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UPSTREAM TAX PLANNING: A CASE STUDY OF WHY CONGRESS SHOULD INSTITUTE A GENERAL ANTI-ABUSE RULE[*]

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Tax abuse—a process by which taxpayers secure tax outcomes that directly or indirectly contravene congressional intent—is a commonplace phenomenon that has plagued the nation's economic fabric since Congress instituted the income tax. A typical pattern associated with tax abuse is as follows: one or more taxpayers devise a methodology to mitigate their tax burdens in a way that skirts their civic obligations, the practice becomes widespread, and Congress responds by instituting reform measures. Often, however, the legislative process takes years or, in some cases, decades to unfold; in the meantime, billions of dollars of tax revenue are lost.

Consider the case of upstream tax planning. This is a process by which younger-generation taxpayers gift appreciated assets to older loved ones with the expectation of receiving such assets back in the form of outright bequests or in trust for their benefit. After the application of the Internal Revenue Code's "basis equal to fair market value" rule, the transferred assets are cleansed of their former gains, making upstream tax planning very financially enticing.

Using upstream tax planning as a case study, this Article advocates that Congress enact a general anti-abuse rule that vests the Treasury Department with broad administrative authority to promulgate anti-abuse regulations whenever the agency perceives a tax-compliance problem. The grant of such administrative authority combined with its utilization would yield a vast improvement over the status quo: it would safeguard the nation's coffers in a faster and more timely manner; enhance and invigorate taxpayer compliance; and, where necessary, shape the Code into being more standard based rather than rule based in nature.

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INTRODUCTION

Taxpayers are employing a technique that is depriving the federal government of significant revenue.[1] Commonly referred to as "upstream tax planning," this technique involves taxpayers transferring appreciated assets to the elderly with the expectation that such assets will be returned to the taxpayers or given to their children or grandchildren with their embedded tax gains completely erased after the death of the elderly transferee.[2] This tax-minimization device is not some hidden, dark secret; to the contrary, a quick review of articles found in the popular press and online attests to this technique's popularity.[3]

1. *See, e.g.*, OFF. OF MGMT. & BUDGET, A BUDGET FOR AMERICA'S FUTURE: ANALYTICAL PERSPECTIVES 151 tbl.13-1 (2020), https://www.whitehouse.gov/wp-content/uploads/2020/02/spec_fy21.pdf [https://perma.cc/D3GE-BT3W] (estimating, in row sixty-nine, the annual cost associated with step-up basis of capital gains at death (in other words, the application of the "basis equal to fair market value" rule) in 2020 to be nearly $52 billion); Jay A. Soled & Richard L. Schmalbeck, *Determining an Asset's Tax Basis in the Absence of a Meaningful Transfer Tax Regime*, 10 COLUM. J. TAX L. 49, 57–59 (2018) (explaining that the annual cost associated with taxpayer utilization of Internal Revenue Code section 1014(a) is staggering and anticipated to grow rapidly in the absence of a meaningful transfer tax system).

2. *See* I.R.C. § 1014(a)(1) (deeming the tax basis of inherited assets to be equal to fair market value on the date of death).

3. *See, e.g.*, HECKERLING INSTITUTE ON ESTATE PLANNING, PLANNING AFTER THE 2017 TAX ACT 3 (2019), https://media.law.miami.edu/heckerling/2019/brochure/53_Heckerling_Brochure.pdf [https://perma.cc/7H2P-VPNF] (highlighting a presentation given by Lester B. Law

But from a sound public policy perspective, there are several troubling aspects surrounding this technique. First, relegated to being a wallflower, the Internal Revenue Service ("IRS") is at a loss to curtail taxpayers from engaging in upstream tax planning.[4] Second, even though politicians from across the political spectrum would likely agree that this sort of tax planning violates the spirit of the Internal Revenue Code (the "Code"), they would also readily acknowledge that eliminating this loophole via legislation could take years or decades to achieve.[5] Third, taxpayer utilization of this technique exacerbates the nation's already teetering fiscal situation[6] and puts its solvency at further risk.[7]

and Howard M. Zaritsky that covered upstream planning); Jonathan Curry, *TCJA Supercharges 'Upstream' Estate Tax Planning Techniques*, 158 TAX NOTES 1845, 1845–47 (2018); Karen Hube, *An Old Tax Dodge for the Wealthy Is Making a Comeback*, BARRON'S, https://www.barrons.com/articles/upstream-planning-tax-dodge-51556918447 [https://perma.cc/CZ2D-7DR8] (May 7, 2019); Edwin P. Morrow III, The Optimal Basis Increase and Income Tax Efficiency Trust: Exploiting Opportunities To Maximize Basis, Lessen Income Taxes and Improve Asset Protection for Married Couples After ATRA (or: Why You'll Learn To Love the Delaware Tax Trap) 107–11 (Dec. 2017) (unpublished outline), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2436964 [https://perma.cc/9VSB-WVWS].

4. The only way that the IRS could possibly challenge this transfer tax technique would be under the so-called step-transaction doctrine. *See* Philip Sancilio, Note, *Clarifying (or Is It Codifying?) the "Notably Abstruse": Step Transactions, Economic Substance, and the Tax Code*, 113 COLUM. L. REV. 138, 138 (2013) ("The economic substance and step transaction doctrines are two specific examples of courts' general willingness to sometimes look past transactions' technical form and impose taxes based on their underlying substance."). However, in the transfer tax context, courts are generally reluctant to apply those doctrines. Jay A. Soled, *Use of Judicial Doctrines in Resolving Transfer Tax Controversies*, 42 B.C. L. REV. 587, 602–03 (2001). Albeit, on rare occasions they have done so. *See, e.g.*, Brown v. United States, 329 F.3d 664, 672–73 (9th Cir. 2003) (holding that, under the step-transaction doctrine, a husband's gift to his wife, who immediately paid the husband's gift tax, were interrelated steps that should be amalgamated into one).

5. For a discussion of section 1014's obscure origins dating back to Treasury regulations issued in 1914, see, for example, LAWRENCE ZELENAK, FIGURING OUT THE TAX: CONGRESS, TREASURY, AND THE DESIGN OF THE EARLY MODERN INCOME TAX 85–88 (2018). Although the origins of section 1014(a) are unclear, for the past century section 1014(a) has remained in the Code to facilitate the perceived administrative difficulty of making accurate asset tax basis determinations at death. *See, e.g.*, Howard J. Hoffman, *Drive To Repeal Carryover Basis Goes into High Gear*, 9 TAX NOTES 211, 211–12 (1979) (explaining the perceived need to repeal carryover basis and instead apply the basis equal to fair market value rule); Stefan F. Tucker, *Thoughts on Radical Estate and Gift Tax Reform*, 91 TAX NOTES 163, 165 (2001) ("It can be extraordinarily difficult to trace the historic basis of many assets, such as personal property held for generations within families for reasons of family history or affection, rather than because the property was not marketable.").

6. *See* Jim Tankersley & Emily Cochrane, *Budget Deficit on Path To Surpass $1 Trillion Under Trump*, N.Y. TIMES, https://www.nytimes.com/2019/08/21/us/politics/deficit-will-reach-1-trillion-next-year-budget-office-predicts.html [https://perma.cc/27E5-FHSH (dark archive)] (Aug. 22, 2019) ("The deficit — the gap between what the government takes in through taxes and other sources of revenue and what it spends [in excess of receipts] — will reach $960 billion for the 2019 fiscal year, which ends Sept. 30. That gap will widen to $1 trillion for the 2020 fiscal year, the Congressional Budget Office said in updated forecasts . . . .").

7. *See generally* OFF. OF MGMT. & BUDGET, *supra* note 1 (highlighting various points on insolvency in federal programs).

Make no mistake about it: upstream tax planning is part of a broader problem of tax abuse, which is defined as "when a taxpayer reduces its tax liability by ordering its affairs in a manner that complies with the text of the statute but contradicts the intent of the law it purports to follow."[8] Taxpayers routinely utilize the Code's literal language to achieve results differing from the law's intent, and their actions are often met with impunity.[9] Examples of tax-abuse techniques range from taxpayers making tax-free gifts using grantor-retained annuity trusts[10] to reformulating their business enterprises to circumvent their employment tax obligations.[11] Upstream tax planning makes for an emblematic case study specifically due to its lack of novelty.

Which taxpayers are most likely to avail themselves of these tax-saving techniques? It is not low- or moderate-income taxpayers but rather high-income taxpayers perched on the upper socioeconomic tiers.[12] In other words, the taxpayers who are most likely to use these morally questionable techniques

8. Orly Sulami, *Tax Abuse—Lessons from Abroad*, 65 S.M.U. L. REV. 551, 558 (2012).

9. *See, e.g.*, Chamberlin v. Comm'r, 207 F.2d 462, 471–72 (6th Cir. 1953) (holding a tax-free preferred stock distribution to common shareholders, followed by its sale to an accommodating investor and then its redemption by the corporation, to be valid, notwithstanding the fact that these steps were a coordinated effort to secure favorable capital gains treatment in lieu of such funds being treated as ordinary income).

10. Grantor retained annuity trusts ("GRATs") are sanctioned under Code section 2702(a)(2)(B) and section 2702(b). I.R.C. § 2702(a)(2)(B), (b). The Code permits settlors to establish trusts, retain the right to a fixed annuity for a term of years or over the settlor's life, and have the remainder interest pass to targeted beneficiaries. *See generally* Mitchell M. Gans, *GRIT's, GRAT's and GRUT's: Planning and Policy*, 11 VA. TAX REV. 761 (1992) (analyzing GRAT dynamics). The planning virtue associated with this rule is that the value of the retained interest is often made equal to the value of the contributed property, negating any gift tax exposure; however, if the value of the trust assets appreciates during the designated time period at a rate greater than the applicable federal rate under I.R.C. § 7520, wealth will inure transfer tax-free to the trust beneficiaries. *See generally* Steven J. Arsenault, *Grantor Retained Annuity Trusts: After $100 Billion, It's Time To Solve the Great GRAT Caper*, 63 DRAKE L. REV. 373 (2015) (explaining how using GRATs erodes the transfer tax base); Carlyn S. McCaffrey, Lloyd Leva Plaine & Pam H. Schneider, *The Aftermath of* Walton*: The Rehabilitation of the Fixed-Term, Zeroed-Out GRAT*, 95 J. TAX'N 325 (2001), 2001 WL 1549325 (detailing how taxpayers can capitalize upon GRAT usage).

11. *See generally* Karen C. Burke, *Exploiting the Medicare Tax Loophole*, 21 FLA. TAX REV. 570 (2018) (discussing, among other things, how taxpayers use S corporations to avoid their employment tax obligations); Walter D. Schwidetzky, *Integrating Subchapters K and S and Beyond*, 18 CHAP. L. REV. 93 (2014) (same).

12. *See, e.g.*, Linda Sugin, *Payroll Taxes, Mythology, and Fairness*, 51 HARV. J. ON LEGIS. 113, 115 (2014) ("The payroll tax produces substantial inequity between wage earners and investors with the same total income, and the income tax exacerbates that inequity by taxing wage earners more heavily in addition to the payroll tax."); Richard Rubin, *Joe Biden Used Tax-Code Loophole Obama Tried To Plug*, WALL ST. J. (July 10, 2019), https://www.wsj.com/articles/joe-biden-used-tax-code-loophole-obama-tried-to-plug-11562779300 [https://perma.cc/CN5F-322Y (dark archive)] ("Mr. Biden and his wife, Dr. Jill Biden, routed their book and speech income through S corporations, according to tax returns the couple released this week. They paid income taxes on those profits, but the strategy let the couple avoid the 3.8% self-employment tax . . . .").

are those who can readily afford the expert advice of tax planners and advisers trained to navigate the Code's linguistic hoops and hurdles.[13]

The problem of tax abuse in the United States is nothing new. It dates back to the Code's inception, a by-product of taxpayers' crafty actions and the linguistic limitations associated with word usage.[14] Traditionally, Congress has appeared one step behind the ball, constantly trying to play catch-up and dealing with each new instance of tax abuse on a case-by-case basis.[15] And, in the current Information Age, the problem of tax abuse has gone from bad to worse as discussions regarding circumvention techniques travel faster and more widely than ever before.[16] Moreover, as indicated by past efforts, the legislative machinery is typically slow, awkward, and ill-equipped to respond.[17]

13. *See, e.g.*, David M. Einhorn, *Unintended Advantage: Equity REITS vs. Taxable Real Estate Companies*, 51 TAX LAW. 203, 217 (1998) ("For many high-income-earning taxpayers, the allure of the real estate tax shelter was too strong to resist."); Stanley A. Koppelman, *At-Risk and Passive Activity Limitations: Can Complexity Be Reduced?*, 45 TAX L. REV. 97, 104 (1989) ("Tax shelters are asserted to be both inefficient, in that they cause a misallocation of resources, and inequitable, because tax shelter benefits are derived mostly by high income taxpayers."); Robert J. Peroni, *A Policy Critique of the Section 469 Passive Loss Rules*, 62 S. CAL. L. REV. 1, 4 (1988) ("Since the passive loss rules do not adequately deal with the sources of the tax shelter problem . . . they reduce, but do not eliminate, the use of artificial tax losses by high-income taxpayers to avoid paying their fair shares of the federal income tax burden.").

14. *See* Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 STAN. L. REV. 195, 209 (2020) ("Although the IRS has not followed the judicial trend toward textualism, the apparent tension between textualism and anti-abuse doctrines has emboldened tax lawyers to sign off on transactions that would have been dubious to purposivists. Thus, textualism's prominence in scholarly debates undermines a key barrier to abusive tax schemes." (footnotes omitted)); Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 4 (2004) ("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."); Brian Galle, *Interpretative Theory and Tax Shelter Regulation*, 26 VA. TAX REV. 357, 369 (2006) ("[A]s textualism has become more prevalent over the past two decades, the [economic substance] doctrine has been subjected to ever-increasing skepticism from textualist-minded courts."); John F. Manning, *The New Purposivism*, 2011 SUP. CT. REV. 113, 126–29 (describing the recent rise of textualism by purposivist judges).

15. *See* Cunningham & Repetti, *supra* note 14, at 6 (arguing that if Congress is left to handle tax abuse, it will result "in a hopeless attempt to keep pace with the latest tax gimmick").

16. *See, e.g.*, Michelle Fox, *Here Are 5 Ways the Super-Rich Manage To Pay Lower Taxes*, CNBC, https://www.cnbc.com/2019/02/21/here-are-5-ways-the-super-rich-manage-to-pay-lower-taxes.html [https://perma.cc/8JKD-VBS2] (Feb. 22, 2019, 10:02 AM) (explaining tax-saving techniques that exploit legislative loopholes).

17. *See, e.g.*, Erik M. Jensen, Book Review, 1 COLUM. J. TAX. L. 262, 265 n.10 (2010) (reviewing MOSHE SHEKEL, THE TIMING OF INCOME RECOGNITION IN TAX LAW AND THE TIME VALUE OF MONEY (2009)) ("One reason that extra-statutory, anti-abuse doctrines developed in the U.S. is that Congress can be slow to react."); Stephanie Hunter McMahon, *Political Hot Potato: How Closing Loopholes Can Get Policymakers Cooked*, 37 J. LEGIS. 142, 142 (2012) ("Congress acted only after the federal judiciary and Treasury Department pleaded for congressional reform and, receiving none, reduced their roles policing wealthy couples' tax abuse.").

Furthermore, often hamstrung by its limited authority, the Treasury Department's efforts to curb tax abuse have commonly yielded mixed results.[18]

To address the problem of tax abuse head-on, a more encompassing, revolutionary reform approach is necessary. Therefore, this Article advocates the institution of a broad, general anti-abuse rule.[19] Such a rule, were Congress to codify it,[20] would sanction the Treasury Department's ability to strategically and timely promulgate regulations whenever a tax-abuse technique came to light. If, for any reason, Congress perceived that the Treasury Department had overstepped the scope of this broad authority, it could respond by crafting legislation that endorsed taxpayer use of the particular technique at hand.[21]

Utilizing upstream tax planning as a case study, this analysis makes the case for granting broad license to the Treasury Department to restrain any and all perceived tax abuses. Part I elaborates on why upstream tax planning has recently come back into vogue and how taxpayers' actions are diametrically opposed to congressional intent. Part II then analyzes the role that anti-abuse provisions have traditionally played in the Code and Treasury Regulations. Last, Part III advocates that Congress institute a general anti-abuse rule and discusses the likely consequences associated with this legislative initiative.

