NOTE

TEXTUALISM WITHOUT TAX SHELTERS: A PROPOSAL FOR INTEGRATING JUDICIAL ANTI-ABUSE DOCTRINES WITH TEXTUALISM

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ABSTRACT

The line between legitimate tax planning and abusive tax positions, while clear in many instances, produces a significant amount of controversy. Judicial scrutiny of close cases has led to the development of a body of loosely related anti-abuse doctrines designed to separate the wheat from the chaff. However, textualist judges have increasingly rejected or limited the use of anti-abuse doctrines out of a concern that such doctrines undermine taxpayer reliance on the law. Critics contend that by rejecting anti-abuse doctrines, these textualist judges legitimate abusive tax shelters and deprive the judiciary of essential tools for curbing abuse. This Note responds to textualists and their critics alike by arguing that textualism is not incompatible with judicial anti-abuse doctrines. After surveying major landmarks in the historical development of the legal system's treatment of tax abuse and considering the Sixth Circuit's approach to the issue, this Note develops an account of judicial anti-abuse doctrines as textually sensitive aids to statutory interpretation.

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INTRODUCTION

Abusive tax shelters[1] are a perennial problem facing the United States tax system.[2] The Internal Revenue Service ("IRS") estimates that the federal tax gap—the amount of federal taxes owed but not paid (including those attributable to abusive tax shelters)—is approximately $441 billion per year.[3] Moreover, tax shelters are problematic because they not only result in lost revenue but also threaten the equitable administration of tax laws and undermine taxpayer confidence.[4] Judicial anti-abuse doctrines are one weapon in the fight to control

[1] A brief note on terminology is in order. As used in this Note, "tax evasion" refers to "conduct that entails deception, concealment, destruction of records, and the like." BORIS I. BITTKER & LAWRENCE LOKKEN, *Interpreting the Internal Revenue Code*, *in* FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3, Westlaw (database updated July 2021). In contrast, "tax avoidance" "refers to behavior that the taxpayer hopes will serve to reduce his tax liability but that [the taxpayer] is prepared to disclose fully to the IRS." *Id.* An instance of tax avoidance may or may not be legal, but it at least represents a good faith effort to apply the law to the taxpayer's situation. Similarly, while the phrase "tax shelter" is a pejorative term in the colloquial sense, taken literally the term merely describes an arrangement for reducing or eliminating taxable income, which may or may not be legal. *See* TAX POL'Y CTR., THE TAX POLICY CENTER'S BRIEFING BOOK 133 (2020) (noting that 401(k) programs are technically "tax shelters"). As such, all tax shelters involve tax avoidance, but not all tax shelters involve tax evasion. This is why the IRS and the Tax Policy Center use the narrower term "abusive tax shelter" to describe illegal tax avoidance—i.e., "a transaction or strategy that generates tax benefits unintended by the Congress or the IRS." *Id.*

[2] *See* Joseph Bankman, *The Tax Shelter Problem*, 57 NAT'L TAX J. 925, 926 (2004) [hereinafter Bankman, *The Tax Shelter Problem*] (summarizing history of tax shelters in United States); *see also* Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325, 346 (2002) (summarizing failing efforts to control tax shelters).

[3] *See* I.R.S. News Release IR-2019-159 (Sept. 26, 2019), https://www.irs.gov/newsroom/irs-releases-new-tax-gap-estimates-compliance-rates-remain-substantially-unchanged-from-prior-study [https://perma.cc/WA5W-2QZG] ("The average gross tax gap was estimated at $441 billion per year based on data from tax years 2011, 2012 and 2013."). While it is difficult to determine how much of the tax gap is due to abusive tax shelters, one scholar estimates revenue loss of at least $10 billion per year in the early 2000s. *See* Joseph Bankman, *The Tax Shelter Battle*, *in* THE CRISIS IN TAX ADMINISTRATION 9, 12 (Henry J. Aaron & Joel Slemrod eds., 2004) [hereinafter Bankman, *The Tax Shelter Battle*]. Other considerations suggest the number may be higher. After implementing the voluntary offshore compliance rules, the IRS announced that "voluntary disclosures under its tax amnesty provisions had yielded over $30 billion in shelter-related deductions." *See id.*

[4] *See* Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 863 n.15 (1982) ("One man's tax shelter being everyone else's budget deficit, all taxpayers ultimately have an interest in the reasonable interpretation of the tax laws."); *see also* Theodore S. Sims & Emil M. Sunley, Book Review, 45 NAT'L TAX ASS'N 451, 454 (1992) (noting that while it "is too much to expect that private parties . . . ever will refrain

abusive tax shelters.[5] While these doctrines are not uniformly defined or consistently applied, they are widely understood as offering judges tools for weeding out abusive tax positions.[6] Nevertheless, textualist judges often express reservations about the use of judicial anti-abuse doctrines—reservations that have led some to identify textualism as at least compounding the tax shelter problem.[7]

Textualists' concerns over judicial anti-abuse doctrines stem from the belief that such doctrines undermine a taxpayer's ability to rely on the letter of the law.[8] As Judge Learned Hand famously quipped, "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."[9] To preserve that right, textualists maintain that it must be legitimate for taxpayers to rely on the plain meaning of the tax laws when

from attempting to secure the very best tax results they can[,] . . . [tax planning] endeavors, especially when pressed to extremes that neither Congress nor the Treasury ever anticipated, are a prime source of complexity, unfairness, and *perceived* unfairness in the system." (quotation omitted)).

[5] *See* Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 STAN. L. REV. 195, 195 (2020) (arguing that judicial anti-abuse doctrines serve as substantive canons of construction).

[6] *See* BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3 (observing that judicial anti-abuse doctrines "are, however, extremely important despite their vagueness . . . when the meaning of a provision is veiled by fog, taxpayers may tread more warily than when the landmarks are clearly visible"); *cf.* Daniel M. Schneider, *Use of Judicial Doctrines in Federal Tax Cases Decided by Trial Courts, 1993-2006: A Quantitative Assessment*, 57 CLEV. ST. L. REV. 35, 39 (2009) (assessing use of judicial anti-abuse doctrines and noting that both government and taxpayers benefit from their use).

[7] *See* Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 2 (2004) ("The recent proliferation of tax shelters has, at least in part, been facilitated by the ascendency of textualism." (footnote omitted)); *see also* Reuven S. Avi-Yonah, Rodriguez*,* Tucker*, and the Dangers of Textualism*, 167 TAX NOTES FED. 87, 95 (2020) (arguing that "textualism poses a significant threat to the proper administration of tax law," and warning that if textualism results in elimination of judicial anti-abuse doctrines "the resulting third tax shelter wave will put the 1969-1986 and 1987-2006 ones to shame").

[8] *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 782 (6th Cir. 2017) (criticizing judicial anti-abuse doctrines as granting Internal Revenue Service Commissioner "sweeping authority" to recharacterize transactions and undermine taxpayer reliance on letter of law); *see also* Richard M. Lipton, 2019 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *Proper Application of the Judicial Doctrines and the Elimination of Section "I Don't Like It*,*"* 72 TAX LAW. 621, 622 (2019) ("The problem which arises is that the IRS and the courts will sometimes see a transaction that achieves tax results that are more favorable than they believe is appropriate, and they will wrongly apply the judicial doctrines . . . . to undo the results that are clearly permissible by the existing provisions of law as amplified by the judicial doctrines.").

[9] Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

ordering their affairs.[10] Textualist jurisprudence becomes controversial, however, when taxpayers, through evidently literal compliance with the law, produce results that are unexpected, quite plainly unreasonable, and appear to conflict with congressional intent.[11] In such cases, the government's interest in the equitable administration of tax law is pitted against the taxpayer's right to lawfully minimize his tax liability. The resulting tension plays out in opposing theories of statutory interpretation; textualist judges tend to protect the taxpayer's reliance on the tax laws at the expense of their reasonable and equitable administration, while intentionalist judges do just the opposite.[12]

This Note analyzes a pair of relatively recent Sixth Circuit decisions that highlight this dilemma. In *Summa Holdings v. Commissioner*,[13] the Sixth Circuit suggested that textualist judges are powerless to close self-evidently unintended and arguably inequitable statutory "loophole[s]."[14] That case involved a taxpayer-manufactured interaction of two parts of the Internal Revenue Code ("Code") that have little to do with one another: the domestic international sales corporation ("DISC") provisions and the Roth individual retirement account ("Roth IRA") provisions.[15] While the Sixth Circuit recognized that the result of their combined use was perhaps "unintended by both the Roth IRA and DISC provisions," the Sixth Circuit nevertheless ruled that the taxpayers were entitled to the tax benefits they sought because the "Internal Revenue Code allowed Summa Holdings and the Benensons to do what they did."[16] In reaching that conclusion, the Sixth Circuit declined to employ judicial anti-abuse doctrines so as to recharacterize the transactions in a manner that more accurately reflected

[10] *Summa Holdings*, 848 F.3d at 787 ("Before long, allegations of tax avoidance begin to look like efforts at text avoidance.").

[11] Joseph Isenbergh provides a famous example to illustrate this point in a hypothetical congressional subsidization of farmers through a deduction for cows. *See* Isenbergh, *supra* note 4, at 865. If a taxpayer who owns no cows claims the deduction under the theory that his dogs are cows, he has committed tax evasion. However, if a wealthy taxpayer, in an effort to drum up deductions to offset income from other sources, invests in a large number of cows, he has engaged in tax avoidance. If the law failed to specify limits on the deduction (or the wealthy taxpayer employed a team of tax lawyers to find a creative solution around the limits provided), would it be just to deny the deduction to the wealthy taxpayer, even if his conduct appears to conform to the letter of the law?

[12] *Compare Summa Holdings*, 848 F.3d at 784, 791 (upholding transaction that was likely "unintended by both the Roth IRA and DISC provisions" because "[t]he Internal Revenue Code allowed Summa Holdings . . . to do what [it] did"), *with* Goldstein v. Comm'r, 364 F.2d 734, 740 (2d Cir. 1966) (denying Code-compliant transaction entered into solely for tax avoidance reasons where transaction was inconsistent with congressional intent).

[13] 848 F.3d 779 (6th Cir. 2017).

[14] *See id.* at 787.

[15] *Id.* at 782.

[16] *Id.* at 784, 790.

their underlying substance.[17] In a subsequent decision, *Hawk v. Commissioner*,[18] involving another unexpected tax windfall, the Sixth Circuit did apply judicial anti-abuse doctrines to recharacterize the transaction in a manner that comported with its underlying substance.[19] The Sixth Circuit reconciled these two apparently conflicting opinions by suggesting that judicial anti-abuse doctrines are appropriately applied to ambiguous questions of fact, but not to ambiguous questions of law.[20]

This Note proposes that judicial anti-abuse doctrines could play a broader role in textualist jurisprudence than that espoused by the Sixth Circuit. While often deployed as nontextual modes of statutory interpretation, the doctrines are not inherently antitextualist; nothing in their nature requires abandoning the text of the tax laws in favor of extratextual sources of meaning. The Sixth Circuit partly recognized that such doctrines are not fundamentally incompatible with textualism when it conceded that the doctrines may serve as aids to the interpretation of ambiguous questions of fact.[21] Nevertheless, the Sixth Circuit insists that the doctrines are inappropriate in dealing with ambiguous questions of law.[22] The assumption underlying this dichotomization is that judicial anti-abuse doctrines necessarily involve nontextual modes of inquiry and, as such, should not inform the analysis of questions of law. This Note challenges that assumption by developing an account of the doctrines that relies squarely on a text-based mode of inquiry[23]—one that looks not just to the statutory text in

[17] *Id.* at 790. The First and Second Circuits also ruled on the exact same transaction at issue in *Summa Holdings* in related appeals of the Tax Court's determination, which were brought by the parents (Second Circuit) and the sons (First Circuit). *See* Benenson v. Comm'r, 910 F.3d 690, 693 (2d Cir. 2018); Benenson v. Comm'r, 887 F.3d 511, 513 (1st Cir. 2018). The First and Second Circuits largely adopted the Sixth Circuit's reasoning and refused to use judicial anti-abuse doctrines to recharacterize the transaction on the grounds that "the transaction does not violate the plain intent of the relevant statutes." *Benenson*, 887 F.3d at 523. This Note confines itself primarily to the Sixth Circuit's treatment of the case. For a brief discussion of the First and Second Circuit opinions, see *infra* Section II.D.

[18] 924 F.3d 821 (6th Cir. 2019).

[19] *See id.* at 823 (affirming Tax Court holding that Hawks "were transferees of a delinquent taxpayer under federal law and permitting the government to recover the unpaid taxes").

[20] *See id.* at 831.

[21] *See Summa Holdings*, 848 F.3d at 787-88 (agreeing with Professor Isenbergh's suggestion that judicial anti-abuse doctrines may illuminate ambiguous questions of fact).

[22] *See id.* at 789 (rejecting application of judicial anti-abuse doctrines to question of law—i.e., whether Roth IRA can own shares in DISC).

[23] *Cf.* Choi, *supra* note 5, at 209 (proposing that perceived incompatibility between textualism and judicial anti-abuse doctrines may be resolved by viewing doctrines as substantive cannons of construction). For a comparison of this Note's proposal with Choi's, see *infra* note 294 and accompanying text.

question but also to "the language of accompanying statutory provisions," and their "relation to the entire act of which the statute is a part."[24]

Part I covers some major landmarks in the historical development of the legal system's treatment of tax avoidance. It surveys four historically significant tax avoidance cases and describes some of the resulting congressional and judicial responses. This survey demonstrates that, while congressional solutions tend to provide less ambiguous guidance than judicial doctrines, statutory anti-tax avoidance provisions complicate the tax laws, and are ultimately incapable of anticipating and preventing novel and abusive tax avoidance schemes. Part II explores the tension between the Sixth Circuit's textualism and the judicial anti-abuse doctrines described in Part I. A comparison of *Summa Holdings* and *Hawk* discloses the Sixth Circuit's ambivalence toward judicial anti-abuse doctrines. Because of the Sixth Circuit's dual concerns to protect taxpayers' reliance on the text of the law while simultaneously upholding its equitable administration, the Sixth Circuit landed on a stratagem of using judicial anti-abuse doctrines, but only after limiting their scope to ambiguous questions of fact. Part III pushes back against the Sixth Circuit's approach and offers an account of judicial anti-abuse doctrines as textually sensitive aids to statutory interpretation.

I. Enforcement Against Abusive Tax Avoidance

A. *Classic Tax Avoidance Cases*

Scholars generally describe tax avoidance schemes as transactions that rely on facially plausible readings of the Code to obtain unexpected, and at a minimum aggressive, tax results.[25] This Section surveys four classic tax avoidance cases—*Knetsch v. United States*,[26] *Goldstein v. Commissioner*,[27] *Estate of Franklin v. Commissioner*,[28] and *Helvering v. Gregory*[29]—to set the stage for an evaluation of the merits and shortcomings of judicial and legislative

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[24] *See* Gary Lawson, Federal Administrative Law 10 (8th ed. 2019) (discussing methods of statutory interpretation).

[25] *See* Bankman, *The Tax Shelter Battle*, *supra* note 3, at 9 (defining tax shelter, in part, as transaction that "succeeds under at least one literal reading of the governing statute or regulation" and achieves results that are "inconsistent with any purposive or intentionalist reading"); Cunningham & Repetti, *supra* note 7, at 4 ("Tax shelter promoters have exploited the move towards textualism by designing transactions that comply with the letter of the law but that generate results clearly never contemplated by Congress or the Treasury."); *see also* Boris I. Bittker & James S. Eustice, *Corporate Reorganizations*, *in* Federal Income Taxation of Corporations and Shareholders ¶ 12.02, Westlaw (database updated Nov. 2020) ("As elsewhere in the law of taxation, the lawyer's passion for technical analysis of the statutory language should always be diluted by distrust of a result that is too good to be true.").

[26] 364 U.S. 361 (1960).

[27] 364 F.2d 734 (2d Cir. 1966).

[28] 544 F.2d 1045 (9th Cir. 1976).

[29] 69 F.2d 809 (2d Cir. 1934).

responses to tax avoidance transactions.[30] The first three cases are manifestations of what is typically called "tax arbitrage," which generally involves deducting the interest on borrowing to acquire an asset that is in some fashion taxed in a "preferential" way.[31] In its purest (and probably original) form, the tax-favored asset consists of a state or local bond the interest on which is exempt from tax.[32] Deducting interest paid on the debt while excluding the interest received from the investment could combine to convert an investment that incurred a pre-tax loss into one that yields an after-tax profit.[33] Although the extent to which that is a "bad thing" has been a matter of academic debate,[34] the Code has disallowed deductions for interest on debt to purchase or carry tax-exempt municipal bonds almost from the beginning.[35]

But debt-financed investment in municipal bonds does not exhaust the opportunities for tax arbitrage. Far from it: it barely scratches the surface. As illustrated below, the history of the income tax is replete with examples in which the tax system has had to address taxpayer efforts to exploit debt-financed investments in tax-favored assets, and it is typically the courts that have had to deal with such matters first.

[30] *See generally* George K. Yin, *Getting Serious About Corporate Tax Shelters: Taking a Lesson from History*, 54 SMU L. REV. 209 (2001) (proposing that history of tax shelter activity in U.S. during 1970s and 1980s and tax system's response offers insight into future judicial and legislative responses to tax avoidance).

