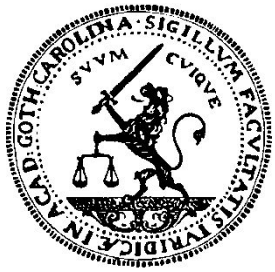

FACULTY OF LAW
Lund University

Sotirios Apostolou

General Anti-Avoidance Rules and the rule of law

LAGF03 Essay in Legal Science

Bachelor Thesis, Master of Laws programme
15 higher education credits

Supervisor: Britta Sjöstedt

Term: Autumn term 2016

Contents

Summary

General anti-avoidance rules, or GAARs, are legislative measures against unacceptable tax avoidance. The typical structure of a GAAR refers to two prerequisites: the intent of the taxpayer and the intent of the legislator. If the main purpose of a transaction is to minimize tax expenses in a way unintended by the legislator, the transaction can be disregarded from a tax perspective. The potentially problematic part of the GAARs is the reference to the legislator's intent. The reason is that this intent is not clarified in any binding source of law and thus creates predictability issues for the taxpayer.

The GAARs' predictability issues have been discussed since the 1980's and are still relevant today. However, the researched literature reveals no clear answer as to whether or not, bearing these issues in mind, the GAARs conform to the rule of law. It is precisely at this point where I believe this essay can be valuable.

In this essay I set the GAARs against a generally accepted theory of the rule of law: Fuller's eight principles of legality, expressed in his work "The Morality of Law". The test reveals that the GAARs are problematic from a rule of law perspective. Nonetheless, authors have argued that GAARs are still justified, mainly because they serve the demands of substantive justice. In conclusion, I suggest that the position one can take on this issue is subjective and depends on what we accept as the point of law.

Sammanfattning

Generella skatteflyktsregler, eller GAARs (general anti-avoidance rules), är legislativa åtgärder mot skatteflykt. GAARs typiska struktur består av två förutsättningar: skattebetalarens syfte och lagstiftarens syfte. Om det huvudsakliga syftet med en transaktion är att minimera skatteutgifter på ett sätt som lagstiftaren inte hade avsett får transaktionen bortses ifrån vid beskattningen. GAARs potentiellt problematiska del är hänvisningen till lagstiftarens syfte. Anledningen till detta är att det syftet inte tydligt anges i någon bindande rättskälla och följaktligen skapar förutsebarhetsproblem för skattebetalaren.

GAARs förutsebarhetsproblem har diskuterats sedan 1980-talet och är fortfarande aktuella idag. Litteraturen ger emellertid inget tydligt svar angående huruvida GAARs, med tanke på dessa problem, är förenliga med rättssäkerheten. Det är just angående denna punkt jag tror att denna uppsats kan ha ett visst värde.

I uppsatsen ställer jag GAARs mot en allmänt erkänd rättssäkerhetsteori: Fullers åtta legalitetsprinciper, formulerade i hans verk "The Morality of Law". Testet tyder på att GAARs är problematiska ur rättssäkerhetsperspektiv. Några författare har dock argumenterat att GAARs ändå är rättfärdigade, huvudsakligen eftersom de tjänar den substantiva rättvisan. Avslutningsvis menar jag att den ståndpunkt man kan ta i denna fråga är subjektiv och beror på vad vi accepterar som lagens syfte.

Abbreviations

GAAR: General Anti-Avoidance Rule.

SAAR: Specific Anti-Avoidance Rule.

Introduction

1. In general

Taxes constitute an important factor for both the states' social policy and the financial policy of corporations.[1] Inevitably, there tends to be tension between these two policies, as states are interested in increasing their tax profit, while corporations, as well as individual citizens, are interested in decreasing their tax expenses. Tax planning is an expression of this tension.

Tax planning has been increasing in the last decades in pace with the increased possibilities for international transactions.[2] In its turn, increased tax planning has been problematic for states, who are taking measures in order to counter its undesirable effects.[3]

---

[1] Pettersson, Lennart, Conclusions in *International tax avoidance and evasion: compendium of documents*, International Bureau of Fiscal Documentation, Amsterdam, 1981, p. 131; Nowotny, Christian, Taxation, Accounting and Transparency: The Interaction of Financial and Tax Accounting in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008 p. 101; Erle, Bernd, Tax Risk Management and Board Responsibility in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008 p. 207-208; Friese, Arne, Link, Simon and Mayer Stefan: Taxation and Corporate Governance - The State of the Art in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008 p. 379; Kirby, Michael, Sham and Tax Law in Australia in Simpson, Edwin & Stewart, Miranda (red.), *Sham transactions*, 2014, p. 277.

[2] Uckmar, V, General Report in *Cahiers de droit fiscal international: Studies on international fiscal law = Schriften zum internationalen Steuerrecht,* Kluwer, Deventer, 1939, Volume LXVIIIa, Venice, 1983 p. 17; Hilling, Maria, *Skatteavtal och generalklausuler: ett komparativt perspektiv*, 1. uppl., Wolters Kluwer, Stockholm, 2016, p. 69 with further reference to C. Evans, *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, Hong Kong Law Journal vol. 37 2007, p. 103 and J. Braithwaite, *Markets in Vice: Markets in Virtue*, Oxford 2005, kap. 2.

[3] *International tax avoidance and evasion: four related studies*, Organisation for Economic Co-operation and Development, Paris, 1987 p. 11; Hilling p. 70 with further reference to C. Evans, *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, Hong Kong Law Journal vol. 37 2007, p. 103 and J. Slemrod, *The Economics of Corporate Tax Selfishness*, 2004 NBER Working Paper Series, p. 22.