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18. For example, when trying to issue regulations concerning Code section 385 (pertaining to corporate debt and equity identification), the Treasury Department has been met with stiff resistance and outcries that it is overstepping its authority. *See, e.g.*, Paul C. Nylen, *The Harry Potter Regulations: The Magic of the 385 Regulations and the Successor and Predecessor Rules*, 18 HOUS. BUS. & TAX L.J. 56, 57–61 (2018) (explaining the long and tortured history of the Treasury Department's attempts to promulgate the section 385 regulations).

19. *See* Frank V. Battle, Jr., *The Appropriateness of Anti-Abuse Rules in the U.S. Income Tax System*, 48 TAX LAW. 801, 802 (1995) (explaining that, in general, anti-abuse rules are "designed to prevent a taxpayer from achieving a result which is inconsistent with a dominant policy of the law by altering the tax consequences which would otherwise have flowed from a transaction, to others more consistent with that policy").

20. To a limited extent, Congress has already enacted an anti-abuse rule by codifying the so-called economic substance doctrine. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067–68 (codified at I.R.C. § 7701(o)). However, as tax-abuse techniques continue to thrive, they present clear evidence that the formulated statute is too narrow in scope, negating its efficacy. *See* Galle, *supra* note 14, at 359 ("[C]ourts read the economic substance doctrine narrowly, if they are willing to apply it at all.").

21. *See* Rachelle Holmes Perkins, *The Threat of Law: Regulatory Blackmail or an Answer to Congressional Inaction?*, 65 U. KAN. L. REV. 621, 650 (2017) ("Moreover, to the extent that Congress more regularly and timely engages in substantive law making, administrative agencies will have fewer opportunities to engage in overreaching, quasi-legislative rulemaking."). In contrast to attacking tax loopholes, there is often much political capital to be gained by upbraiding or chastising the IRS and the Treasury Department. Miranda Perry Fleischer & Daniel Hemel, *The Architecture of a Basic Income*, 87 U. CHI. L. REV. 625, 696 (2020) ("[M]embers of Congress have sought to vilify the IRS for a range of alleged infractions and starved the agency of cash.").

I. CASE STUDY: UPSTREAM TAX PLANNING

To familiarize readers with the nature of the problem, this Article demonstrates how the Code's rule-based approach cracks open the door to tax abuse.[22] Section I.A presents a short history of Code sections 1014(a) and 1014(e) and then summarizes the recent transformation of the nation's transfer tax system. Section II.B outlines the specifics of upstream tax planning and the reasons for its popularity.

A. *Background*

Approximately a century ago, out of whole cloth, the Treasury Department instituted a rule that the tax basis of an inherited asset would equal its fair market value on the date of the decedent's death.[23] Due to the rule's protaxpayer bias, apparently no one objected to its institution; additionally, the rule obviated the administrative concern that, in the absence of good recordkeeping, accurately identifying the tax basis of a decedent's assets was apt to prove, in many cases, nettlesome or, in other cases, impossible.[24] For example, the heirs of an estate might have a difficult time ascertaining what a decedent dying in 1925 originally paid for stock that the decedent had purchased in 1915.

Following the lead of the Treasury Department, in 1921 Congress decided to codify this rule in the predecessor to section 1014(a).[25] The statute mimicked the Treasury regulation, providing the identical rule, to wit, that the tax basis of each inherited asset would equal its fair market value at the time of a decedent's date of death.[26] Because assets generally appreciate in

22. *See* Linda D. Jellum, *Codifying and "Miscodifying" Judicial Anti-Abuse Tax Doctrines*, 33 VA. TAX REV. 579, 579 (2014) ("The length and complexity of the Internal Revenue Code (Code) is largely the result of the U.S. government's rule-based approach to curtail tax abuse. Taxpayers, aided by literalism, have long found and used language in the tax laws to avoid or minimize their tax obligations."); Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 LAW & CONTEMP. PROBS. 673, 703 (1969) (recommending "a gradual shift from a highly detailed statute to more generalized provisions").

23. Treas. Reg. 45, § 202, art. 1562 (1919). The term "tax basis" represents the capital investment a taxpayer has in an asset which the Code then uses in a number of settings (e.g., computing depreciation, amortization, depletion, and casualty losses), but primarily as a mechanism to eliminate the potential for double taxation. *See id.* § 214(a)(4)–(6), (8)–(10).

24. *See* ZELENAK, *supra* note 5, at 96–99 (explaining the origins of this rule and why, for the past century, Congress has chosen to retain Code section 1014).

25. Revenue Act of 1921, Pub. L. No. 67-98, § 202(a)(3), 42 Stat. 227, 229 (codified at 26 U.S.C. § 954(b)(11) (1925)).

26. Actually, in determining an inherited asset's basis, the original statute referred to the value "at the time of . . . acquisition." *Id.* The U.S. Supreme Court construed this language to mean the decedent's date of death rather than the date that an executor distributed such property. Brewster v. Gage, 280 U.S. 327, 335 (1930). Later, in 1934, Congress amended the statute to reference a decedent's date of death. Revenue Act of 1934, Pub. L. No. 73-216, § 113(a)(5), 48 Stat. 680, 706 (codified as amended in 26 I.R.C. § 1014).

value over time, the government would stand to lose a vast amount of revenue on its failure to tax the gain that accrued between the time a decedent purchased an asset and the time its basis resets to fair market value upon death per 1014(a).[27] However, Congress apparently deemed this to be a worthwhile price to pay for the administrative convenience of eliminating the need for taxpayers to undertake challenging basis identifications of assets that decedents had purchased years or decades earlier.[28]

But, in due course, some taxpayers decided to take advantage of Congress's magnanimous approach to tax basis identifications, marking the first appearance of upstream tax planning whereby, in a prototypical situation, a younger generation member gifts assets to an older generation family member. Although it sounds a bit ghoulish, these taxpayers would strategically transfer appreciated assets to very sick and dying older relatives or loved ones with the expectation of quickly receiving such assets back with a higher tax basis in the form of inheritances.[29] For example, a child might transfer the title of his farm with a tax basis of $100,000 and fair market value of $500,000 to his cancer-ridden, widowed mother with the hope that if she perished soon, he would receive title back to the farm with a $500,000 tax basis, thereby erasing the $400,000 embedded gain (in other words, $500,000 fair market value less $100,000 basis).[30]

As expected, Congress was slow to respond to this tax-abuse technique. It waited sixty years before instituting section 1014(e) in 1981,[31] which provides that if a taxpayer transfers title to an asset to another taxpayer, the latter taxpayer dies within one year, and asset ownership returns to the original taxpayer, then no tax basis adjustment is to be made.[32] To illustrate, in the prior example, if the mother died within one year of receiving title to the farm and she bequeathed the farm back to her son, the farm's tax basis would remain at $100,000 in the son's hands.

27. By way of example, assume a taxpayer purchases an asset in 2021 for $10,000 and by 2023, it appreciates to $13,000 and is then sold. The taxpayer must pay tax on this $3,000 gain ($13,000 less $10,000).

28. *See, e.g.*, Karen C. Burke & Grayson M.P. McCouch, *Death Without Taxes?*, 20 VA. TAX REV. 499, 529 (2001) [hereinafter Burke & McCouch, *Death Without Taxes?*] ("Nevertheless, as a matter of political expediency and administrative convenience, a general exemption [embodied in section 1014(a)] may be necessary to ameliorate the problems of proving basis.").

29. *See, e.g.*, Peter S. Cremer, *The 1981 Act and Section 2035: Problems and Possibilities*, 35 TAX LAW. 389, 401 (1982) ("In the absence of [section 1014(e)], a deathbed transfer between spouses in any amount or between others in the amount of the unified credit equivalent could result in a transfer tax-free purchase of basis.").

30. *See* I.R.C. § 1014(a).

31. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 425(a), 95 Stat. 172, 318 (codified as amended at I.R.C. § 1014(e)).

32. *Id.*

In enacting section 1014(e), Congress thought that it had put the brakes on the macabre tax-planning practice of the sort described above. And, for a while, it did. When Congress instituted section 1014(e), the country had a somewhat vibrant transfer tax system. More specifically, taxpayers could transfer tax-free up to $600,000 via their lifetime-exemption amount, during their lifetime or upon death.[33] But if they exceeded this threshold, the nation's transfer tax, with rates extending as high as seventy-seven percent, would then apply.[34] The vigor of the nation's transfer tax system, combined with section 1014(e), had a tremendous chilling effect upon taxpayers considering upstream tax planning. In particular, most taxpayers would not have wanted to risk losing part of their lifetime exemption amount if this ploy failed (for example, if the recipient died within one year). Furthermore, transferring valuable property to the aged and infirm might trigger unanticipated transfer tax exposure if the aggregate value of the transferred assets combined with the recipient's other assets exceeded the recipient's lifetime-exemption amount. To illustrate this point using the prior example, if the child transferred the $100,000 farm to his mother and the value of his mother's estate thereby exceeded the estate tax threshold for taxability, the associated estate tax liability would negate the attractiveness of upstream tax planning.

But over the last two decades, Congress has rendered the nation's transfer tax system largely ineffectual.[35] Evidence for this proposition is twofold. First, Congress reduced the highest transfer tax rate to a flat forty

33. Here is a dynamic illustration of how the lifetime exemption operates both while the taxpayer is living and upon death. Assume a taxpayer has a net worth of $1 million and the lifetime exemption amount is $600,000. Consider two scenarios:

(1) The taxpayer makes no lifetime gift and she dies. In this case, her taxable estate would be $400,000 (the $1 million net worth less the $600,000 lifetime exemption) upon which an estate tax would be levied.

(2) The taxpayer makes a $200,000 taxable gift, leaving a balance of $400,000 of her lifetime exemption amount available (the $600,000 lifetime exemption less the $200,000 gift) and a net worth of $800,000 (the $1 million net worth less the $200,000 gift). If she then dies, her taxable estate would be $400,000 (the remaining net worth of $800,000 less the $400,000 remaining lifetime exemption) upon which an estate tax would be levied.

34. *See generally* Darien B. Jacobson, Brian G. Raub & Barry W. Johnson, ***The Estate Tax:*** *Ninety Years and Counting*, STATS. OF INCOME BULL., Summer 2007, at 118, 122 fig.D, https://www.irs.gov/pub/irs-soi/07sumbul.pdf [https://perma.cc/9MPX-JPEU] (detailing the history of the estate tax, the available exemption, and its rate structure).

35. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §§ 511(a), 521(b), 115 Stat. 38, 70–71 (codified as amended at I.R.C. §§ 2001(c)(1), 2010(c)) (raising the estate tax exemption and lowering estate tax rates); Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 302(a), 124 Stat. 3296, 3301 (codified as amended at I.R.C. § 2010(c)) (further raising the estate tax exemption); Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11061(a), 131 Stat. 2054, 2091 (codified as amended at I.R.C. § 2010(c)(3)) (same).

percent,[36] much lower than it has been throughout most of its hundred-plus-year history.[37] Second, the lifetime exemption amount is presently set at $11.7 million,[38] a dollar figure far more generous than preceding figures,[39] even after the latter are adjusted for inflation.[40] For the vast majority of the nation's taxpayers, the combination of a lower tax rate and a much higher lifetime exemption amount has turned the nation's transfer tax system into a paper tiger. No longer feared, the nation's transfer tax system has become feeble, and this has had the unintended consequence of resurrecting upstream tax planning.

B. *The Popularity of Upstream Tax Planning*

In the aftermath of the vast changes that the Tax Cuts and Jobs Act of 2017[41] made to the transfer tax system,[42] members of the estate planning bar have decided that taxpayers should shift their focus. Rather than concentrating on transfer tax minimization (particularly since 99.9% of taxpayers no longer have transfer tax exposure),[43] the bar has placed a renewed emphasis on income tax minimization and, in particular, maximization of the tax basis that heirs have in their inherited assets.[44]

There are several tax-basis-maximization strategies that the estate planning bar has coaxed taxpayers to consider. Such strategies include, but are not limited to, (a) retaining, rather than gifting, appreciated assets;[45] (b) using high date-of-death valuations;[46] and (c) moving to community property states.[47]

36. I.R.C. § 2001(c).

37. *See* Jacobson et al., *supra* note 34, at 122 fig.D.

38. The 2021 estate tax exemption amount was $11,700,000. Rev. Proc. 2020-45, § 3.41, 2020-46 I.R.B. 998, 1024.

39. *See* Jacobson et al., *supra* note 34, at 122 fig.D.

40. *See generally* Jay A. Soled, *The Federal Estate Tax Exemption and the Need for Its Reduction*, 47 FLA. ST. L. REV. 649, 659 (2020) ("The aftermath of this series of legislative changes can be distilled down to one salient observation: even after taking inflation into account, the size of the estate tax exemption amount has ballooned relative to the size it has been historically.").

41. Pub. L. No. 115-97, 131 Stat. 2054 (codified in scattered sections of the I.R.C.).

42. *Id.* § 11061, 131 Stat. 2054, 2091 (doubling the estate tax exemption amount).

43. *See* Sasha A. Klein & Mark R. Parthemer, *The New Tax Law: It's Déjà Vu All Over Again*, PROB. & PROP., Mar./Apr. 2018, at 40, 43 ("In fact, it is estimated that the number of taxable estates will drop from around 5,000 in 2017 to fewer than 1,800 in 2018. Said another way, there will be fewer than 36 taxable estates per state in 2018.").

44. *See, e.g.*, Griffin H. Bridgers, *Basis Step-Up Planning: A Double-Edged Sword: A Review of Common State Law Nuances*, PROB. & PROP., July/Aug. 2018, at 24, 24 ("One of the biggest modern goals of tax planning now is maximizing the opportunity to obtain a step-up in income tax basis for family assets at least at the death of the client. The recent doubling of the estate tax applicable exclusion amount is certain to increase this type of planning.").

45. *See* I.R.C. § 1015(a) (requiring a carryover tax basis in the gift-giving context).

46. MICKEY R. DAVIS & MELISSA J. WILLMS, ALL ABOUT THAT BASIS: HOW INCOME TAXES HAVE RESHAPED ESTATE PLANNING 1 (2019), http://daviswillms.com/yahoo_site_admin/

Upstream planning is an additional tax-basis-maximization strategy that has gained renewed traction.[48] As explained above, this strategy is fairly straightforward: a taxpayer, say, a son, gifts appreciated property (such as the title to an appreciated farm) to another taxpayer, say, his mother; the son patiently waits for his mother to die; and the mother bequeaths the original property back to the son.

This seemingly straightforward strategy is, however, fraught with logistical concerns. The mother could enter a nursing home, exposing the gifted asset to the risk of being sold and the proceeds used to meet her medical needs. Alternatively, the mother could meet the next Don Juan, who sweeps her off her feet and convinces her to leave her entire estate to him. A final possible scenario is that the mother develops misgivings about her son and decides to bequeath the gifted property to her other children, if any, or a favorite charity. Indeed, gifting assets outright to a loved one who is sick or dying is fraught with risk. Many taxpayers harbor deep misgivings about using this tactic precisely because the risks associated with outright gifts are so grave.