[31] *See* Theodore S. Sims, *Income Taxation and Asset Valuation (II): The Value of Preferential Taxation*, 71 TAX L. REV. 53, 108-09 (2017) [hereinafter Sims, *Asset Valuation (II)*] (discussing taxation of state and local bonds as illustration of tax arbitrage); *see also* Daniel N. Shaviro, *The Story of* Knetsch*: Judicial Doctrines Combating Tax Avoidance*, *in* TAX STORIES 345, 347 (Paul L. Caron ed., 2d ed. 2009) (describing tax arbitrage as transaction "whereby you profit after-tax from both paying and receiving a dollar because the dollar you pay is treated more favorably than the dollar you receive").

[32] *See* I.R.C. § 103(a) (providing "gross income does not include interest on any State or local bond").

[33] Assume that an investor with a 40% marginal rate could borrow at a rate of 10% to finance tax-exempt bonds yielding 8%. If the interest used to carry the bonds is deductible, the deduction reduces the after-tax borrowing cost to 6%, thereby transforming an investment with a pre-tax loss into one yielding an after-tax profit. *See* Sims, *Asset Valuation (II)*, *supra* note 31, at 109 n.147 (2017) (comparing value of tax-exempt bonds to investors subject to various marginal rates).

[34] *See id.* (suggesting that limitations on deductibility of interest used to carry tax-exempt bonds "probably contribute[s] to incomplete capitalization" of tax benefit into asset price).

[35] The Revenue Act of 1916, the first modern federal income tax statute, categorically allowed for deductions of "[a]ll interest paid within the year on . . . indebtedness." *See* Revenue Act of 1916, Pub. L. No. 64-271, § 12(a), 39 Stat. 756, 769. However, one year later Congress added an exception for interest on indebtedness incurred for the purchase of tax-exempt obligations. *See* War Revenue Act, Pub. L. No. 65-50, § 1201(1), 40 Stat. 300, 330 (1917) (allowing deduction for interest on indebtedness "except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income").

In *Knetsch*, the tax-favored treatment was not an exemption like that accorded interest on municipal bonds; it was the fact that income from a deferred annuity is only taxed when the contract is surrendered.[36] The taxpayer acquired $4 million worth of thirty-year maturity deferred annuity bonds financed entirely with a nonrecourse note provided by the insurance company, secured by a pledge of the bonds.[37] Knetsch owed 3.5% interest on the $4 million nonrecourse debt ($140,000 per year), while his return on the deferred annuity bonds was only 2.5% ($100,000 per year).[38] Knetsch borrowed against the appreciation of his policy, and after three years he terminated the deal.[39] Simplifying the numbers somewhat, assume that Knetsch borrowed $100,000 in the first year against the appreciation of his policy and paid $140,000 of interest.[40] At the time of the transaction, interest paid to carry annuities was currently deductible, even though the income from the deferred annuity would not be taxed until the contract was surrendered.[41] Knetsch therefore received a current deduction of $140,000 that, assuming a marginal tax rate of 80%,[42] had a value of $112,000. The present value of the corresponding $80,000 deferred tax liability (assuming an 80% tax rate, an 8% discount rate, and a thirty-year maturity) would have been only $7,950.19. Under these assumptions, the first year of the transaction

[36] *See* I.R.C. § 72 (governing tax treatment of annuities).

[37] Knetsch v. United States, 364 U.S. 361, 362 (1960). The face amount of the bonds was $4,004,000, but Knetsch only paid $4,000 up front because the remaining $4,000,000 consisted of "nonrecourse annuity loan notes," which were secured only by the bonds themselves. *Id.*

[38] *Id.* at 362-63.

[39] *Id.* at 364.

[40] For reasons that the opinion does not make clear, Knetsch's interest deductions and borrowings in the years at issue were somewhat different. *See id.* at 365 ("Knetsch paid the insurance company $294,570 during the two taxable years involved and received $203,000 back in the form of 'loans.'"). For a similar simplification of the facts and analysis of the tax benefits of *Knetsch*, see Calvin H. Johnson, *Is an Interest Deduction Inevitable?*, 6 VA. TAX REV. 123, 133 (1986).

[41] *See* I.R.C. § 163(a) ("There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."). Section 264(a)(2), which currently disallows the deduction for interest used to carry annuities, did not apply to the years at issue in *Knetsch*. *See id.* § 264(a)(2) (providing that limitation "shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954").

[42] The court reports that $294,570 of interest deductions would have decreased Knetsch's taxes by $233,297.68, so his marginal tax rate appears to have been 79.2%. *See Knetsch*, 364 U.S. at 366.

would transform a $40,000 pre-tax loss into a present value, after-tax profit of $64,049.81.[43]

Despite the fact that the transaction would have made no sense in a no-tax world, the transaction in *Knetsch* served to reduce the taxpayer's tax liability through apparent compliance with the letter of the Code.[44] Nevertheless, the transaction did not survive judicial scrutiny. The Supreme Court disallowed the interest deductions on the grounds that the apparent "loan" did not create a genuine "indebtedness" because it was a "sham" involving "nothing of substance."[45] The Supreme Court arrived at that holding even though, by the time the case was decided, Congress had acted statutorily to disallow interest deductions on debt used to purchase annuity contracts, something known to the Supreme Court when it rendered its decision.[46]

As in *Knetsch*, *Goldstein* involved a tax-arbitrage transaction that, in the view of the Second Circuit, had no non-tax motive.[47] In 1958, the taxpayer won approximately $140,000 in the Irish Sweepstakes.[48] In that year, she borrowed

[43] **Table 1.** Impact of Tax in *Knetsch*.

	Pre-Tax	(Tax) Savings	Present Value of (Tax) Savings	After-Tax Present Value
Return on Investment	$100,000	($80,000)	($7,950.19)	$92,049.81
Interest on Debt	($140,000)	$112,000	$112,000	($28,000)
Net	($40,000)	$32,000	$104,049.81	$64,049.81

For a similar analysis, see Johnson, *supra* note 40, at 133. The $64,049.81 after-tax profit is the difference between the $92,049.81 after-tax return ($100,000 pre-tax return less $7,950.19, the present value of the deferred tax liability) and the $28,000 after-tax cost ($140,000 pre-tax interest cost less $112,000, the present value of the interest deduction). It is theoretically possible, although unlikely, that Knetsch could have generated a pre-tax profit on the transaction if interest rates decreased below 2.5%. At that point he could borrow at the lower rate and use the newly borrowed funds to pay off the higher interest loan. *See* Shaviro, *supra* note 31, at 361.

[44] *See* Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 408 (2010) ("It is hard to imagine a clearer case in which a taxpayer's behavior was influenced by the tax system than a transaction in which the taxpayer has little chance of a pre-tax profit.").

[45] *Knetsch*, 364 U.S. at 366.

[46] *See id.* at 367 (observing that "§ 264(a)(2) denies a deduction for amounts paid on indebtedness incurred to purchase or carry a single-premium annuity contract, but only as to contracts purchased after March 1, 1954").

[47] Goldstein v. Comm'r, 364 F.2d 734, 738 (2d Cir. 1966); *see also* Lederman, *supra* note 44, at 426 (noting that *Goldstein*, like *Knetsch*, "involved borrowing by an individual in a tax-arbitrage transaction").

[48] *See Goldstein*, 364 F.2d at 736.

$465,000 at 4% interest and used the proceeds to procure treasury bonds with stated coupon rates of 1.5%, then trading at a discount.[49] She then entered into a similar transaction with another bank, and each loan was secured by a pledge of the bonds.[50] In both instances, the taxpayer prepaid the interest on the loans.[51] If the interest was deductible, the deduction would have occurred in the year of her winnings, while some of the coupon interest and all of the gain on the sale or surrender of the bonds would not be taxed until later.[52] The net pre-tax loss on the transactions was anticipated to be $18,500.[53] However, the combination of the current interest deductions against the taxpayer's income from the sweepstakes and the deferred and possible preferential taxation of her pre-tax income rendered the transaction profitable on an after-tax basis.[54]

Goldstein differs from *Knetsch*, in which the Supreme Court disregarded as a "sham" what purported to be a loan from an insurance company, secured by annuity contracts issued by the very same company.[55] Even though the loans in *Goldstein* were also secured by the securities in which the loan proceeds were invested, the loans were made in the ordinary course by commercial banks, and the investments were in U.S. government bonds. The Second Circuit treated the loans as bona fide transactions and rejected the Tax Court's finding that the loan

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[49] *See id.* In late 1958, treasury bonds with three-year maturities yielded about 3.5%. *See* Bd. of Governors of the Fed. Rsrv. Sys., *3-Year Treasury Constant Maturity Rate (GS3)*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/GS3 [https://perma.cc/AT6K-F3F9] (last visited Sept. 1, 2021) (charting three-year maturity rate bond yields from 1953-2021). At that yield, bonds with three- and four-year maturities bearing coupon payments of 1.5% would trade at approximately the purchase price recited in the opinion.

[50] *Goldstein*, 364 F.2d at 736.

[51] *Id.* at 737.

[52] *See id.* at 738-39.

[53] *Id.* at 739. As it turned out, Goldstein's actual economic loss on the transaction was $25,091.01 because some of the bonds were sold for less than the price that her advisors originally anticipated.

[54] It is also conceivable that the gain on the surrender of the bonds at maturity (or on sale before maturity) may have qualified for preferential taxation as a long-term capital gain, which would have substantially enhanced the bonds' after-tax profitability. *See* Comm'r v. Caulkins, 144 F.2d 482, 484 (6th Cir. 1944) (treating gain accruing to holder of debt instrument as long-term capital gain despite acknowledging "that the increment in value of the certificate constitutes compensation for the use of the taxpayer's money, which the Supreme Court has recently stated to be interest . . . [which is otherwise] taxed in its entirety as ordinary income"); Theodore S. Sims, *Long-Term Debt, the Term Structure of Interest and the Case for Accrual Taxation*, 47 TAX. L. REV. 313, 319 (1992) ("Before 1954, the statute sometimes was interpreted as classifying gain accruing to the holder of a debt instrument as long-term capital gain, to be taxed at favorable rates at the time of surrender or sale." (footnote omitted)).

[55] *See* Knetsch v. United States, 364 U.S. 361, 366 (1960).

transactions were "shams" that created "no genuine indebtedness."[56] The Second Circuit concluded that the loans were "indistinguishable from any other legitimate loan transaction contracted for the purchase of Government securities."[57] It held instead that the loans failed to qualify for the Section 163(a) deduction because they had neither economic substance nor a business purpose.[58] While the Second Circuit acknowledged that Section 163(a) did not explicitly require that "deductible interest serve a business purpose," it found that limitation to be implied by the "Congressional policy of encouraging purposive activity to be financed through borrowing."[59] The Second Circuit concluded that Section 163(a) includes an implicit requirement of either economic substance or business purpose.[60] Because Goldstein's "sole purpose" in entering the transaction was to reduce her tax liability, she could not deduct the interest paid on the loans.[61]

Although *Franklin*, like both *Knetsch* and *Goldstein*, involved borrowing to buy a tax-favored asset, it is a more complex decision. For example, it involved a less obvious source of tax-favored treatment, namely the ability to take accelerated depreciation on real estate.[62] Moreover, it was more plainly abusive

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[56] *Goldstein*, 364 F.2d at 737 ("In our view, however, the facts of the two loan arrangements now before us fail in several significant respects to establish that these transactions were clearly shams.").

[57] *Id.* (quoting Goldstein v. Comm'r, 44 T.C. 284, 301 (1965) (Fay, J., dissenting)).

[58] *Id.* at 741-42 (finding that Section 163(a) "should not be construed to permit an interest deduction when it objectively appears that a taxpayer has borrowed funds in order to engage in a transaction that has no substance or purpose aside from the taxpayer's desire to obtain the tax benefit of an interest deduction: and a good example of such purposeless activity is the borrowing of funds at 4% in order to purchase property that returns less than 2% and holds out no prospect of appreciation sufficient to counter the unfavorable interest rate differential").

[59] *Id.* at 741.

[60] *See id.* ("[T]he deduction is proper if there is some substance to the loan arrangement beyond the taxpayer's desire to secure the deduction.").

[61] The Tax Court rejected Goldstein's son's testimony that Goldstein "intended a sophisticated, speculative, sortie into the market for government securities." *See id.* at 739. As with *Knetsch*, Congress eventually responded with a statutory provision dealing with problems like *Goldstein*, found in the investment interest limitation of Section 163(d). *See* I.R.C. § 163(d) ("In the case of a taxpayer other than a corporation, the amount allowed as a deduction under this chapter for investment interest for any taxable year shall not exceed the net investment income of the taxpayer for the taxable year.").

[62] In contrast to "economic depreciation," which mirrors the actual decline in value of an asset over time, "accelerated depreciation" allows for depreciation deductions "earlier in an asset's productive life than would have been the case if depreciation were truly 'economic.'" *See* Theodore S. Sims, *Debt, Accelerated Depreciation, and the Tale of a Teakettle: Tax Shelter Abuse Reconsidered*, 42 UCLA L. REV. 263, 280 n.58 (1994) [hereinafter Sims, *Tax Shelter Abuse Reconsidered*]. Accelerated depreciation results in deferral of income, and, at the extreme, expensing an asset (deducting the entire cost of an asset in the year it is acquired)

in that it involved aggressive valuation of the tax-favored asset.[63] In *Franklin*, the taxpayers, a group of doctors, formed a partnership that purchased a motel for $1,224,000 using a nonrecourse mortgage provided by the seller and then immediately leased the motel back to its former owner.[64] Like in *Knetsch*, the "loan" was made by the person from whom the asset was purchased, and the loan's repayment was secured by an interest in the same asset.[65] The partnership's basis in the motel for depreciation purposes included the amount of the nonrecourse debt.[66] The doctors made a $75,000 down payment on the purchase that they deducted as "prepaid interest."[67] Other than that payment, no cash ever exchanged hands.[68] The agreement provided that the rent due to the partnership would equal the interest payments on the seller-financed nonrecourse mortgage.[69] The previous owners went about their business as usual, the doctors had essentially no involvement with the motel, and the rent

is "equivalent to exempting the asset returns from tax." *See id.* at 281-82. This insight is generally attributed to E. Cary Brown. *See* E. Cary Brown, *Business-Income Taxation and Investment Incentives, in* INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN 300, 309-10 (1948).

[63] Estate of Franklin v. Comm'r, 544 F.2d 1045, 1046 n.1 (9th Cir. 1976) ("[T]he Commissioner recognized that the fundamental issue in these cases generally will be whether the property has been 'acquired' at an artificially high price, having little relation to its fair market value.").

[64] *See id.* at 1046-47. This Note also relies on the Tax Court's fuller recitation of the facts. *See* Estate of Franklin v. Comm'r, 64 T.C. 752, 756 (T.C. 1975) ("The sales agreement further provides . . . [that] there shall be no personal liability on the part of Buyer . . . and Seller will be limited to forfeiting out Buyer's interest in the real property, improvements and personal property if the payments are not made . . . ."). For an in-depth analysis of the tax shelter in *Franklin*, see Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 357. Sims explains that the essential element in debt-financed tax shelters such as *Franklin* is not, as conventionally assumed, the use of nonrecourse debt, but rather the treatment of purchase-money financing under the old installment sale rules of I.R.C. § 453. *See id.* at 345.

[65] *See* Knetsch v. United States, 364 U.S. 361, 362 (1960).

[66] *See* Crane v. Comm'r, 331 U.S. 1, 13-14 (1947) (holding that amount realized on disposition of property encumbered by nonrecourse debt includes outstanding balance of debt, thereby implying that nonrecourse debt used to finance acquisition of property is included in owner's depreciable basis); *see also* Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 320 (explaining that *Crane*'s holding implied "that the owner's adjusted basis for depreciation included that portion of the cost of the property financed with the nonrecourse debt").

[67] *Franklin*, 544 F.2d at 1047.

[68] *Franklin*, 64 T.C. at 754, 759 ("No payments have been actually made under either the sales agreement or the lease. Instead, entries have been made by both parties in books of account which are reconciled annually. Up to the date of the trial, no money other than [the partnership's] original $75,000 payment to the Romneys had changed hands between the parties.").

[69] *See id.* at 757.

and interest payments canceled each other out.[70] The lender-lessee was responsible for all utilities, taxes, and maintenance costs.[71] Apart from the $75,000 "down payment," the transaction in *Franklin* accomplished little. From a tax perspective, however, the transaction was highly advantageous to the physician-partners.[72] The partnership claimed depreciation deductions on its basis in the motel, which passed through to the doctors and was available to offset their unrelated salary income.[73] If the partners defaulted on their payment obligations and the seller foreclosed, his only recourse would be to retake the property because the partners had no recourse liability.[74] In that event, the partnership would have cancellation of indebtedness income, but that income would not exceed the depreciation deductions that were already taken plus any deducted but unpaid interest on the mortgage.[75]

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[70] *See id.* ("These rental payments approximate the payments due for the same period under the sales agreement after the buyer is credited with the $75,000 described as prepaid interest in the sales agreement.").