In the broadest of terms, the legislative measures employed to counter undesirable tax planning consist of specific (SAAR) and of general (GAAR) anti-avoidance rules (see section 1.5). The main problem of the latter has always been their lack of predictability.[4]

2. The overall aim of the essay

The overall aim of the essay is to set the GAARs against the requirements for the rule of law, in an attempt to reach a conclusion whether or not their lack of predictability renders them problematic from a rule of law perspective.

3. Framing the issue

In the aforementioned context, the question at issue can be formulated as follows: do the GAARs conform to the requirements of the rule of law? Since the researched material does not reveal a clear "yes or no" answer to this question, in this essay I present arguments both for and against the GAARs conformity and I attempt to weigh them against each other in the conclusion.

4. Demarcations

First of all, the question of this essay concerns measures against *tax avoidance*, i.e. the *legal* form of tax planning; consequently, the *illegal* forms of tax planning that fall under tax evasion will only be discussed in order to draw the line between these two forms (see section 1.2).

Second, the GAARs constitute *legislative measures* against tax avoidance. *Court doctrines* are also used, along with legislative

[4] Tikka, Kari S., Vad avses med rättssäkerheten i beskattningen? in Nordiska skattevetenskapliga forskningsrådet. Seminarium, *Rättssäkerheten i beskattningen: rapporter vid Nordiska skattevetenskapliga forskningsrådets seminarium i Helsingfors i oktober 1982*, Forskningsrådet, Stockholm, 1983 p. 9, 12.

measures, to counter the practice. Such doctrines are mentioned, as part of the states' measures against tax avoidance, but are otherwise not a part of the discussion.

Last, it is only the GAARs that are tested against the requirements for the rule of law. I saw no reason to include the SAARs in the discussion, as no issue has been raised for them, apart from the complexity they add to the system.

5. Perspective, method and theory

In this essay, I mainly use the legal philosophical method and secondarily the legal doctrinal method. Whereas the latter concerns itself with "the solution to a legal problem by applying a legal rule to it", the former treats law from a philosophical perspective.[5] I use the legal rule, the GAARs, as the problem and try to find a solution by applying a legal philosophical theory to it, the theory in Fuller's "The Morality of Law."

This theory is presented in more detail in section 2. I have chosen to use this theory on two grounds. First, because it has been a part of legal theory for almost fifty years, gone through extensive peer review and, in the revised version, the author himself has had the opportunity to answer to many of its critics. Second, because I find that the author's view of law as a "purposeful enterprise", dependant for its success on "an effective interaction" between the lawgiver and the citizen, is especially appropriate in the field of tax law. That is because I believe tax law to be the field of public law which most requires the cooperation of the individual in order to be effective.[6]

[5] Kleineman, Jan, Rättsdogmatisk metod in Korling, Fredric & Zamboni, Mauro (red.), *Juridisk metodlär*a, 1. uppl., Studentlitteratur, Lund, 2013 p. 21.
[6] Fuller, Lon L., *The morality of law,* Rev. ed, New Haven ..., 1969 p. 145, 193.

6. Setting the scene

The issue of GAARs and the rule of law was debated in the 1980's in works such as "International Tax avoidance and evasion: compendium of documents" by the International Bureau of Fiscal Association and "Seminarium, Rättssäkerheten i beskattningen: rapporter vid Nordiska skattevetenskapliga forskningsrådets seminarium i Helsingfors i oktober 1982". There appeared no relevant publications in later decades, even though the issue of GAARs and the rule of law is still problematic, as observed in 2016 by Hilling in "Skatteavtal och generalklausuler: ett komparativt perspektiv".[7]

In this context I believe this essay to be of value, as it addresses the issue of the GAARs conformity to the rule of law and sets it against a generally accepted theory in the field.

7. Material

The source used most extensively in this essay is Fuller's "The Morality of Law", which constitutes the exclusive source for section 2. Sources that stand out among the rest of the material are Hilling's "Skatteavtal och generalklausuler: ett komparativt perspektiv", which is also the most recent source, published in 2016, Uckmar's General Report in Volume 83a of Cahiers de droit fiscal international and Tikka's "Vad avses med rättssäkerheten i beskattningen?" from the Nordic Tax Research Council's seminar in Helsinki in 1982.

[7] Hilling, p. 74.

8. Disposition

In section 1 I attempt to explain the GAARs' position in the legal order. I start from a relatively familiar concept of simple forms of effort to minimize tax expenses, for which I chose to adopt the term tax saving, (1.1) and proceed to set the limits between avoidance and evasion (1.2), acceptable and unacceptable tax avoidance (1.3), judicial and legislative measures against the latter (1.4) and, finally, general and specific anti-avoidance rules (1.5).

In section 2 I aim to frame Fuller's morality of law by introducing his concept of law (2.1) and the difference between internal and external morality of law (2.2) before proceeding to his eight principles of legality (2.3).

In section 3 I make the effort to test the GAARs against certain of the aforementioned principles of legality before concluding in section 4.

1. The road to GAARs

GAARs constitute the main object of this essay. In this first section I attempt to clarify what GAARs are and what position they occupy in the legal order.

As the acronym itself, General Anti-Avoidance Rules, suggests, GAARs are legal provisions intended to deal with unacceptable tax avoidance in a general way. At first glance, this sentence creates more questions than it answers: what is tax avoidance, what constitutes an unacceptable such and how "general" is "a general way"? In the following sections I seek to navigate the area from a known concept, the concept of tax saving - in the sense of taxpayer behaviour aiming at minimizing tax expenses - under section 1.1, to GAARs under section 1.5. On the way, I introduce what I call four forks on the road from tax saving to GAARs: avoidance or evasion (1.2), acceptable or unacceptable tax avoidance (1.3), judicial or legislative measures (1.4) and specific or general anti-avoidance rules (1.5). These "forks" represent the way I have made sense of the information I studied while I researched the subject; in this section I use them in order to explain the terms that give rise to the questions mentioned in the beginning of this paragraph as well as to try to locate the GAARs in the legal order, in an effort to clarify their role in countering tax avoidance. The road begins with the concept of tax saving.

