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Emily Cauble
De Paul University College of Law

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Unsophisticated Taxpayers, Rules Versus Standards, and Form Versus Substance

*Emily Cauble**

Many features of tax law can simplify the law in some senses for some taxpayers but make it more complex in other ways and for other taxpayers. This Essay focuses, in particular, on design choices that make the form of a transaction more determinative of tax consequences than its substance or that make tax law more rule like and less standard based. While such measures may simplify matters for taxpayers who contemplate tax law prior to acting (by making tax consequences more predictable), they can make the law more complex for taxpayers who do not attempt to ascertain the content of law prior to acting. As a result, these measures disadvantage unsophisticated taxpayers who are most in need of simplification.

INTRODUCTION 329
I. TAX PLANNING COMPLEXITY...332
A. *Taxpayers Who Plan*...333
B. *Nonplanners*...335
C. *Trade-Offs*..336
II. RULES VERSUS STANDARDS 336
III. FORM VERSUS SUBSTANCE 341
IV. CONCLUSION..346

INTRODUCTION

Avoiding undue complexity is often cited by lawmakers and scholars as a justification for some of the design features of current tax law.[1]

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* Professor of Law, DePaul University. The author would like to thank the editors of the Loyola University Chicago Law Journal for their helpful comments and edits.

1. Some invocations of the goal of simplification may be merely window dressing—an explanation that is offered for proposed measures that have different, truer aims. *See*, *e.g*., Emily Cauble, *Superficial Proxies for Simplicity in Tax Law*, 53 U. RICH. L. REV. 329, 332 (2019) (noting that lawmakers will often describe a reduction in the number of tax brackets as a simplifying measure when its truer aim is to reduce progressivity in the tax code); Steven A. Dean, *Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification*,

However, many provisions that offer simplification, in some sense, assist taxpayers who least need simplification, while at the same time, compound complexity for taxpayers who are least equipped to handle it. For instance, measures that make tax consequences turn on the form of a transaction rather than its substance or that ground tax law in rules rather than standards can, in one sense, be simplifying measures in that they make tax consequences more predictable. While such measures may make tax law more predictable for taxpayers who contemplate tax law prior to acting, they can make the law more complex for taxpayers who do not attempt to ascertain the content of law prior to acting, disadvantaging unsophisticated taxpayers who are most in need of simplification.

A taxpayer who acts without determining the resulting tax outcome might engage in a transaction with less favorable tax consequences than the transaction in which he or she would have engaged if he or she had considered each transaction's tax treatment. The tax consequences of the transaction selected by the nonplanner are likely to be more significantly inferior to those of the transaction selected by the planner when tax law is rule based and form driven than when tax law is standard based and substance driven. When tax law is rule based and form driven, minor nontax variations to a transaction are more likely to produce significant tax differences than when tax law is standard based and substance driven. When large tax differences turn on small nontax modifications to a transaction, the nonplanner has more to lose by not planning.

Standard-based and substance-driven aspects of tax law are often invoked to defend the tax system against potentially abusive tax planning strategies used by sophisticated taxpayers.[2] This Essay argues that

34 HOFSTRA L. REV. 405, 408–09 (2005) (noting that often what is described as tax simplification could be more accurately described as tax deregulation); Samuel A. Donaldson, *The Easy Case Against Tax Simplification*, 22 VA. TAX. REV. 645, 647–48 (2003) ("In some cases, proposals for simplifying the Code appear to be mere rhetorical diversions that conceal other, more controversial objectives."). Some invocations of the goal of simplification may be more sincere. This Essay focuses on measures that fall into the latter category in that they provide simplification in some genuine way. However, this Essay notes that, in many cases, even these measures may miss the mark. They simplify the law in some respects and for some taxpayers, make it more complex in other respects and for other taxpayers, and, on balance, may do more harm than good.

2. For discussion of how relying on rules alone, without background standards and principles of substance, cannot defend against abusive tax planning, see, e.g., Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 33 (2004) ("[P]romoters could easily concoct new abusive transactions that literally complied with the rule."); Andrew T. Hayashi, *A Theory of Facts and Circumstances*, 69 ALA. L. REV. 289, 291 (2017) ("If the facts that create a favorable inference about a hidden factor are publicized in advance, they will provide a roadmap for well-advised individuals to create those very facts to induce factfinders to draw the inference those individuals want."); Calvin H. Johnson, *H.R. ____, The Anti-Skunk Works Corporate Tax Shelter Act of 1999*, 84 TAX NOTES 443, 445 (1999) ("Loopholes can be created in any human tax

standard-based and substance-driven features of tax law have the added advantage of making tax law less complex for unsophisticated taxpayers who are most in need of simplification.

This Essay will proceed as follows. Part I will provide an overview of various factors that contribute to complexity at the planning stage, as experienced both by taxpayers who assess tax consequences prior to acting and taxpayers who do not do so. Part II will discuss the greater propensity of rules to trap unwary taxpayers and the capacity for standards to be more forgiving. Part III will describe the similar dynamic at work in the case of form versus substance. Finally, Part IV will conclude by making some suggestions for measures that could assist unsophisticated taxpayers.