[71] *See id.* ("[T]he Romneys are to pay all utilities and real property taxes and other taxes, assessments, rents, charges, and levies . . . . [and expenses] to keep and maintain the premises in good repair.").

[72] Sims raises the illuminating question of whether such transactions were correspondingly disadvantageous to the seller. *See* Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 353. If the parties overvalued the property in order to inflate the buyer's basis, this would seem to trigger a correspondingly inflated gain to the seller. However, as Sims observes, under Section 453 the seller is only taxed in the year of sale on the amount of gain attributable to any down payment actually made on the note. *See id.* at 354. Thus, the combination of *Crane*'s basis rule and Section 453 results in an inconsistent treatment of the buyer and the seller; the buyer may include the amount of purchase-money debt in his depreciable basis in the year of sale, but the seller will not be taxed on the gain attributable to the unpaid portion of the debt until—and unless—the debt is actually paid. *See id.* Congress addressed this problem by enacting Section 453A, which requires most installment sellers to pay interest on the deferred tax liability caused by Section 453 nonrecognition. *See id.* at 366 (explaining that Section 453A "would have imposed prohibitive additional costs on the promoter" of purchase-money depreciation shelters).

[73] *See Franklin*, 64 T.C. at 760 ("Decedent and his wife reported $22,244 and $16,583 as their distributive share of the losses of [the partnership] for 1968 and 1969, respectively.").

[74] *See id.* at 766 (reporting that mortgage was nonrecourse).

[75] *See* I.R.C. § 108(e)(2) (providing that "[n]o income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction"); *see also* Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 348 ("[T]he amount of [cancellation of indebtedness] will *never* exceed the deductions attributable to the purchase-money note that the investor was previously allowed."). For an analysis of the various "end-game" scenarios facing investors in the debt-financed deprecation shelters of the 1970s, see Martin D. Ginsberg, *The Leaky Tax Shelter*, 53 TAXES 719, 724-39 (1975) (describing scenarios including refinancing burdensome debt, mortgagee in possession, purchasing the mortgage, new rich partner, exchange of property, gift of partnership interest, mortgage in excess of value, deed in lieu of foreclosure, abandonment, incorporation, insolvency and bankruptcy, and death).

The Tax Court disallowed the partners' distributive share of the depreciation deductions on the grounds that the transaction was "too indefinite and tentative to create 'indebtedness.'"[76] Note that the court did not treat the transaction as a tax evasion scheme. Had the court found that the indebtedness was genuine, the transaction would have successfully imparted tax benefits on the taxpayers because governing Code provisions allowed the taxpayers to do what they did.[77]

Finally, *Helvering v. Gregory* plays a central role in the Sixth Circuit's decisions. The taxpayer, Mrs. Gregory, was the sole shareholder of United Mortgage Corporation ("United"), which held appreciated shares in Monitor Securities Corporation ("Monitor").[78] Under the rules at the time, dividend income was taxable at the same rate as ordinary income.[79] Accordingly, if United had sold its shares and distributed the proceeds to Mrs. Gregory as a dividend, she would have been taxed on the fair market value of the shares as ordinary income.[80] However, the reorganization rules applicable at the time seemed to allow another, more tax-efficient, transaction. Mrs. Gregory created the Averill Corporation ("Averill") and entered into an agreement with United whereby United would transfer the Monitor shares to Averill and Averill would issue all of its own shares to Mrs. Gregory.[81] Her basis in the Averill shares was determined by apportioning to them part of her basis in her United shares.[82] She

[76] *See Franklin*, 64 T.C. at 762. To use an expression suggested to me by Professor Sims, the taxpayers were "renting depreciation." The Ninth Circuit agreed that the transaction did not create a genuine indebtedness, but it identified the nonrecourse nature of the debt and the inflated purchase price as the key facts supporting its holding. *See* Estate of Franklin v. Comm'r, 544 F.2d 1045, 1047, 1049 (9th Cir. 1976) ("For debt to exist, the purchaser, in the absence of personal liability, must confront a situation in which it is presently reasonable from an economic point of view for him to make a capital investment in the amount of the unpaid purchase price. . . . [The taxpayers] during the taxable years in question, confronted no such situation.").

[77] One qualification is necessary here. It is possible that the parties fraudulently over-valued the property to achieve an inflated depreciable basis. Because of the inconsistent treatment of buyers and sellers allowed by the combination of *Crane* and Section 453, buyers and sellers "*shared* an interest in inflating the price of a depreciable asset." Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 345. If that were the case here, then the transaction would involve elements of tax evasion rather than just tax avoidance.

[78] Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

[79] *Id.*

[80] *Id.* Similarly, if her company simply made an in-kind distribution of the shares themselves, the fair market value of the shares would be treated as a dividend. However, there would have been no corporate-level tax upon their distribution because the *General Utilities* doctrine allowing for no corporate-level tax upon the disposition by a corporation of appreciated property to its shareholders had not yet been repealed by statute. *See* Gen. Utils. & Operating Co. v. Helvering, 296 U.S. 200, 206 (1935), *abrogated by* I.R.C. § 311(b).

[81] *See Gregory*, 69 F.2d at 810.

[82] *See* Gregory v. Comm'r, 27 B.T.A. 223, 226 (B.T.A. 1932).

likewise took a tacked holding period in the Averill shares.[83] A few days later, Mrs. Gregory liquidated Averill, at which point Averill distributed the Monitor shares to her in a liquidating distribution.[84]

Mrs. Gregory took the position that the transaction was a "reorganization" under Section 112(i)(1)(B) of the Revenue Act of 1928[85] and that the distribution of the Monitor shares to United qualified for nonrecognition because the distribution was made "in pursuance of a plan of reorganization."[86] Under the then-prevailing *General Utilities* doctrine, the distribution of the appreciated shares from Averill to Mrs. Gregory did not trigger gain at the corporate level; thus, the only taxable event was the liquidating distribution.[87] Mrs. Gregory reported long-term capital gain upon the liquidating distribution determined by subtracting her basis in the Averill shares from their fair market value.[88]

The Commissioner took the position that Averill Corporation "was without substance and must therefore be disregarded."[89] He reasoned that the corporation was "a transparent fiction" because it was formed for the sole purpose of facilitating a conversion of dividend income into capital gain, and it existed for only a matter of days.[90] The Commissioner recharacterized the transaction and assessed a tax "as upon a dividend consisting of the amount received upon the sale of the Monitor shares as if such amount had been distributed by the United corporation directly to her."[91] The United States Board of Tax Appeals ruled in favor of the taxpayer on the grounds that the transaction satisfied the requirements of the reorganization statute: "A statute so meticulously drafted must be interpreted as a literal expression of the taxing policy, and leaves only the small interstices for judicial consideration."[92] On appeal to the Second Circuit, Judge Learned Hand reversed, but he rejected the Commissioner's reasoning.[93] Judge Hand reasoned that corporations are legal entities whose

[83] *See Gregory*, 69 F.2d at 810.

[84] *See id.*

[85] *See* Revenue Act of 1928, Pub. L. No. 70-562, § 112(i)(1)(B), 45 Stat. 791, 818 (defining "reorganization" for purpose of corporate reorganization nonrecognition rules).

[86] *Gregory*, 69 F.2d at 810.

[87] *See* Gen. Utils. & Operating Co. v. Helvering, 296 U.S. 200, 206 (1935), *abrogated by* I.R.C. § 311(b) (allowing for no corporate-level tax upon distribution by corporation of appreciated property to shareholders).

[88] *See Gregory*, 27 B.T.A. at 224 ("In her return, she treated these several transactions as governed by the several reorganization provisions of the statute, and returned as capital net gain derived from the sale price of $133,333.33 the amount of $76,007.88 upon an apportioned cost basis of $57,325.45.").

[89] *Id.*

[90] *Id.* at 225.

[91] *Id.* at 224.

[92] *Id.* at 225.

[93] *See* Gregory v. Helvering, 69 F.2d 809, 811 (2d Cir. 1934).

existence the court could not ignore.[94] Nevertheless, the Second Circuit upheld the Commissioner's notice of deficiency on the grounds that the transaction did not satisfy the implicit requirement of the reorganization statute that the transaction must have a business purpose.[95]

The argument for taxpayer reliance in *Gregory* was particularly strong. The Code at the time not only allowed for nonrecognition incident to reorganizations but also specifically defined the term "reorganization," and the taxpayer qualified under the express requirements.[96] As discussed in Part II, the perception that judicial anti-abuse doctrines undermine taxpayer reliance in such situations has led textualist courts to allow tax benefits even in cases where they recognize that the result reflects questionable policy and is arguably inconsistent with the structure of the tax laws.[97]

B. *Legislative Responses*

Critics of judicial anti-abuse doctrines contend that the proper response to abusive tax avoidance is congressional, rather than judicial, action.[98] Accordingly, this Section briefly considers three congressional responses to the tax avoidance schemes considered above: provisions governing the deductibility

[94] *See id*. (finding that Averill "had a juristic personality, whatever the purpose of its organization; the transfer passed title of the Monitor shares and the taxpayer became a shareholder in [Averill]. All these steps were real").

[95] *See id.* The Second Circuit did not need to recharacterize the transaction as a dividend of the Monitor shares from United to Mrs. Gregory because, as a consequence of the failed reorganization, the distribution of Averill's shares to Mrs. Gregory did not qualify for nonrecognition. Because the Monitor shares were Averill's only asset, the value of the Averill shares was equivalent to the value of the Monitor shares. Accordingly, while Judge Hand disagreed with the Commissioner's recharacterization of the transaction, he reached the same result. *See id.* ("[I]t is plain that the taxpayer may not avoid her just taxes because the reasoning of the assessing officials has not been entirely our own."). It is an interesting question whether Judge Hand would have recharacterized the transaction as a distribution of the Monitor shares from United to Gregory had the outcome of the failed reorganization not been the same as a dividend of the Monitor shares.

[96] *See* Revenue Act of 1928, Pub. L. No. 70-562, § 112(i), 45 Stat. 791, 818 (defining "reorganization" as, among other things, "a transfer by a corporation of all or a part of its assets to another corporation" such that immediately after "the transferor or its stockholders or both are in control of the corporation to which the assets are transferred").

[97] *See, e.g.*, Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 790 (6th Cir. 2017) (allowing claimed tax benefits despite recognizing that result was perhaps unintended by relevant provisions).

[98] *See* Isenbergh, *supra* note 4, at 879-80 (arguing that solution to tax shelters is "to change the law" rather than use judicial anti-abuse doctrines).

of interest,[99] the at-risk rules of Section 465,[100] and the passive loss rules of Section 469.[101] This Section suggests that, while congressional action is a necessary response to tax avoidance schemes, such action is an inherently incomplete, and sometimes overbroad, solution to the problem. Moreover, the codification of the economic substance doctrine, discussed in Section I.C, complicates the distinction between congressional and judicial actions because Congress has statutorily instructed judges to use at least one anti-abuse doctrine.[102]

Congress has repeatedly responded to tax-arbitrage schemes that used debt to finance tax-favored investments by disallowing the associated interest deductions. Thus, Section 265(a)(2) denies deductions for "interest on indebtedness incurred or continued to purchase or carry" tax-exempt bonds.[103] Similarly, Congress responded to *Knetsch*-style tax arbitrage with Section 264, mirroring Section 265, which denies deductions for interest on indebtedness "incurred or continued to purchase or carry" various tax-favored insurance and annuity policies.[104] More generally, Section 163(d) prevents *Goldstein*-like transactions by limiting the amount deductible on investment interest to the taxpayer's net investment income for a given taxable year.[105]

Congress responded to depreciation shelters with the at-risk rules of Section 465, first adopted in 1976 and extended to real estate investments in 1986.[106] Section 465 limits deductions with respect to "activities" to the extent that the taxpayer is "at-risk" with respect to the activity.[107] At-risk amounts include cash

[99] *See* Revenue Act of 1918, Pub. L. No. 65-254, § 234(a)(2), 40 Stat. 1057, 1077 (codified as amended at I.R.C. § 265(a)(2)) (denying deduction of interest on obligations used to purchase tax-exempt investments); Internal Revenue Code of 1954, Pub. L. No. 83-591, § 264(a)(2), 68A Stat. 3, 77 (codified as amended at I.R.C. § 264(a)(2)) (denying deduction of interest on obligations used to purchase annuity); I.R.C. § 163(d) (imposing limitation on deductibility of investment interest).

[100] *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 204, 90 Stat. 1520, 1531-33 (codified as amended at I.R.C. § 465) (limiting depreciation deductions to amount at-risk for certain investments). Congress extended the rule to cover real estate investments in 1986. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 503, 100 Stat. 2085, 2243-44 (codified as amended I.R.C. § 465) (extending at-risk limitations to investments in real property).

[101] *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 100 Stat. 2085, 2233-41 (codified as amended at I.R.C. § 469) (limiting deductibility of losses from passive activities to extent of gains from passive activities).

[102] *See infra* Section I.C (discussing codification of economic substance doctrine).

[103] I.R.C. § 265(a)(2).

[104] *Id.* § 264(a)(2).

[105] *See id.* § 163(d). Net investment income is defined generally as investment income minus investment expenses other than interest but excludes income (including "qualified" corporate dividends") taxable at long-term capital gains rates only to the extent that the taxpayer relinquishes eligibility for the preferential rate. *Id.* § 163(d)(4).

[106] *See supra* note 100 and accompanying text.

[107] I.R.C. § 465(a).

and recourse debt but do not include nonrecourse debt.[108] The at-risk rules address depreciation shelters by attacking the nonrecourse financing generally employed in such shelters. However, scholars have questioned both the conceptual and practical soundness of the at-risk rules.[109] In any event, tax shelters continued to flourish after adoption of Section 465.[110]

In 1986, Congress took another shot at the problem with the passive loss rules of Section 469.[111] Section 469 provides that losses from passive activities may only be deducted to the extent of passive activity gains.[112] A passive activity is an activity on an investment that involves a trade or business and in which the taxpayer does not materially participate.[113] Section 469 prevents taxpayers from participating as passive investors in schemes designed to generate tax losses that might be used to offset income from other sources. Section 469 thus proves particularly effective at curbing the kind of debt-financed depreciation shelter utilized in *Franklin*.[114] However, scholars contend that Section 469 is overly broad because it deters not only investment in depreciation-based tax shelters but also legitimate investments in depreciable assets.[115]

There are at least three shortcomings of legislative responses to tax avoidance. First, legislative fixes add complexity to the Code, which raises the compliance

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[108] *Id.* § 465(b).

[109] *See* Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 324-25 ("[I]n focusing *generally* on nonrecourse debt, Section 465 was not merely conceptually unsound, but practically wide of the mark."). Conceptually, Sims argues that the differences between recourse and nonrecourse debt are not essential to depreciation tax shelter schemes. *See id.* at 324 ("In short, as long as interest properly accrues to, and some form of [cancellation of indebtedness] rule applies to, a nonrecourse loan, it is indistinguishable in principle from a personal recourse loan. Ex ante, the differences are of degree. Ex post, the nonrecourse borrower will be taxed in the same, conceptually accurate fashion as any other borrower, *regardless* of whether the loan is actually repaid."). Practically, because nonrecourse debt is not essential to depreciation tax shelters, shelter promoters can work around the at-risk rules. *See id.* at 325.

[110] *See id.* (noting that shelters "became *more* of a problem—both more prevalent and more aggressive—even after the scope of Section 465 was expanded in 1978").

[111] *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 100 Stat. 2085, 2233-41 (codified as amended at I.R.C. § 469) (limiting deductibility of losses from passive activities to extent of gains from passive activities).

[112] *See* I.R.C. § 469(a).

[113] *See id.* § 469(c).

[114] *See* Estate of Franklin v. Comm'r, 64 T.C. 752, 753-55 (T.C. 1975) (describing physician partners' investment in motel in terms that would qualify as "passive activity" under Section 469).

[115] *See* Sims, *Tax Shelter Abuse Reconsidered*, *supra* note 62, at 331 (contending that Section 469 was overly broad: "in enacting section 469, Congress effectively shut down *all* debt-financed investments in depreciable assets by investors subject to the rules, without ever having specified in any convincing way just why it is that *all* such investments *ought* to be curtailed").

cost of investing or operating a business.[116] Second, legislative responses occur only after the IRS has discovered the issue. Bankman analogizes the legislative response to tax avoidance to the selective removal of land mines: "It is prohibitive or unfeasible to remove all the mines buried in a field, and removing most of them is not enough. All it takes is a few loopholes to siphon off most tax revenues."[117] Third, legislative responses are not self-executing, and taxpayers and their advisors significantly outnumber the IRS.[118]

C. *Judicial Anti-Abuse Doctrines*

During the nineteenth century, there existed a presumption that tax laws were to be strictly construed against the government.[119] Over the last hundred years, this presumption has not merely fallen away. It has been replaced by a collection of judicial anti-abuse doctrines that might be understood as creating the opposite presumption.[120] According to Boris Bittker and Lawrence Lokken, these doctrines "are so pervasive that they resemble a preamble to the Code, describing the framework within which all statutory provisions are to function."[121] Isenbergh identifies *Gregory* as "perhaps the case most widely

[116] Bankman, *The Tax Shelter Battle*, *supra* note 3, at 33 ("As attacks on shelters get stronger, the tax system becomes more complex or more vague, and administrative costs go up.").

