What Is a GAAR? A Functional Analysis of General Anti-Avoidance Instruments Based on Legal Comparison

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Abstract The following article contributes to the debate on the concept of abuse of tax law by presenting a functional analysis of general anti-avoidance instruments based on extensive comparative and theoretical prior work. It develops a theoretical model which can be applied to any GAAR or judicial anti-avoidance/anti-abuse doctrine, independently of its particular national or international legal framework. The model is able to explain various methodological and content-related uncertainties concerning general anti-avoidance instruments. In particular, it provides a conceptual framework to categorize common criteria for identifying abusive transactions, e.g., artificiality, taxpayer's intent, the conflict with legislative intent, business purpose or economic substance considerations, and to understand their function. Furthermore, the functional analysis makes clear why different legal frameworks might suggest different legal answers to the challenge of tax avoidance.

1 Introduction: Tax Avoidance—a Challenge to Tax Systems

Following the two CJEU decisions in the so-called "Danish Cases",[1] the debate among tax lawyers on whether there is a unitary concept of abuse in European tax law has intensified recently.[2] However, that debate is neither new nor specific to European law. In fact, legal scholars in different jurisdictions have been arguing time

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[1] ECJ, 26 February 2019, Joined Cases C-115/16, C-118/16 and C-299/16, *N Luxembourg 1 and Others*, ECLI:EU:C:2019:134; ECJ, 26 February 2019, Joined Cases C-116/16 and C-117/16, *T Danmark and Y Danmark*, ECLI:EU:C:2019:135.

[2] See Schön, in this volume; De Broe (2022); Marres/de Groot (2021); Danon/Gutmann/Lukkien/Maisto/Jimenez/Malek (2021); de la Feria, in: Loutzenhiser/de la Feria (2020) *The Dynamics of Taxation. Essays in Honour of Judith Freedman*, p. 155; on the discussion before the "Danish Cases" see Jimenez (2012).

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and again about a unitary or a pluralistic approach to tax avoidance or abuse of tax law.[3]

How the debate is framed very much depends on the historical and methodological particularities of each tax system. In the German-speaking tax community, it takes its most salient form in the juxtaposition of the so-called "internal" and "external" theories of tax avoidance.[4] "Internalists" will argue that dealing with tax avoidance is just about purposive interpretation of substantive tax law (and that, therefore, substantive tax law is able to defy attempts of abuse "internally").[5] In contrast, "externalists" will hold that fighting tax avoidance requires a particular ("external") legal basis in the form of a general anti-avoidance rule (GAAR) or a variety of specific anti-avoidance rules (SAARs) targeted against particular types of abusive transactions.[6] Clearly, the "internal theory" defends a unitary approach to tax avoidance, as arguably do the "Danish Cases". In contrast, the "external theory" implies a pluralistic approach, if only because GAARs can be shaped in different ways by different legislators. Hence, the "unitary vs. pluralistic" debate is closely linked to understanding the function of GAARs like Art. 6 ATAD[7] and comparable legal instruments in the process of the application of substantive tax law.

The intensive debate on the concepts of "abuse of tax law", "tax avoidance" or "aggressive tax planning"[8] is just one manifestation of a profound methodological uncertainty concerning the legal framework for fighting tax avoidance which we find in many jurisdictions. In this debate, scholars who claim that tax avoidance can be counteracted simply by interpreting substantive tax law in view of its purpose have not yet been able to prevail, despite the intuitive appeal of their theory as an apparently

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[3] For Germany see Fischer (1992), p. 122, and Gassner (1972) *Interpretation und Anwendung der Steuergesetze*, p. 88 et seq., both arguing for a unitary concept of "avoidance of law" covering tax as well as other areas of law. The opposing view is defended in particular by Schön, in: Hüttemann (2010) *Gestaltungsfreiheit und Gestaltungsmissbrauch im Steuerrecht*, p. 60, and Hüttemann (2015), p. 1148. For the methodological discussion in the UK see Freedman (2007), p. 65 et seqq. On the methodological categorization of different anti-avoidance instruments in the US, see, on the one hand, McMahon, in: Avery Jones et al. (2008) *Comparative Perspectives on Revenue Law—Essays in Honour of John Tiley*, p. 55, and on the other hand Cummings (2016) *The Supreme Court's Federal Tax Jurisprudence*, Second Edition, p. 160 et seqq. (arguing for a unitary concept based on purposive interpretation).

[4] For a concise overview of both positions, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 75 et seq.

[5] Major proponents of this view are Danzer (1981) *Die Steuerumgehung*, and Gassner (1972) *Interpretation und Anwendung der Steuergesetze.*

[6] Schön (2010), p. 60; Hüttemann (2015), p. 1148.

[7] Directive (EU) 2016/1164, 12 July 2016.

[8] This article will not introduce a terminological differentiation between these concepts but will use them largely interchangeably, although the author is well aware of the fact that they are often assigned at least partly diverging meanings. In particular, in many jurisdictions, the notion of "abuse" implies a subjective element, which is often not part of legal definitions of tax avoidance. However, as this article will explore a functional perspective on the way legal systems deal with the phenomenon of tax avoidance which is independent of any particular methodological tradition, it can not only dispense with any differentiation; such a differentiation would even be inappropriate, as it would almost necessarily draw on such a particular tradition.

neat, clear-cut and unitary solution.[9] One reason for this observation probably is that their approach just does not seem to reflect what courts really do when they defy tax avoidance transactions.[10] In most cases, their arguments cannot be reduced to purposive interpretation. In particular, they often take into account at least some considerations which have nothing to do with the purpose of the circumvented tax provisions, e.g., taxpayer's tax avoidance motive.