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system unless the system is defended and repaired. Shelters take razor-thin fissures of no material concern and turn them into gaping holes in the tax base."); Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 366 (2005) ("[I]t simply is not possible to write tax laws that are devoid of all unintended loopholes."); Martin J. McMahon Jr., *Beyond a GAAR: Retrofitting the Code to Rein in 21st Century Tax Shelters*, 98 TAX NOTES 1721, 1722 (2003) ("The mechanical terms of specific rules . . . provide a tremendous temptation to treat the rules as an instruction manual for creating and structuring transactions outside the ordinary course of business or normal investments in which the taxpayer would not engage except as a result of the tax avoidance potential of the inventive transaction."); 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, 409 (2010) ("[T]hese flaws create a playground for those who engage in transactions that comply with . . . literal language, yet result in tax consequences that Congress did not contemplate."); Daniel N. Shaviro & David A. Weisbach, *The Fifth Circuit Gets It Wrong in* Compaq v. Commissioner, 94 TAX NOTES 511, 512–13 (2002) ("Inevitably, there will be some unforeseen interaction of the tax rules so that, if one arranges one's affairs in just the right manner, magic happens."); David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860–63 (1999) (addressing the question of whether (or when) anti-abuse rules are desirable) [hereinafter Weisbach, *Formalism*]. For similar discussion regarding rules, generally, see, e.g., Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165, 179 (2015) ("Rules allow self-seeking individuals to 'walk the line' by engaging in conduct that runs against society's interest and would be prohibited by a standard."); Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953, 995 (1995) ("Because rules have clear edges, they allow people to 'evade' them by engaging in conduct that is technically exempted but that creates the same or analogous harms.") For further discussion of substance-driven aspects of tax law designed to defend against abusive tax planning, see the sources cited *infra* in note 38.

I. TAX PLANNING COMPLEXITY

Much has been written about complexity[3] in tax law and in law, generally.[4] This Part will place existing observations within a framework that aims to provide an overview of factors that are relevant to complexity from the point of view of different types of taxpayers at the tax planning stage.[5]

Complexity in tax law affects taxpayers at the planning stage by making more onerous the process of predicting the tax consequences of an anticipated transaction.[6] In addition, complexity causes some

3. There is a growing literature that imports concepts from complexity science into studies of legal complexity. *See, e.g.*, J.B. Ruhl & Daniel Martin Katz, *Measuring, Monitoring, and Managing Legal Complexity*, 101 IOWA L. REV. 191, 194–96 (2015) (describing the ways in which legal scholars have begun to use complexity science and describing how complexity science could be used to shed light on how complex the tax code is). As Professors Ruhl and Katz explain, "there is a difference between complexity in the sense of 'complicatedness' and complexity in the sense of system structure and behavior." *Id.* at 201. The term "complexity" might be better understood, in a formal sense, in the way in which it is defined by this body of literature, and some of the factors that I identify as contributing to "complexity" might be more accurately described as contributing to "complicatedness." However, when policymakers aim to reduce "complexity," or claim to be taking steps to do so, they are likely referring to both complicatedness and complexity, and therefore, the discussion in this Essay is not limited to "complexity" in the formal sense. However, I nevertheless use the term "complexity" for ease of exposition.

4. *See generally* Boris I. Bittker, *Tax Reform and Tax Simplification*, 29 U. MIAMI L. REV. 1 (1974); DAVID F. BRADFORD, UNTANGLING THE INCOME TAX (1986); Dean, *supra* note 1; Donaldson, *supra* note 1; William G. Gale, *Tax Simplification: Issues and Options*, 92 TAX NOTES 1463 (2001); Louis Kaplow, *How Tax Complexity and Enforcement Affect the Equity and Efficiency of the Income Tax*, 49 NAT'L TAX J. 135 (1996); Stanley A. Koppelman, *At-Risk and Passive Activity Limitations: Can Complexity Be Reduced?*, 45 TAX L. REV. 97 (1989); Edward J. McCaffrey, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267 (1990); Charles E. McClure Jr., *The Budget Process and Tax Simplification/Complication*, 45 TAX L. REV. 25 (1989); John A. Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 WASH. L. REV. 1 (1993); Jeffrey Partlow, *The Necessity of Complexity in the Tax System*, 13 WYO. L. REV. 303 (2013); Deborah L. Paul, *The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?*, 76 N.C. L. REV. 151 (1997); Randolph E. Paul, *Simplification of Federal Tax Laws*, 29 CORNELL L.Q. 285 (1943–44); Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusions of Tax Simplification*, 2 GEO. MASON INDEP. L. REV. 319 (1994); Sidney I. Roberts et al., *A Report on Complexity and the Income Tax*, 27 TAX L. REV. 325 (1972); Peter H. Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, 42 DUKE L. J. 1 (1992); Karla W. Simon, *Tax Simplification and Justice*, 36 TAX NOTES 93 (1987); Deborah H. Schenk, *Simplification for Individual Taxpayers: Problems and Proposals*, 45 TAX L. REV. 121 (1989); Mila Sohoni, *The Idea of Too Much Law*, 80 FORDHAM L. REV. 1585 (2012); Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 LAW & CONTEMP. PROBS. 673 (1969); R. George Wright, *The Illusion of Simplicity: An Explanation of Why the Law Can't Just Be Less Complex*, 27 FLA. ST. U. L. REV. 715 (2000); Lawrence Zelenak, *Complex Tax Legislation in the TurboTax Era*, 1 COLUM. J. TAX L. 91 (2010).

5. Taxpayers also face complexity at the compliance stage (when they report the consequences of transactions that have already occurred) and at the enforcement stage (when the Internal Revenue Service (IRS) audits and potentially challenges the tax consequences claimed by the taxpayer).