In recognition of these risks, the estate planning bar has been proactive in developing mechanisms that attempt to ensure return of the appreciated asset to its original owner, the owner's spouse, or the owner's offspring.[49] In lieu of making outright gifts, the bar is therefore instructing taxpayers (such as the son in the example above) to establish prophylactic trusts for the benefit of their loved ones (such as the mother in the example above). The terms of such trusts grant to the trust beneficiary (the mother) what the Code defines

assets/docs/davis_willms_basis_2019.89191738.pdf [https://perma.cc/43MF-S59U]. With estate tax exemption at a historically high level, the tendency now for many taxpayers is to seek a high date-of-death valuation. *Id.* In years past, the common practice was to try to minimize asset values. *See, e.g.*, William S. Blatt, *Minority Discounts, Fair Market Value, and the Culture of Estate Taxation*, 52 TAX L. REV. 225, 225 (1997) ("The allowance of minority discounts encourages transactions designed to reduce transfer taxes."); Joseph M. Dodge, *Redoing the Estate and Gift Taxes Along Easy-to-Value Lines*, 43 TAX L. REV. 241, 244 (1988) ("[V]irtually all of the transfer tax loopholes involve undervaluation of gratuitous transfers with the blessing of existing law."); James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 416 (1995) ("A common tool of estate planning involves the purposeful diminution in value of family property in order to reduce estate and gift taxes.").

47. *See* I.R.C. § 1014(b)(6) (permitting the tax basis of both the decedent's and their spouse's assets to equal fair market value under community property law). *See generally* Paul L. Caron & Jay A. Soled, *New Prominence of Tax Basis in Estate Planning*, 150 TAX NOTES 1569, 1572 (2016) ("To maximize the advantage of section 1014(b)(6), married couples should transform as much common law property as possible into community property.").

48. *See supra* note 3 and accompanying text.

49. *See* DAVIS & WILLMS, *supra* note 46, at 31–35 (describing the virtues of a so-called "Accidentally Perfect Grantor Trust," which capitalizes upon upstream planning while seeking to ensure the return of gifted property).

as a general power of appointment.[50] To exercise a general power of appointment, however, invariably requires the retention of knowledgeable legal counsel, and thus the actual exercise power is apt to remain inactive.[51] Nevertheless, because the potency of control a general power of appointment affords its holders, its mere presence causes the assets in such a trust to be included in the power holder's estate (namely, that of the mother), triggering the application of step-up in basis rule applicable to all of the trust's assets.[52] With respect to these appreciated assets, taxpayers engaging in upstream tax planning can thus defeat their income tax obligations, while the elderly and infirm act as passive shills. The loser in this arrangement is not the taxpayer, the tax adviser, or the sick/elderly family member; instead, it is the government, which stands to lose significant tax dollars on the embedded gains that upstream planning erases.

Analyzing upstream tax planning leads to several important observations about tax avoidance. First and foremost is that planning of this sort directly contravenes congressional intent. It seems clear that Congress has chosen to retain section 1014 to alleviate the need for tax-basis identifications.[53] Historically, securing this information was deemed too nettlesome or impossible to obtain.[54] In the case of upstream tax planning, however, all of the involved parties know with specificity the tax basis of the asset being transferred; and to augment it, they undertake a series of contrived transfers. Second, upstream tax-planning gifting is driven by pure tax avoidance, not detached and disinterested generosity to the elderly and infirm.[55] Finally, notwithstanding the fact that upstream tax planning is abusive, it is still lawful. As such, the IRS lacks any meaningful ability to judicially challenge

50. *See* I.R.C. § 2041(b)(1) (defining a general power of appointment to mean "a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate").

51. The scope of this general power of appointment is often limited to the creditors of the decedent's estate. Why? To further limit its potential of being exercised. *See* Elizabeth L. Pack, *Income Tax Planning Strategies for Estate Plans Under the TCJA*, EST. PLAN., Feb. 2019, at 19, 20 ("Th[e] risk [of the older generation member directing the trust assets to unintended beneficiaries] can be reduced, but not eliminated, by granting [such person] only a narrow testamentary general power of appointment, so that, for example, the permissible appointees consist of only the [person's] creditors . . . .").

52. *See* I.R.C. § 1014(a)–(b) (providing that the basis-equal-to-fair-market-value rule is applicable for any asset includable in a decedent's gross estate).

53. *See* ZELENAK, *supra* note 5, at 110–32 (2018) (explaining why, for the past century, Congress has chosen to retain section 1014).

54. *See* Burke & McCouch, *Death Without Taxes?*, *supra* note 28, at 528.

55. *See* Cremer, *supra* note 29, at 401–02 ("Unless the donee spouse will certainly die within a year, a transfer of property returning to the donor spouse may well be worth making to purchase a stepped-up basis."); Comm'r v. Duberstein, 363 U.S. 278, 285 (1960) (holding that for a gift to be bona fide, it must spring from "detached and disinterested generosity").

taxpayers' actions, so the agency's only recourse is to prod Congress to enact remedial legislation.[56]

II. ANALYSIS

With over a century of experience with section 1014 under its belt,[57] Congress is not oblivious to incidences of tax abuse. In terms of upstream tax planning, Congress undoubtedly recognizes that this is not an isolated incident of tax abuse. Indeed, there are numerous forms of tax abuse that share common traits with upstream tax planning, each having a corrosive effect on overall tax compliance and, as a whole, costing billions of dollars annually in lost tax revenue.[58]

Thus, Congress remains vigilant. On multiple occasions, Congress and the Treasury Department have taken important steps to address and curtail various tax-abuse techniques brought to its attention.[59] However, these actions have been less than successful. Below, Section II.A details these vigilant efforts, and Section II.B explains why such efforts have often fallen short of meeting their intended goals.

56. *See, e.g.*, Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1952 (2005) (arguing the need for a statutory solution to the corporate tax shelter problem, which would disallow noneconomic losses); McMahon, *supra* note 17, at 152–53 ("[W]ithin the constraints of the statute, the Treasury Department troubleshot problems of tax avoidance as it lobbied Congress to legislate a change to alleviate this burden.").

57. Congress instituted the income tax system in 1913, Revenue Act of 1913, Pub. L. No. 63-16, § 2, 38 Stat. 114, 166–81, and the estate tax in 1916, Revenue Act of 1916, Pub. L. No. 64-271, §§ 200–212, 39 Stat. 756, 777–80.

58. *See, e.g.*, Matthew C. Klein, *How Much Do Tax Havens Cost the Rest of Us?*, BARRON'S (June 19, 2018, 10:58 AM), https://www.barrons.com/articles/how-much-do-tax-havens-cost-the-rest-of-us-1529420282 [http://perma.cc/Q5PS-ZRK8] (estimating that billions of tax dollars go unpaid annually because of the use of aggressive tax strategies, namely corporate tax havens); David J. Herzig, *Am I the Only Person Paying Taxes?: The Largest Tax Loophole for the Rich—Exchange Funds*, 2009 MICH. ST. L. REV. 503, 540.

> The underlying fact that must finally be accepted is that exchange funds exist only for the purpose of avoiding taxation. Every part of the exchange fund is designed around a specific rule. The term of the fund, set at seven years, is designed to avoid Section 704(c)(1)(B). The 80%–20% asset breakdown exists only to avoid the investment company rules under Sections 351 or 721. The 20% illiquid security is specifically engineered for the fund to satisfy the tax code.

Id.

59. *See, e.g.*, Education Jobs and Medicaid Funding Bill, Pub. L. No. 111-226, § 211, 124 Stat. 2389, 2394–96 (2010) (codified as amended at I.R.C § 909) (introducing Code section 909 and closing several foreign tax credit loopholes, including preventing the separation of creditable foreign taxes from the associated foreign income).

A. *Efforts of Congress and the Treasury Department To Curb Incidences of Tax Abuse*

When enacting tax legislation, Congress is mindful that if it delves too deeply into legislative minutiae it will be accused of micromanaging and being overly intrusive. Instead, by presenting a general framework, it hopes that taxpayers will be fully compliant and will orchestrate their affairs to adhere to both the letter and spirit of the Code. To the extent that taxpayers fulfill this goal, neither Congress nor the Treasury Department needs to take any further action. Not only will the revenue targets associated with the legislative landscape be met, but also taxpayers and their advisers can concentrate on meeting nontax-related economic objectives.

But, inevitably, not all taxpayers fall into line. Some instead seek to circumvent their tax obligations, endeavoring to avert their financial burdens. Consider several examples:

- During the 1970s and 1980s, in an attempt to secure large noneconomic tax depreciation and amortization deductions, taxpayers used nonrecourse debt instruments to purchase tangible and intangible equipment and other property from promoters at greatly inflated prices.[60]
- During the 1990s, in order to manufacture large noneconomic losses, taxpayers invested in tax shelters that artificially produced augmented tax bases in their investments.[61]
- Beginning in the 2000s, taxpayers established grantor-retained annuity trusts ("GRAT"), enabling them to transfer vast amounts of wealth to beneficiaries, free of any gift tax.[62]

60. *See, e.g.*, Sandra L. DeGraw, *Retributive Justice for Tax Shelter Investors: The Tax Reform P.A.L.*, 61 TEMP. L. REV. 51, 53 n.7 (1988) (presenting a comprehensive overview of the nature of the tax shelters that dominated during the 1970s and 1980s).

For example, a taxpayer purchases an abandoned building with a $100,000 fair market value for $1 million, paying the entire purchase price from funds borrowed from the seller and secured by a nonrecourse mortgage on the building (meaning that there is no personal liability for taxpayer's failure to pay). Going forward, the taxpayer can take enormous depreciation deductions.

61. *See, e.g.*, Karen C. Burke & Grayson M.P. McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 TAX LAW. 59, 59 (2008) ("In essence, [the basic shelter transaction] uses offsetting options to inflate the basis of property that is distributed by a partnership and then contributed to and sold by another partnership, resulting in a large tax loss without any corresponding economic loss.").

For example, a taxpayer sells an option to acquire securities (short sale), simultaneously purchases a similar one (long sale), contributes both to a partnership, and claims a high basis therein on the theory that the liability on the first leg of the transaction was to be ignored due to its contingent nature while the second leg of the transaction was to be respected.

62. *See, e.g.*, McCaffrey et al., *supra* note 10, at 325 ("The GRAT is an attractive planning device because it can facilitate the transfer of substantial wealth at little or no gift tax cost without using a significant portion of the transferor's gift tax exemption.").

- Because numerous states have either repealed or eviscerated their rule against perpetuities,[63] taxpayers now routinely establish dynasty trusts specifically designed to skirt the congressional goal that the wealth of high-net-worth taxpayers endures transfer tax at least once at every generational level.[64]

These and a plethora of other examples reveal several salient traits associated with tax-abuse techniques.[65] In some instances, these abuses flourish because taxpayers (in cooperation with attorneys and promoters) are willing to commit what is tantamount to fraud.[66] In other instances, tax-abuse techniques flourish because taxpayers skillfully utilize the Code's written words in a highly technical fashion as strategic tools to defend against tax imposition.[67] And still in other cases, knowing that sets of laws often lack coordination, taxpayers lobby for changes in one set of laws that ameliorate their tax burdens related to another set of laws.[68]

Regardless, it is evident that Congress did not anticipate the tax-abuse technique in question. Indeed, had Congress known in advance how taxpayers would react, it would have certainly taken more comprehensive and protective measures to secure tax outcomes in line with its intended goals and objectives.

For example, a taxpayer establishes a two-year trust by contributing $1 million dollars, yet retains an annual annuity right of $524,000. The retention of such a right negates the value of the remainder interest. However, if the value of the property appreciates in excess of the Code section 7520 rate, wealth will inure transfer tax-free to the remaining beneficiaries.

63. *See, e.g.*, Debra Cassens Weiss, *States' Repeal of Rule Against Perpetuities Creates US Aristocracy, Law Prof Says*, ABA J. (July 12, 2010, 3:30 PM), http://www.abajournal.com/news/article/states_repeal_of_rule_against_perpetuities_creatomg_us_aristocracy_law_prof [http://perma.cc/T79L-CGKY] ("In the mid-1990s, however, many states eliminated the rule [against perpetuities] with the aim of attracting business, a goal encouraged by banking lobbyists."). For example, a taxpayer establishes a testamentary trust with a 1,000-year term that provides income interests for her offspring, and upon their demise, passes to the next generation and onward and so forth.

64. *See, e.g.*, Grayson M.P. McCouch, *Who Killed the Rule Against Perpetuities?*, 40 PEPP. L. REV. 1291, 1291–93 (2013) (describing why many states have chosen to eliminate their rule against perpetuities and the rise of the perpetual trust market).

65. This Article refers to large-scale, rather than isolated, instances of tax abuse (such as one taxpayer's failure to report cash receipts).

66. *See, e.g.*, Paul Braverman, *Helter Shelter*, AM. LAW., Dec. 2003, at 65, 66, https://lfdslaw.com/downloads/American_Lawyer_Dec_2003.pdf [https://perma.cc/X3TB-UKYN] (describing the fraudulent practices of the tax shelter industry).

67. *See, e.g.*, Janet Novack, *The Hustling of Rated Shelters*, FORBES (Dec. 14, 1998, 12:00 AM), https://www.forbes.com/forbes/1998/1214/6213198a.html#20fce7e771db [http://perma.cc/G83X-FKLL] ("Today's shelter hustlers parse the numerous weaknesses in the tax code and devise schemes that can be pitched as 'products' to corporate prospects. Then they sell them methodically and aggressively, using a powerful distribution network not unlike the armies of pitchmen who sold cattle and railcar tax shelters to individuals in the 1970s and 1980s.").

68. *See, e.g.*, Mark J. Mazur, *Luck and Tax Policy*, 44 OHIO N.U. L. REV. 103, 107–08 (2018) ("Sometimes, steps intended to result in basic reform may have unintended consequences and perhaps move the tax system in the wrong direction.").

When a particular tax-abuse technique becomes especially egregious and widespread, one of the following three responses is commonplace: (1) Congress reforms the Code; (2) Congress authorizes the Treasury Department to promulgate new regulations to curb the particular kind of tax-abuse technique; or (3) the Treasury Department, on its own initiative, promulgates regulations to safeguard the tax base.

1. Congress Reforms the Code

Tax laws are commonly scored for their revenue consequences.[69] Some tax laws are specifically intended to generate additional revenue (for example, eliminating business entertainment expense deductions),[70] while other tax laws come with the "price tag" of reducing revenue yields (for example, shortening the class life of property for depreciation deduction purposes).[71] Other statutory provisions—such as allowing the deduction of interest paid on qualified home purchases[72]—are known in tax parlance as tax expenditures[73] and constitute indirect government subsidies rather than direct cash outlays.[74] To maintain fiscal solvency, Congress seeks to ensure that its revenue projections are met and that its outlays, including those pertaining to tax expenditures, are in line.

When it becomes clear that taxpayers are engaging in particular forms of tax abuse, Congress can take legislative measures to restore financial equilibrium.[75] On Capitol Hill, this is a regular occurrence.[76] Rather than

69. *See generally* Emil M. Sunley & Randall D. Weiss, *The Revenue Estimating Process*, 10 AM. J. TAX POL'Y 261, 261–62 (1992) ("Although revenue estimates do not represent a complete economic analysis of a tax proposal, they provide useful information to those evaluating the desirability of the proposal.").

70. I.R.C. § 274(a).

71. *Id.* § 168(a), (e).

72. *Id.* § 163(h)(2)–(3).

73. Congressional Budget and Impoundment Act of 1974, Pub. L. No. 93-344, § 3, 88 Stat. 297, 299 (codified as amended at 2 U.S.C. § 622(3)) (defining "tax expenditures" as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability"). For a list of expenditure estimates, see STAFF OF JOINT COMM. ON TAX'N, 115-JCX-81-18, ESTIMATES FOR FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2018–2022, at 20–40 (2018).

74. Bernard Wolfman, *Tax Expenditures: From Idea to Ideology*, 99 HARV. L. REV. 491, 491–92 (1985) (book review) ("The concept of a tax expenditure . . . is based upon recognition of the fact that a government can appropriate money to a particular person or group by using a special, narrowly directed tax deduction or exclusion, instead of by using its ordinary direct spending mechanisms.").