This methodological uncertainty is accompanied by considerable doubts about how to define the boundaries between acceptable tax planning (sometimes called tax mitigation) and inacceptable tax avoidance (or aggressive tax planning). Almost every tax lawyer will agree with the famous quote from a famous U.S. decision on tax avoidance formulated by Judge Learned Hand:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury.[11]

But at the same time, the following statement of the U.S. Tax Court seems equally true:

> The freedom to arrange one's affairs to minimize taxes does not include the right to engage in financial fantasies with the expectation that the IRS and the courts will play along.[12]

If, therefore, simple truths do not solve the problem—how can we better understand it in order to make sure that drawing the boundary between legitimate tax planning and tax avoidance amounts to more than just a "smell test"?[13]

As will be shown in the following article, a thorough functional analysis of general anti-avoidance instruments like GAARs contributes a lot of clarity to national as well as to international debates about abusive practices in tax law. It also allows for some insights concerning the "unitary vs. pluralistic" debate.

2 The Basis: Legal Comparison

As every tax system in the world equally faces the challenge of how to deal with tax avoidance, legal comparison seems to be an adequate method for approaching the issue. Thus, some years ago, the author of these lines has conducted an extensive comparative analysis on the way different jurisdictions deal with this challenge and built on it a functional theory of general anti-avoidance measures like GAARs.[14] The

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[9] See, e.g., Hoffmann (2005), p. 204.

[10] For a thorough analysis of case law, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 95 et seqq. (for Germany); p. 180 et seqq. (for France); p. 241 et seqq.; p. 280 et seqq. (for the US); p. 358 et seqq. and p. 421 et seqq. (for the UK).

[11] *Helvering v. Gregory,* 69 F.2d 809 [2. Cir. 1935].

[12] *Forseth v. Commissioner*, 85 T.C. 127 [1985].

[13] This term is sometimes used to characterize (or rather: criticize) the US economic substance doctrine, see Pickhardt (2010), p. 330; Hariton (2006), p. 44.

[14] Osterloh-Konrad (2019) *Die Steuerumgehung*.

analysis focusses on what legislators and courts actually do rather than on scholarly theories on tax avoidance because it aims at comprehensively describing and understanding the reactions of legal systems to the phenomenon of tax avoidance. It covers the status quo as well as the historical development of these reactions within the tax systems of the United Kingdom, the U.S., France, and Germany. As the fight against tax avoidance depends, in various respects, on the legal framework, special emphasis is placed not only on the evolution of the case law on tax avoidance but also on the constitutional constraints on tax law and on the methodological traditions of tax law interpretation.

The comparative analysis yields a variety of interesting conclusions which are explored in the further course of the study. For the functional understanding of GAARs and other general anti-avoidance instruments which will be explained in this article, the following observations are of particular importance:

- Even if the legislator abstains from writing a GAAR into the tax code, courts will sooner or later develop tools which are functionally equivalent to such a provision (e.g., the so-called "Ramsay doctrine" in the U.K.)[15] or extend already existing legal concepts addressing fraudulent or otherwise illegitimate behaviour (like sham)[16] to cases of tax avoidance. Thus, every jurisdiction has developed its own general anti-avoidance instrument (or a set of such instruments[17]), regardless of whether the legislator has adopted a GAAR or confined himself to putting into force various specific anti-avoidance rules (SAARs).
- This observation corresponds to the fact that every tax system faces the problem of how to address hitherto unknown tax shelters. Confronted with this problem, courts will sooner or later actively engage in the fight against tax avoidance. Their timing depends on how urgent they consider the avoidance problem to be in practice (e.g., due to so-called tax shelter waves).[18]
- In every jurisdiction, expert debates on tax avoidance circle around the tension between rule of law issues like legal certainty or the protection of legitimate expectations of taxpayers on the one hand and equality as *the* fundamental standard for

[15] See Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 368 et seqq.

[16] The French GAAR has its historical origins in an application of the concept of "simulation" on cases of tax avoidance by the judiciary, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 161 et seq.

[17] This is the case for the US, where several overlapping judicial doctrines have been developed to combat tax avoidance, in particular the economic substance doctrine, the step transaction doctrine, the concept of sham, the business purpose doctrine, and substance over form, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 258 et seqq.

[18] One example for these dynamics is the US tax shelter wave of the first decades of the twentieth century (see Dean [1940]), to which the courts reacted with a very flexible interpretation of statutory law, e.g., in the landmark decision *Gregory v. Helvering,* 293 U.S. 465, 469 (1935). Another example is the development of the Ramsay doctrine in the UK as a reaction to a flourishing tax shelter industry, as nicely expressed by Lord Wilberforce in *Ramsay v. IRC*: "While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still." (*Ramsay v. IRC* [1981] STC 174, 181).

substantive tax law on the other hand. Depending on the particular legal tradition and constitutional setting, those debates are framed rather in constitutional or rather in legal policy terms.[19] However, regardless of their framing, they tend to go back and forth over the years without really being resolved. This argumentative deadlock should not surprise, given that both sides of the debate invoke fundamental values that can hardly be weighed against each other.

- Countries which have a strong tradition to systematically analyse and categorise legal phenomena share the above-mentioned doubts on the methodological characterization of general anti-avoidance instruments.[20] However, the discussion about those doubts is framed in different terms, depending on their methodological traditions.
- There is surprisingly little correlation between the wording of general anti-avoidance instruments and the way courts deal with specific cases. But although the wording of GAARs or functionally equivalent judicial doctrines barely allows to predict the outcome of particular cases, the analysed legal systems have developed quite similar indicators for abusive transactions (like inadequateness, artificiality, abusive intent, etc.).[21] However, the legal status of various indicators seems rather unclear, in particular the question which of them are necessary characteristics of every abusive transaction and therefore should be part of any attempt to define tax avoidance and which of them are merely accidental features and therefore just potential indicators of an abuse of law. Their relationship to each other often is almost equally obscure.[22]

Given the apparent insignificance of the wording of GAARs and the fact that, in the absence of a written GAAR, courts will develop their own general anti-avoidance instrument (a kind of unwritten GAAR), the question arises as to how the function of a GAAR or of functionally equivalent judicial doctrines can best be described. The methodological uncertainties around general anti-avoidance instruments also need to be resolved; particularly in need of an explanation is the striking fact that tax avoidance is, in practice, not simply treated as a matter of purposive interpretation, although many scholars believe it should be treated so. On a constitutional and legal policy level, it may further be asked whether and how there can be a way forward in a discussion which circles around a tension between values that are, as such, indisputable. Finally, the observations derived from legal comparison lead to the question of how to achieve more clarity concerning the various criteria used to identify tax avoidance transactions.

