.S. income tax. Sometimes this structure results from a so-called "inversion" transaction in which a U.S.-parented multinational replaces its "TopCo" with a non-U.S. corporation. A "hopscotch" loan that bypasses the first-tier or intermediate U.S. subsidiary and instead runs directly from the second-tier non-U.S. subsidiary to the non-U.S. parent is designed to dodge the deemed repatriation provisions of I.R.C § 956.[234] The United States has addressed hopscotch loans in administrative guidance,[235] but the issue of whether and how to challenge hopscotch loans in place prior to the date of the guidance remains.

Under § 956, if the non-U.S. second-tier sub, which holds low-taxed retained profit, distributes a dividend directly to, or makes a loan directly to, or purchases the property of a U.S. parent company, residual U.S. tax would be due on a deemed dividend repatriation.[236] But U.S. practitioners generally believe that a "hopscotch loan" made directly to the new, non-U.S. ultimate parent in the structure is not vulnerable to challenge under the language of § 956,[237] at least absent specific administrative guidance. The statute contemplates "an obligation of a United States person,"[238] and a hopscotch loan creates an obligation of the non-U.S. "TopCo," so it does not neatly fit the statutory language.

Moreover, the transaction cannot be said to lack business purpose when viewed in isolation, any more than any other related-party loan.[239] There is no obligation of the intermediary U.S. first-tier subsidiary to repay the intermediate U.S. corporation; the

231. *Elkhorn Coal Co.*, 95 F.2d at 738.
232. *Gregory*, 69 F.2d at 810; *see also supra* text accompanying notes 82-91 (discussing *Gregory* case).
233. *Elkhorn Coal Co.*, 95 F.2d at 734; *but see* Rev. Rul. 2003-79, 2003-2 C.B. 80 (stating government position that after the 1997 enactment of I.R.C. § 355(e), that a pre-transaction spin off of a target corporation would not prevent subsequent acquisition from qualifying under I.R.C. § 368(a)(1)(C)).
234. Kleinbard, *supra* note 17, at 1068-69 (suggesting statutory amendment); Shay, *supra* note 17, at 476-77 (suggesting regulation based on several provisions including but not featuring I.R.C. § 7701(o)).
235. *See, e.g.*, I.R.S. Notice 2014-52, 2014-42 I.R.B. 712 (citing I.R.C. §§ 956(e), 7701(1) (authorizing regulations that re-characterize "multiple-party financing transactions")).
236. *See* I.R.C. § 956.
237. *Id.*
238. *Id.* § 956(c)(1)(C).
239. *See* H. David Rosenbloom, *Banes of Income Tax: Legal Fictions, Elections, Hypothetical Determinations, Related Party Debt*, 26 SYDNEY L. REV. 17, 30 (2004) ("There seems to be only one serious problem with related party debt: by most standards of economics, 'substance,' or common sense, it is not debt.").

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obligation to repay flows from the non-U.S. "TopCo." That the intermediate U.S. corporation owns the grandchild non-U.S. subsidiary is not thought sufficient to successfully mount a form-over-substance or other anti-avoidance argument, absent specific guidance.

In contrast, such a hopscotch loan would seem to fit the Australian anti-avoidance conception comfortably, as it is a contrived, tax-motivated departure from a more natural dividend distribution of profits from non-U.S. second-tier subsidiary to U.S. first-tier subsidiary and thence to non-U.S. parent.[240] More generally, the formulation of the Australian law as an "artificial and contrived" departure from a more natural course of action seems to explicitly invite the government to tax according to a hypothetical course of action.[241] Australian courts, more than U.S. courts, might embrace hypothetical steps, such as a pair of two back-to-back loans, as an adequate basis for taxation in the hopscotch loan situation. Other factors that indicate a tax avoidance purpose—such as the presence of related parties, the immaterial changes in the financial positions of the relevant parties (given that they are related), and the "manner in" and "time at" "which the scheme was carried out"[242] (such as immediately following an inversion)—suggest that a strong argument could be made for the application of Part IVA, if that statute applied under U.S. law.[243]