75. Consider two examples. First, for decades, taxpayers used their passive investments to manufacture losses and, in response, Congress enacted Code section 469. Robert J. Peroni, *A Policy Critique of the Section 469 Passive Loss Rules*, 62 S. CAL. L. REV. 1, 3 (1988) ("[S]ection 469 attempts to eliminate, or at least substantially reduce, the attractiveness of tax shelters by preventing taxpayers from using their net losses from passive activities to offset or 'shelter' their income from wages, trades or businesses in which the taxpayer materially participates, or portfolio investments (such as

summarize a myriad of such initiatives, consider the case of hidden offshore accounts and how they ultimately led to the passage of the Foreign Account Tax Compliance Act ("FATCA").[77]

When the global economy was in its nascent stages of development, many taxpayers sought refuge from paying their taxes by parking their investments in offshore accounts.[78] These taxpayers were confident that the bank secrecy laws of Switzerland and other countries (such as the Philippines or Liechtenstein) would safeguard their earnings from the prying eyes of the IRS.[79] And for decades, taxpayers were correct in their assumptions; their abuse of the Code—in particular, ignoring explicit disclosure requirements on the face of their federal income tax returns—was generally met with impunity.[80]

Information gradually trickled into the Treasury Department and to Congress that taxpayer noncompliance regarding offshore reporting was rampant.[81] The IRS's only recourse to fulfill its oversight mission was to dedicate more of its limited resources to the near-impossible task of learning

dividends and interest)."). Second, in the aftermath of highly publicized tax shelters, Congress enacted a reporting requirement for all so-called reportable transactions. *See* I.R.C. § 6707A(c)(1) (defining "reportable transaction" as "any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion").

76. *See, e.g.*, I.R.C. § 306(a)(1)(A), (c)(1)(A) (declaring that the disposition of preferred stock received tax-free under Code section 305(a) can give rise to the receipt of ordinary income). This provision overturned the strategy that taxpayers employed to convert ordinary income into capital gains. *See id.*; *see also, e.g.*, Chamberlin v. Comm'r, 207 F.2d 462, 463–65, 468–70 (6th Cir. 1953).

77. Hiring Incentives to Restore Employment Act (Foreign Account Tax Compliance Act), Pub. L. No. 111-147, §§ 501–541, 124 Stat. 71, 97–117 (2010) (codified as amended in scattered sections of 26 U.S.C.).

78. *See Tax Haven Banks and U.S. Tax Compliance: Hearing Before the S. Permanent Subcomm. on Investigations, of the Comm. On Homeland Sec. & Gov't Affs.*, 110th Cong. 1 (2008) (statement of Carl Levin, Senator). (estimating that the United States loses about $100 billion of tax revenue from hidden offshore accounts). *See generally* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (2006) (describing the offshore industry and giving its related case history).

79. *See, e.g.*, Ray Flores, *Lifting Bank Secrecy: A Comparative Look at the Philippines, Switzerland, and Global Transparency*, 14 WASH. U. GLOB. STUD. L. REV. 779, 779–81 (2015) (examining the bank secrecy laws of both the Philippines and Switzerland); Scott A. Schumacher, *Magnifying Deterrence by Prosecuting Professionals*, 89 IND. L.J. 511, 524 (2014) ("Until very recently, Liechtenstein also had strict bank secrecy laws, which caused it to be described as 'the most dangerous tax haven in Europe.'" (footnotes omitted)).

80. *See, e.g.*, David Cay Johnston, *Tax Cheats Called Out of Control*, N.Y. TIMES (Aug. 1, 2006), http://www.nytimes.com/2006/08/01/business/01tax.html [https://perma.cc/R3JV-LDBE (dark archive)] ("So many superrich Americans evade taxes using offshore accounts that law enforcement cannot control the growing misconduct, according to a Senate report that provides the most detailed look ever at high-level tax schemes.").

81. *See generally* Shu-Yi Oei & Diane Ring, *Leak-Driven Law*, 65 UCLA L. REV. 532 (2018) (explaining how leaked data can be used to create and enforce tax law for policy outcomes).

about such secret accounts and prosecuting those who availed themselves of this strategy.[82] This painstaking endeavor, though, yielded few tangible benefits.[83]

Due to a host of factors, such as the introduction of a comprehensive whistleblower law that offered more robust financial rewards for reporting tax noncompliance,[84] information-sharing arrangements between and among countries,[85] and the digitalization of information,[86] the once-hermetic seal of secrecy surrounding offshore bank accounts went by the wayside. Consider the consequences when Bradley C. Birkenfeld, an employee at UBS (a Swiss Bank) in search of a whistleblower award, came forward with a treasure trove of information regarding the Swiss banking system.[87] He divulged that his employer had devised schemes to attract U.S. investors and coached them on available methodologies to circumvent their tax obligations.[88] In addition, Birkenfeld turned over the account information of nearly 50,000 U.S. taxpayers who had secret overseas accounts.[89] For his efforts and in accordance

82. *See* Khrista McCarden, *Till Offshore Do Us Part: Uncovering Assets Hidden from Spouses and Tax Authorities*, 62 ST. LOUIS U. L.J. 19, 20 (2017) ("[T]he Internal Revenue Service ('IRS') does not have the time or resources to untangle the intricate maze of corporate structures used by wealthy individuals to hide their assets offshore.").

83. *See Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS (Apr. 3, 2016), https://panamapapers.icij.org/20160403-panama-papers-global-overview.html [https://perma.cc/9LWE-YQFK] (describing the "Panama Papers" as a "cache of 11.5 million records [that] shows how a global industry of law firms and big banks sells financial secrecy to politicians, fraudsters and drug traffickers as well as billionaires, celebrities and sports stars").

84. I.R.C. § 7623(b).

85. *See, e.g.*, Itai Grinberg, *The New International Tax Diplomacy*, 104 GEO. L.J. 1137, 1164 (2016) ("The [Organisation for Economic Co-operation and Development] then advances specific enhanced models of information-sharing among tax administrations that delineate aggressive tax-planning arrangements, so as to encourage effective cross-border administrative assistance regarding these arrangements.").

86. *See, e.g.*, Zachary Rozen, *Symposium Review: Leakers, Whistleblowers & Traitors*, 8 J. NAT'L SEC. L. & POL'Y 1, 1 (2015) ("Recently, mass data storage, the digitalization of information, and the sheer size of the modern national security apparatus have made it far easier for government employees to share classified information without appropriate authorization.").

87. *See* Jennifer M. Pacella, *Bounties for Bad Behavior: Rewarding Culpable Whistleblowers Under the Dodd-Frank Act and Internal Revenue Code*, 17 U. PA. J. BUS. L. 345, 345 (2015) ("In 2012, Bradley Birkenfeld received a $104 million bounty reward from the Internal Revenue Service ('IRS') for blowing the whistle on his employer, UBS, which facilitated a major offshore tax fraud scheme.").

88. *See* Bradley Klapper, *Senate: UBS Aided Tax Cheats*, CNBC, https://www.cnbc.com/id/25834785 [https://perma.cc/73F5-AEEK] (Aug. 5, 2010, 1:08 PM) (explaining how UBS and other Swiss banks conspired to assist U.S. taxpayers to shortchange the federal government of tax revenue).

89. Marc D. Shepsman, Comment, *Buying FATCA Compliance: Overcoming Holdout Incentives To Prevent International Tax Arbitrage*, 36 FORDHAM INT'L L.J. 1767, 1790 (2013) ("While Birkenfeld tipped off the United States to the existence of nearly 50,000 US accounts, the Swiss handed over just 4,500 after a heated legal battle.").

with the whistleblower laws at that time, the Treasury Department awarded Birkenfeld the sum of $104 million, the largest award of its kind ever issued.[90]

Birkenfeld's and others' revelations regarding the vastness of taxpayers' failure to report their overseas income stirred Congress into action. The nation's legislative body could no longer blithely pretend that hidden offshore accounts were tactics used by a very small number of rogue taxpayers. Theoretically, Congress could have augmented the IRS's budget and prodded the Commissioner to concentrate on promoting international tax compliance, but these efforts likely would have produced few tangible benefits and would have come at a steep, resource-devouring price tag. Congress knew that if it did not take more significant measures, the very integrity of the tax system was at risk.

Therefore, Congress enacted FATCA[91] as an instrument to target offshore tax evasion. FACTA requires foreign financial institutions that operate in the United States to deliver to the IRS account information regarding U.S. taxpayers or face burdensome U.S. withholding taxes on their U.S.-sourced income.[92] In accordance with FATCA, information sharing with the United States has become commonplace;[93] and this measure, along with others,[94] has proven highly effective in safeguarding the tax base from erosion due to the failures of taxpayers to report their offshore investments.[95]

90. *See* David Kocieniewski, *Whistle-Blower Awarded $104 Million by I.R.S.*, N.Y. TIMES (Sept. 11, 2012), http://www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html [https://perma.cc/YB27-8HV2 (dark archive)] (describing Birkenfeld's whistleblowing efforts).

91. *See supra* notes 75–77 and accompanying text.

92. *See supra* notes 75–82 and accompanying text; Remy Farag, *Deloitte: FATCA Compliance May Proliferate via Peer Pressure*, 23 J. INT'L TAX'N 6, 6 (2012) ("Under these provisions, a withholding agent must deduct and withhold a tax equal to 30% of any withholdable payment made to a nonfinancial foreign entity if the beneficial owner of the payment is a nonfinancial foreign entity that does not meet specified requirements ([I.R.C. §] 1472(a)).").

93. Multiple countries have entered into agreements with the United States to share information under FATCA. For a list of FATCA agreements and understandings in effect by jurisdiction. *See Foreign Account Tax Compliance Act*, U.S. DEP'T TREASURY, https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx [https://perma.cc/W7PN-GXHY].

94. The Organisation for Economic Co-Operation and Development ("OECD") has developed a "Common Reporting Standards" ("CRS") framework based in large part on the FATCA model. *See generally* ORGANISATION FOR ECON. CO-OPPERATIVE & DEV., STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS (2d ed. 2017) (explaining the common due diligence procedures to be followed by financial institutions under CRS). Under the CRS framework, financial institutions share information with tax authorities, and the tax authorities share information with one another. *Id.* More than 100 jurisdictions have adopted binding CRS instruments. *See, e.g.*, *CRS by Jurisdiction 2020*, OECD, http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/crs-by-jurisdiction-2020.htm [https://perma.cc/Z26X-3NDJ] (to view all the jurisdictions that have signed the agreement, click through the years displayed across the top of the page).

95. *See* I.R.S. News Release IR-2016-137 (Oct. 21, 2016), https://www.irs.gov/uac/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-

The FATCA legislation illustrates the power that Congress possesses, when it wishes, to enact legislation that can reduce particular forms of tax abuse. At the same time, it also demonstrates that the legislative process can take years to unfold and that the revenue leakage to the government in the interim can be immense.[96]

2. Congress Authorizes the Treasury Department To Promulgate Regulations

Despite the many virtues of utilizing the legislative approach, Congress recognizes that it must also rely upon other means to address tax-abuse techniques. Indeed, sprinkled throughout the Code are tacit congressional acknowledgments that it lacks the technical expertise to rein in particular tax-abuse techniques and empowers the Treasury Department to take remedial action.[97] The delegation of this responsibility to the administrative arm of the government makes eminent sense: Treasury Department members are skilled tax experts charged with safeguarding the nation's fiscal well-being.[98]

Representative of this approach is Code section 529(f),[99] pertaining to qualified tuition programs ("QTPs"). It reads as follows: "Notwithstanding any other provision of this section, the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of

compliance [https://perma.cc/VB2H-34LR] (heralding FATCA's success and what it has been able to accomplish with the title "Offshore Voluntary Compliance Efforts Top $10 Billion; More Than 100,000 Taxpayers Come Back into Compliance"); U.S. GOV'T ACCOUNTABILITY OFF., GAO-19-180, FOREIGN ASSET REPORTING: ACTIONS NEEDED TO ENHANCE COMPLIANCE EFFORTS, ELIMINATE OVERLAPPING REQUIREMENTS, AND MITIGATE BURDENS ON U.S. PERSONS ABROAD 41–42 (2019) ("Because of FATCA, IRS receives information on foreign financial assets from hundreds of thousands of filers annually. IRS could use this information to help ensure taxpayers holding offshore assets report and pay taxes owed on income generated from such assets.").

96. Consider the fact that in 2010 Congress finally passed the Foreign Account Tax Compliance Act which instituted the panoply of foreign account reporting requirements. *See supra* note 76 and accompanying text. This is an emblematic example of congressional loitering: for decades, it was common knowledge that wealthy taxpayers routinely hid their investments in such accounts to avoid their U.S. tax obligations. *See* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 113TH CONG., REP. ON OFFSHORE TAX EVASION: THE EFFORT TO COLLECT UNPAID TAXES ON BILLIONS IN HIDDEN OFFSHORE ACCOUNTS 9 (2014) ("Over thirty years ago, in 1983, this Subcommittee held hearings on how U.S. taxpayers were using offshore secrecy jurisdictions to hide assets and evade U.S. taxes. Since then, the problem has only grown. In 2000, the U.S. State Department estimated that assets secreted in offshore jurisdictions totaled $4.8 trillion.").

97. *See, e.g.*, I.R.C. § 482 (delegating responsibility to the Secretary of the Treasury to issue regulations to "distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses").

98. *See Role of the Treasury*, U.S. DEP'T TREASURY, https://home.treasury.gov/about/general-information/role-of-the-treasury [https://perma.cc/TW5C-RJ7V] ("Treasury's mission highlights its role as the steward of U.S. economic and financial systems, and as an influential participant in the world economy.").

99. I.R.C. § 529(f).

this section and to prevent abuse of such purposes, including regulations under chapters 11, 12, and 13 of this title."[100]

When Congress first introduced QTPs to the Code,[101] it thought that taxpayers would use them as intended—strictly as a tool to advance the educational interests of their loved ones.[102] Congress did not anticipate that a stampede of taxpayers would instead choose to use QTPs as a strategic wealth-transfer device.[103]

Once Congress learned how taxpayers were manipulating QTPs to achieve unintended objectives, it enacted section 529(f), which granted broad leeway to the Treasury Department to promulgate anti-abuse regulations.[104] In 2008, with congressional authorization, the Treasury Department issued an elaborately detailed announcement that the agency would promulgate comprehensive anti-abuse regulations to curtail taxpayers from utilizing QTPs in ways that Congress never intended.[105]

Section 529(f) is not an isolated example of congressional deference to Treasury Department expertise. The Code is replete with examples of such

100. *Id.*

101. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1806(a), 110 Stat. 1755, 1895 (codified as amended at I.R.C. § 529).

102. *See* STAFF OF JOINT COMM. ON TAX'N, 104TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 104TH CONGRESS 197 (Comm. Print 1996) ("The Congress believed that it is appropriate to clarify the tax treatment of State-sponsored prepaid tuition and educational savings programs in order to encourage persons to save to meet post-secondary educational expenses.").

103. *See* STAFF OF JOINT COMM. ON TAX'N, JCX-38-06, TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006, at 369 (2006).

> For example, assume that in 2007, when the gift tax annual exclusion amount under [Code] section 2503(b) is $12,000, Grandparents wish to give more than $1 million to Child, free of transfer taxes. Grandparents open [Code] section 529 accounts for each of their 10 grandchildren, naming Child the [Account Owner] of each account. Grandparents use the 5-year-spread rule of [Code] section 529(c)(2)(B) to contribute $120,000 ($60,000 from each Grandparent) to each grandchild's account without triggering any gift or generation-skipping transfer (GST) tax liability. The earnings then accumulate on a tax-deferred basis in the accounts and Child may withdraw the balances at any time. If Grandparents survive for 5 years, the account balances will not be included in their gross estates at death. In effect, Grandparents have transferred $1.2 million to Child while claiming that no transfer taxes are due and claiming to use none of their applicable credit amount (formerly the unified credit).