[117] *Id.* at 20.

[118] In *Summa Holdings*, the Sixth Circuit acknowledged the role of creative tax planning but nevertheless felt powerless to address the issue without further legislative action. *See* Summa Holdings v. Comm'r, 848 F.3d 779,781 (6th Cir. 2017) ("The Benenson family, to its good fortune, had the time and patience (and money) to understand how a complex set of tax provisions could lower its taxes. Tax attorneys advised the family to use a congressionally innovated corporation . . . to transfer money from their family-owned company to their sons' Roth Individual Retirement Accounts."). The First Circuit has been even more explicit about the need for congressional rather than judicial action. *See* Benenson v. Comm'r, 887 F.3d 511, 523 (1st Cir. 2018) ("Some may call the Benensons' transaction clever. Others may call it unseemly. . . . [T]o the extent we accept 'the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's.'" (quoting Fabreeka Prods. Co. v. Comm'r, 294 F.2d 876, 879 (1st Cir. 1961))).

[119] BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3.

[120] *See* Choi, *supra* note 5, at 195 (arguing that judicial anti-abuse doctrines "should be considered substantive canons of construction" which establish a rebuttable presumption that transactions entered into purely for tax avoidance purposes are invalid unless text or legislative history suggests otherwise).

[121] BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3. Isenbergh similarly characterizes judicial anti-abuse doctrines as an extra-statutory body of regulations coexisting alongside the text of the Code. *See* Isenbergh, *supra* note 4, at 863 ("From a clean slate, it might be thought sufficient for the taxpayer to show that a transaction, fairly characterized, is encompassed by the statute and that the statute, by its terms, yields the desired result. Things are not so simple,

invoked as a source of first principles on form and substance."[122] While the holding in *Gregory* was simply that the transaction did not qualify as a reorganization, the broad language in the Second Circuit[123] and Supreme Court[124] opinions proved a seedbed for the various judicial anti-abuse doctrines that have subsequently arisen or been developed: the substance-over-form doctrine, the business purpose doctrine, the step transaction doctrine, the sham transaction doctrine, and the economic substance test.[125]

Bittker notes that while the case law often conflates these doctrines, one may discern among the doctrines subtle differences as well as substantial similarities.[126] The substance-over-form doctrine disregards the way in which the taxpayer has structured the transaction and looks instead to the transaction's "true nature," i.e., its "substance."[127] The business purpose doctrine asks whether a transaction has "purpose, substance, or utility apart from [its] anticipated tax consequences."[128] The step transaction doctrine analyzes "the interrelated steps of an integrated transaction . . . as a whole rather than treated separately."[129] The sham transaction doctrine asks whether the transaction as structured should be respected in the manner the taxpayer claims or rather should be ignored.[130]

though, and much has been made to turn on the nature of the taxpayer's desire. There has developed a welter of rules and extrastatutory standards that impose particular scrutiny on transactions with results unfavorable to the Treasury.").

[122] *See id.* at 866.

[123] *See* Helvering v. Gregory, 69 F.2d 809, 811 (2d Cir. 1934) ("[T]he underlying presupposition [of the reorganization statute] is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand . . . . To dodge the shareholders' taxes is not one of the transactions contemplated as corporate 'reorganizations.' . . . [S]o viewed [the steps of the transaction] were a sham . . . .").

[124] *See* Gregory v. Helvering, 293 U.S. 465, 469-70 (1935) ("Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. No doubt, a new and valid corporation was created. But that corporation was nothing more than a contrivance . . . . To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.").

[125] *See infra* Section II.B.3 (discussing judicial anti-abuse doctrines in *Hawk*).

[126] BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3.

[127] *Id.* at ¶ 4.3.3.

[128] *Id.* at ¶ 4.3.4 (quoting Goldstein v. Comm'r, 364 F.2d 734, 740 (2d Cir. 1966)).

[129] *Id.* at ¶ 4.3.5.

[130] *See* JOINT COMM. ON TAX'N, 106TH CONG., STUDY OF PRESENT-LAW PENALTY AND INTEREST PROVISIONS AS REQUIRED BY SECTION 3801 OF THE INTERNAL REVENUE SERVICE

The economic substance doctrine, originating from common law,[131] has since been codified in Section 7701(o).[132] That section provides that "[i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if" it satisfies two requirements.[133] First, "the transaction [must] change[] in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position."[134] Second, "the taxpayer [must] ha[ve] a substantial purpose (apart from Federal income tax effects) for entering into such transaction."[135] That codification "removed the argument that the doctrine is inconsistent with legislative intent," or contrary to textualist forms of statutory interpretation.[136] However, the codification left at least one crucial question unanswered: when is the economic substance doctrine "relevant"?[137] The Code and IRS regulations leave that determination to the courts.[138]

RESTRUCTURING AND REFORM ACT OF 1998 (INCLUDING PROVISIONS RELATING TO CORPORATE TAX SHELTERS) 187 (Comm. Print 1999) ("Sham transactions are those in which the economic activity that is purported to give rise to the desired tax benefits does not actually occur."); *see also* Alvin C. Warren, Jr., *The Requirement of Economic Profit in Tax Motivated Transactions*, 59 TAXES 985, 985 (1981) (describing transactions attacked as "'shams' because the economic activity that supposedly gave rise to the desired tax consequences did not actually occur").

[131] Unlike this Note, Bittker and Lokken treat the economic substance and sham transaction doctrines as essentially identical and both as representing a coalescence of the substance-over-form and business purpose doctrines. *See* BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3. According to Bittker and Lokken, the economic substance doctrine in its common law form is a two-part test: "a transaction will be characterized as a sham if 'it is not motivated by any economic purpose outside of tax considerations' (the business purpose test), and if it 'is without economic substance because no real potential for profit exists' (the economic substance test)." *Id.* at ¶ 4.3.4A (quoting IES Indus., Inc. v. United States, 253 F.3d 350, 353 (8th Cir. 2001)).

[132] I.R.C. § 7701(o). *See generally* Jonathan M. Prokup, *Codification of the Economic-Substance Doctrine—A Legislative Paradox*, 89 TAXES 17 (2011) (critiquing Congress' codification of economic substance doctrine in Section 7701(o)).

[133] *Id.* § 7701(o).

[134] *Id.* § 7701(o)(1)(A).

[135] *Id.* § 7701(o)(1)(B).

[136] JOSEPH BANKMAN, DANIEL N. SHAVIRO, KIRK J. STARK & EDWARD D. KLEINBARD, *Tax Shelters and Tax Planning*, *in* FEDERAL INCOME TAXATION 515 (18th ed. 2019).

[137] Prior to the codification of the economic substance doctrine, Warren proposed that the doctrine—which he defined as "the requirement that tax motivated transactions must involve a pretax economic profit to be given effect"—should not apply to "provisions specifically enacted by Congress as incentives." Warren, *supra* note 130, at 985. A possible interpretation of the economic substance's relevancy determination relies on whether the provision at issue was enacted as an incentive provision.

[138] *See* Prokup, *supra* note 132, at 17 ("[T]he codified doctrine provides no guidance about when or how it is properly invoked or applied."); *see also* Wade Sutton, Byron Taylor &

II. THE TEXTUALIST'S DILEMMA: LITERALISM AND LOOPHOLES

A. *The Tension Between Textualism and Judicial Anti-Abuse Doctrines*

At bottom, textualism is a theory of statutory interpretation that restricts its search for the meaning of a statute to the confines of the statutory text.[139] While textualists understand that meaning is always a function of context, they insist that the relevant context for statutory interpretation must be intratextual.[140] For textualists, congressional intent is relevant to statutory interpretation, but only insofar as the text of the statute embodies and manifests that intent: legislatures have no "collective intent" beyond that incorporated into the statute itself.[141]

In *Summa Holdings*, the Sixth Circuit offered textualism as a bulwark against its perception of the IRS's overreaching use of judicial anti-abuse doctrines. The Sixth Circuit went so far as to take issue with the expression "substance-over-form" itself.[142] According to the Sixth Circuit, if the "form" of the law is the letter while the "substance" is its content, then textualism stands for the proposition that "'[f]orm' *is* 'substance' when it comes to law."[143] In the Sixth Circuit's view, judicial anti-abuse doctrines hamstring taxpayer efforts to order their affairs in accordance with the plain meaning of the tax laws: "How odd, then," the Sixth Circuit remarked, "to permit the tax collector to reverse the

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Lawrence Reger, Summa Holdings*: The Relevance of Congressional Intent in Applying the Economic Substance Doctrine*, 95 TAXES 27, 37 (2017) (contending that real issue in *Summa Holdings* is whether economic substance doctrine is "relevant" to transaction at issue).

139 *See* Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1184 (1989) (describing textualism as "method of textual exegesis" that "adhere[s] closely to the plain meaning of a text"); William N. Eskridge, Jr., *Textualism, the Unknown Ideal?*, 96 MICH. L. REV. 1509, 1511 (1998) ("Scalia's main point is that a statutory text's apparent plain meaning must be the alpha and the omega in a judge's interpretation of the statute."); *see also* Allen D. Madison, *The Tension Between Textualism and Substance-Over-Form Doctrines in Tax Law*, 43 SANTA CLARA L. REV. 699, 702 (2003) ("[A] textualist searches for the meaning of the words used in a statute.").

140 *See* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 29-30 (2018) ("My view that the objective indication of the words, rather than the intent of the legislature, is what constitutes the law leads me, of course, to the conclusion that legislative history should not be used as an authoritative indication of a statute's meaning."); Madison, *supra* note 139, at 712 (noting that textualists tend to eschew "the legislative history of a statute").

141 *See* Green v. Bock Laundry Mach. Co., 490 U.S. 504, 528 (1989) (Scalia, J., concurring) (maintaining that "meaning of terms on the statute books ought to be determined" according to original usage and compatibility with related provisions—"a compatibility which, by a benign fiction, we assume Congress always has in mind"); *see also* Madison, *supra* note 139, at 703 ("[T]extualists point out that legislatures have no collective intent.").

142 Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 782 (6th Cir. 2017) ("Each word of the 'substance-over-form doctrine,' at least as the Commissioner has used it here, should give pause.").

143 *Id.*

sequence—to allow *him* to determine the substance of a law and to make it govern 'over' the written form of the law—and to call it a 'doctrine' no less."[144] To make matters worse, in the view of the Sixth Circuit, not only do judicial anti-abuse doctrines threaten to undermine taxpayer reliance on the law but the doctrines themselves also lack the precision and predictability valued by textualists.[145]

Accordingly, as one commentator observed, "[t]o say that tension exists between textualism and substance-over-form doctrines may state the obvious."[146] Nevertheless, the solution to tax avoidance advanced by some textualists—better tax laws—is at best a partial solution, as "loopholes" will always persist. The opportunity for taxpayer abuse is surely unavoidable given the voluminous nature of tax law,[147] the inevitable ambiguity of statutes,[148] the often glacial pace of legislative fixes,[149] and especially the ingenuity of tax planners.[150] Unless textualists are willing to admit that courts should always uphold the most taxpayer-friendly view of transactions, textualists need tools for

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[144] *Id.*

[145] BITTKER & LOKKEN, *supra* note 1, at ¶ 4.3 (noting that judicial anti-abuse doctrines "are more successful in establishing attitudes and moods than in supplying crisp answers to specific questions").

[146] Madison, *supra* note 139, at 738-39.

[147] *See* CHRISTOPHER H. HANNA, TAX POLICY IN A NUTSHELL 46 (2018) ("The tax code is over one million words with another three million words in tax regulations."). For a more qualitative take on the impossibility of closing every loophole in the Code, consider Judge Learned Hand's commentary on the complexity of tax law:

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness.

Learned Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947).

[148] Bankman, *The Tax Shelter Battle*, *supra* note 3, at 14 ("While reform would undoubtedly reduce the severity of the shelter problem, it is important to keep in mind that tax shelters will exist even under a nearly ideal tax system. Individual statutes and regulations will never be drafted perfectly, to reflect the desires of the drafters in all relevant situations. So long as rules are vulnerable to differing interpretations, advisers can be expected to come up with interpretations that reduce taxes and to sell those interpretations to their clients.").

[149] *Cf.* Grant Gilmore, *On Statutory Obsolescence*, 39 U. COLO. L. REV. 461, 477 (arguing that by the time Congress enacts statutes, the problems they correct have generally already been resolved by courts).

[150] *See* Sims & Sunley, *supra* note 4, at 454.

addressing ambiguity and abuse. Judicial anti-abuse doctrines, I suggest, offer the requisite tools. But as long as textualists view such doctrines as fundamentally at odds with legitimate methods of statutory interpretation, they will remain stuck at the impasse of loopholes and literalism.[151]

B. *The Sixth Circuit's Tax Avoidance Jurisprudence*

1. *Summa Holdings*: Transactional Background

To appreciate what the taxpayers did in *Summa Holdings*, and how the Sixth Circuit responded, one must situate the transaction in statutory perspective, something the Sixth Circuit was careful to do. The case involved the taxpayer-contrived interaction—one is tempted to say manipulation—of two parts of the Code that have little to do with one another: the DISC and Roth IRA provisions.[152] To stimulate export sales, Congress created DISCs,[153] corporate vehicles that sell exports for related parties in exchange for commission payments that are exempt, up to $10,000,000, from corporate-level tax.[154] DISCs incentivize export sales by providing two tax benefits: (1) exemption of income from corporate-level tax on its commissions, and (2) deferral of shareholder-level tax on undistributed DISC earnings. As the Sixth Circuit observed, when the DISC's shareholders also own the export company, the effect is "to transfer export revenue to the export company's shareholders as a dividend without taxing it first as corporate income."[155] And DISCs offer the benefit of deferral of shareholder-level income by allowing the DISC to accumulate earnings indefinitely, subject only to the provision that DISC shareholders must pay

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[151] *See infra* Section III.A (arguing for the compatibility of textualism and judicial anti-abuse doctrines).

[152] *See generally* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779 (6th Cir. 2017) (examining whether payments were DISC payments or dividends to shareholders accompanied by Roth IRA contributions).

[153] *See* Revenue Act of 1971, Pub. L. No. 92-178, § 501, 85 Stat. 497, 535 (codified as amended at I.R.C. § 991) (enacting domestic international sales corporation tax regime). After the DISC regime was enacted, U.S. trading partners argued that DISCs constituted an illegal export subsidy under the General Agreement on Tariffs and Trade ("GATT"). *See* John H. Jackson, *The Jurisprudence of International Trade: The DISC Case in GATT*, 72 AM. J. INT'L L. 747, 764-65 (1978) (dissecting the issue of DISC tax practice constituting a subsidy as defined by Article XVI paragraph 1 or 4). While the United States never officially conceded that DISCs violated GATT, the Reagan Administration transformed the DISC regime to comply with GATT by instituting interest-charging rules for DISCs and creating a different kind of export subsidizing entity, the foreign sales corporation. *See* The Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 802, 98 Stat. 494, 997-98 (codified as amended at I.R.C. § 995) (instituting foreign sales corporation regime and providing that DISC shareholders must pay interest equal to treasury bill rate on deferred tax liability).

[154] I.R.C. § 995(b)(1)(E) (providing $10,000,000 limitation on exemption).

[155] *Summa Holdings*, 848 F.3d at 782.

annual interest on their deferred tax liability.[156] In 1989, Congress modified the DISC regime to provide, among other things, that distributions of DISC income to tax-exempt entities constitute income from an unrelated trade or business,[157] taxable to the otherwise exempt entity at ordinary corporate rates, under the unrelated trade or business income tax ("UBIT").[158]

Congress created Roth IRAs as part of the larger statutory regime governing "qualified" retirement plans, intended to stimulate individual savings for retirement.[159] With a traditional IRA, contributions are made with pre-tax income, and distributions (including all accumulated earnings in the account) are taxed as ordinary income. A Roth IRA, in contrast, is funded with after-tax income; like other qualified vehicles (including traditional IRAs) it is exempt from tax on its investment earnings, but all withdrawals, including investment income accumulated in the account, are untaxed.[160] And like other qualified savings vehicles, Roth IRAs are subject to annual contribution limits.[161] It is evidently contemplated that Roth IRAs would primarily make conventional portfolio investments, as evidenced by the fact that Roth IRAs, as otherwise exempt organizations, are subject to UBIT when they participate in an active trade or business.[162]

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[156] I.R.C. § 995(f).

[157] *See id.* § 995(g) (providing that any distributions from DISC to tax-exempt shareholder "shall be treated as derived from the conduct of an unrelated trade or business").

[158] *See id.* § 408(e)(1) (subjecting IRAs to UBIT as imposed in Section 511); *id.* § 511(a)(1) (imposing tax on UBIT at corporate rates).

[159] *See id.* § 408A.

[160] *See id.* § 408A(c) (providing detailed explanations of how contributions are treated). By funding the account in after-tax dollars and exempting all withdrawals, Roth IRAs function as a prepaid consumption or "cash flow" tax rather than as an income tax. Exactly how much investment income is exempt under a consumption tax is a matter of some dispute. *See* Theodore S. Sims, *Capital Income, Risky Investments, and Income and Cash Flow Taxation*, 67 TAX L. REV. 3, 3-6 (2013) (arguing "claim that imposing an income tax is generally tantamount to taxing the original portfolio on the risk-free return is unsound"); Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax Is Exempt Under a Cash Flow Tax?*, 52 TAX L. REV. 1, 1 (1996) (discussing four responses to "question of how much capital income taxed under an income tax is exempt under a cash flow tax").