U.S. courts are more uncertain about making up steps.[244] Indeed, some case law contains statements to the effect that U.S. courts refuse to make up steps, including *Esmark*[245] and *Cumberland*.[246] Yet, some cases imputing interest income when none is paid pre-date Section 7872.[247] Others embrace the project of imputing distributions and contributions to give the proper substance to bargain transactions among related corporations.[248] This case law certainly would support the imputation of two successive capital contributions if the hopscotch loan bore a below-market interest rate, but it does not clearly support re-characterization as a back-to-back loan.[249]

Perhaps the Plan A/Plan B framework of Australian law might help U.S. tax administrators and judges develop a bolder application of the U.S. anti-avoidance standard in these and similar cases. U.S. doctrine, as demonstrated by step transaction cases, embraces the

240. *See supra* Section II.A.

241. *See* BOUCHER, *supra* note 28, at 67-68.

242. *ITAA 1936*, s 177D(2).

243. Although the chances are better than under U.S. law, the capacity of the Australian law for taxing a counterfactual that lacks basis in fact is also limited. *See, e.g.*, *Macquarie Bank Ltd*, [2011] FCA 1076 (refusing to apply Part IVA where broker claimed high basis in shares of subsidiary company that was subject of broker agreement to on-sell, in part because of factual finding of risk of ownership assumed by broker.)

244. Thanks to Calvin Johnson for clarifying our thinking on this. *See, e.g.*, Hariton, *supra* note 108, at 240 ("What room is there . . . for the Commissioner's ability to impose by reference to the transactions which the taxpayer *might* have undertaken to reach her economic objectives but *didn't*? . . . The relevant jurisprudence is confused, ambiguous, and contradictory.") (footnote omitted).

245. *See Esmark*, 90 T.C. at 195-197.

246. *See Cumberland Pub. Serv.*, 388 U.S. at 455.

247. *See, e.g.*, Dean v. Comm'r, 35 T.C. 1083 (1961) (holding that taxpayers could not deduct interest on loans from insurance company secured by life insurance policies after irrevocably assigning such policies to their children.).

248. *See* BITTKER & EUSTICE, *supra* note 224, ¶ 13.23[3][b] (discussing tax treatment of bargain transactions).

249. *Id.*

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idea of disregarding steps. It is not clear why it should be less appropriate to make steps up.

III. Government Structure and Tax Anti-Avoidance Law

A. Tax Administrators as Protagonists

The similarities between Australian and U.S. tax anti-avoidance law cover not only doctrine, but also process as shaped by government structure. Because anti-avoidance law is a standard, it selects future decision makers to apply the law to specific facts in the future.[250] Under both the Australian structure of government and the U.S. structure of government, tax administrators are the first-order actors in this future development of the law.

The reason why tax administrators are the protagonists in the development of anti-avoidance law is simple: They are the ones who can see the transactions, and they are the ones who decide whether to challenge them. This is a process that has its genesis in return examination and audit, not in legislation or politics.

The foreign tax credit generator stories illustrate the centrality of the role of the tax administrator.[251] In Australia, the ATO and the Australian Treasury proposed and drafted the amendment that added foreign tax credits to the list of possible benefits under Part IVA.[252] It audited, litigated and won the *Citigroup Pty* case.[253] In the United States, the IRS and Justice Department pursued initially unsuccessful, then successful, litigation from *Compaq* to *BNY Mellon*.[254] U.S. administrators issued different flavors of guidance targeting FTC generator transactions, including regulations, notices, a coordinated audit plan, and a technical advice memorandum.[255] And tax administrators, including those who drafted successive White House budget proposals, played at least a supporting role in influencing the development and 2010 enactment of § 909 and § 7701(o).[256]

The special role of government employees in the development of tax anti-avoidance law raises a familiar problem. This is the tension between administrative discretion and rule of law.[257] There is a fast-expanding literature that considers the issue of administrative