Guidance on Qualified Tuition Programs Under Section 529, 73 Fed. Reg. 3441, 3442 (proposed Jan. 18, 2008).

104. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, § 1304, 120 Stat. 780, 1109–10 (codified as amended at I.R.C. § 529(f)).

105. *See generally* Guidance on Qualified Tuition Programs Under Section 529, 73 Fed. Reg. at 3442–43 (detailing proposed anti-abuse regulations in an announcement). For reasons unknown, the Treasury Department has not yet acted upon its own initiative and promulgated regulations targeting the abuse of QTPs.

99 N.C. L. REV. 643 (2021)

delegations of authority.[106] The message that Congress intends to send via these legislative initiatives is clear: taxpayers' attempts at circumvention will be scrutinized for legitimacy. Akin to judicial doctrines, the mere threat of such delegations of authority chills taxpayers' temptations to engage in tax abuse. Yes, with the help of their trusted advisers, taxpayers can devise intricate tax-avoidance plans, but equipped with appropriate regulatory authority, the Treasury Department, at a moment's notice, can thwart these plans.

3. The Treasury Department, on Its Own Initiative, Promulgates Regulations To Safeguard the Tax Base

The Treasury Department is comprised of some of the most skilled tax experts in the country.[107] Deeply ensconced in the accounting community, these experts routinely learn through a multitude of media—professional continuing education seminars, the popular press, online research, and various investigations—how taxpayers skillfully mitigate their tax burdens in ways that contravene congressional intent.[108] Under a congressional mandate,[109] when the Treasury Department uncovers a new tax avoidance technique (a so-called "reportable transaction"),[110] it is supposed to publish notice of these "listed transactions,"[111] and, in addition, ensure that certain additional

106. When Congress authorizes so-called legislative regulations, their governing effect is noteworthy. *See, e.g.*, Allstate Ins. Co. v. United States, 329 F.2d 346, 349 (7th Cir. 1964) ("Thus the regulations so promulgated became legislative in character having the force and effect of law, so long as they were reasonably adapted . . . to the administration and enforcement of the act and did not contravene some statutory provision."); E.I. DuPont De Nemours & Co. v. Comm'r, 102 T.C. 1, 8–9 (1994) ("[A] legislative regulation, which flows from a specific congressional grant of authority, is entitled to greater deference than a regulation promulgated under the general rulemaking power in section 7805(a)."), *aff'd*, 41 F.3d 130 (3d Cir. 1994), *aff'd sub nom.* Conoco, Inc. v. Comm'r, 42 F.3d 972 (5th Cir. 1995).

107. *See* RICHARD E. ANDERSEN, THE FUNDAMENTALS OF INTERNATIONAL TAX LAW (2008), 2008 WL 5689071, at *3 ("Throughout the tax area, . . . the Treasury Department is generally able to draw upon experienced and thoughtful officials.").

108. *See, e.g.*, Diana B. Henriques & Floyd Norris, *Wealthy, Helped by Wall Street, Find New Ways To Escape Tax on Profits*, N.Y. TIMES (Dec. 1, 1996), https://www.nytimes.com/1996/12/01/business/wealthy-helped-by-wall-st-new-find-ways-to-escape-tax-on-profits.html [https://perma.cc/G7PJ-68D7 (dark archive)].

> Seventy-five years after it was enacted, the Federal tax on profits from the sale of stock, land or other assets—known as the capital gains tax—is becoming largely academic to the nation's wealthiest taxpayers. Even as a growing number of Americans with more modest incomes are paying capital gains taxes because of their growing mutual-fund profits, wealthy taxpayers . . . can take advantage of a growing arsenal of Wall Street techniques to delay or entirely avoid taxes on their investment gains.

Id.

109. I.R.C. § 6011(a).

110. Treas. Reg. § 1.6011-4(b) (as amended in 2010).

111. *Id.* § 1.6011-4(b)(2).

reporting requirements are met.[112] Once the IRS publishes notice of these so-called "listed transactions" on its website, [113] anti-abuse regulation promulgation is commonplace.[114]

One such taxpayer-compliance initiative received nationwide attention: in the mid-1990s, the Treasury Department instituted anti-abuse partnership tax regulations.[115] The promulgation of these regulations did not happen in a vacuum; to the contrary, the Treasury Department crafted these regulations in response to widespread publicity that hordes of taxpayers were utilizing partnerships (as defined under subchapter K of the Code) as tax-minimization devices with little or no economic substance, thereby threatening the integrity of the income tax base.[116]

To protect the nation's coffers, the Treasury Department responded by promulgating regulations which adopted a two-pronged approach. The agency's regulations provide (1) a general anti-abuse set of rules and (2) an abuse-of-entity set of rules.[117] Together, these two rule sets are designed to foil taxpayers' ability to thwart congressional will.[118] Consider how each rule set operates.

112. *See generally* Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629 (2009) (describing the disclosure process associated with abusive tax transactions).

113. Recognized Abusive and Listed Transactions, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/corporations/listed-transactions [https://perma.cc/JNE6-RPW9] (last updated Dec. 30, 2020) (listing transactions in chronological order).

114. *See, e.g.*, Proposed Amendments to the Regulations, § 1.302-5(b)(4): Redemptions Taxable as Dividends, 67 Fed. Reg. 64,331, 64,337 (proposed Oct. 18, 2002) (proposing that after a taxpayer's shares are entirely redeemed, rather than the taxpayer's basis in those shares passing to a related taxpayer (as was the case under the prior regulations), the tax basis is instead held suspended and treated as a putative loss on the so-called inclusion date). The promulgation of anti-abuse regulations attests to the narrative that the Treasury Department considers its taxpayer-compliance mission of paramount importance. *The Agency, Its Mission and Statutory Authority*, I.R.S., https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority [https://perma.cc/T3G7-YL3R] (last updated Sept. 28, 2020) ("Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.").

115. Treas. Reg. § 1.701-2 (as amended in 1995). These new regulations were announced under the title "Subchapter K Anti-Abuse Rule" and went into effect in 1994. Subchapter K Anti-Abuse Rule, 60 Fed. Reg. 23, 23–24 (Jan. 3, 1995) (codified at 26 C.F.R. pt. 1 § 1.701-2).

116. *See, e.g.*, Cunningham & Repetti, *supra* note 14, at 4–5 ("Subchapter K also has several special rules not otherwise available in the Internal Revenue Code . . . . It is, therefore, not surprising that subchapter K has become the vehicle of choice for a wide variety of tax shelters.").

117. § 1.701-2(a), (e).

118. Herman J. Marino, *The Final Partnership Anti-Abuse Regulation: The Treasury Redefines the "Intent of Subchapter K"*, 73 TAXES 171, 172 (1995). The Treasury claimed that its purpose in promulgating the anti-abuse regulation was to target the limited number of taxpayers who were entering "into partnerships for the sole purpose of reducing their . . . tax liability, especially packaged partnership transactions." *Id.*

The general anti-abuse set of rules is broad in nature. It first sets forth the central underlying tenets of subchapter K.[119] With this foundation in mind, it declares that if taxpayers utilize partnerships "in a manner that is inconsistent with the intent of subchapter K, the Commissioner can recast the transaction for federal tax purposes, as appropriate to achieve tax results that are consistent with the intent of subchapter K."[120] The rule then details the exact manner in which the Commissioner may recast questionable partnership use, offering eleven examples of potential tax abuse and various remedial measures that are at the Commissioner's disposal to yield correct tax outcomes.[121]

The second set of anti-abuse rules is different in nature from the first. It pertains to situations where taxpayers seek to abuse a partnership's entity nature by using it as a mechanism to achieve tax savings.[122] When this occurs, the second rule set permits the Commissioner to "treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder."[123] For example, if a partnership issues a debt instrument in order to maneuver around one of the Code's interest deduction limitations, the IRS may ignore the partnership's separate existence and instead treat the individual partners as if they had each issued a pro-rata share of the debt.[124]

Given the sweeping nature of these anti-abuse Treasury regulations, some commentators have questioned their legitimacy,[125] while other observers

119. § 1.701-2(a).

120. *Id.* § 1.701-2(b).

121. *Id.* § 1.701-2(d).

122. *Id.* § 1.701-2(e), (f).

123. *Id.* § 1.701-2(e)(1).

124. *Id.* § 1.701-2(f), Example 1.

125. *See, e.g.*, Alan Gunn, *The Use and Misuse of the Antiabuse Rules: Lessons from the Partnership Antiabuse Regulations*, 54 SMU L. REV. 159, 159 (2001) ("The regulations [anti-abuse rules] are badly written; so badly written that it is hard to imagine that they can actually be applied to many cases. Furthermore, they attempt to make the concept of abuse do too much work."); Linda D. Jellum, *Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation Is Unconstitutional*, 70 U. MIA. L. REV. 152, 155 (2015) ("However, the anti-abuse regulation should not fill [the] gaps [in the economic-substance statute] because [the anti-abuse regulation] is unconstitutional or, alternatively, *ultra vires*."); William F. Nelson, *The Limits of Literalism: The Effect of Substance over Form, Clear Reflection and Business Purpose Considerations on the Proper Interpretation of Subchapter K*, 73 TAXES 641, 641 (1995) ("The Treasury's promulgation of the Anti-abuse Rule, which was issued in final form on December 24, 1994, has provoked unusual, if not unprecedented, opposition from tax professionals."). *But see* FLA. BAR SECTION OF TAX'N, COMMENTS CONCERNING PROPOSED TREAS. REG. SECTION 1.701-2 PERTAINING TO THE RECHARACTERIZATION OF CERTAIN PARTNERSHIP TRANSACTIONS (reprinted in *Florida Bar Committee Call for Antiabuse Rule's Overhaul*, TAX NOTES TODAY, June 22, 1994, 1994 TNT 142-41 (LEXIS)) ("The adoption of proposed regulation section 1.701-2 to attack perceived abuses involving a 'small number of large partnership transactions' is akin to using an atomic bomb to perform delicate brain surgery.").

have steadfastly supported the anti-abuse regulatory initiative and commended the Treasury Department for its efforts.[126] Tested over the last quarter of a century, the anti-abuse regulations have withstood judicial scrutiny and have been upheld as a legitimate exercise of administrative authority, well within the Treasury Department's jurisdiction.[127] Admittedly, it is hard to gauge exactly how successful these regulations have been in achieving their stated objective of curbing partnership tax abuse.[128] Nevertheless, the regulations have added a valuable defensive instrument to the Treasury Department's toolbox to protect the fisc by defeating tax-minimization schemes.

B. *Shortcomings of Efforts To Curb Tax Abuse*

To some extent, the combined efforts of Congress and the Treasury Department to address tax abuse have proven efficacious. Evidence of this is found in revenue numbers and voluntary compliance rate percentages. In 2017, the United States collected approximately \$3.3 trillion in taxes,[129] the vast bulk of which was paid voluntarily rather than as the result of IRS audits.[130] In terms of overall compliance, the voluntary compliance rate for taxpayers fulfilling their tax obligations remains fairly steady, hovering in the lower-to-middle eighty-percent range.[131] Revenue collections and the voluntary compliance rate indicate that while tax abuse may be a fairly common feature of the tax landscape, it does not dominate it.

Despite the nation's revenue collections and voluntary compliance rate, there is clearly room for improvement. The so-called gross tax gap—or the

126. *See, e.g.*, Gunn, *supra* note 125, at 173–76 (extolling the virtues of the anti-abuse regulations); Andrea Monroe, *What's in a Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 CASE W. RSRV. L. REV. 401, 406 (2010) (suggesting that "Treasury regulation section 1.701-2, commonly referred to as the partnership anti-abuse rule ('PAAR'), may provide subchapter K with the support it so desperately requires").

127. *See, e.g.*, Kearney Partners Fund, LLC v. United States, No. 10-cv-153-FtM-SPC, 2013 WL 1774871, at *8–9 (M.D. Fla. Apr. 25, 2013), *aff'd per curiam*, 803 F.3d 1280 (11th Cir. 2015) (referencing the anti-abuse partnership regulations, the court indicated that the IRS may disregard the entire transaction).

128. *See* 2 ARTHUR B. WILLIS, JOHN S. PENNELL & PHILIP F. POSTLEWAITE, PARTNERSHIP TAXATION ¶ 1.03[6], at 1-59 (student ed. 1999–2000) ("It appears doubtful that the overall landscape of Subchapter K has changed meaningfully by reason of th[e] [anti-abuse partnership] [r]egulation[s].").

129. STAFF OF THE J. COMM. ON TAXATION, JCX-3-18, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2018, at 25 tbl.A-1 (Comm. Print 2018).

130. *See* I.R.S., INTERNAL REVENUE SERVICE DATA BOOK 2018, at 21, 27 tbl.9b (2019) (indicating that the IRS audit rate on individual returns for fiscal year 2018 hovered around 0.6%).

131. I.R.S., No. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, at 1 (2019) [hereinafter I.R.S., TAX GAP ESTIMATES FOR 2011–2013], https://www.irs.gov/pub/irs-pdf/p1415.pdf [https://perma.cc/3JW5-8977] ("The estimated [voluntary compliance rate] is 83.6 percent.").

difference between what taxpayers pay in taxes in a timely manner and what they should pay if they fully complied with the tax laws[132]—hovers in the $400 billion range.[133] This dollar figure does not include tax-abuse techniques, such as upstream tax planning, that contravene congressional intent but fall under the umbrella of tax avoidance rather than tax evasion.[134] Furthermore, close to one out of every five tax dollars goes unpaid,[135] signifying that something is awry with how Congress approaches tax abuse, particularly those that taxpayers flaunt.

Distilled down to its essentials, the present approach suffers from two major deficits: Congress is inept at efficiently handling tax abuse, and the Treasury Department lacks a clear mandate to eradicate them. Consider each.

The framers clearly crafted the Constitution so that Congress could not pass legislation willy-nilly and in haste. To the contrary, the framers created two deliberative bodies, the House and the Senate, which together would enact legislation only after careful consideration and debate.[136] And for most major legislation involving large sectors of the economy (for example, health care) or social issues (for example, voting rights), this approach makes sense: the nation needs to pause and discuss the merits and shortcomings of such legislative overhauls. However, although overall tax policy merits careful consideration and debate, the same philosophy does not necessarily extend to tax-abuse techniques that suddenly crop up in the public domain. When a particular form of tax abuse becomes known, it is important that the IRS immediately eradicates it. This currently does not happen; rather, in the years or decades that it takes Congress to respond, billions of dollars of valuable tax

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132. *Id.* ("The gross tax gap is the amount of true tax liability that is not paid voluntarily and timely.").

133. *Id.*

> The estimated gross tax gap is $441 billion. The net tax gap is the gross tax gap less tax that subsequently will be paid, either paid voluntarily or collected through IRS administrative and enforcement activities; it is the portion of the gross tax gap that will not be paid. It is estimated that $60 billion of the gross tax gap eventually will be paid resulting in a net tax gap of $381 billion.

Id.

134. *See* Dave Rifkin, *A Primer on the "Tax Gap" and Methodologies for Reducing It*, 27 QUINNIPIAC L. REV. 375, 377–79 (2009) ("The 'tax gap' represents the annual amount of 'noncompliance' with the Code.").

135. *See* I.R.S., TAX GAP ESTIMATES FOR 2011–2013, *supra* note 131, at 1 ("The estimated [voluntary compliance rate] is 83.6 percent.").