6. *See*, *e.g.*, BRADFORD, *supra* note 4, at 266–67 ("We may distinguish three kinds of complexity: . . . 'transactional complexity' (referring to the problems faced by taxpayers in

taxpayers who act without adequately considering or understanding applicable tax law to act differently than they would have had they known the law. Furthermore, at the planning stage, complexity can cause taxpayers who do inform themselves of applicable law to make costly changes to their behavior.[7]

A. Taxpayers Who Plan

For a taxpayer who attempts to ascertain the content of tax law prior to acting or who utilizes an advisor who attempts to do so on the taxpayer's behalf, complexity at the planning stage consists of anything that increases the amount of time required to determine the likely tax outcome of a contemplated transaction. The volume of applicable law as well as the technical nature of relevant rules can be aggravating factors.[8] When a wide array of sources must be consulted to determine tax law's content, the task of the taxpayer (or the taxpayer's advisor) becomes more arduous.[9] Uncertainty will also increase the cost of predicting the tax

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organizing their affairs so as to minimize their taxes within the framework of the rules) . . . ."); McCaffrey, *supra* note 4, at 1271 (discussing "structural complexity").

7. *See*, *e.g*., BRADFORD, *supra* note 4, at 266–67 (referring to "transactional complexity" as the problems faced by taxpayers in organizing their affairs so as to minimize their taxes within the framework of the rules); McCaffrey, *supra* note 4, at 1271 (discussing "structural complexity").

8. *See*, *e.g*., Donaldson, *supra* note 1, at 733–34 ("The federal tax laws are 'complex' because: (1) they contain a large number of rules, (2) those several rules are highly detailed . . . (5) they require technical expertise to comprehend fully . . . ."); McCaffrey, *supra* note 4, at 1270–71 ("The first basic understanding of simplification may be termed 'technical complexity.' Such complexity refers to the sheer intellectual difficulty of ascertaining the meaning of tax law."); Andrea Monroe, *Integrity in Taxation: Rethinking Partnership Tax*, 64 ALA. L. REV. 289, 300 (2012) ("Complex provisions typically involve opaque terminology, elaborate definitional schemes, computations, or multifactored tests."); Schuck, *supra* note 4, at 3–4 (describing technicality as a feature of a complex legal system and observing how "[t]echnical rules require special sophistication or expertise on the part of those who wish to understand and apply them. Technicality is a function of the fineness of the distinctions a rule makes, the specialized terminology it employs, and the refined substantive judgments it requires. The Internal Revenue Code is probably the leading example of technical rules."). The technical nature of rules may matter more or less depending on the type of taxpayer at which the provision is targeted. *See*, *e.g.*, Bittker, *supra* note 4, at 2, 5 (observing that technical language is less of a concern when it is addressed to tax experts and applies to transactions that rarely occur, while simplification of "mass" provisions that affect millions of taxpayers may be more important); Donaldson, *supra* note 1, at 672 ("There is no question that the Code makes for slow reading (and in many cases, re-reading). Yet the calls to make the Code more reader-friendly forget that the Code's intended audience is not the lay taxpayer."); Surrey, *supra* note 4, at 697 ("In general, the pattern here is that of experts speaking to experts, with the knowledgeable practitioners talking to the draftsmen in the stilted, artificial language that each understands well. But it is their language alone and not that of the less expert and uninitiated.").

9. *See*, *e.g*., Partlow, *supra* note 4, at 320 ("With broad statutes and imprecise language, the task of filling in the detail is left to the courts and the Treasury. As courts interpret the law, the 'simple' and easily understood words in the Code become complex because their meanings stem from judicial interpretation and can be understood only by reference to case law."); Schuck, *supra* note 4, at 3–4 (listing differentiation as a feature of a complex legal system and stating, "[a] legal system is institutionally differentiated insofar as it contains a number of decision structures . . . .").

consequences of a proposed transaction.[10]

A closer match between applicable law and the taxpayer's or his or her advisor's intuitive expectations can streamline the process of ascertaining applicable law's content. Law is more amenable to quick understanding when it conforms to our expectations. In addition, when law is more consistent with expectations, a taxpayer or his or her advisor can more readily reach a conclusion with some confidence about the tax treatment of a transaction that is not explicitly covered by existing law—when applicable law forms a more coherent, intuitive framework it is easier to predict the tax consequences of facts that are not squarely covered by existing rules.[11]

Consistency in the law can also facilitate easier determinations of the law's content.[12] Thus, others have suggested that the adoption of uniform definitions of various terms across different Internal Revenue Code provisions could simplify tax law in some respects.[13] On an even more

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10. *See*, *e.g.*, Roberts, *supra* note 4, at 327–28 (describing how the difficulty of reaching a sufficiently certain conclusion can prevent some transactions from going forward); Schuck, *supra* note 4, at 3 (listing indeterminacy or uncertainty as a feature of a complex legal system).

11. *See*, *e.g.*, Surrey, *supra* note 4, at 699 (observing that, when tax law is not intuitive, "[I]t becomes impossible to fly by the seat of one's tax pants. . . . While this is not a serious calamity, there is a need to provide working room for the use of tax instinct. An intelligent statutory structure makes it possible to rely on a well-trained tax instinct to provide the probable answer to the problems unforeseen by the draftsman.").