250. *See* Schauer, *supra* note 1, at 541-42 (arguing that using rules assigns jurisdiction to past decision makers at the expense of future decision makers); *see also* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 568-69 (1992) (contrasting "ex ante" rules with "ex post" standards).
251. *See supra* Section II.B.2.
252. *See supra* text accompanying notes 161-164.
253. *See Citigroup Pty Ltd.*, 193 FCR at 405-06.
254. *See supra* text accompanying notes 172-174, 183-98 (describing U.S. foreign tax credit generator litigation).
255. *See supra* text accompanying notes 170-171, 176-178 (describing U.S. administrative guidance).
256. *See supra* text accompanying notes 118-122, 179-182 (discussing U.S. statutory amendments).
257. *See, e.g.*, Dominic de Cogan, *Tax, Discretion and the Rule of Law*, *in* The Delicate Balance: Tax, Discretion and the Rule of Law 1, 6 (Chris Evans, et al. eds., 2011) (describing "common themes" underlying this debate across jurisdiction); Rebecca Prebble & John Prebble, *Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*, 55 St. Louis U. L.J. 21, 44-45 (2010) (surveying the interaction between tax anti-avoidance law and rule of law commitments in various jurisdictions and philosophies and concluding that general anti-avoidance law is an appropriate breach of the rule of law); Victor Thuronyi, Comparative Tax Law 70-71 (2003) (describing the "principle of legality" applied to taxation law by many constitutions). In Australia, the constitutional power to tax requires, among other items, that the revenue provision is contestable. *See Australian Constitution* s 51(ii); *see also MacCormick v. Fed Comm'r of Tax'n*, 158 CLR 622 (1984). In the United States, even in the absence of

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discretion, particularly in the area of tax law.[258] We do not offer a solution to this difficult problem here, but instead, provide some preliminary observations that emerge from this study of Australian and U.S. tax anti-avoidance law.

The possibility that discretion may lead to over enforcement, where tax administrators inappropriately challenge acceptable transactions, typically greets proposals for anti-avoidance law.[259] The Australian and U.S. stories suggest that these concerns are often misplaced. History shows that tax administrators are only the first-order actors when it comes to challenging transactions as tax avoidant.[260] When Australian and U.S. tax administrators apply anti-tax avoidance law to challenge a transaction, the taxpayer has at least some incentive to challenge the application, and either the courts or the legislature (or both) provide a forum for the taxpayer to object.[261] The government may seriously consider but decide not to bring suit because of the possibility of judicial reversal;[262] if the government overreaches, it may lose in court. In Australia, concerns about over enforcement are further reduced by the use of a committee composed of tax administrators and practitioners, which advises the ATO on application of Part IVA and other anti-avoidance law.[263]

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any constitutional hook, scholars have invoked rule-of-law arguments against judicial application of anti-avoidance rules in the tax context. *See* Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 879 (1982) ("More parsing of the statute . . . and less concern with how to save the world from manipulative taxpayers would have led to sounder results in all these cases."); *see also* Alan Gunn, *Tax Avoidance*, 76 MICH. L. REV. 733, 767 (1978) (arguing that judicial interpretation can serve important purposes but should be anticipated by "broad and general" legislation in appropriate cases).

258. *See, e.g.*, Leigh Osofsky, *The Case for Categorical Nonenforcement*, 69 TAX L. REV. 301, 303 (2015) (arguing that publicly disclosed "categorical non-enforcement" may increase legitimacy, for example by encouraging public debate); Linda Sugin, *Invisible Taxpayers*, 69 TAX L. REV. __ (forthcoming 2016) (manuscript at 5) (arguing that lack of any route to challenge unconstitutional tax treatment of other taxpayers violates fundamental conceptions of legal fairness); Lawrence Zelenak, *Custom and the Rule of Law in the Administration of Income Tax*, 62 DUKE L.J. 829, 847 (2012) (criticizing the lack of taxpayer standing).

259. *See, e.g.*, Canellos, *supra* note 141, at 71 (expressing concern that a broad statutory prohibition of "tax shelter[s]" could "morph into[,] a general anti-avoidance rule of the type recently adopted in a number of foreign countries" and thus transfer too much power from courts to the I.R.S.).