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[19] This is particularly evident when comparing the (over?)constitutionalized debate in Germany on the one hand and the discussion in the US on the other hand, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 480.

[20] Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 520 et seq.

[21] For an overview on the indicators used in Germany, France, the US, and the UK, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 491 et seqq.

[22] Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 516.

As all these questions are independent of any particular legal system, the search for answers requires taking an external perspective which abstracts from methodological, constitutional, and historical particularities of specific legal systems. Such a perspective may be found in an adequate legal theory framework.[23]

3 Changing Perspective: Legal Theory

To identify a theoretical framework that appropriately captures the phenomenon of tax avoidance, it is helpful to start with categorizing the type of problem this framework is meant to address.

3.1 The Starting Point: An Unhappy Interpreter

In a nutshell, the problem of tax avoidance arises from cases which are characterized by a kind of dilemma faced by someone who has to apply rules to a particular case. This dilemma can be described as follows:

The interpreter (a judge, a tax officer) of a given set of rules (the substantive tax law provisions) is confronted with a case in which this set of rules does not seem to produce an adequate outcome because the result of a *prima facie* application of the rules seems to be in conflict with those same rules' purpose, i.e., the legislator's intention behind those rules.[24] From the interpreter's perspective, the relevant statutory provisions seem to be either under-inclusive (because they do not cover a case which, considering their purpose, they should cover) or over-inclusive (because their wording seems to require applying them to a case to which they do not seem appropriate). In rule theory, this dilemma has been described as the problem of the "unhappy interpreter".[25] The interpreter has a certain idea on what the legislator

[23] An obvious alternative could be an economic perspective. However, an in-depth analysis shows that (and why) economics does not offer an appropriate framework for drawing the line between legitimate tax planning and tax avoidance; see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 545 et seqq. One reason is that, from a macro-economic perspective, all efforts of taxpayers to reduce their tax burden by meticulous legal planning are possible sources of dead-weight losses and, as such, essentially equivalent, whereas, from a legal perspective, there clearly is a distinction between acceptable and inacceptable tax planning. This distinction is purely legal; it does not reflect economic considerations.

[24] See Schler (2002), p. 330 et seq. (2002). The term "*prima facie* application" signifies taking statutory law at face value; it describes the process of applying the criteria explicitly spelled out in a statutory provision without correcting the result to align it with legislative intent. The reason for not adopting the commonly used legal term of "literal interpretation" for this process is that the possible limits of interpretation of statutory law are discussed in different methodological terms and set differently in each legal system. To argue independently of any particular methodological framework makes it necessary to choose a different term.

[25] Twining/Miers (2010) *How to Do Things with Rules*, Fifth Edition, p. 139.

intended substantive tax law to achieve,[26] and she has the impression that this intention would be counteracted by the result of a *prima facie* application of statutory law. It is this mismatch which makes her unhappy.

To give a very simple example[27]: In German tax law, interest payments on debt incurred for the acquisition of a taxpayer's own home are not deductible, whereas interest payments on debt incurred for the acquisition of rented property are. Let us assume that there are two persons, A and B, who both want to buy debt-financed similar apartments in a newly constructed building and intend to move in with their families. To generate tax deductible expenses, A purchases the apartment B wants to inhabit and rents it out to B, and vice versa. In this case, a *prima facie* application of tax law implies that the interest on the loans taken out by A and B is deductible. However, the "unhappy interpreter" will ask herself whether this result really is compelling or whether she may deviate from it, as she will have the impression that granting the deduction would run counter to the legislator's intent behind the differentiation between non-deductible and deductible interest payments.

A comparative analysis of the design and application of general anti-avoidance instruments in different jurisdictions shows that the mismatch perceived by the unhappy interpreted is not always addressed explicitly; nevertheless, the question of abuse is raised exclusively in cases where such a mismatch is at least conceivable.[28] Actually, legislators and courts have found various ways to describe potentially abusive transactions in terms which do not include any explicit reference to a mismatch between the wording of statutory law and its purpose, but they all address this mismatch implicitly. This observation can be illustrated using the over-cross-lease example:

One way to describe the unhappy interpreter's problem in the above-mentioned case would be to say that, "in substance", A and B each acquired an own home (implying interest payments to be non-deductible), even if, "in form", each of them acquired an apartment rented out to another person (implying the deductibility of interest). Yet another way to frame the problem could be to say that A and B chose an artificial or an inadequate structure (the acquisition followed by a reciprocal lease) to achieve an economic result they could have accomplished much easier (by just acquiring their own homes, i.e., using an adequate legal structure).

Explaining tax avoidance cases in the terms of the "unhappy interpreter" problem shows that the challenge they represent for the tax system relates to the process of rule-application. A person has to apply a set of rules which, at first glance, produce a result running counter to their purpose. Therefore, the question arises whether a

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[26] In many cases of potentially abusive transactions, legislative intent is not easily discerned, and disputes between taxpayers and the treasury accordingly circle around the question of how to identify the purpose of the relevant statutory provisions. For further analysis of this problem, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 495 et seqq. (from a comparative perspective) and p. 714 et seqq. (concerning the German constitutional framework).