12. *See*, *e.g.*, Surrey, *supra* note 4, at 696 ("The sections and provisions carrying the rules for the treatment of a given area must possess an internal consistency, so that the framework and inner logic of the statutory solution can be grasped."). Consistency across rules and with statutory purpose also eases the process of determining the likely tax consequences of a transaction not explicitly covered by existing rules and makes it more likely that taxpayers who act without verifying the content of law might make correct guesses. *See*, *e.g.*, Donaldson, *supra* note 1, at 737–38 ("Tax expenditures routinely violate basic principles of the federal income tax. This breeds confusion among taxpayers. An individual, for instance, might know of the home mortgage interest deduction and reasonably extrapolate from this rule that all home-related expenses are deductible. Of course, this extrapolation is wrong, but the mortgage interest deduction reasonably leads taxpayers into thinking other, related expenditures may be deductible. Some taxpayers will likely claim such deductions without checking for authority."); Deborah L. Paul, *supra* note 4, at 161–62 ("[C]oherence eases application of a tax regime. Under a coherent regime, people may interpret the law in the absence of a specific authority on point by considering the regime's purposes. Under an incoherent regime, interpretation of the law is more difficult because the competing purposes embodied in the regime favor inconsistent interpretations.").

13. *See*, *e.g.*, Donaldson, *supra* note 1, at 727–28 ("Consistent definitions would do a lot to reduce the tax complexity of phase outs."); Michelle Lyon Drumbl, *Those Who Know, Those Who Don't and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns*, 11 PITT. TAX REV. 113, 127 (2013) ("Olson recommends that Congress consolidate the family status provisions as a measure to simplify the Code."); Richard M. Lipton, *Statement of Richard M. Lipton on Behalf of the American Bar Association Section of Taxation Before the Committee on Finance of the United States Senate on the Subject of Tax Simplification April 26, 2001*, 54 TAX LAW. 617, 631–32 (2001) (proposing standardization of attribution rules); McClure, *supra* note 4, at 53 ("Under a rational policy there should be fewer such rules and the rules would

ambitious scale, consistency would be well served by taxing all similar transactions in the same manner to the greatest extent possible.[14]

B. Nonplanners

If a taxpayer engages in a transaction without attempting to determine its tax consequences, the only cost caused by complexity that burdens the taxpayer at the planning stage is the potential cost of engaging in a transaction that differs from the transaction in which the taxpayer would have engaged had he or she assessed the relevant tax consequences prior to acting.[15] When small nontax changes to a transaction produce radical differences in tax outcome, this cost is likely to be higher. The idea that making a slight modification to a transaction could save significant tax liability may be counterintuitive so that an unsophisticated taxpayer may not think to ask about tax consequences ahead of time (or may lack the

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be consistent."); Partlow, *supra* note 4, at 328 ("Congress could eliminate one area of unnecessary complexity by adopting a uniform definition of qualified education expenses for purposes of the various education tax incentives, qualified state tuition programs, and education IRAs."); Schenk, *supra* note 4, at 129 ("[D]efinitions and qualifying thresholds should be as simple and uniform as possible.").

14. *See*, *e.g.*, BRADFORD, *supra* note 4, at 267 ("Transactional complexity arises basically because of the possibility that economically equivalent activities may have very different tax consequences, depending on the precise way the transactions are structured. . . . Rules with a high degree of economic consistency serve transactional simplicity, although they may impose costs in the form of compliance and rule complexity."). Taxing similar transactions similarly eases the learning process. Taxing similar transactions similarly might also reduce planning costs that take the form of taxpayers modifying their contemplated transactions. It is also possible that taxing some transactions similarly could induce taxpayers to make even more costly modifications to their transactions to obtain more favorable tax treatment. For further discussion, see, e.g., David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312, 1320 (2001) ("[E]ven if some planning is stopped, total planning waste could still increase if those who continue to plan face higher costs."); David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 VA. TAX REV. 971, 973 (2007) [hereinafter Weisbach, *Disrupting the Market*] ("Thus, as the government shuts down the easy to find and use shelters, taxpayers must spend more to find new ones and also more to implement new ones."); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in Tax Law*, 84 CORNELL L. REV. 1627, 1669–70 (1999) [hereinafter Weisbach, *Line Drawing*] ("A line can be *too* hard to avoid, at least from an efficiency perspective. . . . If a line is too hard to avoid, there may be few shifts, but each shift will have a large cost."); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 239 (2002) [hereinafter Weisbach, *Ten Truths*] ("[B]ecause we cannot perfectly identify shelters, attacks on shelters make those shelters that remain worse."); Philip A. Curry, Claire Hill & Francesco Parisi, *Creating Failures in the Market for Tax Planning*, 26 VA. TAX REV. 943, 945 (2007) (discussing how policymakers face a trade-off when considering taking steps to attack current tax planning strategies, namely, the trade-off between (i) costs arising from taxpayers' use of those current tax planning strategies and (ii) costs arising from taxpayers' search for new tax planning strategies once the existing methods are attacked).

15. This group of taxpayers does not face the cost of determining what tax law provides as they do not attempt to do so, and this group of taxpayers does not face the cost of redesigning their transactions to obtain more favorable tax consequences because these taxpayers do not contemplate tax consequences prior to acting.

resources to obtain advice even if the possibility that advice could be beneficial did occur to the taxpayer). If the taxpayer does not ask for advice, he or she might happen upon a transaction that produces vastly inferior tax consequences compared to the tax treatment of an otherwise quite similar transaction.

C. Trade-Offs

Because different features of tax law are more likely to impose costs on different taxpayers, measures that might make law simpler for one group of taxpayers can often increase costs borne by another group of taxpayers.[16] Of particular relevance to this Essay, simplification measures that cater to taxpayers who consider tax ramifications prior to acting can, in some cases, exacerbate the plight faced by taxpayers who do not do so, as discussed in greater detail in Parts II and III below.