1.1 Tax saving

Fiscally irrelevant behaviour

I adopted the expression "tax saving" from the general report of a publication of the Studies on international fiscal law. The term

expresses legally irrelevant taxpayer behaviour, "in an area [...] which the legislator *did not wish* [emphasis mine] to regulate or to consider fiscally relevant." This legislative intent is the main difference between tax saving and tax avoidance: the latter takes place "in an area of behaviour which the legislator *wished* [emphasis mine] to bring under control *but did not succeed* [emphasis mine] in so doing." Examples of tax saving include reduction of consumption or work in order to avoid paying the relevant taxes.[8]

1.2 Tax evasion and tax avoidance

Tax evasion: violates the letter of the law

Tax avoidance: follows the letter of the law

When we face more aggressive and/or sophisticated practices that go beyond the fiscally irrelevant area of tax saving, we are faced with behaviour which falls under either tax evasion or tax avoidance. This is the first fork on the road from tax saving to GAARs. At this point, we find ourselves at the level of the letter of the law; namely, behaviour that contravenes the letter of the law is classified as tax evasion, while behaviour that respects the letter of the law constitutes tax avoidance.

It follows from the above that the most significant difference between tax evasion and tax avoidance is that tax evasion is illegal, more specifically criminal behaviour from the part of the taxpayer punished by criminal law, while tax avoidance is legal.[9] I believe that

[8] Uckmar, p. 20,23.

[9] Ilersic, A. R., THE ECONOMICS OF AVOIDANCE/EVASION in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979 p. 23; Recommendation 833 (1978) on cooperation between Council of Europe member states against international tax avoidance and evasion Point 5, in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981 p. 162; Seldon, Arthur PROLOGUE: AVOISION:

this is an appropriate point to clarify that the distinction between acceptable and unacceptable forms of tax avoidance, discussed in the next section 1.3, is, thus, a distinction between two *legal* forms of taxpayer behaviour.

1.3 Acceptable and unacceptable tax avoidance

Acceptable tax avoidance: follows the spirit of the law

Unacceptable tax avoidance: violates the spirit of the law

Legal taxpayer behaviour aimed at minimizing tax expenses, that is, as mentioned under 1.2 above, more aggressive and/or sophisticated

---

THE MORAL BLURRING OF A LEGAL DISTINCTION WITHOUT AN ECONOMIC DIFFERENCE in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979 p. 3-4; Myddelton D. R., TAX AVOISION - ITS COSTS AND BENEFITS in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979 p. 44; Dymond, A. Christopher, Reid, Robert J. & Curran, Michael A., *Income tax administration, avoidance & evasion,* Butterworth, Toronto, 1981 p. 99-100; Bracewell-Milnes, B., EPILOGUE: IS TAX AVOISION A BURDEN ON OTHER TAXPAYERS? in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979 p. 107; Tixier, G., Definition, scope and importance of international tax evasion in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981, p. 37; TAX EVASION, TAX AVOIDANCE AND TAX PLANNING Edited extracts from a 1980 report by the Committee on Fiscal Affairs in *International tax avoidance and evasion: four related studies,* Organisation for Economic Co-operation and Development, Paris, 1987 p. 16; Friese et al. p. 399-400; Gammie, Malcolm, The judicial approach to avoidance: some reflections on BMBF and SPI in in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009 p. 29-30 with further reference to Kay, J. (1979), 'The Economics of Tax Avoidance', *British Tax Review*, 1979: 354–65; Schön, Wolfgang, Abuse of rights and European tax law in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009 p. 79; Schreiber, Ulrich., *International Company Taxation [Elektronisk resurs] : An Introduction to the Legal and Economic Principles,* Springer Berlin Heidelberg, Berlin, Heidelberg, 2013, p. 47; Hilling, p. 71-72.

than tax saving, constitutes tax avoidance.[10] This legal behaviour can, nevertheless, be deemed either acceptable or unacceptable by the competent administrative authorities and/or courts of law, depending on whether or not it conforms to the spirit, as well as the letter, of the law. This is the second fork on the way from tax saving to GAARs. While the first fork, under 1.2 above, was based upon whether or not a behaviour respected the letter of the law, this one is based upon whether or not the *legal* behaviour respects the *spirit* of the law.[11]

I adopted the adjectives "acceptable" and "unacceptable" to characterize the two forms of tax avoidance for two reasons. First, because I believe that they are more neutral than the often used terms "abusive" and "non-abusive" tax avoidance.[12] This is important because tax avoidance "is actually a neutral term", as opposed to tax evasion.[13] Second, because the often made distinction between tax avoidance, as the unacceptable form, and tax planning, as the acceptable form, presents, I find, the problem that it denotes a fixed boundary, in the sense that once a practice is categorized as one or the other, it tends to stay that way. Unfortunately, the space limitations of this essay do not allow for elaboration on the matter; I will, however, briefly comment that there are arguments, such as the artificiality of the transaction, its business purpose or lack thereof, and the taxpayer's intent, that can lead to the same practice being judged differently under different circumstances.[14] Therefore, I

[10] Seldon, p. 3-4, Uckmar, p. 23.
[11] Boer, P. den, Anti-avoidance measures in the Netherlands in Avery Jones, John Francis (red.), *Tax havens and measures against tax evasion and avoidance in the EEC*, London, 1974, p. 44; TAX EVASION, TAX AVOIDANCE AND TAX PLANNING, p. 17.
[12] Hoorn Jr., J. van, The Use and Abuse of Tax Havens in Avery Jones, John Francis (red.), *Tax havens and measures against tax evasion and avoidance in the EEC,* London, 1974, p. 8-10.
[13] Hoorn, p. 1.
[14] Uckmar, p. 26 - 28, TAX EVASION, TAX AVOIDANCE AND TAX PLANNING, p. 17.

believe that the terms “acceptable” and “unacceptable” tax avoidance express in a better way the notion that “acceptable” and “unacceptable” are subjective qualifications of a given practice that can vary according to the facts of each specific case.