[161] *See* I.R.C. § 408A(c)(2) (providing inflation-adjusted annual contribution limit for Roth IRAs).

[162] *See id.* § 408(e)(1) (subjecting IRAs to UBIT as imposed by Section 511). Section 513 defines an "unrelated trade or business" as "any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its . . . purpose or function constituting the basis for its exemption"). *Id.* § 513(a). The First Circuit disagrees with the notion that Congress generally contemplated Roth IRAs to be used for conventional investments. *See* Benenson v. Comm'r, 887 F.3d 511, 520 (1st Cir. 2018) ("For some taxpayers, Roth IRAs are safe places to squirrel away $5,000 in cash per year, with a hope of modest returns and tax-free distribution at retirement. For other, often wealthier, taxpayers, Roth IRAs are strategic vehicles for investments in companies, which pay out substantial dividends.").

The taxpayers in *Summa Holdings*, the Benensons, combined the DISC and Roth IRA provisions in the following way. The Benensons owned a closely held export company, Summa Holdings, Inc. ("Summa").[163] The father, James Benenson, Jr., owned approximately 23% of the corporation's shares, and over 76% was owned by a trust, the beneficiaries of which included James Benenson's wife and two sons.[164] In 2001, the Benensons established Roth IRAs, one for each of their sons, and funded them with $3,500 each.[165] Both IRAs purchased 50% of JC Export ("Export"), a newly formed DISC, for $1,500.[166] The Benensons then formed another corporation, JC Holding ("Holding"), which exchanged its own shares for the shares in Export owned by the Roth IRAs.[167] As a result, the Roth IRAs each owned 50% of Holding, which in turn owned 100% of Export.[168] Export entered into a commission agreement with Summa, and over six years Summa paid Export millions in commissions.[169] Export distributed the commissions to Holding, which, after paying a corporate-level tax, distributed what remained, $5,182,314, to the Roth IRAs as dividends.[170]

Why did the Benensons go through all the trouble? To appreciate the role played by the interaction of the DISC and Roth IRA provisions, consider the same transaction without Export.[171] Imagine that Summa had incorporated Holding as a plain vanilla corporate subsidiary and had sold it to the Roth IRAs for $3,000. Summa could thus pay sales commissions directly to Holding, which could then distribute the $5,182,314 (an average of about $740,000 annually) to the two Roth IRAs, producing a 2,460-fold annual increase to their $3,000 investment.

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163 Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 783 (6th Cir. 2017).

164 *Id.*

165 *See id.*

166 *See id.*

167 *See id.* The court suggests that the purpose of Holding was to "prevent the Roth IRAs from incurring any tax-reporting or shareholder obligations by owning JC Export directly." *Id.* Sutton and co-authors propose that the role of Holding was to function as a UBIT blocker, meaning that it incurred the corporate-level income tax on any dividends received from Export instead of having the Roth IRAs pay the UBIT. Sutton et al., *supra* note 138, at 37. The tax advantage of having Holding pay the corporate-level tax in place of the Roth IRAs paying the UBIT is that Holding could deduct related expenses, whereas the Roth IRAs could not. *Id.*

168 *Id.*

169 *Summa Holdings*, 848 F.3d at 784 ("From 2002 to 2008, the Benensons transferred $5,182,314 from Summa Holdings to the Roth IRAs . . . , including $1,477,028 in 2008. By 2008, each Roth IRA had accumulated over $3 million.").

170 *Id.*

171 The dissent in *Benenson* makes the same point. *See* Benenson v. Comm'r, 887 F.3d 511, 524 (1st Cir. 2018) (Lynch, J., dissenting) ("Had this transaction used a C corporation (or an LLC or almost any other type of entity) to pass money from Summa Holdings into the Roth IRAs, recharacterization would clearly be appropriate.").

In Notice 2004-8, the IRS served notice that it would challenge arrangements in which taxpayers engage in non-arm's length transactions with their Roth IRAs to circumvent the Roth IRA contribution limits.[172] The IRS took note of the risk that a taxpayer might contribute shares to a Roth IRA from a wholly owned corporation and then cause the corporation to transact with the Roth IRA on a non-arm's length basis.[173] One of several ways that the IRS cautioned it would challenge such transactions was to apply the transfer pricing rules of Section 482, under which the Commissioner generally may adjust related parties' "gross income, deductions, credits, or allowances" to reflect how the transaction would have been treated if the parties were transacting at arm's length.[174] The Sixth Circuit appeared to concur with that possibility (albeit by characterizing the non-arm's length pricing as a "sham"): "[W]hen a family sets up an ordinary corporation owned by Roth IRAs and pays the corporation fees for sham 'services' that it never performed, the Commissioner may rightly refuse to recognize the Roth IRA's gains as investment earnings and may reclassify them as contributions."[175]

However, in contrast to C corporations, the regulations exempt DISCs, which are subject to generous limits on what they may "charge" as "commissions," from general transfer pricing rules.[176] Accordingly, DISCs seem to offer a way around the IRS's position in Notice 2004-8.[177] The DISC in *Summa Holdings* sought to do just that. It did not effectuate either of the tax benefits provided by Congress for DISCs, because the DISC immediately distributed its commission payments (no shareholder deferral) to a C corporation that paid corporate tax on the earnings before making the ultimate distribution to the Roth IRAs.[178] The

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[172] *See* I.R.S. Notice 2004-8, 2004-1 C.B. 333, 333 [hereinafter I.R.S. Notice].

[173] *See id.* ("To the extent that the consideration paid or received in transactions between the Business and the Roth IRA Corporation is not in accordance with the arm's length standard, the Service may apply § 482 as necessary to prevent evasion of taxes or clearly to reflect income.").

[174] *See id.* ("Section 482 provides the Secretary with authority to allocate gross income, deductions, credits or allowances among persons owned or controlled directly or indirectly by the same interests, if such allocation is necessary to prevent evasion of taxes or clearly to reflect income.").

[175] *Summa Holdings*, 848 F.3d at 785-86.

[176] I.R.C. § 994(a) (exempting DISCs from Section 482 and providing transfer-pricing formula); Treas. Reg. § 1.992-1(a) (2021) ("A corporation which satisfies the [DISC] requirements . . . is treated as a separate corporation for Federal tax purposes . . . even though such corporation would not be treated (if it were not a DISC) as a corporate entity for Federal income tax purposes. . . . The rules contained in this paragraph constitute a relaxation of the general rules of corporate substance otherwise applicable under the Code.").

[177] *See* I.R.S. Notice, *supra* note 172, at 333 (noting that DISCs were designed to "avoid the statutory limits on contributions to a Roth IRA contained in § 408A").

[178] Even without the holding company, the distributions would have been subject to corporate-level tax because distributions from DISCs to Roth IRAs are subject to UBIT. *See*

only function of the DISC, therefore, was to circumvent the transfer pricing requirements that would ordinarily have prevented parties from overfunding Roth IRAs through related-party transactions.[179] As such, the effect of the transaction was to eviscerate the Roth IRA contribution limits by channeling millions of dollars, limited only by the commission limits provided in the DISC statute, into the accounts where it could accumulate tax-free.[180]

The fact that DISCs are exempt from general transfer pricing requirements partially explains why the IRS did not challenge the valuation of the DISC shares, or attempt to reallocate the commission payments back to Summa.[181] Instead, the IRS applied the substance-over-form doctrine to "reclassify the payments to JC Export as dividends from Summa Holdings to its major shareholders," the Benensons and the trust, which were, in turn, contributed to the Roth IRAs in violation of the contribution limits.[182] The Tax Court agreed with the Commissioner's view of the transaction.[183]

2. *Summa Holdings*: The Sixth Circuit's Analysis

The Sixth Circuit's opinion is detailed and at one level seems both thoughtful and well crafted. The Sixth Circuit laid out the background and operation of the DISC and Roth IRA statutes, and it concluded that each offers tax benefits as an incentive to exporting (DISC) and long-term retirement savings (Roth IRA).[184] The Sixth Circuit recognized that the effect of the transaction was to circumvent the Roth IRA contribution limits, and it acknowledged that the DISC's role in the transaction was to avoid the transfer pricing rules that would have otherwise prevented the overfunding of Roth IRAs through related-party transactions.[185]

Despite its acknowledgment that "permitting these DISC-Roth IRA arrangements amounts to dubious tax policy," the Sixth Circuit felt compelled by textualist principles to resist the Commissioner's attempt to recharacterize

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Vorris J. Blankenship, *Using DISCs to Avoid Roth IRA Limits: An Overlooked Fact in* Summa, 157 TAX NOTES 973, 974 (2017) ("[C]ontrary to the appellate court's apparent belief, the Summa DISC did not take advantage of the tax deferral benefits Congress provided for DISC income. . . . Congress later classified distributions of DISC income to exempt entities (including IRAs) as unrelated business taxable income taxed at corporate rates.").

[179] *See* Benenson v. Comm'r, 887 F.3d 511, 525 (1st Cir. 2018) (Lynch, J., dissenting) ("The DISC here was not used for the purpose intended by Congress, but to evade the Roth IRA contribution limits . . . . Congress did not intend the use of DISCs to circumvent well established Roth IRA contribution limits and certainly did not say so.").

[180] *See Summa Holdings*, 848 F.3d at 782.

[181] *Id.* ("The Commissioner did not challenge the valuation of these shares then and has not challenged them since.").

[182] *Id.* at 784.

[183] *See id.*

[184] *See id.* at 782-83.

[185] *See id.* at 781 ("Tax attorneys advised the family to use a [DISC] . . . to transfer money from their family-owned company to their sons' Roth Individual Retirement Accounts.").

the transaction.[186] The Sixth Circuit begins with a telling invocation of the Roman emperor Caligula, who "posted the tax laws in such fine print and so high that his subjects could not read them."[187] Like Caligula, the Sixth Circuit maintained that upholding the Commissioner would undermine the taxpayer's ability to rely on the law by denying "relief to a set of taxpayers who complied in full with the printed and accessible words of the tax laws."[188] The Sixth Circuit challenged the Commissioner's use of judicial anti-abuse doctrines in circumstances where, as in this case, the Code appeared specifically to authorize the transaction. It held that to disallow any of the tax benefits that the Code expressly authorized "is hard to square with the Supreme Court's textually respectful methods of statutory interpretation."[189]

An essential, and perhaps inadequately appreciated, move in the Sixth Circuit's analysis is its broad characterization of both the DISC and Roth IRA statutes as "tax avoidance" provisions.[190] It is true, of course, that DISCs and Roth IRAs offer tax benefits intended to incentivize specific behavior, and therefore offer legitimate and intended means of what might reasonably be called "tax avoidance" strategies. But neither provision can be viewed, as the Sixth Circuit effectively did, as legitimating "tax avoidance" in the large. The opportunities conferred by each provision were in service of a well-defined statutory objective: stimulating export sales in the one case, encouraging retirement savings in the other. And each was subject to express statutory limits on the benefit conferred, on the aggregate of "commissions" eligible for DISC treatment, and on the extent to which the preferentially taxed Roth IRA could be funded. The Commissioner surely saw himself as *upholding* the letter of the law, rather than undermining it, when he applied the substance-over-form doctrine to prevent the Benensons from using DISCs to achieve a tax avoidance result almost wholly unrelated to stimulating export sales, while simultaneously opening a massive gap, limited only by the statutory limitation on funding a DISC, in the Roth IRA contribution limits.[191]

But once the Sixth Circuit concluded its otherwise fair and faithful description of the DISC and Roth IRA regimes as "tax avoidance" provisions *writ large*, it felt positioned to refuse to consider the application of any *anti*-tax avoidance

[186] *Id.* at 790 (noting that "the substance-over-form doctrine does not give the Commissioner a warrant to search through the Internal Revenue Code and correct whatever oversights Congress happens to make or redo any policy missteps the legislature happens to take").

[187] *Id.* at 781.

[188] *Id.*

[189] *Id.* at 787.

[190] *See id.* at 789 (stating that "[t]he point of [DISCs and Roth IRAs] *is* tax avoidance").

[191] Indeed, while it is nowhere noticed in the Sixth Circuit's opinion, the basic effect of the decision in *Summa Holdings*, for anyone situated roughly like the Benensons, can be viewed as effectively substituting the limitations on DISC commissions for the nominal statutory Roth IRA contribution limits as the *true* limitations on funding a Roth IRA.

doctrines to those provisions, even if the doctrines were employed to prevent an instance of tax avoidance different from, and both obviously and wildly at odds with, what Congress had in mind when it adopted the DISC regime in 1971 and the Roth IRA regime in 1997.[192] Thus, the Sixth Circuit concluded that, while the ultimate result in the case may have been "unintended by both the Roth IRA and DISC provisions," the taxpayers were entitled to prevail because, in the abstract and divorced from their statutory origins and animating rationale, the two regimes in question both authorized "tax avoidance," and all the taxpayers had done was to achieve a bit of "tax avoidance."[193]

Despite its textualism-inspired reservations, the Sixth Circuit nevertheless recognized a limited usefulness to judicial anti-abuse doctrines: "As originally conceived and as traditionally used, the substance-over-form doctrine has something to it."[194] According to the Sixth Circuit, courts might properly resort to using the substance-over-form doctrine when a taxpayer falsely describes a transaction.[195] When courts consider the taxpayer's claimed tax benefit, "they focus, quite appropriately, on the transaction's workaday realities, not the labels used by the taxpayers."[196] The Sixth Circuit thus seems to limit judicial anti-abuse doctrines to situations involving ambiguous questions of fact: a court should use them only "when the taxpayer's formal characterization of a transaction fails to capture economic reality and would distort the meaning of the Code in the process."[197] By contrast, the doctrines go "too far" when used to analyze ambiguous questions of law: "When two potential options for structuring a transaction lead to the same end and the taxpayers choose the lower-tax path, the Commissioner [does not have] the power to recharacterize the transactions as the higher-taxed equivalents."[198] In other words, courts

[192] *See id.* at 782 ("Because Summa Holdings used the DISC and Roth IRAs for their congressionally sanctioned purposes—tax avoidance—the Commissioner had no basis for recharacterizing the transactions . . . .").

[193] *Id.* at 790.

[194] *Id.* at 785.

[195] *Id.* ("What the taxpayer cannot do is claim that the label he affixes on the transaction precludes it from being 'income' under the Code or prevents the courts from treating it as 'income' under the Code."). The court quotes approvingly Isenbergh's example of the taxpayer who calls his dogs cows to claim a deduction for cows. *Id.* at 787-88; *see* Isenbergh, *supra* note 4, at 865 (discussing principle that "[n]o label can make a diamond of a rhinestone").

[196] *Summa Holdings*, 848 F.3d at 785.

[197] *Id.* at 787.

[198] *Id.* at 786. Unlike the Sixth Circuit, the First Circuit seems to allow the use of judicial anti-abuse doctrines as an aid to statutory interpretation. *See* Benenson v. Comm'r, 887 F.3d 511, 517 (1st Cir. 2018) (describing substance-over-form doctrine as interpretive tool). The First Circuit explains that while the federal tax system is based primarily on statute, judicial anti-abuse doctrines "can thus perhaps best be thought of as a tool of statutory interpretation." *Id.* (quoting Santander Holdings USA, Inc. v. United States, 844 F.3d 15, 23 (1st Cir. 2016)).

should use judicial anti-abuse doctrines to prevent taxpayers from applying factually false labels to transactions, but where everyone agrees about the factual nature of a transaction and the dispute concerns only how the law should apply to it, judicial anti-abuse doctrines should not inform the analysis.[199] Absent ambiguous factual issues, courts should not ask whether the transaction has "economic substance" or look at the transaction's "substance-over-form."[200]

The Sixth Circuit justified its limiting gloss on judicial anti-abuse doctrines by suggesting that their broader use would undermine Congressional design, especially with respect to provisions that incentivize behavior by providing an opportunity for "tax avoidance."[201] Thus, the Sixth Circuit claimed that "[b]y congressional design, DISCs are all form and no substance, making it inappropriate to tag Summa Holdings with a substance-over-form complaint with respect to its use of DISCs."[202] If, the Sixth Circuit concluded, Congress did not intend for related parties to use DISCs to funnel money from export businesses into Roth IRAs, then it is up to Congress, and not the courts, "to fix the problem."[203]

3. *Hawk*: *Summa Holdings* Reconsidered

The Sixth Circuit's decision in *Hawk* came down two years after *Summa Holdings*.[204] While certain facts make *Hawk* an easier case than *Summa Holdings*, Judge Sutton (who also authored the opinion in *Summa Holdings*)

As a guide to statutory interpretation, the First Circuit notes, the doctrines encourage courts to view transactions "as a whole." *Id.* (quoting Comm'r v. Court Holding Co., 324 U.S. 331, 334 (1945)). Despite this superficial embrace of the doctrines as aids to questions of law, the First Circuit does not apply the doctrines and instead follows and cites the Sixth Circuit in upholding the transaction because the DISC and Roth IRA provisions, viewed individually, facially support the transaction. *See id.* at 521 ("As outlined above, both DISCs and Roth IRAs 'are designed for tax-reduction purposes.'" (quoting *Summa Holdings*, 848 F.3d at 786)). The dissent makes a similar observation. *See id.* at 525 (Lynch, J., dissenting) (observing that majority declines to apply substance-over-form doctrine to recharacterize transaction "because [it finds that] DISC commissions do not need to have economic substance").