136. *See, e.g.*, Consumer Energy Council of Am. v. Fed. Energy Regul. Comm'n, 673 F.2d 425, 464 (D.C. Cir. 1982) ("What emerges from our analysis of the purposes of the lawmaking restrictions in Article I is that the Framers were determined that the legislative power should be difficult to employ. The requirements of presentation to the President and bicameral concurrence ultimately serve the same fundamental purpose: to restrict the operation of the legislative power to those policies which meet the approval of three constituencies, or a supermajority of two.").

revenue may be lost.[137] Furthermore, tax advisers who make handsome professional fees plotting these devices have significant financial incentives to continue to devote their time and effort to engineering new tax-abuse techniques. They know that even if Congress ultimately eliminates particular tax-saving devices, they will, in the meantime, reap fees handsome and bountiful enough to make such endeavors well worthwhile.[138]

The Treasury Department's actions are sometimes met with stiff resistance. This is particularly true when it seeks to implement anti-abuse regulations where Congress has not explicitly delegated this responsibility. When the Treasury Department first issued its partnership–anti-abuse regulations, for example, there was a firestorm of opposition.[139] A more recent example involves the utilization of valuation discounts involving transfers between family members whereby the fair market values of assets are strategically diminished—at least on a temporary basis—to reduce transfer tax exposure.[140] In 2016, the Treasury Department proposed regulations that would have curtailed this practice.[141] The release of these proposed regulations caused a tumult in the estate-planning community,[142] which vigorously attacked the Treasury Department's actions as being beyond the scope of its

137. The sentiment has been well summed up by Professor Joseph Bankman: "One obvious disadvantage to the legislative approach is that it gives taxpayers a multi-year window in which to 'cash in' on even the most egregious tax-driven transactions, so long as those transactions are supported by the literal language o[f] one or more statutes." Joseph Bankman, *Stanford Professor Rebuts Criticisms of Partnership Antiabuse Reg.*, TAXNOTES (July 1, 1994), https://www.taxnotes.com/tax-notes-today-federal/partnerships/stanford-professor-rebuts-criticisms-partnership-antiabuse-reg/1994/07/20/13h88 [https://perma.cc/L9T3-LVS9 (staff-uploaded dark archive)].

138. *See, e.g.*, Pierre Paulden & Ben Steverman, *What Leon Black Got for Paying Jeffrey Epstein $158 Million (2)*, BLOOMBERG NEWS (Jan. 26 2021), https://www.bloomberg.com/news/articles/2021-01-26/what-leon-black-got-for-paying-jeffrey-epstein-158-million?sref=dcitGkK3 [https://perma.cc/X8LZ-A8CD (staff-uploaded dark archive)] (explaining the exorbitant fee paid to a consultant to remedy a deficit grantor retained annuity trust).

139. *See, e.g.*, Richard M. Lipton, *Controversial Partnership Anti-Abuse Prop. Regs. Raise Many Questions*, 81 J. TAX'N 68, 74 (1994), 1994 WL 555084 ("Although most tax practitioners are opposed to abuse and support the IRS in its efforts to attack the improper use of partnerships, many have questioned whether the Proposed Regulations are the appropriate means to reach that end."); *Partnership Antiabuse Regs Are 'Fatally Flawed,' Banoff Contends*, 63 TAX NOTES 1692, 1692 (1994) (arguing that the proposed Treasury anti-abuse regulations are misguided).

140. *See generally* Repetti, *supra* note 46 (explaining how taxpayers strategical make gifts to their loved ones that purposefully diminish asset values until, at a later point in time, they can coordinate their efforts to subsequently maximize asset values).

141. *See* Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, 81 Fed. Reg. 51413, 51413–25 (proposed Aug. 4, 2016).

142. *See* Robert Grossman, *Update on the Proposed Section 2704 Regulations*, PRAC. TAX STRATEGIES, Feb. 2017, at 36, 36 ("The public reaction to these proposed regulations has been incredible. After the proposed regulations were published in the Federal Register on 8/4/16, those wishing to submit comments to the Treasury had a 60-day window to do so (until 11/2/16). In that short time frame, the Treasury Department received nearly 9,800 submissions.").

authority.[143] As a result of this lobbying campaign, the Treasury Department ultimately withdrew these proposed regulations.[144] When it comes to tax abuse, the absence of explicit congressional delegation of authority often gives secure refuge to tax planners: they can question the legitimacy of the Treasury Department's actions and, in doing so, may quash the Treasury's attempts to rein in a particular form of tax abuse.

Thus, the nation appears stymied. On the one hand, due to structural limitations, Congress is ill-equipped to address tax abuse. On the other hand, while the Treasury Department has fared somewhat better in its endeavors to curb tax abuse, its record is replete with failures to intercede. In a nutshell, Congress is constantly playing after-the-fact catch-up to taxpayers' tax shenanigans, and the Treasury Department's preventative actions and their legitimacy are routinely challenged and attacked. Corrosive tax abuse thus remains an enduring fixture of the tax landscape. Left unchecked, the status quo is problematic: many taxpayers dedicate significant resources to defeating their tax obligations, and as a consequence of taxpayers' actions, the government is left underfunded. In short, something must be done.

III. REFORMING THE STATUS QUO

In many legislative spheres, to implement its policies, Congress routinely delegates power to administrative agencies such as the Food and Drug Administration and the Security and Exchange Commission.[145] For example, when it comes to the goal of securing clean air in the Clean Air Act,[146]

143. *See* Robert J. Grossman, *Proposed Section 2704 Regulations Work To Minimize Valuation Discounts*, PRAC. TAX STRATEGIES, Dec. 2016, at 259, 259 ("The new rules represent a camouflaged means of imposing a significant tax increase without direct congressional authorization."); Opinion, *A Stealth Death Tax Increase*, WALL ST. J., Sept. 6, 2016, at A14 ("Since Congress does not agree that the Internal Revenue Service should suck more cash out of family farms, Treasury Secretary Jack Lew is up to his usual tricks, trashing established interpretations of tax law to bypass the legislative branch.").

144. *See* STEVEN T. MNUCHIN, U.S. DEP'T OF THE TREASURY, SECOND REPORT TO THE PRESIDENT ON IDENTIFYING AND REDUCING TAX REGULATORY BURDENS EXECUTIVE ORDER 13789, at 3 (2017), https://www.treasury.gov/press-center/press-releases/Documents/2018-03004_Tax_EO_report.pdf [https://perma.cc/76YN-UT4M] ("After reviewing these comments, Treasury and the IRS now believe that the proposed regulations' approach to the problem of artificial valuation discounts is unworkable . . . . In light of these concerns, Treasury and the IRS currently believe that these proposed regulations should be withdrawn in their entirety. Treasury and the IRS plan to publish a withdrawal of the proposed regulations shortly in the Federal Register.").

145. David J. Barron & Todd D. Rakoff, *In Defense of Big Waiver*, 113 COLUM. L. REV. 265, 266 (2013) (noting that "the delegation of broad lawmaking power to administrative agencies" is a "foundational government practice"); F. Andrew Hessick & Carissa Byrne Hessick, *The Non-Redelegation Doctrine*, 55 WM. & MARY L. REV. 163, 170 (2013) ("Congress frequently delegates its power and regularly confers on administrative agencies the power to develop policy through rulemaking."); Richard B. Stewart, *Beyond Delegation Doctrine*, 36 AM. U. L. REV. 323, 329 (1987) (explaining that federal administrative agencies wield tremendous decisional powers).

146. Pub. L. No. 84-159, 69 Stat. 322 (1955) (codified as amended at 42 U.S.C. §§ 7401–7671q).

Congress did not detail the criteria of the term *pollution*.[147] Instead, through a broad delegation of regulatory power, it directed the Environmental Protection Agency ("EPA") to take the necessary steps—including detailing the criteria of *pollution*—to accomplish this goal.[148] This example is not unique; the United States Code is replete with numerous other examples of Congress delegating its legislative powers to appropriate administrative agencies rather than undertaking the nettlesome and time-consuming task of enacting more elaborate and detailed statutory provisions.[149]

Yet, when it comes to the delegation of authority in the tax realm, Congress has been far more circumspect. On the one hand, cognizant that its command of tax knowledge is lackluster, Congress has issued a blanket invitation to the Treasury Department to promulgate interpretative regulations[150] to provide illuminating guidance to taxpayers.[151] On the other hand, Congress periodically issues legislative mandates that essentially instruct the Treasury Department to act as a deputy legislature by crafting binding rules upon taxpayers;[152] such delegations result in what are commonly known as legislative regulations.[153]

147. *See* Charles de Saillan, *The Use of Imminent Hazard Provisions of Environmental Laws To Compel Cleanup at Federal Facilities*, 27 STAN. ENV'T. L.J. 43, 132 (2008) ("The Clean Air Act does not define the term 'pollution' . . . .").

148. *See* 42 U.S.C. § 7521(a)(1) (authorizing the EPA administrator to set emissions standards for "any air pollutant . . . which in his judgment cause[s], or contribute[s] to, air pollution which may reasonably be anticipated to endanger public health or welfare").

149. *See, e.g.*, James R. Hines Jr. & Kyle D. Logue, *Delegating Tax*, 114 MICH. L. REV. 235, 236–37 (2015) ("Congress regularly delegates enormous amounts of lawmaking power, from control over the money supply (power delegated to the Federal Reserve Board) to the process for closing military bases after the end of the Cold War (which Congress entrusted to the Base Closure and Realignment Commission)." (footnotes omitted)).

150. I.R.C. § 7805(a) (requiring the Secretary of the Treasury to "prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue").

151. *See* Kuhn v. United States, 392 F. Supp. 1229, 1233 (S.D. Tex. 1975) ("On any journey through the labyrinth of the Tax Code, each judicial step must be carefully taken."); *see also* Learned Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947) (describing the Income Tax Code as words that "merely dance before . . . in a meaningless procession: cross-reference to cross-reference, exception upon exception").

152. *See* BORIS I. BITTKER & LAWRENCE LOKKEN, 3 FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 110.5.3 (2019) ("Legislative regulations were often said to have the force of law because they entail an exercise of power delegated by Congress to the agency, as though it were a deputy legislature.").

153. *See, e.g.*, Allstate Ins. Co. v. United States, 329 F.2d 346, 349 (7th Cir. 1964) ("Thus the regulations so promulgated became legislative in character having the force and effect of law, so long as they were reasonably adapted . . . to the administration and enforcement of the act and did not contravene some statutory provision."); E.I. DuPont DeNemours & Co. v. Comm'r, 102 T.C. 1, 8–9 (1994) ("[A] legislative regulation, which flows from a specific congressional grant of authority, is entitled to greater deference than a regulation promulgated under the general rulemaking power in section 7805(a)."), *aff'd*, 41 F.3d 130 (3d Cir. 1994), *aff'd sub nom.* Conoco, Inc. v. Comm'r, 42 F.3d 972 (5th Cir. 1995).

When combating tax abuse, the Treasury Department has historically relied exclusively upon its interpretative powers to target and eliminate questionable taxpayer practices.[154] In some instances, its efforts have been upheld.[155] In other instances, notwithstanding the deference ordinarily afforded Treasury regulations,[156] its efforts have fallen short of the mark.[157] And in still other instances, the agency has decided not to take action for fear that its action would be struck down as impermissible and beyond the scope of the enabling legislation.[158]

Yet, in an era in which the federal government spends approximately four dollars for every three dollars it collects,[159] Congress must consider taking novel measures to ensure that every tax dollar that it anticipates receiving is actually collected. This is why Congress should issue a legislative mandate in the form of a new Code section that encapsulates a general anti-abuse rule and reads something along the following lines:

> In order to curb taxpayers from engaging in transactions and other endeavors that are abusive in nature (i.e., specifically designed to minimize a taxpayer's tax burden in a manner that is inconsistent with or contrary to congressional intent), the Treasury Department shall craft regulations that delineate the scope and boundaries of those transactions and endeavors that are permissible and those that are not. In no event shall the absence of the Treasury Department promulgating regulations be construed to mean that the agency sanctions a particular tax practice.

154. For example, when taxpayers, in order to reduce their tax burden, sought to assign the tax basis they had in their redeemed shares to related parties, *see* I.R.S. Notice 2001-45, 2001-33 I.R.B. 129, the Treasury Department stepped in and revamped the governing regulations to eliminate this practice. *See* Treas. Reg. § 1.302-2(c) (as amended in 2007).

155. *See, e.g.*, Mayo Found. for Med. Educ. & Rsch v. United States, 562 U.S. 44, 53 (2011) (noting that a Treasury regulation will generally be upheld as valid "unless it is 'arbitrary or capricious in substance, or manifestly contrary to the statute'" (quoting Household Credit Servs., Inc. v. Pfennig, 541 U.S. 232, 242 (2004)).

156. *See* Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984).

157. *See, e.g.*, United States v. Home Concrete & Supply, LLC, 566 U.S. 478, 487, 490 (2012) (declining to apply the extended limitations period of Treasury Regulation section 6501(e)(1)(A) to the case at bar on the basis that when "a statute is unambiguous . . . there is 'no gap for the agency to fill' and thus 'no room for agency discretion'" (quoting Nat'l Cable & Telecomms. Ass'n. v. Brand X Internet Servs., 545 U.S. 967, 982–83 (2005))).

158. *See, e.g.*, I.R.S. Announcement 2002-18, 2002-10 C.B. 621 (announcing that the IRS will not promulgate regulations on the taxability of frequent flyer miles and other promotional benefits until Congress issues additional guidance).

159. *See* Kimberly Amadeo, *US Federal Budget Breakdown: The Budget Components and Impact on the US Economy*, BALANCE, https://www.thebalance.com/u-s-federal-budget-breakdown-3305789 [https://perma.cc/EPA9-5DQ5] (Oct. 29, 2020) ("President Donald Trump released a would-be record $4.829 trillion federal budget proposal for fiscal year (FY) 2021 on Feb. 5, 2020. The U.S. government estimates it will receive $3.863 trillion in revenue, creating a $966 billion deficit for Oct. 1, 2020, through Sept 30. 2021." (footnote omitted)).

Empowering the Treasury Department with such broad authority would be consequential: the Treasury Department's power would be augmented; taxpayers and their advisers would be far more circumspect in how they craft their tax-minimization techniques; in particular instances of tax abuse, the judiciary might grant greater deference to Treasury Department regulations; and, finally, the government coffers could anticipate greater revenue yields from existing statutory tax laws.

Below, Section III.A explores the legitimacy of granting such broad authority to the Treasury Department to curb tax abuse; Section III.B details the advantages that an administrative approach offers; Section III.C explains the disadvantages associated with that administrative approach; and Section III.D, utilizing upstream tax planning as a case study, explores the application of the administrative approach.

A. *Granting Broad Authority to the Treasury Department To Curb Tax Abuse*

There is little doubt that Congress has the constitutional authority to delegate to the Treasury Department the power to promulgate anti-abuse regulations.[160] Throughout its history, with only two exceptions,[161] the U.S. Supreme Court has routinely endorsed Congress's ability to delegate its rulemaking power to administrative agencies,[162] and this power has gone virtually unchallenged ever since.[163] Indeed, a large segment of the nation's

160. As a general proposition, Congress can delegate its authority "so long as the statutory delegation includes an 'intelligible principle' by which a court can evaluate the agency's exercise of its discretion." Hines & Logue, *supra* note 149, at 240; *see also* Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 472 (2001) ("In a delegation challenge, the constitutional question is whether the statute has delegated legislative power to the agency. Article I, § 1, of the Constitution . . . permits no delegation of those powers . . . and so we repeatedly have said that when Congress confers decisionmaking authority upon agencies *Congress* must 'lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform.'" (alteration in original) (citations omitted) (quoting J.W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928))). This same authority to delegate extends to tax. *See* Mayo Found. for Med. Educ. & Rsch., 562 U.S. at 55 ("[W]e are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, we have expressly '[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action.'" (alterations in original) (quoting Dickinson v. Zurko, 527 U.S. 150, 154 (1999))).

161. *See* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 550 (1935) (holding that the relevant section of the contested legislation was an unconstitutional delegation of legislative power); Panama Refin. Co. v. Ryan, 293 U.S. 388, 432–33 (1935) (same).

162. *See* Nicholas Bagley, Opinion, *Most of Government Is Unconstitutional*, N.Y. TIMES (June 21, 2019), https://www.nytimes.com/2019/06/21/opinion/sunday/gundy-united-states.html?searchResultPosition=1 [https://perma.cc/CD3C-FX3D (dark archive)] ("Since 1935, the Supreme Court has approved laws telling agencies to regulate 'in the public interest' and to set pollution standards 'requisite to protect the public health.' Not once in the 84 years since has the Supreme Court invalidated a law because it offends the so-called nondelegation doctrine.").