1.4 Judicial and legislative measures

When state organs become aware of unacceptable tax avoidance practices, that is, as explained under 1.3 above, practices that respect the letter but violate the spirit of the law, they tend to employ measures to counter such practices and apply the tax legislation as intended. For the most part, these measures belong to either the judicial or the legislative power.[15] This is the third fork on the way from tax saving to GAARs. These measures are not mutually exclusive; rather they can complement each other and coexist in a legal order.

In the case of judicial measures, the courts apply a number of doctrines, such as the substance over form doctrine, the sham transaction doctrine, the step transaction doctrine, the economic substance doctrine and the business purpose doctrine, in order to decide what the tax consequences of a specific practice should be.[16] Such consequences can refer to, for example, the nature of income or the deductibility of an expense.

---

[15] Tikka, p. 17.

[16] Uckmar, p. 28, 29; *International tax avoidance and evasion: four related studies,* p. 82; Korb, Donald L., Shelters, Schemes, and Abusive Transactions: Why Today’s Thoughtful U.S. Tax Advisors Should Tell their Clients to “Just Say No” in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008, p. 302-305; Gammie, p. 49, 61, 68-70; Jensen, Erik M. - The US legislative and regulatory approach to tax avoidance in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009 p. 110-111; Arnold, Brian J., Canada, referring [Shell Canada v. The Queen 1999] in Ault, Hugh J. & Arnold, Brian J., *Comparative income taxation: a structural analysis,* 3. ed., Wolters Kluwer, Austin, Tex., 2010, p. 41.

In the case of legislative measures, these can fall into the category of either SAARs or GAARs, as detailed under 1.5 below.

1.5 SAARs and GAARs

In this section we have reached the fourth and final fork on the road from tax saving (section 1.1) to GAARs: this is the case of taxpayer behaviours which respect the letter of the law (section 1.2) but violate its spirit (section 1. 3: unacceptable tax avoidance) and the state has elected to deal with them through legislative measures. These measures can take the form of specific (SAARs) or general (GAARs) anti-avoidance rules.[17]

These two types of rules complement each other. [18] The SAARs counter specific, known anti-avoidance behaviours, like transfer pricing, Controlled Foreign Corporations (CFC) and thin capitalization, while the role of the GAARs is to hinder upcoming tax-avoidance practices that fall outside the scope of the SAARs.[19]

In order to fulfill that role, GAARs are typically formulated as follows: they tend to have two prerequisites, the intent of the taxpayer and the intent of the legislator.[20] The first prerequisite, the intent of the taxpayer, means that the transaction in question has as its main purpose (or one of its main purposes, depending on the

[17] Hilling, p. 73.
[18] Hilling, p. 75.
[19] *International tax avoidance and evasion: four related studies,* p. 5; Schreiber, p. 48; Hilling, p. 75.
[20] Arnold, Brian, A comparison of statutory general anti-avoidance rules and judicial general anti-avoidance doctrines as a means of controlling tax avoidance: Which is better? (What would John Tiley think?) in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009 p. 12-13; Krever, Richard & Brederode, Robert F. van, Legal interpretation of Tax Law: A Reflection on Methods and Issues in Brederode, Robert F. van. & Krever, Richard (red.), *Legal interpretation of tax law,* Wolters Kluwer, Law & Business, Alphen aan den Rijn, 2014 p. 11; Hilling, p. 74.

formulation of the individual GAAR) the minimization of tax expenses.[21] The second prerequisite, the intent of the legislator, is related to the criterion discussed under 1.3 above, used to distinguish between acceptable and unacceptable tax avoidance, the spirit of the law.[22] It means that a transaction seeks to take advantage of tax rule in a way unintended by the legislator. If both of these conditions are met, the otherwise valid transaction, for example, from the point of civil or corporate law, cannot be invoked before the tax authorities and will not produce the tax law related results intended by the taxpayer.[23]

It is the second prerequisite, the intent of the legislator, that conceivably constitutes a problem from a rule of law perspective and will be tested under section 3. In short, the reason is that this intent is not articulated in any binding legal source and constitutes a source of uncertainty for the taxpayer.

[21] Arnold, 2009, p. 12-13.
[22] *Ibid.*
[23] Griffiths, Shelley and Palmer, Jessica SHAM, TAX AVOIDANCE, AND A GAAR: A NEW ZEALAND PERSPECTIVE in Simpson, Edwin & Stewart, Miranda (red.), *Sham transactions*, 2014, p. 242, Hilling, p. 74, 76.

2. Fuller's "morality of law"

Before proceeding, under 2. 3, to Fuller's eight principles of legality, I believe it is proper to define, however briefly, what the author's work, "The morality of law", essentially is about. To that end, I proceed to cite the definition of "law", according to the author, under 2.1, and the kind of morality of law his principles are meant to apply to, under 2.2.

2.1 Definition of "law"

The author uses the following definition of law: "law is the enterprise of subjecting human conduct to the governance of rules. Unlike most other theories of law, this view treats law as an activity and regards a legal system as the product of a sustained purposive effort."[24] This "purposive" element differentiates Fuller's theory of law from the positivistic theories of law, which treat law "as a manifested fact of social authority or power, to be studied for what it is and does, and not for what it is trying to become."[25] The reason this difference is important is that,

> [i]f law is simply a manifested fact of authority or social power, then, though we can still talk about the substantive justice or injustice of particular enactments, we can no longer talk about the degree to which a legal system as a whole achieves the idea of legality [...] There is in this determination no question of degree; one cannot apply to it the adjectives 'successful' or 'unsuccessful'. This, it seems to me, is the gist of the theory which opposes that underlying these chapters.[26]

[24] Fuller, p. 106.
[25] Fuller, p. 145.
[26] Fuller, p. 147-148.