[199] *See* I.R.C. § 7701(o) (codifying economic substance doctrine).

[200] *See Summa Holdings*, 848 F.3d at 786-87.

[201] *Id.* at 782.

[202] *Id.* at 785.

[203] *Id.* at 790 ("If Congress sees DISC-Roth IRA transactions of this sort as unwise or as creating an improper loophole, it should fix the problem. Until then, the DISC will continue to provide tax savings to the owners of U.S. export companies, just as Congress intended—even if subsequent changes to the Code have increased the scale of the savings beyond Congress's original estimation. The last thing the federal courts should be doing is rewarding Congress's creation of an intricate and complicated Internal Revenue Code by closing gaps in taxation whenever that complexity creates them.").

[204] Hawk v. Comm'r, 924 F.3d 821, 823 (6th Cir. 2019).

devoted considerable effort in *Hawk* attempting to reconcile the two.[205] That makes *Hawk* an ideal vantage point from which to flesh out the Sixth Circuit's tax avoidance jurisprudence.

The taxpayers in *Hawk*, the Hawks, were individual shareholders of Holiday Bowl ("Holiday"), a closely held corporation, and faced fraudulent transferee liability under Section 6901 for participating in an arrangement intended to reduce Holiday's corporate-level tax following a sale of its assets.[206] The Hawks first sold Holiday's assets to an unrelated company for $4.2 million, resulting in an approximately $1 million federal tax liability.[207] After this sale, another company, MidCoast, approached the Hawks and proposed to acquire the stock of Holiday, which then consisted of nothing but $4.2 million cash and its $1 million federal tax liability, for $3.4 million, financed by a "loan" from a company called Sequoia Capital ("Sequoia").[208] MidCoast represented to the Hawks that it could pay more than Holiday's net worth, $3.2 million, because it claimed its intention was to "enter the debt-collection business, rapidly generating new losses that would offset Holiday Bowl's existing taxes."[209] In fact, the Hawks never received the proceeds from the Sequoia "loan" but were instead paid out of Holiday's own cash.[210] After MidCoast purchased Holiday's stock, it transferred the stock to Sequoia in exchange for cancellation of the "loan" and about $320,000.[211] Holiday was then liquidated, and no party ever paid its $1 million federal tax liability resulting from the prior asset sale.[212] The IRS sued the Hawks for Holiday's unpaid taxes under Section 6901.[213]

Section 6901 provides a mechanism for the Commissioner to pursue the transferees of delinquent taxpayers for unpaid federal taxes.[214] That section does not establish or define substantive transferee liability, but rather allows the government to stand "in the position of a private creditor, [where] state law determines whether the transferee must pay the taxpayer's debts."[215] However, before determining whether the Hawks were liable under state law, the Sixth Circuit first had to determine that the Hawks were "transferees" of Holiday, the

[205] *See id.* at 830 (discussing how certain facts "separate this case from *Summa Holdings*").

[206] *See id.* at 824.

[207] *See id.*

[208] *See id.*

[209] *Id.*

[210] *See id.* at 825 ("The Tax Court found that the Hawk's didn't even get Sequoia's (ostensibly) loaned funds. They got Holiday Bowl's own funds . . . .").

[211] *Id.* at 824.

[212] *See id.* The IRS investigated MidCoast and discovered approximately sixty similar transactions involving MidCoast, Sequoia, and a law firm. *Id.* The Sixth Circuit reports that "a grand jury indicted several individuals associated with each of them. One defendant pleaded guilty. Others fled the country." *Id.*

[213] *See id.* (claiming that the Hawks were liable as Holiday Bowl's fraudulent transferees).

[214] *See* I.R.C. § 6901 (providing for liability of fraudulent transferees).

[215] *See Hawk*, 924 F.3d at 824.

delinquent taxpayer, under Section 6901, despite the fact that they formally received payment from MidCoast and not from Holiday.[216]

The Sixth Circuit determined that the Hawks were "transferees" under Section 6901 by applying judicial anti-abuse doctrines to recharacterize the payment from MidCoast to the Hawks as a transfer from Holiday to the Hawks.[217] The Sixth Circuit used the substance-over-form doctrine to disregard the sale of Holiday to MidCoast because, the Sixth Circuit determined, the sale "had no economic substance to it" and the Hawks "*really* transferred [Holiday's] cash directly to themselves."[218]

The Sixth Circuit invoked both the economic substance and the sham transaction doctrines in reaching its conclusion.[219] These doctrines provide distinct theoretical grounds for denying the Hawks' characterization of the deal. While the Sixth Circuit is not entirely consistent in its usage, it generally uses the term "sham" to describe nonexistent aspects of the transaction.[220] After invoking that doctrine, for example, the Sixth Circuit notes that the "quintessential explanation for refusing to respect the form of a transaction is that it amounts to a charade."[221] The "sham" was that the loan MidCoast purportedly used to finance its purchase of Holiday Bowl "was not in fact real, as MidCoast paid for the transaction with Holiday Bowl funds."[222] Thus, the fact that MidCoast did not obtain a genuine loan from Sequoia means that the loan was a "sham"—i.e., did not really occur—and so should be disregarded for tax purposes.[223]

By contrast, the Sixth Circuit uses the term "economic substance," although again not entirely consistently, to describe transactions that, while actually occurring, do not meaningfully change the taxpayer's position apart from tax considerations.[224] For example, the Sixth Circuit describes a hypothetical in which Company A, a company with $5 million in cash and a $4 million realized

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[216] *Id.* at 825 ("Applied here, § 6901 prompts three questions: (1) Did Holiday Bowl owe any taxes? (2) Are the Hawks transferees of Holiday Bowl? (3) If so, are the Hawks liable to the government under Tennessee's fraudulent transfer statute?").

[217] *See id.*

[218] *Id.*

[219] *See id.* ("All of this requires a digression about a doctrine, in truth a series of doctrines . . . ."). The court refers to the "economic substance" of the transaction eight times and uses the word "sham" to characterize various aspects of the transaction nine times. *See id.* at 824-31.

[220] *See id.* at 830 (describing nonexistent loan from Sequoia as "sham").

[221] *Id.* at 825-26.

[222] *Id.* at 826.

[223] *See id.*

[224] This formulation comes from the codification of the economic substance doctrine in Section 7701(o) rather than the court. *See* I.R.C. § 7701(o) (defining transactions with economic substance as those that, among other characteristics, change "in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position").

gain, sells itself to foreign Company B for $5 million.[225] After liquidating Company A, Company B disappears and never pays Company A's taxes, and the owners of Company A walk away with $5 million.[226] The hypothetical transaction really happened—it was not a "sham" in that sense—but, according to the Sixth Circuit, a court might recharacterize the transaction as a distribution directly from Company A to its shareholders because "the sale of Company A had no economic substance to it."[227]

While the Sixth Circuit thus provides two independent justifications for its recharacterization of the transaction, it relies primarily on the first when distinguishing *Summa Holdings*.[228] Consider the Sixth Circuit's analysis of whether the outcome of the case would have been different if the transaction had complied with all applicable formalities:

> Was there a way to make this tax-reduction strategy work . . . say by making the Sequoia loan a kosher one and dotting another "i" and crossing another "t" in the underlying transactions? The answer is "maybe" in the abstract and "not likely" here. . . .
>
> . . . .
>
> [Whereas in *Summa Holdings*,] "[the] Internal Revenue Code allowed" the taxpayers "to do what they did." . . .
>
> . . . .
>
> [In *Hawk*] the Commissioner isn't disregarding statutory text in the name of economic substance; he's honoring the written word and the economic realities of this transaction.[229]

In other words, in *Summa Holdings*, the Commissioner was wrong to recharacterize the transaction as a distribution to the Benensons followed by a contribution to their Roth IRAs because the transactions actually occurred, and the Code authorizes both transactions.[230] In *Hawk*, by contrast, the Commissioner properly recharacterized the Hawks' sale of Holiday to MidCoast as a distribution by Holiday directly to the Hawks because the sale was a "sham."[231]

The Sixth Circuit waffles on whether the Hawks could have gotten away with this scheme if the transaction actually occurred and complied with all requisite

225 *Hawk*, 924 F.3d at 824-25.

226 *Id.* at 825 (describing transaction as creating "classic transferee liability").

227 *Id.*

228 *See id.* at 831.

229 *Id.* at 830-31 (second alteration in original) (quoting Summa Holdings, Inc. v. Comm'r, 848 F.3d 784 (6th Cir. 2017)).

230 *See id.* at 831 ("When all was said and done, *Summa Holdings* was a case in which the taxpayers forced the government to play it straight—to make *it* respect the form and substance of the laws Congress wrote.").

231 *See id.* at 830-31.

formalities.[232] On the one hand, the Sixth Circuit's hypothetical situation involving Company A's use of Company B as an intermediary suggests that the lack of economic substance alone could be sufficient to justify recharacterizing the transaction.[233] On the other hand, the Sixth Circuit's attempt to distinguish *Summa Holdings* relies primarily on the sham component of the transaction; it goes out of its way to emphasize that "[t]he problem . . . is not that the Hawks were trying to lower their taxes. . . . The problem is that . . . it was nothing but misleading labels and distracting forms—trompe l'oeil from start to finish."[234]

Hawk therefore raises but does not resolve whether a lack of economic substance—i.e., the lack of a meaningful change in the taxpayer's economic position—is alone sufficient to justify denying the claimed tax benefits. If the economic substance doctrine is independently sufficient to trigger substance-over-form recharacterization, then the taxpayers in *Hawk* should have lost even if they had complied with all formalities. But if such were the case, how would the Sixth Circuit distinguish *Summa Holdings*? The answer turns on the Sixth Circuit's understanding of "tax avoidance" statutes. Where, in order to incentivize certain behavior, the plain text of the law allows for substance-less transactions, courts should not disturb the resulting tax benefits.[235] Therefore, under the Sixth Circuit's approach, courts are powerless to prevent "loophole" schemes that accomplish a tax result apparently at odds with sound policy when the text of the Code seems to allow the result.

C. *The Limits of the Sixth Circuit's Approach*

The Sixth Circuit identifies *Knetsch* as an example of the proper use of judicial anti-abuse doctrines because it agreed the taxpayer did not, as a matter of fact, have a genuine "indebtedness," justifying the characterization of the entire transaction as a sham.[236] *Knetsch* is a paradigmatic example of the Sixth Circuit's limited approach to the judicial anti-abuse doctrines: if a transaction raises an ambiguous question of fact, deploy the doctrines to look through any

[232] *See id.* at 830 (describing Hawks' prospects of making their tax-reduction strategy work as unlikely).

[233] *See id.* at 824-25 ("In this setting, a court might decide that the sale of Company A had no economic substance to it, and that the owners really transferred Company A's cash directly to themselves.").

[234] *Id.* at 826.

[235] *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 787 (6th Cir. 2017) ("If the Code authorizes the 'formal' transactions the taxpayer entered into, then 'it is of no consequence that it was all an elaborate scheme to get rid of income taxes.'" (quoting Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934))).

[236] *See id.* at 785 ("A taxpayer is not 'indebted'—and thus not entitled to deduct his interest payments—when the 'loan' has no business function other than enabling those deductions and does not create a true obligation to pay interest.").

false or misleading labels used by the taxpayer and tax the transaction according to its "true" substance.[237]

In contrast, the Sixth Circuit's limited application of the doctrines would not support the rationale of *Goldstein*, because the court there ruled on the issue as a matter of law.[238] Recall that in *Goldstein,* the Second Circuit rejected the Tax Court's finding that the transactions were shams, and instead relied on a business purpose requirement said to be implicit in Section 163(a).[239] The Sixth Circuit's textualism would very likely prevent it from taking that approach to the extent that the implicit requirement finds support only in extra-statutory indicia of legislative intent.[240] Accordingly, the Sixth Circuit's options in *Goldstein* would have been limited to affirming the Tax Court's factual finding that the loans did not represent a genuine "indebtedness" or reversing the decision on the grounds that the law allowed Goldstein to do what she did.

The Sixth Circuit also addresses *Gregory* with approbation.[241] In so doing, however, the Sixth Circuit misreads the Second Circuit's opinion as embracing the very argument that Hand rejected.[242] The Sixth Circuit characterizes *Gregory* as correctly decided on the ground that a "corporation that shuffles shares from one entity to another in order to avoid capital gains tax may not obtain the tax benefits that come with a genuine corporate 'reorganization.'"[243] That rationale implies that the Sixth Circuit views the issue in *Gregory* as one of fact.[244] It is something of an *ipse dixit* to say that Mrs. Gregory's label ("reorganization") was false *because* what she did consisted merely of "shuffl[ing] shares from one entity to another."[245] As discussed in Section I.A, the Second Circuit's opinion in *Gregory* rested its holding squarely on a question of law.[246] It rejected the

[237] *See id.*

[238] Goldstein v. Comm'r, 364 F.2d 734, 740 (2d Cir. 1966) ("We hold, for reasons set forth hereinafter, that Section 163(a) of the 1954 Internal Revenue Code does not permit a deduction for interest paid or accrued in loan arrangements, like those now before us, that can not with reason be said to have purpose, substance, or utility apart from their anticipated tax consequences.").

[239] *Id.* at 741 (looking to "underlying purpose" of Section 163(a)).

[240] *See Summa Holdings*, 848 F.3d at 788 ("Only a parody of a purpose-based approach to interpretation, unanchored to statutory text, could justify a one-way use of this power.").

[241] *See id.* at 787, 789.

[242] *See id.* at 787.

[243] *See id.* at 785. Note that the purpose of the transaction in *Gregory* was not to "avoid capital gains tax" but actually to achieve it. *See* Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934). As discussed in Section I.A, the transaction in *Gregory*, if allowed, would have resulted in capital gain to the extent that the fair market value of the Averill shares exceeded Gregory's basis in the stock. *See id.*

[244] *See Summa Holdings*, 848 F.3d at 785.

[245] *Id.*

[246] *See Gregory*, 69 F.2d at 810-11 (upholding Commissioner's notice of deficiency on grounds that transaction did not satisfy implicit requirement of reorganization statute that

Commissioner's characterization of the transaction as a distribution of Monitor Shares and acknowledged, as the Board of Tax Appeals had found, that all the steps taken by Mrs. Gregory in structuring the transaction "were real."[247] But after reviewing the legislative history and purpose of the reorganization provisions, Judge Hand expressly ruled that, because it served no business purpose, Mrs. Gregory's arrangement did not qualify as a reorganization, "even though the facts answer the dictionary definitions of each term used in the statutory definition."[248] Their "only defect was that they were not what the statute means by a 'reorganization.'"[249]

Because of the Sixth Circuit's textualism and its limitation of judicial anti-abuse doctrines to ambiguous questions of fact, its only option for reconciling the outcome in *Gregory* with its jurisprudence was to mischaracterize the Second Circuit's treatment of the newly formed corporation and the intercorporate exchanges of shares as mere shams, despite what Judge Hand's opinion actually holds and notwithstanding the Supreme Court's subsequent affirmation that there was "[n]o doubt, a new and valid corporation was created."[250] Accordingly, the Sixth Circuit's limitation of the judicial anti-abuse doctrines to questions of fact either requires it to strain to characterize cases like *Gregory* as involving mere shams, or allow the taxpayer's claimed tax treatment.

D. *Textualism and the Future of Judicial Anti-Abuse Doctrines*

Approximately one year after *Summa Holdings*, the First Circuit in *Benenson v. Commissioner*[251] decided the Benenson sons' appeal of the same adverse Tax Court determination and generally followed the Sixth Circuit.[252] The First Circuit found that "the transaction does not violate the plain intent of the relevant statutes,"[253] because Congress designed DISCs and Roth IRAs as incentive vehicles, and their combined use "violates neither the letter nor the spirit of the relevant statutory provisions."[254] While the First Circuit acknowledged that the

transaction must have business purpose). As discussed in Section I.A, Judge Hand looked to the congressional intent behind the reorganization statute and found that the law contained an implicit business purpose requirement. *See id.* at 811 (finding support for "underlying presupposition" that reorganizations must be undertaken for legitimate business purpose in history of statute).

[247] *See id.*

[248] *Id.* at 810.

[249] *Id.* at 811.

[250] *See* Gregory v. Helvering, 293 U.S 465, 469 (1935).

[251] 887 F.3d 511 (1st Cir. 2018).

[252] The court ruled against issue and claim preclusion challenges on the grounds that the parties in the two cases differed because the sons who owned the Roth IRAs were not parties in *Summa Holdings*. *See id.* at 517 ("[T]he parties here are different from the parties in *Summa Holdings*.").

[253] *Id.* at 523.