II. RULES VERSUS STANDARDS

When lawmakers adopt rules in lieu of standards, they may succeed in making things easier for those who plan, but they risk harming taxpayers who engage in transactions without considering resulting tax consequences. A "rule" specifies, clearly and in advance, the tax consequences resulting from various activities.[17] A "standard" provides only limited guidance to taxpayers before they act, deferring definitive determinations of tax consequences to after-the-fact analysis by the IRS and courts.[18] Thus, the presence of a rule makes it less costly to determine tax consequences ahead of time.[19] At the same time, however, rules make it so that large differences in tax consequences can turn on small nontax differences, or, stated differently, rules make it so that significant tax

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16. *See*, *e.g*., Sohoni, *supra* note 4, at 1608 ("Complexity is easy to redistribute but hard to reduce."); Wright, *supra* note 4, at 716 ("We can reduce legal complexity in one respect without also reducing the law's complexity in other respects, and usually only at the cost of greater complexity in other respects.").

17. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 560 (1992) ("This Article will adopt such a definition, in which the only distinction between rules and standards is the extent to which efforts to give content to the law are undertaken before or after individuals act."); *see also* Alice G. Abreu & Richard K. Greenstein, *Defining Income*, 11 FLA. TAX REV. 295, 330 (2011) ("A rule . . . is formal, and in the great majority of circumstances the rule either clearly applies or clearly does not.").

18. *See* Abreu & Greenstein, *supra* note 17, at 330 ("Application of a standard tends to be contextual and fact-sensitive."); Kaplow, *supra* note 17, at 560 ("A standard may entail leaving both specification of what conduct is permissible and factual issues for the adjudicator.").

19. *See, e.g*., Kaplow, *supra* note 17, at 577 ("[R]ules' benefits arise from two sources: Individuals may spend less in learning the content of the law, and individuals may become better informed about rules than standards and thus better conform their behavior to the law.").

consequences may depend on arbitrary distinctions.[20] With standards, on the other hand, tax consequences are more difficult to predict ahead of time, and also obtaining guidance on the standard's content often requires consulting more diffuse sources like case law and IRS rulings. However, the presence of a standard can also reduce the risk that small, insignificant nontax differences will produce drastic differences in tax outcome. Therefore, unsophisticated taxpayers may be less likely to commit costly errors when faced with standards.[21] To put it differently, standards may be less likely than rules to trap unwary taxpayers.

To the extent that rules are easier to apply than standards,[22] at first it might seem that standards would disadvantage unsophisticated taxpayers even more severely than rules. However, although rules may be easier to apply than standards, ease of application assists only taxpayers who attempt to apply the rules.[23] While sophisticated taxpayers will often

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20. This depends in part on how the rule is designed because some rules may be more arbitrary than others. For further discussion of rules' arbitrariness, see, e.g., Miller, *supra* note 4, at 43–44 ("[The] essential feature [of mathematical rules] is the failure to distinguish between individual circumstances in their application in a way that is more pronounced than other rules. In short, the mathematical rule is overtly arbitrary. This overt arbitrariness accounts for its relative determinacy. . . . [A]rbitrariness, to the extent it achieves determinacy, may be seen to do so at the sacrifice of legitimacy."); Sunstein, *supra* note 2, at 992 ("If strictly followed, the rule will often produce arbitrariness and errors in particular cases."); Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65, 68 (1983) ("A rule that makes eligibility for disability insurance turn on one's birth date, the argument runs, fails adequately to discriminate between those who are capable and those who are incapable of supporting themselves.").

21. In a similar vein, Professor Kovach argues that unsophisticated advisors may fare better under standards than rules, stating, "if many important tax determinations are based on facts and circumstances tests, practitioners who are not very familiar with a particular taxation subject might experience less anxiety about their lack of knowledge, since vague standards allow for at least arguable compliance over a wide range of putatively misguided transactions. Error under bright line rules is more clearly established and displayed." Richard J. Kovach, *Bright Lines, Facts and Circumstances Tests, and Complexity in Federal Taxation*, 46 SYRACUSE L. REV. 1287, 1315–16 (1996); *see also* Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 600 (1988) (discussing how crystalline rules in property law tend to disadvantage "fools" and favor "sharp dealers" and stating that fuzzier standards "will also reassure those of us who fear we may be made fools; we can go about our business and take part in the world of trade without cowering at home because we think we need to hire a lawyer and an accountant every time we leave the car at a commercial parking lot.").

22. *See, e.g.*, Kaplow, *supra* note 17, at 577 ("[R]ules' benefits arise from two sources: Individuals may spend less in learning the content of the law, and individuals may become better informed about rules than standards and thus better conform their behavior to the law."); *id*. at 569 ("Because a standard requires a prediction of how an enforcement authority will decide questions that are already answered in the case of a rule, advice about a standard is more costly.").