From the aforementioned arguments one can draw the conclusion that legality, according to Fuller, is not a duality, i.e. either it exists or it does not, but rather a scale with qualifying degrees. Legal systems can, therefore, be qualified as more or less successful in achieving the objective of legality, according to the degree to which they fulfill the principles of legality, presented under 2.3.

2.2 Internal and external morality of law

The following, under 2.3, eight principles of legality are relevant in the context of the internal morality of law. This internal morality is procedural and

> concerned, not with the substantive aims of legal rules, but with the ways in which a system of rules for governing human conduct must be constructed and administered if it is to be efficacious and at the same time remain what it purports to be.[27]

This internal morality is opposed to the external morality of law, which corresponds to substantive natural law: "the proper ends to be sought through legal rules".[28]

Beyond this theoretical level, the difference between internal and external morality of law demands different attitudes from the judges as well; while the judges should remain neutral regarding the external morality of the law, i.e. the substance of the legal provisions, they should, on the other hand, definitely take a stand as far as issues of internal morality are concerned. For example,

[27] Fuller, p. 97.
[28] Fuller, p. 98.

> a neutral stand between an interpretation of a statute that would bring obedience to it within the capacity of the ordinary citizen and an interpretation that would make it impossible for him to comply with its terms

would be, according to the author, "an abdication of the responsibilities of [the judge's] office".[29]

2.3 The eight principles of legality

In this section, I present Fuller's eight principles of legality. It is according to certain of these principles that I aim to, in the following section 3, discuss the degree to which the GAARs comply with the rule of law. Due to constraints regarding the size of the essay, I only comment further on certain of the principles; either where the wording of the author may cause misunderstanding compared to the established meaning of the terms used, e.g. Principle 1: The Generality of law, or where I believe some demarcations are in order, e.g. Principle 2: Promulgation.

In his work, Fuller introduces the following eight principles of legality.[30]

Principle 1: The Generality of Law[31]

This requirement does not deal with the *content* of the law, but merely points to its *existence*: the first principle simply means that there must be rules.[32] The following principles apply to the rules that exist, granted that the requirement of generality is fulfilled.

[29] Fuller, p. 132.
[30] Fuller, p. 46-90.
[31] Fuller, p. 46-49.
[32] Fuller, p. 46.

Principle 2: Promulgation[33]

As regards the requirement of promulgation, the author distinguishes between the *act of promulgation* and *actual knowledge* of the law: he remarks that this principle does not necessarily demand that every citizen will actually "sit down and read [every law that might conceivably be applied to him]."[34]

Principle 3: Retroactive laws[35]

Regarding the retroactivity of laws, the author does not completely exclude the possibility that retroactive rules can be necessary in a legal order, "in a context of rules that are generally prospective", in order to, for example, correct violations of legality by earlier laws, for instance laws that have not been promulgated.[36] It follows that retroactive laws should constitute the exception and not the rule.

Principle 4: The clarity of Laws[37]

Regarding the principle of clarity the author makes the point that it is the responsibility of the legislator and should not be delegated "to the courts or to special administrative tribunals."[38]

Principle 5: Contradictions in the laws[39]

Principle 6: Laws requiring the impossible[40]

Here, Fuller talks about the concept of strict liability. He argues that, as a rule, legal liability should rest on either intent or neglect and that a law which prescribes accountability without either of these

[33] Fuller, p. 49-51.
[34] Fuller, p. 51.
[35] Fuller, p. 51-63.
[36] Fuller, p. 53-54.
[37] Fuller, p. 63-65.
[38] Fuller, p. 64.
[39] Fuller, p. 65-70.
[40] Fuller, p. 70-79.

elements "has ascribed to [a man] responsibility for an occurrence that lay beyond his powers."[41] However, the author makes the concession that strict liability, in the aforementioned form of "commanding the impossible", could be acceptable, as long as "it define[s] as clearly as possible the kind of activity that carries a special surcharge of legal responsibility."[42]

Principle 7: Constancy of the Law through Time[43]

Principle 8:Congruence between Official Action and Declared Rule[44]

Here, the author points out both the advantages and the disadvantages of entrusting "the task of preventing a discrepancy between the law as declared and as actually administered" to the courts: the advantages include the judges' experience and the public scrutiny that comes with judicial procedures, while the main disadvantage seems to be that such an attitude "makes the correction of abuses dependent upon the willingness and financial ability of the affected party to take his case to litigation."[45]

In closing, I would like to underline that, according to the author, the aforementioned principles are not absolutes; instead, they are in dynamic balance with each other, they constitute

> means toward a single end [...] thus, where laws change frequently, the requirement of publicity becomes increasingly stringent. In other words, under varying circumstances the elements of legality must be combined and recombined in accordance with something like an economic calculation that will suit them to the instant case.[46]

[41] Fuller, p. 71.
[42] Fuller p. 71,75.
[43] Fuller p. 79-81.
[44] Fuller p. 81-91.
[45] Fuller p. 91.
[46] Fuller p. 104.