260. Our confidence in continued robust judicial review in the United States presumes that strong *Chevron* deference would not apply for an administrative statement, including a final Treasury regulation, which categorized a certain transaction as lacking economic substance. *See* Luke, *supra* note 84, at 607 (relying on statutory references to economic substance as a "common law doctrine" that applies when a court decides that it is "relevant") (citing *Chevron*, 467 U.S. at 865).

261. Not every administrative challenge reaches a court, of course, but every such challenge could, if the taxpayer so desired, and those that do reach judicial decision shape tax administrators' actions more generally. *See* Judith Freedman, *Designing a General Anti-Abuse Rule: Striking a Balance*, 2014 IBFD ASIA-PAC. TAX BULL. 167, 168 (May/June). The problem that costs of litigation may exceed benefits to taxpayers of litigating remains, but there is little reason to think that this is the general rule particularly given the possibility of enormous penalties for tax avoidance transactions and the likelihood that tax administrators reserve their resources for challenges to big-dollar cases.

262. The ATO reportedly seriously considered, but then rejected, mounting a GAAR challenge to use of treaty planning and a Cayman Islands holding company where an Australian business appears to have been owned ultimately by beneficial owners resident in other OECD countries. *See* Robert Deutsch, *The Commissioner wants "a piece of Myer" too*, WKLY TAX BULL. No. 49 (2009) ¶¶ 2308, 2160-64.

263. *See* Justice G.T. Pagone, Lecture at The Australian GAAR Panel in London (Feb. 10, 2012), *available at* https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/2012/gaar/pagone-revised.pdf (describing Australia's practitioner and administrator advisory committee); *see also* Freedman, *supra* note 261, at 172-73 (contrasting the UK's external panel which must approve "[a]ll GAAR cases . . . if they are to proceed").

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In contrast, the problem of under enforcement is an issue that deserves further attention. To illustrate the issue, imagine that Australian and U.S. tax administrators had decided *not* to pursue foreign tax credit generator transactions, even though they knew about the transactions and believed the transactions were abusive. Note that this decision not to enforce could emerge for a variety of reasons. For example, it could emerge from an entirely good-faith rationale about using resources wisely, or it could result from the nefarious capture of tax administrators' interests by the multinational corporations who used foreign tax credit generator transactions.

Regardless of why tax administrators failed to enforce, the following question arises: If tax administrators failed to raise the problem of abusive foreign tax credit generator problems, what could be done to force tax administrators to take action? The existing tools are very limited, as others have explained in contemporaneous work.[264] One problem is the lack of information due to confidentiality provisions. Also, taxpayers lack any private right of action in Australia[265] and in the United States.[266] to challenge under enforcement of the law (i.e., as applied to other taxpayers). Finally, no process attaches to public statements—including public statements by well-informed experts[267]—that encourage enforcement.

The vulnerability of under-enforcement in tax anti-avoidance law deserves further study. It seems likely that is a particular concern in this area of tax law because tax anti-avoidance law is (and must be) a standard. One possible line of inquiry might consider the empirical question of the scope and composition of under enforcement of anti-avoidance law. Another might explore whether vulnerability to uneven enforcement weakens the case for an anti-avoidance standard. A third strand might evaluate the merits of various

264. *See supra* note 258 (citing recent work on under enforcement and tax administration).