23. *See, e.g.*, Kaplow, *supra* note 17, at 564 ("[T]he advantage of rules at the stage involving individuals' behavior depends on whether individuals choose to acquire legal advice before they act."). Professor Kaplow argues that individuals may be less likely to acquire information about standards ahead of time because standards are more difficult to apply. *See id*. ("If . . . the cost of predicting standards is high, individuals will not choose to become as well informed about how standards would apply to their behavior."). For that reason, it may be true that a taxpayer who is

attempt to apply tax law before acting, either directly or by seeking tax advice, unsophisticated taxpayers may be unaware of the potential benefit from consulting with a tax advisor prior to acting or may lack the resources to obtain such advice. Therefore, unsophisticated taxpayers may systematically fail to reap the benefits of easy-to-apply rules. Standards, due to their flexible nature, can be more forgiving. To state it differently, although a rule may be easier to apply than a standard when a person seeks information about the rule, a standard may be, in some sense, "easier" than a rule for unsophisticated taxpayers. A standard may be "easier" for unsophisticated taxpayers because it may be more likely than a rule to coincide with a taxpayer's uninformed expectations in that, under a standard, small nontax changes will not necessarily produce significant tax differences to the same degree as what occurs with a rule.[24]

To demonstrate, consider, for example, the provisions governing the tax treatment of the sale of a home. Section 121 of the Internal Revenue Code allows a taxpayer to exclude from gross income up to a certain amount of gain from the sale of a principal residence, provided that various requirements are met.[25] A single taxpayer can exclude up to $250,000 of gain, provided that he or she owned the home and used it as his or her principal residence for periods of time aggregating at least two years during the five-year period ending on the date of sale.[26] However, subject to certain exceptions, the taxpayer may use this exemption only once every two years.[27] If a taxpayer falls short of the two-year requirement for owning the home (or using it as a principal residence) or if a taxpayer has sold another principal residence within two years and exempted the resulting gain under § 121, the taxpayer still may be eligible to exclude gain (up to a reduced maximum amount) if the sale of the

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sophisticated enough to seek advice will be more likely to obtain information about rules than standards. However, unsophisticated taxpayers may be less likely to seek any legal advice ahead of time because they may be unaware of the benefits of tax planning.

24. *See* Kaplow, *supra* note 17, at 562 (describing how individuals either seek legal advice or "act based on their best guess of the law").

25. I.R.C. § 121.

26. *See* I.R.C. §§ 121(a)–(b)(1) (providing that a single taxpayer can exclude up to $250,000 of gain from income as long as the two-year ownership and use requirements are met). A married couple filing a joint return can exclude up to $500,000 of gain from sale of a principal residence provided that either spouse owned the residence for at least two years during the five-year period ending on the date of sale, both spouses used the home as a principal residence for at least two years during the five-year period ending on the date of sale, and neither spouse has excluded gain from sale of another home under § 121 within the preceding two years. I.R.C. § 121(b)(2)(A).

27. *See* I.R.C. § 121(b)(3) (providing that the taxpayer may only exclude gain from income for one sale or exchange within any two-year period).

taxpayer's current home was prompted by change of place of employment, health, or unforeseen circumstances.[28]

Various limitations on the availability of the exclusion contained in § 121 are designed as rules. In order to be eligible for the benefit of § 121, the taxpayer must have owned the home for at least two years, the taxpayer must have used the home as his or her principal residence for at least two years,[29] and the taxpayer must not have used § 121 to exclude gain from sale of another residence within two years.[30] The legislative history surrounding the adoption of these rules in 1997 is devoid of discussion of the rationale for imposing these two-year requirements.[31] Ostensibly, the limitations are motivated by the desire to impose some limitation on the tax benefit that any given taxpayer can obtain from the provision; or by the aim of discerning whether the property is, in some sense, really the taxpayer's home as opposed to predominantly an investment; or by both considerations.

Designing these limitations as rules produces arbitrary outcomes that can trap unwary taxpayers. If a single taxpayer sells a home after owning it and using it as a principal residence for one year and eleven months, the taxpayer may have to include the entire gain in income, while if the same taxpayer waited one more month, the taxpayer could exclude the entire gain (up to $250,000) from income. The potential harshness of this result is softened by provisions that provide relief if the sale was motivated by certain factors—change in place of employment, health, or unforeseen circumstances.[32] However, relief will not be available if the sale is not prompted by any such factor.

Rather than adopting rules limiting the applicability of § 121, lawmakers might have adopted standards. For instance, assume the reason for imposing the two-year limitations on the applicability of § 121 was to determine whether the property was really the taxpayer's home rather than predominantly an investment opportunity—in other words,

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28. *See* I.R.C. § 121(c) (allowing a taxpayer who fails to meet the ownership or use requirement or who has excluded gain from sale of another principal residence within two years to nevertheless exclude gain from sale of a residence, up to a reduced maximum amount, in certain circumstances).

29. *See* I.R.C. § 121(a) (providing the two-year ownership and use requirements). This "rule" also contains an embedded standard—the determination of whether or not something is a "principal residence" depends on the application of a standard.

30. *See* I.R.C. § 121(b)(3) (providing that the taxpayer may only exclude gain from income from one sale or exchange within any two-year period).

31. For discussion of the legislative history, see, e.g., Lily Kahng, *Path Dependence in Tax Subsidies for Home Sales*, 65 ALA. L. REV. 187, 195–97 (2013) (describing the legislative history of the provision).

32. *See* I.R.C. § 121(c) (allowing a taxpayer who fails to meet the ownership or use requirement or who has excluded gain from sale of another principal residence within two years to nevertheless exclude gain from sale of a residence, up to a reduced maximum amount, in certain circumstances).

imagine the provisions were designed to ensure that the taxpayer genuinely intended to live at the residence for some significant period of time and was not, instead, planning to flip the property for a quick profit. Congress could have called on courts to apply a facts and circumstances test to determine whether the taxpayer possessed this requisite intent. To apply the standard, courts might examine a number of factors—how long the taxpayer owned and lived at the property, the reason for the sale, whether the sale generated a significant profit, how many other sales the taxpayer made, whether the taxpayer had other sources of income, the extent to which the taxpayer improved the property, and other relevant facts. I should note that I am not advocating for such a change in the law but merely using it as an illustration of the effects of standards versus rules.