3. GAARs and the principles of legality

As was pointed out under section 1.5 above, the potentially problematic part of the GAARs is the second part, namely the prerequisite that the transaction in question seeks to take advantage of a tax law in a way unintended by the legislator. The reason why this can be problematic is that this legislative intent (also implied by the expression "spirit of the law", which was mentioned under 1.3 above as the factor which distinguishes acceptable from unacceptable tax avoidance), is not clearly articulated in any binding legal source. Therefore, it can present problems both regarding the principle of clarity (principle 3 under 2.3 above), but also the principle of retroactivity (principle 4 under 2.3 above), as the taxpayer "finds out" the standards according to which his/her behaviour will be examined by the tax authorities and the courts essentially ex post facto. Lastly, the principle of congruence between official action and declared rule (principle 8 under 2.3 above) is also relevant in this context, in the sense of delegating to the courts the responsibility/power to implement the law in a way not included in its letter.

In the following paragraphs I present arguments that approach the issue from the point of predictability. I use this term as a combination of the problems regarding all three of the aforementioned principles (congruence, clarity and retroactivity). I have structured this section as follows: first, I state the GAARs predictability issues; then I present what I found to be the most representative justifications for the lack of predictability and I conclude by responding to these justifications. The reason I use the word "justifications" instead of "counterarguments" is that the

proponents of the GAARs do not claim that the rules are not problematic from a predictability perspective. Rather, they assert that the lack of predictability is justified for the reasons explained under "Justifications" below.

Predictability issues

At this point I find it appropriate to cite an excerpt from "The Morality of Law", as I believe it is illustrative enough to set a clear background for the following discussion. Fuller begins the chapter where he talks about the principles of legality with the fictional story of a king named Rex, who wished to give a morally sound law to his subjects.[47] The essence of the story is that the king makes eight mistakes during the course of his effort and through these mistakes we learn how important the principles of legality are. Regarding the principles of clarity and retroactivity, Fuller writes:

> … for an indefinite future the contents of the code would remain an official state secret, known only to him and his scrivener. To Rex's surprise this sensible plan was deeply resented by his subjects. They declared it was very unpleasant to have one's case decided by rules when there was no way of knowing what those rules were. […]
>
> … when they said they needed to know the rules, they meant they needed to know them *in advance* so they could act on them.[48]

Regarding the principle of congruence, the author first acknowledges the importance of interpretation in "maintaining congruence between law and official action.[49] Subsequently, with reference to points to be "discerned and considered" for statute interpretation, he states that one of those points should be the following:

[47] Fuller, p. 33-38.
[48] Fuller, p. 35.
[49] Fuller, p. 82.

> "How would those who must guide themselves by its words reasonably understand the intent of the Act, for the law must not become a snare for those who cannot know the reasons of it as fully as do the Judges."[50]

Indeed, the "chance [for the taxpayers] to foresee the tax consequences of their economic activities", their position "in relation to the tax authorities" and the outcome of their case is considered a part of the rule of law.[51] To set the GAARs second prerequisite, the legislator's intent, in the context of the example from "The Morality of Law" cited above, I believe we can imagine Rex's subjects declaring their discontent if the king were to, clearly and in advance, issue a law saying that the effect of their actions would be judged according to whether or not they conformed to his intent, without mentioning what that intent was, but saying, instead, that he would reveal it on a case by case basis, when deciding the outcome of individual disputes. In this context, the fact that GAARs present a lack of clarity that makes them problematic from a rule of law perspective is evident. As a matter of fact, this is mentioned without hesitation in the relevant literature.[52] How, then, can GAARs be justified from a rule of law perspective?

Justifications

The first justification challenges the value of predictability in general and in the context of tax law in particular. Predictability, it is argued,

[50] Fuller, p. 82, 83.
[51] Helmers, Dag, Taxation levels and disparities in relation to the problem of tax avoidance and evasion in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981, p. 39; Report of the colloquy, citing Mr Noteboom, in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981, p. 145; Tikka, p. 7, 8.
[52] Tikka, p. 9; Qiu Dongmei , Legal interpretation of Tax Law: China in Brederode, Robert F. van. & Krever, Richard (red.), *Legal interpretation of tax law*, Wolters Kluwer, Law & Business, Alphen aan den Rijn, 2014 p. 95; Hilling, p. 75.

in the sense of the taxpayers' ability to "foresee the tax consequences of their economic activities" as mentioned above, is illusory. The reasoning is that, on one hand, tax legislation is "too complicated for the taxpayers to be able to foresee the consequences of their actions in detail" and that, in any case, legal questions are always unpredictable before the highest court has set a precedent regarding the provision in question.[53]

The second justification claims that uncertainty is necessary, at least more necessary than predictability, to counter tax avoidance.[54] A commentator writes:

> To expect that the statute (and/or Treasury regulations) could be crafted to foreclose abusive tax-motivated transactions with exacting specificity is to expect too much. [...] The legislature and revenue authorities simply cannot keep pace on a prospective basis with the army of tax experts continuously engaged in the never-ending design of new tax avoidance transactions.[55]

The last justification asserts that the reference to the legislator's intent serves the demands of substantive justice. The premise here is that justice demands that similar cases be treated in a like manner.[56] The structure of the argument is as follows: "like cases" in this

---

[53] Bergström, Sture, Förutsebarheten vid tillämpningen av skatteflyktsklausuler in Nordiska skattevetenskapliga forskningsrådet. Seminarium, *Rättssäkerheten i beskattningen: rapporter vid Nordiska skattevetenskapliga forskningsrådets seminarium i Helsingfors i oktober 1982,* Forskningsrådet, Stockholm, 1983, p. 376, 378.

[54] Shaviro Daniel: Disclosure and Civil Penalty Rules in the U.S. Legal Response to Corporate Tax Shelters in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008, p. 232-233; Arnold, 2009, p. 18; Morton, Paul, Opinion Standards for Tax Practitioners Under U.S. Department of the Treasury Circular 230 - Comment on the paper by Michael J. Desmond in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008, p. 285; Jensen, p. 116.

[55] Gammie, p. 74-75.