[27] Modelled on a German case decided in 2012, see *Federal Fiscal Court* (BFH), 14 November 2012, I R 53/11, BFH/NV 2013, 690.

[28] Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 106 et seqq. (Germany), p. 189 et seqq. (France), p. 292 et seqq. (US), p. 424 et seqq. (UK), p. 495 et seq. (comparative analysis).

different result may be justified in spite of the letter of the rules. Consequently, rule theory provides an appropriate theoretical framework for further analysis.[29]

3.2 The Characteristics of Rule-Based Decision-Making

From a theoretical perspective, rules may be defined as tools in decision-making processes which, by incorporating a set of relevant criteria, exclude other criteria from consideration. Written tax law provisions do this simply by their wording. They set out criteria and attach a legal consequence to cases which fulfil these criteria. When drafting them, the legislator has a particular standard situation in mind to which he intends to prescribe certain tax consequences; by choosing the criteria incorporated in the rule, he tries to catch the essential features of this situation.

For example, a particular tax law provision might stipulate that, in case of X, Y and Z, the legal consequence should be A. To decide on A, an interpreter (a tax officer, a judge) confronted with a real-life situation has to check it for X, Y and Z. This implies that he does not have to consider any of the millions of additional features the particular case might also present.

In any decision-making environment, every rule has a justification (in legal terminology: a purpose), i.e., a reason why it was put into place. If an individual lives by the rule of running 15 km each week, the justification behind this rule might probably be that he wants to stay in good shape. If a tax system allows for the deduction of interest incurred for the acquisition of rented property, the purpose behind this rule might be that the system aims at attaching an income tax burden to actual increases in ability to pay, thus providing for the deductibility of all expenses incurred for deriving income.

As rules necessarily exclude many circumstances from consideration, it is inherent to the use of rules in general that there may be real-life cases presenting features which, although excluded from consideration by the rule, seem to be relevant with regard to its purpose. If, in the above-mentioned example, the individual has a cold, staying in good shape might require abstaining from his weekly running units—hence, an altogether different result than "playing by the rule", as the rule itself does not contain an exception for cases of illness.[30] If two taxpayers engage in the type of over-cross-lease described above solely for tax purposes, their interest payments

[29] The following analysis draws considerably on the work of the US legal theorist Frederick Schauer, in particular on Schauer (1991) *Playing by the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and in Life.*

[30] In legal theory, it is disputed whether, in such cases, the rule really does not contain an exception or whether it has to be understood as implicitly incorporating the exception; see on the one hand Dworkin (1986/2012) *Law's Empire*, p. 15 et seqq., on the other hand Raz (1972), p. 836 and 849. In the European debate on abuse of tax law, a similar structural question lies at the core of the debate on the scope of the fundamental freedoms: Does the problem of abuse concern their outer limits or does it concern the level of justification (see Jimenez [2012], p. 272)? In the context of this article, it is not necessary to take a definite stance in this debate. It is sufficient to note that, whenever a

might not be considered incurred for deriving income (thus, not reducing their ability to pay) even though their loans were, in fact, taken out to acquire rented property.

3.3 The Unhappy Interpreter's Problem

Those examples show a general feature of the use of rules in any decision-making environment: the potential of mismatches between their meaning and their purpose.[31] This type of mismatch is the reason why the interpreter is unhappy in tax avoidance cases; it lies at the core of the problem of tax avoidance. Therefore, one quite common starting point for trying to define tax avoidance is to say that the tax avoider tries to rely on the wording of the statute in a way that is contrary to its purpose.

At first glance, the problem seems to be solvable quite easily: the interpreter could simply recur to the respective rule's purpose and decide accordingly. This corresponds to the above-mentioned "internal theory" in tax law, which proposes that tax avoidance schemes should simply be counteracted by purposive interpretation. It implies stretching the rule's wording as far as necessary to cover all cases in which its purpose suggests its application.

But if one looks at the practice of fighting tax avoidance, one finds that neither the courts nor the legislators in their GAARs are acting accordingly. In fact, there are a number of good reasons why they abstain from that course of action. These reasons are, again, related to what rules really *are* and why they are put into place in a decision-making environment like a legal system. Consider the following:

If we assumed that every interpreter had the competence to recur to a rule's purpose every time he identifies a mismatch between the *prima facie* outcome of the rule and its purpose, the rule would actually not have any effect on his decision-making. Each case would be treated as if the interpreter *only* decided on the basis of the rule's purpose. There would be no rule-based decision-making at all, as rules would not have any independent weight in the decision-making process; they would be completely dispensable. Consistently thought through to the end for an income tax system oriented on the ability to pay principle, this approach would imply that each tax officer or judge ultimately would decide on the basis of that principle itself—an obviously absurd result.

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rule is expressed in language, there is a significant difference between simply applying its explicitly spelled-out criteria and deviating from them with regard to the rule's purpose.

[31] Drawing on some strands of the philosophy of language, it is sometimes disputed whether there is any context-independent meaning of linguistic terms at all (see Kuntz [2015], p. 387 seqq.; Black [1997] *Rules and Regulators*, p. 14 et seq.). If there was no such independent meaning, the wording of statutory law would not be able to set limits to interpretation, and mismatches between the meaning of rules and their purpose could never occur. However, regardless of the philosophical underpinnings of this discussion, it can be assumed for the purpose of this article that words cannot be ascribed just *any* content and that, therefore, they set at least *some* limit to the range of possible meanings of statutory law. Without this assumption, tax avoidance would not be a challenge for legal systems at all—but it obviously is. In addition, the opposing view neither corresponds to common wisdom nor to practical experience in the application of statutory law.

Its absurdity stems from the fact that even though, measured against their purpose, all rules sometimes produce wrong results, there are good reasons for implementing rules and for making decision-makers abide by them. Despite the possibility of mismatches between meaning and purpose, a certain degree of rule-based decision-making, for "playing by the rules" even in (some) cases of mismatches, might be appropriate in many decision-making environments, in particular in the field of law.