Such a standard-based regime might be less likely to trap unwary taxpayers.[33] The homeowner who sells a home after owning it for one year and eleven months stands a better chance of still obtaining the exclusion if other facts support the conclusion that the taxpayer possessed the requisite intent. It is true that, even with standards, courts must inevitably distinguish among and allot different tax treatment to different taxpayers. When sorting taxpayers between those who are entitled to the benefit of § 121 and those who are not, courts must draw lines, and, inevitably, somewhat similar taxpayers would be treated differently even under a standard.[34] Nevertheless, because courts could evaluate multiple factors (rather than just the time period of ownership) in a flexible way when making distinctions among taxpayers, courts applying a standard might be able to sort taxpayers into categories less arbitrarily than the existing rules do.[35]

33. It is also possible that a standard, might, in some cases, be better designed at carrying out the purpose of the limitations, if one of the purposes is, indeed, to prevent § 121 from applying in cases in which the homeowner is engaged in house flipping. For discussion of how the current regime may encourage house flipping, see Kahng, *supra* note 31, at 215–21 (discussing how the exclusion created an incentive for some homeowners to become "serial 'flippers'").

34. *See, e.g.*, Weisbach, *Line Drawing*, *supra* note 14, at 1646–47 (concluding that, inevitably, similar taxpayers will be treated differently). For related discussion, see, e.g., Kaplow, *supra* note 17, at 577–79 (discussing the possibility that precedent can transform a standard into a rule); Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 413 (1985) ("[T]he 'balancing' or 'totality of circumstances' tests that are often used in constitutional law . . . viewed in isolation look very flexible. But as soon as we consider how they are applied by judges, it becomes apparent that these tests merely defer the constraints on judicial decision making to some external source such as precedent."); Sunstein, *supra* note 2, at 965 ("Once we define the term 'excessive' [in a law prohibiting driving at excessive speeds], we may well end up with a rule."); David O. Taylor, *Formalism and Antiformalism in Patent Law Adjudication: Rules and Standards*, 46 CONN. L. REV. 415, 426 (2013) ("[I]n time, standards may crystallize into rules and rules may dissolve into standards.").

35. However, this difference should not be overstated given that a rule could also employ multiple factors.

While use of a standard might be less likely to trap unwary taxpayers,[36] it also would make it more difficult for taxpayers who contemplate tax consequences prior to sale to determine those consequences. Under current law, if a taxpayer has met the two-year requirements, he or she can be assured of obtaining the benefits of § 121; however, under a standard, the same taxpayer would not be able to predict the resulting tax consequences with certainty. Thus, by opting to use a rule, lawmakers have provided certainty to taxpayers who contemplate tax consequences prior to acting while increasing the risk of trapping unwary taxpayers.

III. FORM VERSUS SUBSTANCE

As discussed above in Part II, when lawmakers adopt rules in lieu of standards, they may succeed in making tax consequences more predictable for those who plan, but they risk harming taxpayers who engage in transactions without considering resulting tax consequences. Relatedly, when lawmakers opt to allow for tax consequences to turn on the form of a transaction rather than its substance, doing so has the same effect—providing certainty for planners while setting more traps for unwary taxpayers. Allowing tax consequences to turn on form makes tax consequences more predictable for planners. However, because form-driven tax consequences increase the extent to which small nontax changes will affect tax outcomes, form-driven tax consequences are less intuitive and, therefore, more likely to trap unwary taxpayers.

Stated differently, tax law is more likely to match intuitive expectations if transactions that have the same substance receive the same tax treatment even if they vary in form.[37] In such a world, a taxpayer who

36. The same objective could be served by other means. As one example, lawmakers could convert a bright-line rule into a safe harbor. For discussion of safe harbors, see generally Emily Cauble, *Safe Harbors in Tax Law*, 47 CONN. L. REV. 1385 (2015), and Susan C. Morse, *Safe Harbors, Sure Shipwrecks*, 49 U.C. DAVIS L. REV. 1385 (2016). In addition, rules could be designed in ways that are more forgiving of unwary taxpayers. In the case of § 121, the unforgiving nature of the two-year requirements stem, in part, from the fact that the rules produce a cliff effect. The rules could be replaced with rules that contained a phase-in. For example, in all cases, not just cases in which the sale was attributable to the reasons listed in § 121(c), the $250,000 amount could be subject to a phase-in based on the length of ownership. For instance, if a taxpayer had owned the home for only one year, rather than lose the benefits of § 121 entirely, the taxpayer would be entitled to exclude up to $125,000 even if the sale was not precipitated by one of the reasons listed in § 121(c). As another example, if a taxpayer had used § 121 within the last two years to exclude gain from sale of another home, rather than lose the benefits of § 121 entirely, the taxpayer could be able to exclude from income gain up to $250,000 reduced by the amount of gain that went untaxed on the previous sale.

37. "Form" is a term of art in tax law. It generally refers to aspects of a business arrangement or transaction that are within a taxpayer's control and that could have been altered without changing the arrangement's or transaction's economic effects. Thus, the concept of form includes not only the "form" of a transaction in the everyday sense of the word (such as the steps by which a

does not ascertain the content of taw law prior to engaging in a transaction is less likely to bear the cost of a missed opportunity to engage in a similar transaction with more favorable tax consequences. By contrast, designing the law so that slight changes to the form of a transaction can radically change its tax outcome is a recipe for costly missteps by uninformed taxpayers.