[56] Bergström, p. 373-374.

context are “alternative business models that achieve the same financial results”, for instance a company that sells its products in the market of land X directly (case A) or through a subsidiary in land Y, in order to, for example, take advantage of a tax treaty between the states concerned (case B).[57] Even though the two cases are legally different, the financial result, i.e. the sale of the specific products of the specific company to the specific market, is, nevertheless, the same. Assuming that the legislator in land X intended for the advantages of the tax treaty to be available exclusively to companies “actually” originating in land Y, it would be “unjust”, the argument concludes, to allow this company to take advantage of tax provisions in a way unintended by the legislator.

Response to the justifications

Regarding the first justification, that of illusory predictability, I have found no sources in the researched material to either support or deny that argument. My reasoning would be the following: assuming the situation actually is like that, should we see it from the perspective of “predictability in the area of tax law is only illusory; we need to address that” or from the perspective of “predictability in the area of tax law is only illusory; we might as well let it be”? I find that to be a subjective stance for each of us to take. I also find that the second stance, while more practical, can also be more demanding for the principle of the rule of law. The reason is that, unless one finds a way to justify exactly where the line should be drawn between acceptable and unacceptable declines in predictability, there is a risk that practice will end up setting the limits for the rule of law instead of the other way around. My premise here is that principle should guide practice.

[57] Tikka, p. 16.

Regarding the second justification and the necessity of uncertainty in tax legislation, there are, however, sources that comment on the matter. The main point seems to be that "[t]he most effective defence against taxpayer avoidance is comprehensive legislation".[58] Indeed, it is up to the legislator to amend the law in order to deal with undesirable taxpayer behaviour.[59] The "legislative abdication" which occurs "where the legislature knowingly walks away from difficult issues, leaving it to the administrations and then judiciary to give shape to the law" creates problems from the perspective of separation of powers.[60] This makes "uncertainty" the "second-best" option to counter tax avoidance.

Regarding the final justification and the demands of substantive justice, this is a question of hierarchy and conflict: if the demands of both the internal and the external morality of law cannot be met, which one should take precedence? Should predictability diminish where substantive justice demands it or should the latter be achieved as far as the boundaries of the rule of law allow? I have found no sources that settle the matter one way or the other; I believe that it is an issue of values and priorities. For example, Lord Houghton has said:

> Any attempt to short-circuit or to overcome the rule of law by providing 'umbrella' cover for bureaucracy to make the law as it goes along, [...] would be a fundamental error. No considerations of economics, finance or administration, or even of equity, could possibly justify removing one of the foundations of our liberty.[61]

---

[58] Dymond, et al. p. 100.
[59] Hoorn p. 1, Report of the colloquy, citing Mr Kreile, in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981 p. 145; Krever, Richard & Brederode, Robert F. van, p. 12.
[60] Krever, Richard & Brederode, Robert F. van, p. 9; Hilling p. 165.
[61] Ilersic, p. 93.

4. Conclusion

The preceding discussion has shown that the GAARs do not conform to the rule of law. They present predictability issues, which conflict with three of Fuller's eight principles of legality: the principle of clarity, the principle of retroactivity and the principle of congruence between official action and declared rule. However, there are justifications for this lack of predictability, which raise a different question: can it still be "just" that the GAARs violate these principles?

In my opinion, the main argument for an affirmative answer to this question has to do with substantive justice. Whereas the rule of law refers to formal justice, that is the procedural rules that must be followed during the process of *law making*, the GAARs contribute to achieving a just result in the level of *application of law*: they allow courts and authorities to intervene against forms of tax avoidance that the legislator meant to counter but did not. Thus, the *sacrifice* of predictability is *for the greater good*: it is justified.

I believe that the position one can take regarding this question is highly subjective, as I consider the question to be more of a philosophical than of a legal nature: is it right to prioritize substantive justice before formal justice or should it be the other way around? My reasoning on this question depends on what we accept as the point of law and it is as follows.

If one accepts that there is objective, natural justice to be found, accepts that the point of law is to deliver that justice to society and accepts that delivering that justice is the ultimate goal, then it is clear that any sacrifice should be made in order to reach that goal, including sacrificing elements of the rule of law to achieve substantive justice. I do not accept that this is the point of law; I side

rather with Fuller's interpretation and accept law as an instrument of harmonizing human conduct. In this context, the priorities become different.

In this context, the point of law is to set the necessary rules for a harmonious social interaction. Since these rules are made by the legislators, the question becomes: should the legislators be bound by rules in their law making, other than the ones they make themselves? I believe they should. I believe they are bound by the rule of law and I believe that the rules that are binding for the citizens should be the rules made in accordance with the principles of the rule of law. I side with Lord Houghton when he said: "No considerations [...] could possibly justify removing one of the foundations of our liberty."[62]

[62] See fn 61.

Bibliography

Arnold, Brian, A comparison of statutory general anti-avoidance rules and judicial general anti-avoidance doctrines as a means of controlling tax avoidance: Which is better? (What would John Tiley think?) in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009.

Arnold, Brian J., Canada, referring [Shell Canada v. The Queen 1999] in Ault, Hugh J. & Arnold, Brian J., *Comparative income taxation: a structural analysis,* 3. ed., Wolters Kluwer, Austin, Tex., 2010.

Bergström, Sture, Förutsebarheten vid tillämpningen av skatteflyktsklausuler in Nordiska skattevetenskapliga forskningsrådet. Seminarium, *Rättssäkerheten i beskattningen: rapporter vid Nordiska skattevetenskapliga forskningsrådets seminarium i Helsingfors i oktober 1982,* Forskningsrådet, Stockholm, 1983.

Boer, P. den, Anti-avoidance measures in the Netherlands in Avery Jones, John Francis (red.), *Tax havens and measures against tax evasion and avoidance in the EEC,* London, 1974.