To explore this point further, it is necessary to look at the decision-making environment, i.e., the legal system, as a whole. Let us take the virtual perspective of someone who has to design this environment. In particular, he has to decide on whether there will be rules at all and on how tightly their interpreters are bound to their wording. To take informed decisions while performing this task, he has to be aware of the advantages rule-based decision-making might have, as well as consider the different players in the particular decision-making environment (the taxpayers, the legislator, the tax administration, the courts).[32]

3.4 Reasons for Playing by the Rules

The first reason for resorting to rules in any decision-making environment is that rules simplify the decision-making process enormously. By setting out a fixed set of criteria for a particular decision (e.g., X, Y and Z), they dispense the interpreter from the need to examine the myriads of other features a particular case might present. Depending on how clear-cut and easy to apply X, Y and Z are, she may decide relatively quickly without having to clarify virtually all facts of the case. This advantage of obliging decision-makers to "play by the rules" is particularly obvious in a field like tax law where the number of cases to be dealt with is enormous. Thus, using rules increase the efficiency of decision-making processes; efficiency would suffer greatly if interpreters were allowed to deviate from the rules in each case where they identify a potential mismatch with the rules' purpose.

Secondly, rules make decision-making processes more predictable for the people subject to the decisions. If X, Y and Z are rather clear-cut criteria and decision-makers "play by the rules", the outcomes of their deliberations may be anticipated relatively easily. To formulate this point appropriately in the context of tax law: Rules enhance legal certainty for taxpayers.

Thirdly, and of great importance in the context of law as a particular decision-making environment: rules function as tools to allocate competences.

If the criteria X, Y and Z incorporated in a rule are relatively clear-cut and present hardly any scope for diverging interpretations, and if decision-makers are not allowed to deviate from the rule, the rule leaves them only with a narrow leeway for weighing facts and circumstances of a particular case at hand. They just have to check for X,

[32] For a thorough exploration of this perspective, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 581 et seqq., p. 626 et seqq.

Y and Z and decide accordingly. Thus, by drafting the rule and obliging decision-makers to abide by it, the rule-maker actually withdraws competences from them and exercises them himself. To put it in legal terms: If a legislator sets a clear-cut rule (and not a standard), he himself has pre-selected a few distinct criteria which he judges relevant for the legal consequence attached to the rule. He thereby discharges legal practitioners who have to apply the rule from having to decide on their relevance themselves.

In the context of democratic legal systems, this function is essential because constitutional separation of powers principles might allocate certain important decisions mandatorily to the legislator. If tax law interpreters were allowed to deviate from the rules in each case they identify a mismatch between the rules' outcome and their underlying purpose, this type of separation of powers principles would be undermined considerably. Against this, it cannot be argued that, by adhering to the purpose of the law, the interpreter actually honors the legislator's intentions instead of defying them. This argument overlooks that it is by no means clear that each particular tax officer or tax judge is always right about the true intentions of the legislator. Rather, there is a considerable risk that he will substitute his own judgment for that of the legislator.

3.5 Conclusion

These theoretical considerations on "playing by the rules" make clear that a tax system has to answer two questions to decide how to deal with tax avoidance. Firstly: To what extent should decision-makers in tax law "play by the rules"? Secondly: Which are the appropriate criteria for deviating from the rules?

Due to the many reasons for rule-based decision-making (despite the fact that rules necessarily have the potential to produce "wrong" results with respect to their purpose), a mismatch between the *prima facie* meaning of statutory tax law and its purpose is a necessary, but never a sufficient condition for deviating from the tax rules.[33] Additional criteria come into play, which differ in detail in the various legal systems.

[33] Compare Duff (2020), p. 595.

4 Understanding GAARs

4.1 The Function of General Anti-Avoidance Instruments and the Role of GAARs

Against this theoretical background, it now becomes possible to identify the function of general anti-avoidance instruments like GAARs or functionally equivalent judicial doctrines. They can be understood as setting a threshold for going beyond the *prima facie* meaning of statutory law. They inform interpreters of the law about the circumstances under which they are allowed to deviate from the rules. They are not descriptive in the sense that they would try to put into words what the real-life phenomenon we call tax avoidance really *is*. Instead, they are about defining conditions under which the meaning of statutory law may be set aside if the result of a rule-abiding legal analysis does not match the purpose of the relevant statutory provisions.

This theoretical analysis shows that a GAAR's function differs fundamentally from the function of regular substantive tax law provisions. Unlike these, GAARs do not attach specific legal consequences to cases in which certain criteria are fulfilled. Instead, they instruct tax law interpreters on how to (not) apply substantive tax law provisions, namely on when to disregard their wording because of a discrepancy between the result of their *prima facie* application and their purpose. One could describe substantive tax law provisions as rules of first order and qualify GAARs as standards of second order, because they set criteria for the application (or the non-application) of first-order rules. Therefore, they are best understood as being part of the standards governing the application of substantive tax law.

This explains why legal comparison shows that, even if the legislator tries to influence what the courts do by changing a GAAR's wording, he is rarely successful. As legal interpretation is the core function of the judiciary, it is not surprising that it is the attitude of the courts vis-à-vis tax avoidance that governs the application of general anti-avoidance instruments even if they are written into the tax code.

Given the limited influence of the legislator on judicial decision-making by amending or introducing a GAAR on the one hand and the observation that, in the absence of a GAAR, courts sooner or later develop functionally equivalent judicial doctrines on the other hand, the question arises whether a GAAR is a useful element in the tax code at all. This question has a twofold answer.