265. *See* Michael Walpole & Chris Evans, *The Delicate Balance: Revenue Authority Discretions and the Rule of Law in Australia*, *in* THE DELICATE BALANCE: TAX, DISCRETION AND THE RULE OF LAW 121, 145 (Chris Evans et al. eds., 2011) (noting that if an administrative decision benefits certain taxpayers, other taxpayers "normally" cannot "challenge the declaration" because they would not be persons "'whose interests are affected by the decision'") (citing *Administrative Appeals Tribunal Act 1975* (Cth.) s 27(1) (Austl.); *see also* KIM SAWYER, LINCOLN'S LAW: AN ANALYSIS OF AN AUSTRALIAN FALSE CLAIMS ACT 32 (2011), *available at* http://ssrn.com/abstract=1923412 ("Australia has no history of false claims actions, and . . . the principle of paying whistleblowers is new."); *see also* Elletta Sangrey et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 VA. J. INT'L L. 879, 897 (2004) ("[N]either the United Kingdom nor Australia has followed the U.S. lead in offering financial incentives for whistleblowing."); *but see* Dan D. Pitzer, *The Qui Tam Doctrine: A Comparative Analysis of Its Application in the US and the British Commonwealth*, 7 TEX. INT'L L. J. 415, 424 (1972) ("The Australian courts ruled that if the statute was silent as to the mode of recovery, and if it was for the public benefit, then '[p]rima facie anyone may lay an information for the enforcement of an Act.'") (citing *Dunstan v Neems*, [1914] Vict. L. R. 364).

266. *See, e.g.*, Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 372 (2008) (noting that even U.S. tax whistleblower statute, I.R.C. § 7623, lacks private right of action). In the United States, the general immunity of tax law non-enforcement to third-party action is atypical, since the False Claims Act permits third-party *qui tam* challenges to many other federal government actions. *See* Richard A. Bales, *A Constitutional Defense of* Qui Tam, 2001 WIS. L. REV. 381, 392-395 (explaining rules for Department of Justice intervention in FCA suits).

267. *See, e.g.*, Gregg D. Polsky, *A Compendium of Private Equity Tax Games*, 146 TAX NOTES 615, 625 (2015) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524593 (arguing that two widespread private equity firm practices, management fee waivers and monitoring fee deductions, are "abusive" and inconsistent with applicable law).

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possible solutions to under enforcement including *qui tam* lawsuits,[268] institutional monitoring,[269] third-party gatekeeper strategies,[270] and collateral consequences[271] under securities or other non-tax law.[272]

B. Political Process

The structure of the Australian and U.S. governments also influences the development of tax anti-avoidance law. The two jurisdictions are similar in that they have well developed administrative agencies, as well as strong judicial systems that capably review administrative action. This similarity permits the observation, outlined above, that tax anti-avoidance law presents more of a risk of under enforcement, rather than over enforcement, in both jurisdictions. Yet the two government structures are also different in important respects, and this too has implications for the development of tax anti-avoidance law. In particular, Australia's tax administrators can influence and direct legislative action to a much greater extent than U.S. tax administrators. But U.S. tax administrators can promulgate guidance, including regulations entitled to significant judicial deference under the *Chevron* doctrine, which Australian tax administrators cannot do.

Australia, of course, has a parliamentary system. The Parliament is composed of two houses—the House of Representatives (or the Lower House, as it is often referred to) and the Senate (or Upper House). The Prime Minister is, by definition, politically aligned with the House of Representatives. In part because of custom and norms, the Prime Minister largely sets the legislative agenda and the House largely goes along with it. As a result of different voting systems adopted in electing members of the House and the Senate, the Australian Senate is not necessarily aligned with the Prime Minister. The Senate may, and often does, block legislation.[273] Nevertheless, Australia's process for enacting tax legislation is quite direct: tax administrators propose, and generally draft, legislation.

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268. *See* Dennis J. Ventry Jr., *Not Just Whistling Dixie: The Case for Tax Whistleblowers in the States*, 59 Vill. L. Rev. 425, 478-485 (2014) (analyzing pro and con arguments for tax *qui tam* suits and outlining a proposed *qui tam* statute including provisions such as in camera examination of whistleblower claims and the ability of courts to limit whistleblower participation, in an effort to protect taxpayer confidentiality and prevent frivolous suits). *Qui tam* action abbreviates a Latin phrase translated as "who sues on behalf of the King as well as for himself." Black's Law Dictionary (10th ed. 2014) at 1251. *See* Note, *The History and Development of* Qui Tam, 1972 Wash. U. L. Q. 81, 83 (noting the "combination of two distinct interests; one of which is public, the other private).