Bracewell-Milnes, B., EPILOGUE: IS TAX AVOIDANCE/EVASION A BURDEN ON OTHER TAXPAYERS? in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979.

Dymond, A. Christopher, Reid, Robert J. & Curran, Michael A., *Income tax administration, avoidance & evasion*, Butterworth, Toronto, 1981.

Erle, Bernd, Tax Risk Management and Board Responsibility in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

Friese, Arne, Link, Simon and Mayer Stefan: Taxation and Corporate Governance - The State of the Art in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs]*, Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

Fuller, Lon L., *The morality of law*, Rev. ed, New Haven ..., 1969.

Gammie, Malcolm, The judicial approach to avoidance: some reflections on BMBF and SPI in in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs]*, Cambridge University Press, Cambridge, 2009.

Griffiths, Shelley and Palmer, Jessica SHAM, TAX AVOIDANCE, AND A GAAR: A NEW ZEALAND PERSPECTIVE in Simpson, Edwin & Stewart, Miranda (red.), *Sham transactions,* 2014.

Helmers, Dag, Taxation levels and disparities in relation to the problem of tax avoidance and evasion in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981.

Hilling, Maria, *Skatteavtal och generalklausuler: ett komparativt perspektiv*, 1. uppl., Wolters Kluwer, Stockholm, 2016.

Hoorn Jr., J. van, The Use and Abuse of Tax Havens in Avery Jones, John Francis (red.), *Tax havens and measures against tax evasion and avoidance in the EEC,* London, 1974.

Ilersic, A. R., THE ECONOMICS OF AVOIDANCE/EVASION in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979.

International tax avoidance and evasion: four related studies, Organisation for Economic Co-operation and Development, Paris, 1987.

Jensen, Erik M. - The US legislative and regulatory approach to tax avoidance in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009.

Kirby, Michael, Sham and Tax Law in Australia in Simpson, Edwin & Stewart, Miranda (red.), *Sham transactions*, 2014.

Kleineman, Jan, Rättsdogmatisk metod in Korling, Fredric & Zamboni, Mauro (red.), *Juridisk metodlära,* 1. uppl., Studentlitteratur, Lund, 2013.

Korb, Donald L., Shelters, Schemes, and Abusive Transactions: Why Today's Thoughtful U.S. Tax Advisors Should Tell their Clients to "Just Say No" in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

Krever, Richard & Brederode, Robert F. van, Legal interpretation of Tax Law: A Reflection on Methods and Issues in Brederode, Robert F. van. & Krever, Richard (red.), *Legal interpretation of tax law,* Wolters Kluwer, Law & Business, Alphen aan den Rijn, 2014.

Morton, Paul, Opinion Standards for Tax Practitioners Under U.S. Department of the Treasury Circular 230 - Comment on the paper by Michael J. Desmond in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

Myddelton D. R., TAX AVOISION - ITS COSTS AND BENEFITS in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979.

Nowotny, Christian, Taxation, Accounting and Transparency: The Interaction of Financial and Tax Accounting in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

Pettersson, Lennart, Conclusions in *International tax avoidance and evasion: compendium of documents*, International Bureau of Fiscal Documentation, Amsterdam, 1981.

Qiu Dongmei , Legal interpretation of Tax Law: China in Brederode, Robert F. van. & Krever, Richard (red.), *Legal interpretation of tax law,* Wolters Kluwer, Law & Business, Alphen aan den Rijn, 2014.

Recommendation 833 (1978) on cooperation between Council of Europe member states against international tax avoidance and evasion Point 5, in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981.

Report of the colloquy in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981.

Schreiber, Ulrich., *International Company Taxation [Elektronisk resurs] : An Introduction to the Legal and Economic Principles,* Springer Berlin Heidelberg, Berlin, Heidelberg, 2013.

Schön, Wolfgang, Abuse of rights and European tax law in Jones, John Avery, Harris, Peter & Oliver, David (red.), *Comparative perspectives on revenue law: essays in honour of John Tiley [Elektronisk resurs],* Cambridge University Press, Cambridge, 2009.

Seldon, Arthur, PROLOGUE: AVOISION: THE MORAL BLURRING OF A LEGAL DISTINCTION WITHOUT AN ECONOMIC DIFFERENCE, in Ilersic, A. R., *Tax avoision: the economic, legal and moral inter-relationship between avoidance and evasion,* Institute of Economic Affairs, London, 1979.

Shaviro Daniel: Disclosure and Civil Penalty Rules in the U.S. Legal Response to Corporate Tax Shelters in Schön, Wolfgang., *Tax and Corporate Governance [Elektronisk resurs],* Springer-Verlag Berlin Heidelberg, Berlin, Heidelberg, 2008.

TAX EVASION, TAX AVOIDANCE AND TAX PLANNING Edited extracts from a 1980 report by the Committee on Fiscal Affairs in *International tax avoidance and evasion: four related studies,* Organisation for Economic Co-operation and Development, Paris, 1987.

Tikka, Kari S., Vad avses med rättssäkerheten i beskattningen? in Nordiska skattevetenskapliga forskningsrådet. *Seminarium, Rättssäkerheten i beskattningen: rapporter vid Nordiska skattevetenskapliga forskningsrådets seminarium i Helsingfors i oktober 1982,* Forskningsrådet, Stockholm, 1983.

Tixier, G., Definition, scope and importance of international tax evasion in *International tax avoidance and evasion: compendium of documents,* International Bureau of Fiscal Documentation, Amsterdam, 1981.

Uckmar, V, General Report in *Cahiers de droit fiscal international: Studies on international fiscal law = Schriften zum internationalen Steuerrecht,* Kluwer, Deventer, 1939, Volume LXVIIIa, Venice, 1983.