[254] *Id.* at 521.

transaction might appear "unseemly," it maintained that courts must wait for a "congressionally sanctioned solution to a potential tax avoidance problem rather than relying on a judicially crafted common law solution."[255] Shortly after the First Circuit's decision, the Second Circuit in *Benenson v. Commissioner*[256] decided the appeal of the Benenson parents and, like the First Circuit, largely adopted the Sixth Circuit's reasoning in reversing the Tax Court.[257] In so doing, both circuits characterized judicial anti-abuse doctrines as "tool[s] of statutory interpretation."[258] While that phraseology might appear to allow the doctrines a broader scope than that afforded by the Sixth Circuit, both circuits ultimately adopted something similar to the Sixth Circuit's limitation of the doctrines.[259]

After the First Circuit's decision in *Benenson*, the Tax Court ruled on *Mazzei v. Commissioner*,[260] another case with similar facts, but unlike the First Circuit and Second Circuits, it rejected the Sixth Circuit's approach.[261] In *Mazzei*, the taxpayers, the Mazzeis, used a foreign sales corporation ("FSC")[262] to route funds from their family business into Roth IRAs.[263] The majority of the Tax Court ruled in favor of the Commissioner (a twelve-judge majority decision, a five-judge concurrence, and a four-judge dissent) and distinguished *Summa Holdings* by challenging the valuation of the FSC's initial purchase of stock from its parent corporation; having determined that the stock purchase was not arm's length, it then proceeded to recharacterize the transaction using the substance-over-form doctrine.[264] The dissent was sharply critical of the majority, stating that "today we have to choose either a well-reasoned opinion [*Summa Holdings*] by a highly respected judge in America's heartland, or Caligula. We

[255] *Id.*

[256] 910 F.3d 690 (2d Cir. 2018).

[257] *See id.* at 700 ("Like the Sixth Circuit, and for much the same reasons, we conclude that Summa's payment of deductible DISC commissions was grounded in economic reality and not distortive of the tax code provisions establishing the DISC program.").

[258] *Id.* at 699 ("[T]he substance-over-form doctrine is a tool of statutory interpretation . . . ."); *Benenson*, 887 F.3d at 517 (substance-over-form doctrine is "tool of statutory interpretation" (quoting Santander Holdings USA, Inc. v. United States, 844 F.3d 15, 23 (1st Cir. 2016))).

[259] *See Benenson*, 910 F.3d at 699 ("[S]ubstance-over-form is a tool to prevent taxpayers from mislabeling transactions . . . . But if the economic reality of what was done 'was the thing which the statute intended,' it is of no matter that its purpose was tax avoidance." (quoting Altria Grp., Inc. v. United States, 658 F.3d 276, 284 (2d Cir. 2011))); *Benenson*, 887 F.3d at 523 (explaining that, because substance-over-form doctrine is tool of statutory interpretation, when "the transaction does not violate the plain intent of the relevant statutes, we can push the [substance-over-form] doctrine no further").

[260] 150 T.C. 138 (2018).

[261] *Id.* at 168-71.

[262] For a note on the history of FSCs and their relationship to the DISC regime, see *supra* note 153 and accompanying text.

[263] *See Mazzei*, 150 T.C. at 148.

[264] *See id.* at 179-80.

pick Caligula."[265] The Mazzeis appealed to the Ninth Circuit.[266] The Ninth Circuit reversed the Tax Court and "join[ed] [its] sister circuits in concluding that, when Congress expressly departs from substance-over-form principles, the Commissioner may not invoke those principles in a way that would directly reverse that congressional judgment."[267]

In yet another recent decision, *Tucker v. Commissioner*,[268] the Fifth Circuit affirmed the Tax Court's assessment of a deficiency against taxpayers who claimed deductions for losses generated by an "FX transaction" that involved a series of offsetting foreign currency options entered into through pass-through entities.[269] The taxpayers, relying on *Summa Holdings*, had argued that the substance-over-form doctrine should not apply because the plain meaning of the Code allowed the taxpayers to do what they did.[270] The taxpayers filed a petition for certiorari where they framed the question presented in terms of the proper relationship between textualism and judicial anti-abuse doctrines:

> May the judge-made "economic substance doctrine" be invoked to supplant any tax results that a court deems abusive, even when those results stem from the application of clear, unambiguous, and mechanical provisions of tax law, as the Fifth Circuit held below and other courts of appeals have concluded, or is the doctrine properly invoked only as a tool for interpreting the meaning of tax laws, as the D.C. and Sixth Circuits have held?[271]

While the petition for certiorari was denied,[272] this collection of decisions demonstrates that the relationship between textualism and judicial anti-abuse doctrines is a significant issue in contemporary tax controversy litigation.[273]

[265] *Id.* at 184 (Holmes, J., dissenting).

[266] Mazzei v. Comm'r, 998 F.3d 1041, 1043 (9th Cir. 2021).

[267] *Id.* at 1060.

[268] 766 Fed. App'x 132 (5th Cir. 2019).

[269] *See id.* at 134-35.

[270] *See id.* at 139.

[271] Petition for Writ of Certiorari at i, Tucker v. Comm'r, 140 S. Ct. 378 (2019) (No. 19-41).

[272] Tucker v. Comm'r, 140 S. Ct. 378, 378 (2019) (denying petition for writ of certiorari).

[273] In *Rodriguez v. FDIC*, 140 S. Ct. 713, 717 (2020), the Supreme Court held that federal judges cannot create federal common law, including in the area of taxation, except in extremely narrow circumstances. Scholars have questioned the implications of *Rodriguez* on judicial anti-abuse doctrines. *See* Beckett G. Cantley & Geoffrey C. Dietrich, Rodriguez v. FDIC*: The Supreme Court's Federal Common Law Hostility & Its Effects on the Economic Substance Doctrine*, 4 BUS. & FIN. L. REV. 93, 117 (2020) ("Federal judges increasing preference towards textualism coupled with *Rodriguez*'s hostility towards judge-made law raises legitimate concerns regarding the continued validity of the substance-over-form tax doctrines."). While the Supreme Court has not ruled on the anti-abuse doctrines since 1978, scholars speculate that *Rodriguez* may signal their looming demise. *See id.* ("In light of the

Because litigation tends to encourage radically polarized positions, the balance of this Note is intended to suggest a kind of rapprochement between textualists and advocates of judicial anti-abuse doctrines.

III. JUDICIAL ANTI-ABUSE DOCTRINES IN SERVICE OF TEXTUALISM

A. *Integrating Judicial Anti-Abuse Doctrines with Textualism*

As discussed in Section II.C, the Sixth Circuit's textualism led it to limit the use of judicial anti-abuse doctrines to ambiguous questions of fact.[274] This Part contends that the Sixth Circuit's limitation rests on the related false assumptions (1) that textualists must look for the meaning of a statutory provision in isolation from the statutory scheme as a whole, and (2) that judicial anti-abuse doctrines require recourse to extra-statutory sources of meaning. After challenging these two assumptions, this Part proposes that judicial anti-abuse doctrines can inform ambiguous questions of law and prevent taxpayers from characterizing transactions in a manner that distorts the meaning of the Code.

Summa Holdings effectively held that because the Code authorized DISCs and Roth IRAs as economically substance-less, tax-saving vehicles, it would violate the plain meaning of those provisions to deny the tax savings that results from their combined use.[275] However, this conclusion assumes a reductionist form of textualism that elsewhere in its opinion the Sixth Circuit rejects: namely, that textualism requires courts to interpret each individual provision in isolation from other parts of the same statutory scheme. Thus, despite its mechanical application of textualism in *Summa Holdings*, the Sixth Circuit approvingly cites Judge Hand's discussion in *Gregory* on the importance of reading statutes in context:

> The best way to effectuate Congress's nuanced policy judgments is to apply each provision as its text requires—not to elevate purpose over text when taxpayers structure their transactions in unanticipated tax-reducing ways. . . .
>
> Yes, finite language must account for infinite tax transactions. . . .
>
> Statutory purpose no doubt has a role to play, even in its most capacious and inviting forms. "[T]he meaning of a sentence may be more than that of the separate words, as a melody is more than the notes." . . . "A

Court's recent trend of resolving tax cases using textualist interpretation methods, it is doubtful the Court would permit the judicially created doctrines to stand." (footnote omitted)); *cf.* Yoram Keinan, *It Is Time for the Supreme Court to Voice Its Opinion on Economic Substance*, 7 HOUS. BUS. & TAX L.J. 93, 101 (2006) (noting that since 1978, "the Supreme Court has not issued any significant economic substance cases . . . . [I]nconsistencies and disparate interpretations of the economic substance doctrine require an intervention by the Supreme Court").

274 *See supra* Section II.C.

275 *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 782 (6th Cir. 2017).

word is not a crystal, transparent and unchanged, it is the skin of a living thought." . . . But purpose must be grounded in text.[276]

The Sixth Circuit does not seem to be claiming that provisions should be interpreted in complete isolation from one other; rather, what it seems to object to is a form of intentionalism that "elevate[s] purpose over text" and ignores the text of the law simply because it appears to result in a bad outcome.[277] The Sixth Circuit worries that when judicial anti-abuse doctrines are applied to questions of law, especially where the Code authorizes a particular "tax avoidance" transaction, they become "a tool that allows the Commissioner to place labels on transactions to avoid textual consequences he doesn't like."[278] Nevertheless, the Sixth Circuit also acknowledges that it is problematic to divorce text from purpose and context because the text "is the skin of a living thought" that must be drawn out through judicial interpretation.[279] To identify the textually grounded purpose of a statute, the Sixth Circuit must consider each provision in statutory context; for just as "[t]he meaning of a sentence may be more than that of the separate words," so too the meaning of a statutory scheme is more than that of its isolated provisions.[280] Accordingly, even the Sixth Circuit's own theory of textualism is not wedded to the assumption that seems operative in *Summa Holdings*: that the combination of two or more laws must be identical to the sum of its parts.[281]

The Sixth Circuit's second mistaken assumption is that judicial anti-abuse doctrines require recourse to extra-statutory sources of meaning. The Sixth Circuit understood the Commissioner's use of the doctrines as an attempt to "recharacterize the meaning of statutes—to ignore their form, their words, in favor of his perception of their substance."[282] Similarly, the Sixth Circuit lambasted the Commissioner's application of substance-over-form doctrines as justified only by "a parody of a purpose-based approach to interpretation, unanchored to statutory text."[283] However, there is nothing inherent in judicial anti-abuse doctrines that requires recourse to extra-statutory sources of

[276] *Id.* at 788-89 (citations omitted) (first quoting Helvering v. Gregory, 69 F.2d 809, 810-11 (2d Cir. 1934); and then quoting Towne v. Eisner, 245 U.S. 418, 425 (1918)).

[277] *Id.*

[278] *Id.* at 787.

[279] *Id.* at 789 (quoting *Towne*, 245 U.S. at 425).

[280] *Id.* (quoting *Gregory*, 69 F.2d at 810-11).

[281] *See, e.g.*, Green v. Bock Laundry Mach. Co., 490 U.S. 504, 528 (1989) (Scalia, J., concurring) ("The meaning of terms on the statute books ought to be determined, not on the basis of which meaning can be shown to have been understood by a larger handful of the Members of Congress; but rather on the basis of which meaning is (1) most in accord with context and ordinary usage . . . and (2) *most compatible with the surrounding body of law into which the provisions must be integrated*—a compatibility which, by a benign fiction, we assume Congress always has in mind." (emphasis added)).

[282] *Summa Holdings*, 848 F.3d at 785.

[283] *Id.* at 788.

meaning.[284] The Sixth Circuit recognized that such doctrines should apply when the taxpayer's characterization of the transaction is inconsistent with the Code: "The substance-over-form doctrine, it seems to us, makes sense only when it holds true to its roots—when the taxpayer's formal characterization of a transaction fails to capture economic reality *and would distort the meaning of the Code in the process*."[285] But the formal characterization of a transaction can distort the meaning of the Code not only when it is factually inaccurate but also when it relies on a combination of statutes to achieve a result that conflicts with the express requirements and limitations of related provisions in the statutory scheme. The substance-over-form doctrine, for example, should apply to a transaction whenever the taxpayer's characterization, if sustained, would violate the *text* of the applicable statutory scheme, not merely when the transaction is factually a sham. A textualist could find that a transaction distorts the meaning of the Code in such circumstances, and therefore warrants the use of judicial anti-abuse doctrines, without looking beyond the text.

Accordingly, textualist judges can use judicial anti-abuse doctrines when interpreting questions of law because there is nothing in the nature of textualism or the doctrines themselves that renders the two fundamentally incompatible. Moreover, because the interpretation and misapplication of a statutory scheme as a whole are prone to a form of taxpayer abuse similar to pure questions of fact, judges should avail themselves of the judicial anti-abuse doctrines as interpretive aids in their application of the Code to transactions.[286] In *Summa Holdings*, the Sixth Circuit correctly applied the doctrines at a factual level by asking whether the taxpayer's labels for its conduct were mere shams. The Sixth Circuit concluded they were not: the taxpayers had, in fact, formed Roth IRAs which had, in fact, purchased shares from what was, in fact, a DISC.[287] However, when the Sixth Circuit turned to the legal question of whether the Roth IRA and DISC provisions might properly be combined in the manner that the taxpayers had, the Sixth Circuit, eschewing the anti-abuse doctrines, simply applied the text of each individual provision to each discrete aspect of the transaction, determined that each isolated provision allowed for "tax avoidance," and then

[284] *Cf.* Choi, *supra* note 5, at 205 (noting that judicial anti-abuse doctrines were historically developed mainly by purposivist judges "as tools of statutory interpretation"). Choi's observation of the historical roots of the doctrines suggests why textualist judges recoil at many of the early opinions that first formulated the rules—the language of those opinions was rife with invocations of congressional intent.

[285] *Summa Holdings*, 848 F.3d at 787 (emphasis added).

[286] *See* Choi, *supra* note 5, at 205 (noting that, historically, judicial anti-abuse doctrines "were not considered standalone rules so much as tools of statutory interpretation" (footnote omitted)).

[287] *Summa Holdings*, 848 F.3d at 786 (concluding that "[n]one of these transactions was a labeling-game sham or defied economic reality").

bestowed the Code's blessing on the tax avoidance realized by the transaction as a whole.[288]

But the Sixth Circuit's resolution of the case was flawed in that the legal issue in *Summa Holdings* was not simply whether the Code authorized DISCs and Roth IRAs individually, but rather whether it authorized their combined use. A less wooden textualism would have addressed this issue by considering "the language of accompanying statutory provisions" and the "relation [of the provisions] to the entire act of which the statute is a part."[289] The Sixth Circuit could and, I suggest, should have asked whether the taxpayer's claimed interpretation of the DISC provisions conflicted with the statutory requirements for Roth IRAs and vice versa. Recall that the DISC in *Summa Holdings* secured neither of the tax benefits that Congress provided in the DISC statute (deferral and avoidance of corporate-level tax),[290] because the taxpayers immediately distributed the DISCs income (no deferral) and the distributions were subject to UBIT (same rate as corporate tax).[291] The only function of the DISC was to channel profit from the taxpayers' business into their Roth IRAs in a fashion that avoided the application of the transfer pricing limitations of Section 482 and wholly eviscerated the Roth IRA contribution limits; in effect, it substituted the limits on funding a DISC, which were orders of magnitude larger than the Roth IRA contributions limits, for the latter. That use of a DISC is not, to quote Justice Scalia, "compatible with the surrounding body of law into which the provision[s] must be integrated."[292] The Sixth Circuit's holding rested on a rigid textualism that failed to appreciate how dramatically out of keeping the transaction was with the statutory scheme.[293] A more robust textualism could, without looking for meaning beyond the text in supposed legislative intent, conclude that the Code does not authorize DISC ownership by Roth IRAs, at least when a combination of the two produced results that were so wildly out of keeping with the restrictions and limitations of the statutory scheme taken as a whole.

The judicial anti-abuse doctrines serve as aids to statutory interpretation by leading judges to think about the *combination* of statutes in complex transactions.[294] For example, under the economic substance requirement of

[288] *See id.* at 789.

[289] *See* LAWSON, *supra* note 24, at 10 (discussing methods of statutory interpretation).

[290] *See Summa Holdings*, 848 F.3d at 782 (discussing purpose of DISC tax incentives).

[291] *See id.* at 784 (describing taxpayers' use of the DISC).

[292] Green v. Bock Laundry Mach. Co., 490 U.S. 504, 528 (1989) (Scalia, J., concurring).

[293] As Blankenship observes, a strong argument can be made that the "substance-over-form doctrine should apply because the taxpayers' actions were inconsistent with the DISC statutory scheme." *See* Blankenship, *supra* note 178, at 974.