269. Ideas are provided by Australian groups such as the Part IVA advisory committee, *see supra* note 266; and U.S. government groups such as the National Taxpayer Advocate, and the Treasury Inspector General for Tax Administration, *see, e.g.*, Bryan Camp, *What Good is the National Taxpayer Advocate?* 126 Tax Notes 1243 (2010) (critiquing the role of the National Taxpayer Advocate office).

270. *See, e.g.*, Leandra Lederman, *Statutory Speed Bumps: The Role Third Parties Play in Tax Compliance*, 60 Stan. L. Rev. 695 (2007).

271. *See* Joshua D. Blank, *Collateral Compliance*, 162 U. Pa. L. Rev. 719 (2014) (arguing that collateral consequences such as the removal of a professional license as a possible sanction would increase tax compliance).

272. *See, e.g.*, Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 Fordham L. Rev. 961 (2006) (arguing that personal officer liability and other features of the Sarbanes-Oxley Act reduced the attractiveness of tax shelters for public corporations).

273. *See* Gwynneth Singleton et al., Australian Political Institutions 156, 185, 252 (10th ed. 2013) (stating that opposition party can block legislation if it has a majority in the Senate; explaining that party with majority in House of Commons establishes government, including prime minister and cabinet; noting influence of Treasury and its bureaucracy on economic policy).

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Enactment after introduction is sufficiently certain that the effective date of tax legislation in Australia is generally the date of its initial introduction into Parliament.[274]

Because of the relative ease of amending the statute, it is one of the two main tools that Australian tax administrators use to develop anti-avoidance law. The other tool is audit and litigation. "[L]ittle or nothing [is left] to [tax] regulations" in Australia.[275] The foreign tax credit generator story illustrates: Australia dispensed with the issue with just one statutory amendment and one case.[276]

The reliance of Australian tax administrators on the tactic of statutory amendment is evident in many other cases. Specific provisions in Part IVA cover dividend stripping to make sure the GAAR applies to cases like *Slutzkin* and *Gregborn*.[277] A 2013 statutory amendment addressed the "do-nothing counterfactual" argument after a single taxpayer win in *RCI Pty*.[278] In 2015, statutory amendments addressed the problem of multinational tax avoidance with a law that carefully describes the targeted abuse: a "supply" to an "Australian customer" by a "significant global entity," where income should have been, but was not, attributed to an Australian permanent establishment.[279]

The U.S. path involves a more complicated set of tools than the Australian approach. This is in part because U.S. tax administrators face a larger and more diverse set of regulatory and enforcement tasks. But there are government structure differences as well.

Statutory amendment is not the ready alternative for U.S. tax administrators. They do not exert a meaningful amount of control over the legislative process. Indeed, it appears that no one exerts meaningful control over the U.S. federal legislative process.[280] This is evidenced, for example, by the fact that U.S. tax administrators did not play a dominant role in the drafting or amendment process for § 7701(o), and by the fact that it took ten years to enact that section.

Instead, U.S. tax administrators rely on "ten [to] twenty" different kinds of administrative guidance,[281] as well as the audit and litigation tactics which are similar to those used in Australia. The IRS and U.S. Treasury have more interpretive discretion than the ATO and Australian Treasury,[282] even if the degree of deference is debated in recent case law.[283]

274. This retrospective approach is consistent with the usual Australian approach. *See* Vann, *supra* note 21, at 9.

275. *Id.*

276. *See supra* Section II.B.2.

277. *See ITAA 1936* s 177E (covering "stripping of company profits").

278. *See supra* note 205.

279. *ITAA 1936* s 177DA. *See supra* note 23 (outlining provisions in 2015 amendment).

280. *See generally* WILLIAM ESKRIDGE JR. ET AL., STATUTES, REGULATION AND INTERPRETATION: LEGISLATION AND ADMINISTRATION IN THE REPUBLIC OF STATUTE (2014) (describing and analyzing numerous legislative process hurdles or "vetogates").