163. *But see* Gundy v. United States, 139 S. Ct. 2116, 2148 (2019) (Gorsuch, J., dissenting) (hinting that Congress might lack the power to delegate broad powers to administrative agencies).

bureaucratic state is founded specifically upon the legitimacy of Congress's ability to rely upon administrative agencies for support.[164]

Notwithstanding the rise of the bureaucratic state, a question has arisen that remains unanswered: In the realm of fiscal matters, why has Congress exercised its delegation power rather gingerly?[165] One reason may be historical in nature. A major catalyst in our nation's formation was the deep antipathy expressed by the American colonies toward the British monarchy for foisting a tax regime upon them.[166] Ever since, Congress has prized the opportunity to craft modes of revenue raising—whether it be a system of excise taxes and tariffs or an income tax—in which all taxpayers are deemed fairly represented.[167] Another likely reason Congress has been hesitant to delegate broad authority to the Treasury Department is that its members relish the political power associated with controlling the nation's purse strings and, in particular, who pays what into the system.[168] Representative of this power has been the House Ways and Means and Senate Finance Committees, both of which are considered by many in the legislative branch and the public as the most important and powerful committees in each respective house.[169] Delegating authority to the Treasury Department to eradicate tax abuse might be tantamount to a relinquishment of power—something that no politician would savor.

By way of contrast, however, Congress has tacitly approved of the judiciary taking broad measures to curb tax abuse. Consider the fact that over the last century the judiciary has developed out of whole cloth a series of

164. Hines & Logue, *supra* note 149, at 236 ("The broad delegation of lawmaking power to administrative agencies is a well-accepted feature of modern U.S. policymaking.").

165. *Id.* at 237 ("Congress rarely enacts tax statutes that set out broad tax policy principles and authorize the Treasury Department or some other regulatory agency to fill in the details.").

166. *See* Thomas C. Grey, *Origins of the Unwritten Constitution: Fundamental Law in American Revolutionary Thought*, 30 STAN. L. REV. 843, 869 (1978) ("The revolutionary struggle broke out in 1764, when the British government began to implement its new policy of taxing the American colonies to reduce the debts from the Seven Years' War. The first step was the Sugar Act, which raised the duty payable by Americans on imported molasses. At the same time, the administration announced its intention to introduce a stamp tax on the colonies the following year.").

167. *See* W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A HISTORY 310 (3d ed. 2016) ("A number of historians have addressed the origins of the federal tax system during the era of the American Revolution and the early republic. All emphasize the role of democratic forces, concepts of equity, and historical contingency in the development of the federal government's tax regimes from 1775 through the early 1790s.").

168. *See, e.g.*, Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159, 1174 (2006) (explaining the role money plays in shaping legislation and how taxing power gives Congress leverage to elicit campaign donations).

169. *See, e.g.*, Eric T. Laity, *The Corporation as Administrative Agency: Tax Expenditures and Institutional Design*, 28 VA. TAX REV. 411, 442 (2008) ("In addition, the congressional committees that control tax expenditures — the Senate Finance Committee and the House Ways and Means Committee — are powerful committees: more powerful than, for example, the education and labor committees, which deal with direct expenditure welfare programs.").

doctrines—for example, the substance-over-form doctrine,[170] the step-transaction doctrine,[171] and the sham-transaction doctrine[172]—which are dedicated to eradicating tax-abuse techniques.[173] Rather than question the judiciary's ability to take such measures, Congress recognizes the judiciary's need to act proactively. Recent evidence of congressional approval of the judiciary's role is found in Code section 7701(o),[174] which codified the economic-substance doctrine[175] and explicitly invited the judiciary to continue to employ this doctrine and to attack tax abuse in ways that the Code failed to address.[176]

Modern political states recognize that administrative agencies can play a vital role in curbing tax abuse. As a case study, consider what has transpired in Ireland. Several decades ago, the Irish legislature passed a law[177]—along the same lines that this analysis is advocating—that authorized the Irish Tax and Customs Agency (the Irish equivalent to the IRS) to institute whatever

170. As articulated by one judge, this is the principle of "looking through form to [the] substance" of a transaction. Estate of Weinert v. Comm'r, 294 F.2d 750, 755 (5th Cir. 1961).

171. The U.S. Supreme Court has defined the step-transaction doctrine as follows:

> [I]nterrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction. By thus "linking together all interdependent steps with legal or business significance, rather than taking them in isolation," federal tax liability may be based "on a realistic view of the entire transaction."

Comm'r v. Clark, 489 U.S. 726, 738 (1989) (quoting 1 BORIS I BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3.5, p. 4-52 (1981)).

172. Winn-Dixie Stores, Inc. v. Comm'r, 254 F.3d 1313, 1316 (11th Cir. 2001) ("[The sham transaction doctrine] provides that a transaction is not entitled to tax respect if it lacks economic effects or substance other than the generation of tax benefits, or if the transaction serves no business purpose.").

173. *See* Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 863–64 (1982) (reviewing BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS (1981)) ("It is from these cases that the basic weapons in the Commissioner's arsenal are derived—the business purpose doctrine, the step transaction doctrine, 'substance over form,' and others. The effect of these doctrines is the existence alongside the Internal Revenue Code of an additional (and somewhat autonomous) set of principles for deciding tax disputes."); *see also* Boris I. Bittker, *Pervasive Judicial Doctrines in the Construction of the Internal Revenue Code*, 21 HOW. L.J. 693, 695 (1978) (describing how judicial doctrines are influential in curbing tax evasion).

174. *See, e.g.*, Rebecca Rosenberg, *Codification of the Economic Substance Doctrine: Agency Response and Certain Other Unforeseen Consequences*, 10 WM. & MARY BUS. L. REV. 199, 260 (2018) ("The statute's enactment quite clearly signals Congressional approval of the economic substance doctrine (even though the doctrine was developed by the courts and did not originate with Congress).").

175. I.R.C. § 7701(o)(5)(A) ("The term 'economic substance doctrine' means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.").

176. *See id.* § 7701(o)(5)(C) ("The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.").

177. *See* Taxes Consolidation Act, 1997 (Act No. 39/1997) (Ir.), http://www.irishstatutebook.ie/eli/1997/act/39/enacted/en/pdf [https://perma.cc/M4HR-K8HJ].

administrative regulations were necessary to curb particular forms of tax abuse.[178] Since then, politicians and commentators have credited the law for invigorating the ability of the Ireland Treasury Department to identify and eradicate tax abuse.[179] There is no reason why Congress cannot adopt the Irish approach or emulate the actions of other countries (e.g., the United Kingdom, France, Germany, The Netherlands, Belgium, Canada, China, Singapore, Italy, South Africa, Kenya, and Australia) that have also enacted general anti-abuse rules and replicate their successes.[180]

B. *Administrative Approach's Advantages*

In contrast to Congress addressing each tax-abuse technique one by one and constantly playing a game of catch-up, vesting broad administrative authority in the Treasury Department offers the following five major advantages.

One of the primary advantages of vesting the Treasury Department with broad administrative authority is that the Code could strike an appropriate

178. *See id.*; REVENUE COMM'RS, IRISH TAX & CUSTOMS AGENCY, GUIDANCE NOTES ON GAAR: THE GENERAL ANTI-AVOIDANCE RULE & PROTECTIVE NOTIFICATIONS 1–2 (2019), https://www.revenue.ie/en/self-assessment-and-self-employment/documents/gaar-guidance-notes.pdf [https://perma.cc/KV4B-RRC7] (discussing the effects of section 811 of the Irish Tax Code on tax-avoidance transactions).

179. *See, e.g.*, Niamh Keogh, Maura Dineen & John Gulliver, *The Tax Disputes and Litigation Review: Ireland*, L. REVS. (Feb. 26 2020), https://thelawreviews.co.uk/title/the-tax-disputes-and-litigation-review/ireland#footnote-004-backlink [https://perma.cc/HB8S-MNQC (staff-uploaded archive)]. *See generally* TOM MAGUIRE, IRELAND'S GENERAL ANTI-AVOIDANCE RULE AND THE RULE OF IRISH LAW (2014), https://www.taxfind.ie/document/IGAA_XML_10032014-top_doc-2909710144 [https://perma.cc/483G-MXWU (dark archive)] (explaining in detail the parameters of the anti-avoidance rule and its implications).

180. *See generally* Christophe Waerzeggers & Cory Hillier, *Introducing a General Anti-Avoidance Rule (GAAR)*, TAX L. IMF TECH. NOTE, Jan. 2016, at 1, 1. The fact that general anti-abuse rules or GAARs have a long and rich history, and have become increasingly popular, reflects their apparent success. Daniel T. Ostas & Axel Hilling, *Global Tax Shelters, the Ethics of Interpretation, and the Need for a Pragmatic Jurisprudence*, 53 AM. BUS. L.J. 745, 767–68 (2016).

> Although new to the United States, GAARs have a long tradition in both common law and civil law nations around the world. The first GAAR, enacted in 1878, traces to the common law nation of New Zealand. Canada and Australia, also common law countries, have longstanding GAARs as well. Sweden, a civil law country . . . , has had a GAAR every year but two since 1980. Similarly, the civil law nations of Belgium, Brazil, Finland, Portugal, and Spain have had GAARs for decades. In each case, the GAAR, or a related specific antiavoidance rule (SAAR), is broadly stated. In fact, ambiguity seems to be the purpose of this kind of regulation. By enacting the GAAR or SAAR, the legislature recognizes the need to protect the tax base, and it empowers the taxing authority and the tax courts with a broadly worded standard designed to protect the legislative intent of other tax provisions.

Id.

balance between being both standards- and rule-based.[181] On the one hand, when it comes to widespread tax-compliance issues (e.g., payroll tax on labor income), the Code should present strict, unambiguous rules that facilitate compliance on a large-scale basis.[182] On the other hand, the Code must also address the tax implications associated with fact patterns and scenarios that arise with far less frequency; in such situations, elaborate rules from Congress could make the Code even more of a labyrinth than it is today.[183] Instead, if Congress broadly delegated, leaving detail duty to the Treasury Department, the Code would be more concise and easier to administer.[184] Akin to the requirement that taxpayers report so-called listed transactions (disclosing those taxpayer activities that the Treasury Department considers suspect),[185] centralizing the tax-abuse regulations would facilitate the Treasury Department's ability to categorize taxpayer actions, distinguishing between those that are permissible and those that are not.

Second, cracking open the administrative door would empower the Treasury Department to act far more expeditiously to quell perceived tax abuse than it currently can. As soon as the Treasury Department learned of an exploitative taxpayer practice, it could immediately issue a proposed regulation to curtail the activity.[186] Not only would such expediency arrest the hemorrhaging of tax revenue, but it would also have an immense chilling effect upon taxpayers and their advisers. The latter would hesitate to spend inordinate amounts of time and resources on developing tax-abuse strategies, knowing that, at a moment's notice, the Treasury Department could obliterate their tactics.

181. *See* David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860 (1999) (asserting that to eliminate excess complexity engendered by a pure rule-based approach, "lawmakers and regulators have shifted the tax system toward standards, primarily by adopting what are known as 'anti-abuse rules'").

182. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 573 (1992) ("[A] law may apply to an activity that is undertaken by many individuals: some federal income tax provisions apply to millions of individuals and billions of transactions. In such instances, rules tend to be preferable.").

183. *See* Rachelle Holmes Perkins, *Breaking the Spell of Tax Budget Magic*, 6 COLUM. J. TAX L. 1, 21 (2014) ("It is well established that the Internal Revenue Code is a complex labyrinth of rules that leaves even the most seasoned tax professionals at times scratching their heads.").

184. *See* Kaplow, *supra* note 182, at 621–22 ("If behavior subject to the law is infrequent, however, standards are likely to be preferable. Of particular relevance are laws for which behavior varies greatly, so that most relevant scenarios are unlikely ever to occur. Determining the appropriate content of the law for all such contingencies would be expensive, and most of the expense would be wasted. It would be preferable to wait until particular circumstances arise.").

185. I.R.C. §§ 6111(b)(2), 6707A(c)(1).

186. *See* Cunningham & Repetti, *supra* note 14, at 6 (explaining that utilizing anti-abuse rules "allows the Service to use broad standards to administer the tax law in place of a collection of narrow rules that must be constantly changed in a hopeless attempt to keep pace with the latest tax gimmick"); Hines & Logue, *supra* note 149, at 243 ("Even when the legislative process is working well, it may take longer for Congress to pass a law than it takes an agency to make a rule.").

Third, the administrative approach would help contain the spread of tax-abuse techniques. Fearing that the publication of their tax stratagems would attract Treasury Department scrutiny, taxpayers and their advisers would be more inclined to keep secret their putative tax-abuse techniques.[187] As such, other taxpayers could not as readily replicate these tax-avoidance devices.

Fourth, advance knowledge that the legislative record may play a greater role in defining permissible and impermissible behavior would incentivize congressional members to be more meticulous about what they enter into the congressional record.[188] Hopefully, such attention to detail would facilitate statutory interpretations and aid the Treasury Department in deciding which taxpayer actions are abusive and require regulatory attention.

Finally, granting the Treasury Department greater administrative leeway would increase the importance of the regulatory process. Under current law, the Treasury Department must submit its regulations in proposed form for public review and comment.[189] During the review phase, taxpayers, tax practitioners, bar associations, and CPA organizations are renowned for offering detailed and elaborate critiques.[190] The Treasury Department has often responded favorably to such assistance and revised and recrafted proposed regulations in a manner consistent with those suggestions that the agency deems meritorious.[191] Were Congress to expand the regulatory purview of the Treasury Department, the same coterie of participants would be apt to play an even more active and vibrant role in the regulation-

187. *See, e.g.*, David Cay Johnston, *A Tax Break for the Rich Who Can Keep a Secret*, N.Y. TIMES (Sept. 10, 2002), https://www.nytimes.com/2002/09/10/business/a-tax-break-for-the-rich-who-can-keep-a-secret.html [https://perma.cc/6LP9-6NE7 (dark archive)] ("To get in on these tax avoidance deals, investors must sign statements promising never to disclose the terms to anyone except their financial advisers."). Admittedly, enhanced public disclosure via the proposed Treasury regulations could drive some tax stratagems into greater secrecy, making them even more difficult for the IRS to uncover.

188. *See, e.g.*, Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845, 847 (1992) ("First, I demonstrate that we need to use legislative history of providing examples of its usefulness. Second, I address the major arguments against its use in order to show that these arguments call, not for abandonment of the practice, but at most for its careful use. Finally, I offer some institutional reasons for why any significant change in the extent to which courts look to legislative history would likely prove harmful.").

189. *See* 5 U.S.C. § 553.

190. *See, e.g.*, Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 EMORY L.J. 209, 224–25 (2019) ("First, major industries and their representatives and trade associations asked Treasury for favorable treatment. Second, professional organizations of sophisticated tax experts (such as the New York State Bar Association (NYSBA) Tax Section and the American Bar Association (ABA) Tax Section) advised Treasury on how various technical issues should be resolved.").

191. *See id.* at 226 ("In the final regulations, Treasury carefully catalogued and responded to the comments that it had received in the official notice-and-comment period. In many cases, Treasury clarified issues raised by commenters through text or examples and made technical changes to the proposed regulations in response to feedback about potential problems." (citations omitted)).

formulation process regarding the labeling of particular transactions as tax abuse.

C. *Administrative Approach's Disadvantages*

The virtues of using a broader administrative approach to combat tax abuse are compelling. However, there are several risks and concerns associated with an administrative approach that should not be discounted or dismissed out of hand. These are threefold in nature.