On the one hand, an explicit statutory GAAR is not necessary to fight tax avoidance. Given that, functionally, a GAAR is part of the standards governing the application of tax law, the judiciary has both the means as well as the competence to shape an equivalent judicial doctrine. On the other hand, drafting a GAAR may be helpful to provide a certain guidance to courts,[34] to avoid "functional misuse" of other legal instruments like sham and to address concerns about the separation of powers between the lawmaker and the judiciary. Such concerns may arise if courts

[34] Duff (2020), p. 591; Freedman (2007), p. 70.

transgress the *prima facie* meaning of statutory law; their weight depends on the particular constitutional and methodological traditions of each jurisdiction.

4.2 The Two-Step Structure of General Anti-Avoidance Instruments

Regardless of the specific design of any particular general anti-abuse instrument, such instruments always follow a two-step model. This model reflects their function to set a threshold for going beyond the meaning of statutory tax law.[35]

As tax avoidance is characterized by a mismatch between the *prima facie* meaning of statutory tax law and its purpose, the starting point is always the identification of such a mismatch. Some GAARs address it explicitly, as does Art. 6 ATAD by requiring that the tax advantage sought after by the taxpayer "defeats the object or purpose of the applicable tax law". Some GAARs or judicial doctrines address it implicitly, e.g., by requiring a kind of "inadequateness"[36] or "unreasonableness"[37] of the arrangement or a divergence between its substance and its form.[38] As shown by the cross-lease example above (under 3.1), many tax avoidance structures may be described in terms of such a form-substance-divide. This is because many tax provisions refer to certain types of legal arrangements with the aim of capturing particular, economically meaningful transactions; as this mechanism fails in cases of a divergence of (legal) form and (economic) substance, a so tailored rule will then miss its purpose.

Second, additional criteria for deviating from the rule come into play. Although comparative legal analysis shows a great number of them, their variety can be reduced to some basic ideas. Sometimes, they address the degree of tension between a *prima facie* application of statutory law and its purpose (thus, the "degree of wrongness" produced by abiding to the rules in a particular case). Often, they address the lack of legitimate expectations of taxpayers or the question whether the legislator could have foreseen a particular tax planning opportunity, thus effectively distributing the risk for the imperfection of rules between the treasury and the taxpayer.

An in-depth comparative analysis shows that all those additional criteria can be traced back either to considerations about an adequate allocation of risk between

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[35] For an in-depth analysis of the "principle purpose test" enshrined in Art. 29(9) OECD Model on the basis of the functional approach to GAARs explained in this article, see Schön, in: Pistone (2022) *Building Global International Tax Law—Essays in Honour of Guglielmo Maisto*, p. 243 et seqq.

[36] Such as the German GAAR, which requires an inadequate transaction, see Art. 42 para. 2 General Tax Code (*Abgabenordnung*).

[37] Such as the UK GAAR, which subjects tax arrangements to the so-called "double reasonableness test", see Part 5 Finance Act 2013, s. 207 para. 2.

[38] Economic substance arguments are very common in the US, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 243 et seqq. and p. 673; but see also Part 5 UK Finance Act 2013, s. 207 para. 4 (b).

the taxpayer and the treasury or to the above-mentioned reasons for "playing by the rules" even in cases of mismatches between meaning and purpose, i.e., to the goals of efficiency, legal certainty, and the conservation of the allocation-of-powers system of the particular jurisdiction.[39]

4.3 Purpose- and Non-Purpose-Oriented Criteria in GAARs

When those goals have to stand back in favour of a purpose-oriented deviation from statutory tax law does not only depend on the mismatch between a rule's meaning and its purpose or on the intensity of this mismatch (the "degree of wrongness"). It may also depend on factors which are entirely unrelated to the purpose of the circumvented provisions. One example for such a factor is a common criterion of GAARs which is frequently called into question: their subjective element.[40]

Many scholars have doubts about whether the tax treatment of a potentially abusive transaction really should depend on subjective intent, i.e., on whether the taxpayer's main (or only) purpose was to achieve a tax advantage.[41] These doubts are understandable, given the fact that fighting tax avoidance is ultimately about denying tax advantages which might correspond to the letter, but are not justified by the spirit of the law. Indeed, a mismatch between the meaning and the purpose of statutory law does not in any way depend on the subjective intent of the taxpayer. Furthermore, the subjective element seems to run counter to the fundamental principle of tax equality, as it implies that two otherwise identical cases could be treated differently solely due to taxpayers' motives.

But when considering the additional criteria for nevertheless "playing by the rules", in particular the goal of legal certainty, it becomes clear why taxpayer's intent has its legitimate place in the panorama of potential indicators for abuse of tax law. It might be considered appropriate for a particular tax system to protect legitimate expectations by allowing the taxpayer to rely on the wording of the tax code if—and only if—he does not intentionally exploit this wording to get a tax advantage which is contrary to the statute's purpose. To clarify the scope of this argument: It is by no means logically compelling that taxpayer's intent is relevant; but there are good reasons for lawmakers or judges to decide that it should be.

Another example is the common criterion of artificiality, which might be justified by considerations of risk allocation. As explained above, all rules are prone to mismatches between their meaning and their purpose. Thus, they may be considered deficient insofar as, with respect to their purpose, they are necessarily under- and

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[39] For an in-depth analysis of specific criteria, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 641 et seqq.

[40] An example for a GAAR in which the subjective element plays a crucial role may be found in France, see Art. L.64 para. 1 *Livre des procedures fiscales.*

[41] Blank/Staudt (2012), p. 1708; Hariton (2006), p. 53; Cummings (2013); Lang, in: de la Feria/Vogenauer (2011) *Prohibition of Abuse of Law: A New Principle of EU Law?*, p. 435 et seqq.; Gunn (1978), p. 765; Sieker (2001) *Umgehungsgeschäfte*, p. 23; Fischer (1996), p. 650.

over-inclusive. The design and the scope of general anti-avoidance instruments like GAARs decides on who bears the risk of this type of deficiency: Is it, in a particular case, to the detriment of the taxpayer or to the detriment of the treasury? As it is the state who creates the rules of taxation, it might be justified to hold the state responsible for their deficiencies, at least in principle. But the more artificial a transaction is, the less the legislator can be blamed if he has not envisaged this particular tax planning opportunity when drafting statutory law. Thus, artificiality is a plausible criterion for allocating the risk of tax provisions being under- or over-inclusive with regard to their purpose.