281. Bryan Camp, *A History of Tax Regulation Prior to the Administrative Procedure Act*, 63 DUKE L. J. 1673, 1676 (2014); *see also* Kristin Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1559, 1600-01 (2006) (noting the presence of both regulations and more informal guidance such as revenue rulings, and arguing that the binary *Chevron/Mead* review standard generally applicable in administrative law applies equally in tax).

282. *See, e.g.*, Malcolm Gammie, *Tax Avoidance and the Rule of Law: A Perspective from the United Kingdom* TAX AVOIDANCE AND THE RULE OF LAW 181, 213 (Graeme S. Cooper ed. 1997) (noting that "the judiciary may confer on the administrator what traditional British constitutional and legal doctrine is supposed to deny–discretion" and that the different U.S. view "ought to be considered with the different constitutional and legislative framework in mind"); *see also* John Tiley, *Judicial Anti-Avoidance Doctrines: Corporations and*

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The U.S. foreign tax credit generator story, which featured multiple waves of administrative guidance and litigation, illustrates the more tortuous path of the U.S. tax administrator, compared to the typically more straightforward Australian tactic of amending and litigating Part IVA.

IV. Conclusion

This Article's comparison of Australian and U.S. tax anti-avoidance law shows that this law can be properly structured as a standard regardless of the location of anti-avoidance law in statute or in case law. The two bodies of law share a common two-part structure. Both focus on taxpayer avoidance purpose, subject to an exception for outcomes clearly intended by the legislature. This leads to a similar result in the vast majority of cases, as examples like the foreign tax credit generator case demonstrate. On the other hand, doctrinal differences may lead to different outcomes in some cases, including the do-nothing counterfactual, unwanted asset, and hopscotch loan examples discussed herein.

In some ways, the government structure as applied to tax anti-avoidance law differs in Australia as compared to the United States. In Australia, tax administrators can significantly influence legislative change, and legislative change to anti-avoidance rules happens regularly in Australia. In the United States, legislative change to anti-avoidance rules rarely happens. Regulatory change in the U.S. also happens less frequently than might be suggested by U.S. administrators' power to write regulations and other guidance.

But in other, and more important, ways, Australian and U.S. government structures as applied to tax anti-avoidance law are similar. Both Australian and U.S. tax administrators have the central protagonist role in the development of tax anti-avoidance law in each country. Because Australian and U.S. tax administrators have charge of audit and litigation, they control which anti-avoidance cases are raised. Finally, administrators' discretion to charge taxpayers with tax avoidance often prompts concern about over enforcement, but under enforcement likely presents the greater risk in both systems examined here.

Conclusions, 1988 BRIT. TAX REV. 108, 143-44 (noting the greater detail of U.S. regulations and the broader drafting norms for U.S. statutes compared to British law and "the fact that the U.S. tax legislation is not controlled by the IRS in the way that the United Kingdom legislation is").

283. *See, e.g.*, King v. Burwell, 135 S. Ct. 2480, 2489 (2015) (suggesting that IRS lacked ability to promulgate certain Affordable Care Act regulations entitled to *Chevron* deference); *see also* Altera Corp. v. Comm'r, 145 T.C. No. 3 (July 27, 2015) (invalidating Section 482 final regulations despite sweeping discretion given to Treasury in statute).

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Appendix A: Excerpts from Part IVA

Section 177A INTERPRETATION

Section 177A(1) [Definitions]

In this Part, unless the contrary intention appears: . . . scheme means

(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable . . .; and

(b) any scheme, plan, proposal, action, course of action or course of conduct. . . .

SECTION 177C TAX BENEFITS

Section 177C(1)

Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

(a) an amount not being included in the assessable income of the taxpayer . . . where that amount would have been included, or might reasonably have been expected to have been included, in the assessable income of the taxpayer . . . if the scheme had not been entered into or carried out; . . .

[Section 177C(1) also lists in analogous fashion tax benefits arising from the claiming of a deduction, capital loss, loss carry back, foreign income tax offset and missing withholding tax.]