The first is that the Treasury Department might overstep its bounds and act too heavy-handedly to curb tax abuse. More specifically, the agency might draft regulations that are overly expansive, attempting to curtail what some commentators consider legitimate taxpayer behavior. For example, the Treasury Department could conceivably promulgate regulations that declare as abusive so-called *Crummey* withdrawal powers,[192] which are designed to transform otherwise future interests (which are ineligible for tax-free treatment) into present interests (which do qualify for tax-free treatment) and thereby significantly narrow the gift tax base.[193] Such regulations would likely cause tremendous havoc in the estate planning world.[194] If the Treasury Department acts too aggressively, there would be two avenues of recourse. During the regulatory vetting process, taxpayers, tax advisers, and bar and CPA associations could mount vigorous campaigns to have the Treasury Department change or retract the particular regulation in question.[195] Or, alternatively, if the Treasury Department ultimately proves recalcitrant, then

192. Eponymously named after the decision in *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968), *Crummey* withdrawal powers are loopholes that allow certain gifts to trusts to be treated as tax-free gifts, thereby circumventing the calendar year dollar limit on the gift amount which will be treated as tax-free. *See* Bradley E.S. Fogel, *The Emperor Does Not Need Clothes—The Expanding Use of "Naked"* Crummey *Withdrawal Powers To Obtain Federal Gift Tax Annual Exclusions*, 73 TUL. L. REV. 555, 556, 616 (1998) ("Further, while the IRS has sought congressional action, and legislation aimed at limiting the use of *Crummey* powers has been proposed, legislative redress has not, as yet, been forthcoming." (footnotes omitted)); Dora Arash, Comment, *Crummey Trusts: An Exploitation of the Annual Exclusion*, 21 PEPP. L. REV. 83, 84 (1993) ("One loophole commonly used to avoid the imposition of estate and gift tax is a 'Crummey Trust.'").

193. *See* I.R.C. § 2503(b)(1).

194. *See generally* Bradley E.S. Fogel, *Billion Dollar Babies: Annual Exclusion Gifts to Minors*, PROB. & PROP., Sept./Oct. 1998, at 6, 11–14 (documenting the ubiquitous use of *Crummey* trusts to navigate around the annual exclusion problem).

195. *See, e.g.*, Oei & Osofsky, *supra* note 190, at 209 ("We find extensive engagement by sophisticated parties and industry groups prior to the official notice-and-comment period, which helped shape and anchor rulemaking outcomes. Subsequent comments submitted in the official notice-and-comment period led to technical and other discrete changes but did not fundamentally change the initial rulemaking approach.").

Congress could pass remedial legislation to safeguard the taxpayer actions under scrutiny.[196]

The second concern is that taxpayers might assert that the congressional delegation of this administrative authority is unconstitutional. While the Constitution vests in Congress the power to tax,[197] it does not vest this same power in the Treasury Department.[198] However, as previously discussed,[199] there is a long history of courts sanctioning Congress's delegation of important responsibilities to administrative agencies, and there is no reason to assume that courts would act any differently in the realm of taxation.[200]

The final concern is one of practicality. In particular, it is unclear whether congressional intent, memorialized in a statute's legislative history, is ever truly lucid enough to identify those activities that constitute tax abuse.[201] A related issue is how the Treasury Department should respond when a statute's legislative history is ambiguous or, in some instances, nonexistent. Over time, of course, resolution of these questions would no doubt be sorted out as congressional members would likely seek to moor statutory verbiage with congressional record entries that weave a coherent picture of legislative intent.

The foregoing concerns are admittedly not entirely without merit or unfounded. However, on balance, they should not dissuade Congress from enacting a general anti-abuse rule that empowers the Treasury Department to curb tax abuse. The risks are minimal; if the Treasury Department runs amok and challenges specific tax-abuse techniques too aggressively, Congress always retains recourse to repeal the law or enact remedial legislation. By the same

196. *See* Hines & Logue, *supra* note 149, at 246 ("First, if an agency acts in a way that substantially diverges from the wishes of the legislature, Congress can pass another statute to restrict or remove the agency's authority.").

197. U.S. CONST. amend. XVI.

198. *See* Hines & Logue, *supra* note 149, at 245, 247 ("Granting agencies broad authority raises the possibility that they will enact regulations inconsistent with congressional intent. . . . If an agency does something egregiously bad, voters find out, and Congress can be animated to act.").

199. *See supra* note 162 and accompanying text.

200. Gary Lawson, *Who Legislates?*, 1995 PUB. INT. L. REV. 147, 147 (reviewing DAVID SCHOENBROD, POWER WITHOUT RESPONSIBILITY: HOW CONGRESS ABUSES THE PEOPLE THROUGH DELEGATION (1993)).

> Delegation of legislative power by Congress is a pervasive feature of modern national governance. In the wake of the New Deal, the federal courts essentially gave up trying to enforce any serious limits on Congress's practice of granting sweeping authority to administrative agencies, and today those agencies rival or surpass Congress as the federal government's principal lawmaking organ.

Id.

201. *See, e.g.*, Brian G. Slocum, *Replacing the Flawed* Chevron *Standard*, 60 WM. & MARY L. REV. 195, 204 (2018) ("The Court in *Chevron* indicated that when congressional intent is unclear, the provision is ambiguous, which signals interpretive choice. The Court thereby established a connection between 'ambiguity' and the absence of congressional intent.").

token, if the Treasury Department is unable to discern legislative history appropriately, Congress can legislatively clarify its statutes—and may learn to craft more comprehensible legislation in the future. With the country's fiscal affairs in such dire straits, Congress must consider new approaches to address national solvency. Delegation to the Treasury Department to counter tax abuse constitutes one encouraging measure so far untested.

D. *Utilizing Upstream Tax Planning To Illustrate the Administrative Approach*

Academics are renowned for promoting promising theories that often lack practicality.[202] This proposal, however, does not suffer from that deficit. To illustrate this point, consider how newly minted Treasury regulations might address the case of upstream tax planning.

As previously discussed, the nature of upstream planning is blatantly abusive: taxpayers transfer property to their elderly and sick loved ones as a vehicle to exploit section 1014, seeking to eliminate taxable gains on the transferred property.[203] What is clear about section 1014 is that it was instituted (or, at the very least, retained) to facilitate tax basis identification for assets owned by a decedent; it was never intended as a mechanism for living taxpayers to negate their taxable gains.[204]

202. *See, e.g.*, Book Note, *The Albatross of Constitutionalism*, 101 HARV. L. REV. 908, 909 (1988) (reviewing A WORKABLE GOVERNMENT? THE CONSTITUTION AFTER 200 YEARS (Burke Marshall ed., 1987)) ("According to [Judge] Easterbrook, modern constitutional theory, with its emphasis on interpretive flexibility and 'the living Constitution' rather than on the ultimate power of the rule of law, is the product of an academic culture that values 'novelty and creativity' over practicality." (quoting Frank H. Easterbrook, *The Influence of Judicial Review on Constitutional Theory in* A WORKABLE GOVERNMENT? THE CONSTITUTION AFTER 200 YEARS (Burke Marshall ed., 1987))).

203. *See supra* Section I.B. Well-known estate-planning practitioner, Martin M. Shenkman, offers the following advice to his readers:

> A client may have made transfers to a trust to benefit family members. If the portfolio assets in the trust have appreciated substantially, can anything be done to increase income tax basis and eliminate the capital gains on those appreciated securities? It may be difficult with the older trust. But if a new trust is being planned, can something be done differently to possibly make it easier to get a basis step-up? Consider adding a parent or other senior family member that has a small estate as a beneficiary and also grant that parent a general power of appointment (GPOA) so that the assets in the trust will be included in her estate. Thus, even if for example, husband created a trust for wife and descendants, the inclusion of an elder parent can eliminate the entirety of the appreciation of the assets in the trust saving substantial capital gains. Key is that this is a basis step-up on the death of the elderly parent, not one that waits until the death of the client or the client's spouse.

Martin M. Shenkman, *Basis Planning and Other Tips for Practitioners*, CPA MAG. (July 29, 2019, 2:37 PM), https://www.cpamagazine.com/issue-module-stories/1871-basis-planning-and-other-tips-for-practitioners [https://perma.cc/38TP-BS3X].

204. *See generally* ZELENAK, *supra* note 5 (regarding the legislative history of section 1014, there is nothing in its enactment which suggests that its institution was designed to ameliorate living taxpayers' income tax burdens).

Assume that Congress heeds this advice and enacts a general anti-abuse rule authorizing the Treasury Department to identify and curb tax abuse. The agency could then identify upstream tax planning as what it is—abusive—and craft a regulation that could read as follows:

> Any taxpayer who transfers an asset which has appreciated in value directly or indirectly to another taxpayer in order to have Code section 1014 apply to such property, and the taxpayer or his family members (as defined in Code section 318(a)(5)) directly or indirectly benefits from such transfer, then the application of Code section 1014 shall be negated and such property shall retain the taxpayer's original tax basis in the transferred asset.

The promulgation of this regulation would likely be met with little, if any, public resistance. There is no natural constituency poised to preserve upstream tax planning. Most taxpayers know that, from a tax policy perspective, upstream tax planning is indefensible. Some might even go so far as to label such actions as abhorrent. After all, who would think of defending the use of the Grim Reaper to secure tax advantages?

But reading the proposed regulation raises an important application question. How would the IRS know if a taxpayer's intent were truly abusive? This is an age-old issue that cannot be readily answered. Yet, as the IRS has done in the past, it could develop a set of practical indicia that could help guide its determination. (For example, was the recipient in need of funds? Could the recipient use the funds for beneficial enjoyment or was he or she languishing in a nursing home? How long after the one-year mark did the recipient die? Did the recipient specifically bequeath the gifted assets back to the donor?)[205] Since the taxpayer's mindset would dictate the application of this and other anti-abuse regulations, the IRS would regularly have to pursue this line of inquiry and, hopefully, periodically issue informative administrative guidance.[206]

205. In other spheres of the law, courts have established criteria to ascertain a taxpayer's mindset. *See, e.g.*, Lowry v. United States, 384 F. Supp. 257, 261 (D.N.H. 1974) ("The critical inquiry is, therefore, whether the taxpayer had or intended an 'expectation of profit.' To aid in its inquiry, the court took into account the following considerations: length of time the taxpayer occupied his former residence prior to abandonment; the availability of the house for the taxpayer's personal use while it was unoccupied; the recreational character of the property; attempts to rent the property; and, whether the offer to sell was an attempt to realize post-conversion appreciation.").

206. *See, e.g.*, J. Martin Burke & Michael K. Friel, *To Hold or Not To Hold:* Magneson*,* Bolker*, and Continuity of Investment Under I.R.C. Section 1031*, 20 U.S.F. L. REV. 177, 182–84 (1986) ("[This series of IRS revenue rulings on 1031 tax-free exchanges], though not expressly discussing intent, demonstrate the importance of the taxpayer's intent with respect to the 'holding' requirement. As indicated, the circumstances surrounding the exchange and the specific actions of the taxpayer with respect to the property prior to its exchange will be considered highly probative of the intent of the taxpayer in holding the property.").

Of course, it is possible that some people will defend upstream tax planning. After all, other tax-abuse techniques have had adherents who have launched intense lobbying campaigns to have their tax circumventions safeguarded.[207] And though such defenses of upstream tax planning may be successful,[208] those in Congress who are willing to succumb to the interests of such lobbyists will have to endure public opprobrium, which could be especially evident on Election Day.

The bottom line is that passage of the proposed legislation, coupled with the promulgation of regulations relating to upstream tax planning and other tax-abuse techniques, will help lead to the elimination of such tax abuse.

CONCLUSION

Upstream tax planning is representative of a significant and reoccurring problem in which taxpayers, despite congressional intent to the contrary, manipulate events and use the Code's literal language to mitigate their tax burdens. Beyond upstream planning, taxpayers have utilized retirement accounts in perverted fashions,[209] sought to convert ordinary income into capital gains,[210] and reconfigured compensation arrangements to circumvent employment tax burdens.[211] Safeguarded by the Code's literal language, the

207. *See, e.g.*, Eric Lipton & Liz Moyer, *Hospitality and Gambling Interests Delay Closing of Billion-Dollar Tax Loophole*, N.Y. TIMES (Dec. 20, 2015), https://www.nytimes.com/2015/12/21/us/politics/hospitality-and-gambling-interests-delay-closing-of-dollar1-billion-tax-loophole.html [https://perma.cc/ZWB3-2G2G (dark archive)] ("[L]obbyists swooped in to add 54 words that temporarily preserved a loophole sought by the hotel, restaurant and gambling industries . . . .").

208. *See, e.g.*, Jonathan Curry, *White House Regrets Not Axing Carried Interest, Cohn Says*, 158 TAX NOTES 55, 55 (2018) (blaming the failure to close the "carried interest loophole" at least in part on a "political system in which hedge funds and private equity investors have outsized influence in both the House and Senate").

209. For decades, taxpayers could designate their children, grandchildren, or more remote descendants as designated beneficiaries of their retirement accounts and then such funds could gradually be withdrawn from these tax-free funds over the designated beneficiary's actuarial lifespan. *See* I.R.C. § 401(a)(9). This occurred notwithstanding the Congressional intent that these funds were supposed to inure to the benefit of retirees and their spouses. *See, e.g.*, Bruce Wolk, *Discrimination Rules for Qualified Retirement Plans: Good Intentions Confront Economic Reality*, 70 VA. L. REV. 419, 427 (1984) ("The Treasury viewed the favorable tax treatment of retirement plans as a tax subsidy granted by Congress out of a desire to improve the welfare of employees by encouraging the creation of such plans.").

210. One common tax-abuse technique that Congress legislatively eliminated via I.R.C. § 1259 was selling stock or securities "short against the box" in order to secure preferential capital gains tax rates. *See* Simon D. Ulcickas, Note, *Internal Revenue Code Section 1259: A Legitimate Foundation for Taxing Short Sales Against the Box or a Mere Makeover?*, 39 WM. & MARY L. REV. 1355, 1356–57 (1998). "Short selling against the box is a financial practice under which an investor sells short a security that is already owned." *Id.* at 1356–57 n.13.

211. Shareholders of so-called S corporations (pass-through entities) orchestrate their business affairs to circumvent their employment tax obligations by paying as little salary as possible and taking the rest of their income as a distributive share. *See* Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United*

IRS has historically been powerless to challenge these abusive techniques, costing the nation vast sums of lost revenue.

In terms of remediation, Congress could continue to use its traditional line of attack. More specifically, when Congress learns about a particular tax-abuse technique, it could put its cumbersome legislative machinery into gear. Metaphorically speaking, it can treat one symptom to the next, ignoring the underlying disease. This piecemeal and resource-intensive approach, however, comes at the steep cost of the patient (here, the nation) being deprived of the treatment it so desperately requires to restore its fiscal health and wellbeing.

This Article, however, champions a far different approach—one that breaks from traditional norms. To bolster taxpayer compliance, it advocates that Congress instead enact a general anti-abuse rule, granting the Treasury Department broad discretionary authority to promulgate regulations that would help close the floodgates of taxpayers' circumvention techniques. Doing so would undoubtedly supply a strong weapon to the Treasury Department's tax-compliance arsenal. A minor concern of this proposed legislative initiative is that the Treasury Department could potentially act too rambunctiously and perhaps curb legitimate maneuvers that limit tax liability. Congress, however, would always maintain the upper hand, retaining recourse to change or clarify the law in order to sanction or protect the particular tax-minimization technique in question.

With the nation's spending outlays greatly outpacing revenue receipts to the tune of a trillion dollars annually,[212] the failure to act is truly not an option. In the battle against tax abuse, Congress has a golden opportunity to change the strategic balance of power. At one time, the legislative approach worked adequately to secure the nation's financial needs; however, adequate will no longer suffice. Something more substantive must be put into practice—and that something more is a delegation of enhanced power to the Treasury Department.

States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002–2006, 15 FORDHAM J. CORP. & FIN. L. 459, 488 (2010) ("Perhaps most importantly, S-Corporation taxation allows the opportunity to avoid significant self-employment taxes as opposed to entities taxed as sole proprietorships or partnerships.").

212. *See* Tankersley & Cochrane, *supra* note 6.