Every GAAR or judicial general anti-avoidance instrument contains blurry criteria which each legal system interprets in line with its own legal tradition.[42] To apply them in an adequate and transparent way, their wording is mostly of little use. Much more clarity can be achieved by understanding how they operate, namely, that they can be traced back either to the function of identifying the mismatch between the (*prima facie*) meaning and the purpose of statutory tax law lying at the core of the problem of tax avoidance, to considerations of risk allocation or to various reasons for nevertheless "playing by the rules".

5 In Search for a Unitary Concept of Abuse of Law

Against the background of this functional analysis of general anti-avoidance instruments, it is now possible to approach the question of whether there is a unitary concept of "abuse of law". The theoretical analysis makes clear that this question actually might be given two very different meanings and that the answer to it might depend on the particular meaning assigned to it.

On the one hand, one might ask whether all cases which could be categorized as "abusive", as "tax avoidance arrangements" or as "aggressive tax planning" fundamentally share the same legal structure. The answer to this question is yes. At the core of each of those cases lies the problem of the unhappy interpreter, i.e., a mismatch between the result of a *prima facie* application of statutory tax provisions and the result suggested by the purpose of those same provisions. In this sense, one might say that there is, indeed, a unitary concept of "abuse of law". It consists precisely in this type of mismatch, which is a challenge to the process of the application of statutory tax law.

On the other hand, one might ask whether the reaction of legal systems to this challenge necessarily is (e.g. for logical reasons) or should be (from a legal policy perspective) uniform, regardless of the particular legal framework in which the challenge arises. This means asking whether the threshold for going beyond the meaning of statutory law necessarily is or at least should be the same within every legal framework.

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[42] Against this background, it is doubtful whether Art. 6 ATAD, which commits all member states to the fight against tax avoidance, will achieve far-reaching harmonization.

Whether there is a unitary concept of "abuse of law" in this sense is a fundamentally different question from the first one—and the answer to it is no.[43] To explain why, we will now look at two examples from different legal frameworks and show that there may be various reasons for different reactions to mismatches between meaning and purpose.

5.1 Higher and Lower Thresholds—Comparing Tax Law and Private Law

The problem of abusive transactions (i.e., the reason for the interpreter's unhappiness) is structurally the same in tax law as it is in private law. Therefore, it has frequently been argued that the methodological solution to it must necessarily also be uniform.[44] This argument is partly true, but only at a very general level. As the structure of the problem is the same in every area of law, so are the function and the basic structure of general anti-avoidance instruments: they all incorporate criteria for going beyond the meaning of statutory law. However, legal comparison shows that the concrete criteria tend to differ a lot between private law and tax law; in particular, the threshold for transgressing the letter of the law in the tax area is, in general, higher than in private law.

This observation can easily be explained by taking into account the above-mentioned reasons for binding interpreters to the rules even in cases of mismatches. First, consider the risk-allocation function of general anti-avoidance instruments. In tax law, one might argue in favour of the artificiality criterion that the risk of deficiencies in the tax code should, in principle, be borne by the state, as it is the state who makes the rules; only if an arrangement exceeds a certain degree of artificiality is it justified to allocate the risk to the (aggressively planning) taxpayer, as the legislator cannot be blamed for not having foreseen every conceivable complex tax planning scheme. In private law, this argument is not convincing at all—in a private lawsuit, the risk of any deficiency of statutory law will always be borne by one of the disputing parties although neither of them is responsible for the deficiency. Thus, considerations of risk allocation run in favour of setting a higher threshold in tax law.

A similar argument holds true for the relevance of taxpayer's intent. As explained above, this criterion may be justified by the aim to protect legitimate expectations, i.e., to guarantee that taxpayers may rely on the letter of the law as long as they do not exploit it with the intention to achieve a tax advantage running counter to its spirit.

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[43] Whether nevertheless to speak of one uniform concept of abuse is just a matter of terminological taste. The following quote is telling: "the fact that there is only one abuse concept in the EU legal order […] does not imply that it is or should be applied identically in various situations" (De Broe [2022], under 5.).

[44] Fischer (1992), p. 122; Gassner (1972) *Interpretation und Anwendung der Steuergesetze*, p. 88 et seqq. A similar line of thought is defended by Hoffmann (2005), p. 204, who argues that the whole problem of tax avoidance should actually disappear if tax law were consistently interpreted according to its purpose.

In many legal systems, there are constitutional principles suggesting a particularly high level of legal certainty in tax law as compared to private law. Therefore, the case for protecting legitimate expectations by designing a GAAR containing a sole or a principle purpose test is much stronger in tax law than in private law. In addition, considerations concerning an adequate allocation of risk might also support the relevance of taxpayers' motives.

Finally, setting the threshold for deviating from the rules particularly high in tax law might also be justified with concerns about the allocation of decision-making power. Due to possible role-related distortions in the decision-making process, it makes a difference whether the interpretation and application of statutory law in disputed cases is the responsibility of a judge in the first instance or whether the tax administration has the first word on the legal consequences. A tax system may well address such concerns about treasury-friendly biases of tax officers by including criteria in general anti-avoidance instruments which set a high threshold for going beyond the meaning of statutory law. Alternatively, or in addition, such concerns may also be countered with particular procedural safeguards, as it is the case with the UK GAAR Advisory Panel[45] or with the specific procedural rules of the French GAAR.[46]

5.2 The Relevance of Substantive Law—Comparing Different Legal Frameworks

With regard to the content of substantive law, there equally lacks a compelling reason why different decision-making environments should contain the same threshold for deviating from the rules. Quite to the contrary, there may be good arguments for setting different thresholds, depending on the objectives of substantive law.