[294] *Cf.* Choi, *supra* note 5, at 224-25 (describing substance-over-form doctrine application method as "using whatever combination of text, legislative history, or other evidence that a judge prefers"). Under Choi's approach, the judicial anti-abuse doctrines establish a presumption that transactions lacking a non-tax purpose are invalid. *Id.* at 224 ("All

Section 7701(o), the combination of the DISC and Roth IRA provisions in *Summa Holdings* would be invalid because the combination itself did not meaningfully change the taxpayer's position apart from tax purposes.[295] While it is reasonable to conclude that Congress exempted Roth IRAs and DISCs in isolation from the economic substance doctrine, there is no evidence that it similarly exempted their combined use, especially where the DISC never took advantage of either of the benefits Congress explicitly provided for DISCs.[296] This economic substance inquiry draws attention to the very issue that the Sixth Circuit overlooked: that the transaction sought to integrate two Code regimes in a manner that neither individually contemplated and that had the effect of circumventing multiple, explicit statutory limitations. Similarly, the substance-over-form doctrine exhorts judges to inquire whether the taxpayer's characterization of a transaction is consistent with the entire statutory scheme. In *Summa Holdings*, the Sixth Circuit should have used the substance-over-form doctrine to consider whether the taxpayer's characterization of a transaction "fails to capture economic reality and would distort the meaning of the Code in the process."[297] If, in substance, the transaction consisted of distributions made from the export business to its shareholders which were, in turn, contributed to their Roth IRAs, then allowing the taxpayer's formal characterization of the transaction would distort the meaning of the Code by undermining the Roth IRA contribution limits.[298]

transactions whose form is selected solely to reduce taxes and not to reflect substance, and especially those undertaken between related parties without an attempt at arm's-length dealing or fair market valuations, are presumptively invalid for tax purposes."). Thus, he contends that even conventional Roth IRAs are presumptively invalid, but Section 408A conclusively rebuts the presumption. *Id.* at 225. In the transaction in *Summa Holdings*, he finds nothing in the text or legislative history to rebut the presumption of invalidity, so he would apply the doctrines to deny the Benensons' characterization of the transaction. *Id.* His approach is similar to that proposed in this Note in that Choi also views the doctrines as a guide to statutory interpretation. However, Choi's approach is substantive—the doctrines establish a presumption of invalidity for certain transactions—whereas this Note's proposal is hermeneutical; when confronted with an ambiguous question of law arising from the interaction of multiple provisions, courts should use the doctrines to guide their inquiry into whether the transaction respects each provision as well as the statutory scheme as a whole. For Choi, the presumption created by the doctrines is alone sufficient to dispose of certain cases; under this Note's proposal, the doctrines can do no more than inform a court's application of the facts to the law, the latter of which ultimately determines the outcome of a case.

295 *See* I.R.C. § 7701(o).

296 *See supra* Section II.B.1 (discussing congressional purpose for DISC tax provisions).

297 Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 787 (6th Cir. 2017).

298 Manns and Todd suggest that the rationale of *Summa Holdings* would support the "backdoor Roth IRA"—a transaction where taxpayers who do not qualify for Roth contributions make contributions to a traditional IRA and then convert the traditional IRA to a Roth IRA. *See* F. Philip Manns Jr. & Timothy M. Todd, *The Front Door Opens Wide for the Backdoor Roth IRA*, 155 TAX NOTES 1325, 1328 (2017) (reasoning that backdoor Roth

Applied in this manner, judicial anti-abuse doctrines do not dispose of cases on extra-statutory grounds; rather, they instruct judges to ask questions about the transaction and its interaction with the Code in a manner that elucidates just how questionable the taxpayer's claims for the "proper" application of the law to the facts are. Accordingly, the doctrines help bring these misapplications of the law to light and therefore facilitate the proper interpretation of the Code.

B. *Examples*

To further illustrate this method, consider the four classic tax avoidance cases discussed in Section I.A.[299] We have already seen that the Sixth Circuit views *Knetsch* as a proper use of the anti-abuse doctrines because it applies the doctrines to ambiguous questions of fact to rightly deny the taxpayer's false or misleading characterization of the transaction.[300] Similarly, the Sixth Circuit might challenge the genuineness of the transaction in *Franklin*. Based on its approach to *Knetsch*, it might conclude that the "mere shuffling" of documents between the parties with no meaningful change in their economic positions was a mere sham, and, as such, the partnership could not claim depreciation deductions on an asset that it did not genuinely own.

The Sixth Circuit squeezed *Gregory* into the mold of the sham transaction doctrine.[301] However, as discussed above, there is little support for denying the genuine existence of the newly formed corporation or the exchange of the shares.[302] Under this Note's proposal, a textualist judge confronted with *Gregory* would first ask if the combination of the reorganization and liquidation provisions in the transaction respected the statutory scheme as a whole. In other words, ask if the taxpayer's characterization of the combination's net effect would do violence to any provision in the statutory scheme. Here, if the taxpayer's characterization of the combination's net effect were allowed, it would partially nullify the rule that dividends are taxed at ordinary rates rather than at capital gain rates.[303] Under the statutory scheme at the time of *Gregory*, if the taxpayer's characterization were upheld, anyone who was a controlling

IRA would be allowed by *Summa Holdings* court logic because "the code expressly authorizes nondeductible contributions to traditional IRAs. Similarly, the code expressly authorizes converting a traditional IRA to a Roth IRA").

[299] *See supra* Section I.A (discussing *Knetsch*, *Goldstein*, *Franklin*, and *Gregory*).

[300] *See Summa Holdings*, 848 F.3d at 785 (citing Knetsch v. United States, 364 U.S. 361, 365-66 (1960)) (approving of logic that interest deduction should be denied when "the 'loan' has no business function other than enabling those deductions and does not create a true obligation to pay interest").

[301] *See supra* Section II.C (arguing that Sixth Circuit incorrectly characterizes dispute in *Gregory* as question of fact rather than question of law).

[302] *See supra* Section II.C (noting that transaction structure was technically compliant with Code).

[303] *See* Helvering v. Gregory, 69 F.2d 809, 811 (2d Cir. 1934) ("To dodge the shareholders' taxes is not one of the transactions contemplated as corporate 'reorganizations.'").

shareholder could have avoided dividend income from distributions in kind of capital assets by forming a new corporation, transferring the property to the new corporation, and then liquidating the new corporation to realize capital gain (and basis offset) on the liquidation instead of ordinary income on the dividend.[304] Accordingly, the taxpayer's characterization of the combination of the reorganization and liquidation rules would distort the meaning of the Code by obliterating a crucial aspect of the distinction between dividends and capital gains.

Under this Note's proposal, after determining that the combination of the provisions would distort the meaning of the Code, the next step would be to apply the judicial anti-abuse doctrines. First, the transaction would fail the economic substance doctrine because it does not meaningfully change the taxpayer's position apart from tax considerations. Second, having failed the economic substance doctrine, a reviewing court would employ the substance-over-form doctrine and recharacterize the transaction in a way that comports with its substance: not a reorganization followed by a liquidation, but rather a distribution from the first corporation to Gregory that should be taxed as a dividend in kind. Accordingly, by applying the judicial anti-abuse doctrines to the ambiguous legal question of whether the combination of the reorganization and liquidation provisions avoids dividend treatment, a textualist judge may close the loophole as a matter of statutory interpretation without inquiring into non-textual sources of congressional intent.

However, even this Note's expanded version of the judicial anti-abuse doctrines likely would not change the outcome in *Goldstein*. In that case there was only one provision at issue, Section 163(a), which provided that "[t]here shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."[305] Neither this nor any related provisions expressly required that the indebtedness have economic substance or a business purpose, and Section 7701(o), which now provides generally that the economic substance requirement applies to all transactions to which it is "relevant," was not then in effect.[306] Accordingly, because the issue in *Goldstein* involved the interpretation of an isolated provision, even under this Note's expanded account of the anti-abuse doctrines, textualist judges would still have to choose between straining to view the transaction as a sham or allowing the claimed tax benefit.

Cases like *Goldstein* ultimately turn on the choice between textualism and intentionalism, irrespective of whether the former employs judicial anti-abuse doctrines. From an intentionalist perspective, textualism's failure to solve a case

[304] *See id.* at 810.

[305] I.R.C. § 163(a).

[306] *Id.* (containing no reference to business purpose or economic substance); *see also id.* § 7701(o) (providing definition of economic substance for "any transaction to which the economic substance doctrine is relevant," without explicitly detailing when doctrine is relevant).

like *Goldstein* evidences its inadequacy as an interpretive method.[307] To the textualist, this contention begs the question; *Goldstein* does not need to be "solved" because the taxpayer complied with the law, and using judicial anti-abuse doctrines to pile on extra-statutory requirements or recharacterize the transaction amounts to allowing "the Commissioner to place labels on transactions to avoid textual consequences he doesn't like."[308] This Note's expanded version of judicial anti-abuse doctrines shifts the point at which this fundamental methodological debate appears from cases like *Gregory* or *Summa Holdings* to cases like *Goldstein*, but the ultimate disagreement between textualism and intentionalism falls beyond its scope.

C. *Counterarguments*

There are three counterarguments to this Note's treatment of judicial anti-abuse doctrines. The first comes from Professor Isenbergh who contends that judicial anti-abuse doctrines do not solve the problem of tax avoidance because legislative action is always necessary. Consider the following:

> A justification frequently offered for extrastatutory or remedial forays by the courts in tax cases is that the tax laws cannot possibly reach all the artful forms of transaction used by taxpayers to reduce taxes and, therefore, that the courts have an important function in filling gaps left open by an imperfectly expressed congressional intent. Few myths so persistent are as easily dispelled. It is hard to think of a single case that has ever permanently staunched any fissure in the congressional dyke.
>
> None of the cases reviewed here forestalled the necessity to change the law.[309]

In other words, judicial anti-abuse doctrines are superfluous and serve little practical purpose because congressional fixes are always necessary to resolve loophole-type problems with the Code.[310] Moreover, Isenbergh continues, judicial anti-abuse doctrines punish taxpayers who justifiably rely on the law, and the only real beneficiaries of the uncertainty created by the doctrines are tax lawyers who become increasingly necessary to navigate not only the Code but also the extra-statutory layers of judicial scrutiny.[311]

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[307] *See* Cunningham & Repetti, *supra* note 7, at 20-32 (arguing that textualism legitimizes taxpayer abuse).

[308] *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 787 (6th Cir. 2017).

[309] Isenbergh, *supra* note 4, at 880 (footnote omitted).

[310] *See id.* (explaining how judicial attempts to resolve perceived congressional oversights are sometimes explicitly repudiated by changes to the Code).

[311] *See id.* at 883 ("The heavier the layers of judicial divination superimposed on the Internal Revenue Code, the richer tax lawyers are apt to get. The development of an exquisite set of intuitions about what kinds of transactions the courts 'like' and 'don't like' has become a large part of what tax lawyers sell.").

This argument overlooks the significance of the gap in time between the discovery of a loophole and its statutory fix.[312] While legislative changes are certainly necessary to combat new shelters, by the time the legislative fix is enacted into law, "shelter promoters will have discovered another existing flaw and will be exploiting that."[313] Because of the prospective nature of most legislation, loophole abuse, at its most extreme, could result in "a state of affairs under which we raise no significant money from capital."[314] The deterrent effect of judicial anti-abuse doctrines is therefore an essential element of effective legal enforcement. Thus, while Isenbergh is likely correct that once a loophole is discovered, legislation is necessary to fully correct the issue, his conclusion that judicial anti-abuse doctrines are superfluous overlooks the gap in time between the discovery of a loophole and its legislative fix.

A second counterargument is that the only way to solve the problem of tax avoidance is to abandon textualism in favor of intentionalism.[315] Cunningham and Repetti argue that textualism legitimizes tax shelters by conflating congressional intent with the literal text of the Code.[316] They contend that "[i]t is in the nature of abusive transactions that the statute in question is inadequate to address the abuse."[317] The only way to prevent this kind of abuse is to "go beyond the literal wording of the statute in order to effectuate its purpose" through the use of "intentionalist and purposivist approaches" to statutory interpretation.[318]

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[312] *See* Bankman, *The Tax Shelter Battle*, *supra* note 3, at 20 (arguing that Code is filled with potential loopholes, and that as one loophole is closed with congressional action, others may be created or discovered); *see also* Steven A. Dean & Lawrence M. Solan, *Tax Shelters and the Code: Navigating Between Text and Intent*, 26 VA. TAX REV. 879, 904 (2007) ("[W]e have little doubt that skilled planners will continue to find ways of thwarting legislative intent, at least until Congress or the Treasury acts to put out fires with respect to individual shelters. Yet we also believe that it is very much worthwhile for the courts and the Treasury to be aware of what interpretive tools they have . . . .").

[313] Bankman, *The Tax Shelter Battle*, *supra* note 3, at 20; *cf.* Gilmore, *supra* note 149, at 476-77 (arguing that by time Congress enacts statutes, problems they correct have generally already been resolved by courts).

[314] Bankman, *The Tax Shelter Battle*, *supra* note 3, at 20.

[315] *See* Cunningham & Repetti, *supra* note 7, at 20 (asserting that textualist approach to Code interpretation undermines purposivist interpretation doctrines and "supports literal interpretations that are the keystone of tax shelters"); *see also* Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, 200 U. ILL. L. REV. 697, 697 (2009) (arguing that judicial anti-abuse rules are "outdated and insufficient to curb tax shelters," and instead advocating for "an alternative test, which inquires directly into the purposes of the tax laws").

[316] *See* Cunningham & Repetti, *supra* note 7, at 20 (arguing that Code's literal text cannot always capture congressional purpose).

[317] *Id.*

[318] *Id.*

The primary issue with this argument is practical rather than theoretical; textualism is on the rise in the federal courts and does not appear to be going anywhere soon.[319] Bankman writes that "[t]he form of literal interpretation upon which shelters are predicated is more popular among young lawyers than among older lawyers."[320] Moreover, the large number of Trump appointees to the bench will likely strengthen the textualist movement in the near future.[321] Thus, while textualism plus judicial anti-abuse doctrines may still allow for more "bad outcomes" than pure intentionalism, as long as textualism remains a significant force in contemporary jurisprudence, internal reform of textualism, rather than a complete paradigm change, is the only workable solution.

A third counterargument is that judicial activism, rather than tax avoidance, is the real problem, and eliminating or sharply constraining judicial anti-abuse doctrines is essential in combating judicial activism.[322] Richard Lipton captures a version of this argument when he states that judicial anti-abuse doctrines should not be applied as a "'catch all' to disallow tax benefits otherwise provided . . . . Likewise, strained readings of the Code and regulations in order to get the 'right answer' must be avoided. If that is not done, at some point we will be living in a world without any respect for the law."[323] Lipton makes the same erroneous assumption that the Sixth Circuit did in *Summa Holdings*; namely, that the meaning of a law is unaffected by other provisions.[324] This hermeneutical assumption is not required by textualism. There is no statute that says statutes are to be construed in isolation from other provisions in the statutory scheme.[325] Accordingly, Lipton's view unnecessarily hamstrings textualism by eliminating a text-based method for denying taxpayer positions that fail "to capture economic reality and would distort the meaning of the Code

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[319] *See* Cantley & Dietrich, *supra* note 273, at 129 ("Both Congress and the Treasury Department must recognize that the Supreme Court's textualist-focused interpretation of statutes is the new judicial norm.").

[320] *See* Bankman, *The Tax Shelter Battle*, *supra* note 3, at 22.

[321] John Gramlich, *How Trump Compares with Other Recent Presidents in Appointing Federal Judges*, PEW RSCH. CTR. (Jan. 13, 2021), https://www.pewresearch.org/fact-tank/2021/01/13/how-trump-compares-with-other-recent-presidents-in-appointing-federal-judges/ [https://perma.cc/2E5Q-NDHB] (reporting that "[m]ore than a quarter of currently active federal judges are now Trump appointees" and that "Trump 'flipped' the balance of several appeals courts from a majority of Democratic appointees to a majority of Republican appointees").

[322] *See* Lipton, *supra* note 8, at 622 (criticizing decisions that involve "the stretching and misapplication of the Code and the judicial doctrines to undo the results that are clearly permissible by the existing provisions of law").

[323] *Id.* at 637-38.

[324] *See supra* Section II.B.2 (discussing Sixth Circuit's refusal to consider interplay between DISC tax rules and Roth IRA contribution limits).

[325] *See supra* Section III.A (reasoning that interpreting Code provision in context with other Code provisions comports with textualist approach to statutory interpretation).

in the process."[326] The account of judicial anti-abuse doctrines proposed by this Note attempts to respect the letter of the law through textualist hermeneutics while simultaneously addressing the problem of lost revenue caused by loopholes in the Code through the use of judicial anti-abuse doctrines.

CONCLUSION

This Note proposes an account of judicial anti-abuse doctrines that does not give judges free rein to impose their policy judgments on a statute, but rather provides an opportunity to consider whether a taxpayer's use of the Code respects the text—not only at the level of each individual provision but also when considering the interaction of multiple provisions. Textualist judges are not powerless to close statutory loopholes. They should employ judicial anti-abuse doctrines to prevent parties from using a combination of laws to achieve results that conflict with the provision's "relation to the entire act of which the statute is a part."[327] Or in the Sixth Circuit's words, when taxpayers combine provisions of the Code in ways that are inconsistent with related statutory provisions and with the relation of the statute to the Code as a whole, courts should use judicial anti-abuse doctrines to characterize the transaction in a manner that respects both "the written word [of the Code] and the economic realities of this transaction."[328]

[326] *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 787 (6th Cir. 2017) (explaining appropriate time to invoke economic substance doctrine).

[327] *See* LAWSON, *supra* note 24, at 10.

[328] Hawk v. Comm'r, 924 F.3d 821, 831 (6th Cir. 2019).