Section 177C(2)

A reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as not including a reference to:

(a) the assessable income of the taxpayer . . . not including an amount that would have been included . . . where: (i) the non-inclusion of the amount . . . is attributable to the making of an agreement, choice, declaration, election or selection, the giving of a notice or the exercise of an option expressly provided for by [Australian income tax statutes] . . .

[Section 177C(2) also carves out in analogous fashion tax benefits arising from the claiming of a deduction, capital loss, loss carry back, or foreign income tax offset; or from missing withholding tax, in each case where the tax benefit is "expressly provided for" by statute.]

SECTION 177CB THE BASES FOR IDENTIFYING TAX BENEFITS

Section 177CB(1)

This section applies to deciding, under Section 177C, whether any of the following . . . would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

(a) an amount not being included in the assessable income of the taxpayer;

[Section 177CB(1) also lists in analogous fashion other tax benefits whose presence needs to be determined in part by examining a counterfactual, including the claiming of a deduction, capital loss, loss carry back, or foreign income tax offset; or missing withholding tax.]

Section 177CB(2)

A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

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Section 177CB(3)

A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

Section 177CB(4)

In determining for the purpose of subsection (3) whether a postulate is such a reasonable alternative:

(a) have particular regard to:

(i) the substance of the scheme; and

(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but

(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).

SECTION 177D SCHEMES TO WHICH THIS PART APPLIES

Section 177D(1) Scheme for purpose of obtaining a tax benefit

This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of:

(a) enabling a taxpayer (a relevant taxpayer) to obtain a tax benefit in connection with the scheme . . . whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers.

Section 177D(2) Have regard to certain matters

For the purpose of subsection (1), have regard to the following matters:

(a) the manner in which the scheme was entered into or carried out;

(b) the form and substance of the scheme

(c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;

(d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;

(e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;

(f) any chance in the financial position of any person who has, or has had, any connection (whether or a business, family, or other nature) with the relevant taxpayer, being a chance that has resulted, will result, or may reasonably be expected to result, from the scheme;

(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;

(h) the nature of any connection (whether or a business, family, or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

SECTION 177DA SCHEMES THAT LIMIT A TAXABLE PRESENCE IN AUSTRALIA

(1) Without limiting Section 177D, this Part also applies to a scheme if:

(a) under, or in connection with the scheme:

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(i) a foreign entity makes a supply to an Australian customer of the entity; and
(ii) activities are undertaken in Australia directly in connection with the supply, and;
(iii) some or all of those activities are undertaken by an Australian entity who, or are undertaken at or through an Australian permanent establishment of an entity who, is an associate of or is commercially dependent on the foreign entity; and
(iv) the foreign entity derives ordinary income, or statutory income, from the supply; and
(v) some or all of that income is not attributable to an Australian permanent establishment of the foreign entity; and

(b) [a principal purpose test is met]; and
(c) the foreign entity is a significant global entity . . .

(2) [Section 177DA(2) provides that principal purpose test shall include consideration of several factors, including non-Australian tax results.]

. . . .

SECTION 177F CANCELLATION OF TAX BENEFITS ETC.

Section 177F(1)

Where this Part applies to a scheme in connection with which a tax benefit has been obtained . . . the Commissioner may:

(a) In the case of a tax benefit that is referable to an amount not being included in the assessable income of the taxpayer of a year of income–determine that the whole or a part of that amount shall be included in the assessable income of the taxpayer of that year of income; . . .

[Section 177F(1) also allows the Commissioner to reverse out tax benefits arising from the claiming of a deduction, capital loss, loss carry back, or foreign income tax offset; or from missing withholding tax.]

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Appendix B: Excerpts from I.R.C. § 7701(o)

§ 7701(o) CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.–

(1) Application of doctrine.—In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

(2) Special rule where taxpayer relies on profit potential.—

(A) In general.—The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.

(B) Treatment of fees and foreign taxes.—Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

. . .

(5) Definitions and special rules.—For purposes of this subsection—

(A) Economic substance doctrine.—The term "economic substance doctrine" means the common law doctrine under which tax benefits under [the U.S. income tax statute] with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

. . .

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