This point may be demonstrated by comparing the so-called fundamental freedoms cases on the one hand and the issue of abuse of law in the harmonized area of VAT on the other hand.[47] When the question arises whether a taxpayer may be excluded from relying on a fundamental freedom because his behaviour might be considered abusive, the problem of "abuse of law" is about the purpose of the fundamental freedoms, not about the purpose of specific tax rules. Even though, at first glance (when adhering to the letter of the law, i.e., to the letter of the TFEU), there seems to be a cross-border arrangement falling into the scope of the fundamental freedoms, the unhappy interpreter wonders whether he might deny the taxpayer their protection because, in substance (with regard to the intention behind the fundamental freedoms), this protection does not seem to be justified. In those cases, the traditional,

[45] UK Finance Act 2013, Schedule 43 (General anti-abuse rule: procedural requirements).

[46] Art. R*64–1, Art. L.64 para. 2 *Livre des procédures fiscales.*

[47] For the differentiation between different types of abuse of law cases in European tax law referred to here, see Schön, in: Loutzenhiser/de la Feria (2020) *The Dynamics of Taxation. Essays in Honour of Judith Freedman*, p. 193 et seqq.

quite narrow criterion "wholly artificial arrangement" may be considered convincing because of the member states' commitment to the single market.

The problem is fundamentally different in the harmonized area of VAT. There, "abuse of law" is about the purpose of VAT rules. Given the harmonization intention behind the European VAT regime, it might be considered appropriate to employ a less demanding criterion as a prerequisite for denying the taxpayer a tax advantage in cases of a mismatch between the purpose of the VAT rules and the result of their *prima facie* application.

6 Abuse of Tax Law: A Unitary Challenge with Diverging Answers

This article shows that GAARs and comparable legal instruments like judicial anti-avoidance doctrines have the function of defining a threshold for "not playing by the rules" for the interpreters of tax law. It also argues that there are various reasons for setting this threshold differently in different areas of the law and in different legal systems, and that those reasons stem from divergences between different legal frameworks. Such divergences may concern the fundamental objectives of the relevant area of the law, as has been shown by comparing fundamental freedoms and VAT abuse cases in European tax law (5.2.). They may as well concern the relevant players (including institutions) and their incentives, the allocation of rule-making (and rule-changing) power or the probability of mistakes in particular decision-making processes, as has been shown by comparing tax law and private law (5.1.). Relevant differences may also relate to the institutional settings for rule-changing: in jurisdictions where the process of changing the tax code is difficult and tedious, courts will tend to broaden general anti-avoidance instruments, whereas courts in jurisdictions where substantive tax law can be changed more easily might tend to allocate the risk of deficiencies in the tax code to the state, thus incentivizing the drafting of better statutory law.[48] Furthermore, the incidence of over- or under-inclusiveness of rules, e.g., due to the frequency of standard or non-standard situations, can also play a role. Insofar, setting an appropriate threshold for not "playing by the rules" interacts with the choice of rule-makers between clear-cut rules and standards discussed in the rules vs. standards debate.[49]

[48] This might be one reason why the practical relevance of the so-called *plain meaning rule* (the principle that there is no leeway for deviating interpretations if the wording of a statutory provision is unambiguous) has traditionally been very different in the UK and in the US: *Congress* typically is not able to react as quickly as *Parliament*; see Atiyah/Summer (1987) *Form and Substance in Anglo-American Law*, p. 270.

[49] For an overview on this debate, see Kaplow (1992); Korobkin (2000); Ehrlich/Posner (1974); Braithwaite (2002), p. 47 (employing the term "principle" instead of "standard"); for an application of the main insights from the debate on the problem of tax avoidance, see Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 610 et seqq.

In any particular legal environment (a national legal system, an area of law, or other), the task of setting this threshold—which is mostly performed by the judiciary, who shapes the standards for the application of statutory law—is an optimization problem.[50] If the threshold is set very high to safeguard legal certainty and to limit the discretion of the interpreters of legal rules (e.g., tax officers and tax judges) for the sake of separation of powers principles, tax equality suffers because tax avoidance will often be successful. Furthermore, such a practice may be detrimental to the quality of statutory tax law because the legislator will react by closing loopholes in the tax code by more and more detailed provisions because he cannot rely on courts doing at least part of this job. If, on the contrary, the threshold is set very low for the sake of tax equality, constitutional principles reserving certain important decisions for the democratic legislator may be harmed, legal certainty suffers, and lawmakers may have little incentive to improve statutory tax law because its deficiencies are almost entirely compensated for by the courts.

What an appropriate threshold could be depends on a multitude of factors within each particular legal environment, especially on the institutional settings for law-making and law-changing and on the procedural rules for decision-making. In practice, the evolution of such a threshold is highly path-dependent and influenced by constitutional and methodological traditions which are different in every country.

The most important insight from these considerations arguably is that there is no logically or methodologically compelling answer to the question of how to deal with cases of abusive tax arrangements. Although the challenge of tax avoidance is the same for each jurisdiction, answers differ considerably. Due to the inherently vague nature of the criteria included in GAARs or judicial anti-avoidance doctrines, and due to the fact that their interpretation depends on the interpretational and constitutional traditions of each jurisdiction, comparing those answers and finding out how different they really are requires a thorough analysis of case law.

As those differences are often justified by individual characteristics of each jurisdiction, the value of attempts to harmonize the legal reactions to tax avoidance across legal systems should be questioned. The same holds true for the seemingly persuasive power of any theory proposing one unitary, "right" approach to tax avoidance.

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[50] This idea is explored in depth in Osterloh-Konrad (2019) *Die Steuerumgehung*, p. 612 et seqq.

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