Designing tax law so that transactions with the same underlying substance receive the same tax treatment, regardless of form, can be accomplished generally in one of two ways. One approach involves use of various doctrines in tax law that tend to employ facts-and-circumstances tests, making use of standards rather than rules. When this approach is used to make law substance based, substance versus form represents a subset of the general distinction between standards and rules. Such doctrines include the substance-over-form doctrine, the step transaction doctrine, the economic substance doctrine, and a number of anti-abuse rules applicable to specific areas of tax law such as the partnership anti-abuse rules.[38] In very general terms, these doctrines work in the following manner. Suppose that a taxpayer engages in a transaction using one form ("Transaction B") and suppose that another transaction ("Transaction A") would have the same substance (in other words, it would achieve the same nontax objectives) but would have involved a different form (such as reaching the same outcome in a less convoluted manner that involved fewer steps). Imagine Transaction A would receive less favorable tax treatment than the tax treatment that the taxpayer

transaction is undertaken), but also other aspects of a transaction or arrangement such as labels adopted by the taxpayer and whether the taxpayer files a given tax election. "Substance" refers to aspects of a transaction that a taxpayer cannot easily change without having a significant effect on the nontax aspects of the transaction. Thus, it includes things such as the pretax economic outcome that the transaction is intended to achieve.

38. Literature discussing these doctrines and rules is extensive. *See generally* Ellen P. Aprill, *Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines*, 54 S.M.U. L. REV. 9 (2001); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5 (2000); Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 S.M.U. L. REV. 131 (2001); Daniel Halperin, *Are Anti-Abuse Rules Appropriate?*, 48 TAX LAW. 807 (1995); James S. Halpern, *Putting the Cart Before the Horse: Determining Economic Substance Independent of the Language of the Code*, 30 VA. TAX REV. 327 (2010); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235 (1999); David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 TAX L. REV. 29 (2006); Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982) (reviewing BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS (Warren, Gorham, & Lamont, 3rd ed. 1981)); Jeffrey L. Kwall & Kristina Maynard, *Dethroning King Enterprises*, 58 TAX LAW. 1 (2004); Leandra Lederman, *W(h)ither Economic Substance*, 95 IOWA L. REV. 389 (2010); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365 (1988); Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325 (2002); Weisbach, *Disrupting the Market*, *supra* note 14; Weisbach, *Ten Truths*, *supra* note 14; Martin J. McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters*, 94 TAX NOTES 1017 (2002).

claims as a result of engaging in Transaction B. If Transaction A is truer to the underlying substance of the transaction than Transaction B, the IRS can successfully impose upon Transaction B the same tax consequences that would have followed from Transaction A.

Using the substance-over-form doctrine and related doctrines entails uncertainty. The distinction between form and substance in tax law is not always clear-cut, and it is not always obvious whether one transactional form is truer to a transaction's underlying substance than an alternative form.[39] Thus, using this approach to make tax law more intuitive can make law less certain, which can, in some respects, increase planning costs for taxpayers who consider tax outcomes prior to acting.

Another approach to ensuring that transactions with the same substance receive the same tax treatment regardless of form makes use of rules (at least to some degree) and specifically identifies different transactional forms that have the same substance and grants them the same tax treatment. This latter approach expands the volume and technical detail of tax law.[40] As a result, this approach, too, can exacerbate planning complexity, at least in some respect, for taxpayers who contemplate tax consequences prior to acting.[41] Thus, efforts to

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39. *See*, *e.g.*, Isenbergh, *supra* note 38, at 865–66 ("When someone calls a dog a cow and then seeks a subsidy provided by statute for cows, the obvious response is that is not what the statute means. It may also happen that rich people who would not otherwise have cows buy them to gain cow subsidies. Here, when people say (as they do) that this is not what the statute means, they are in fact saying something quite different. Many of the difficulties that bedevil that pursuit of 'substance' and 'form' in taxation stem from the assimilation of these two fact patterns.").

40. Taking the approach of specifically identifying transactions that will be treated similarly, rather than relying on more general substance-over-form standards, gives rise to a proliferation in applicable rules. For this reason, Professor Weisbach observes that there is a tendency for rules in tax law to be more complicated than standards. Building on observations by Professor Surrey, Professor Weisbach argues that "rules are systematically more complex than standards because rules can less afford to overlook uncommon transactions than can standards." *See* Weisbach, *Formalism*, *supra* note 2, at 861, 867–870 (elaborating upon this reason for the greater complexity of rules). For related discussion, see, e.g., Cunningham & Repetti, *supra* note 2, at 6 ("In addition to being valid, we also believe that, as a general proposition, it is sound tax policy to use broad standards to administer the tax law . . . . This approach 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.").

41. *See also* BRADFORD, *supra* note 4, at 267 ("Of particular importance is the tension between rule and transactional complexity. Transactional complexity arises basically because of the possibility that economically equivalent activities may have very different tax consequences, depending on the precise way the transactions are structured . . . . Rules with a high degree of economic consistency serve transactional simplicity, although they may impose costs in the form of compliance and rule complexity."); Walter J. Blum, *Simplification of the Federal Income Tax Law*, 10 TAX L. REV. 239, 250 (1955) ("In theory it would be possible to create a system which would bring virtually all items of economic enhancement into the tax equation without any distinctions among them . . . . This theoretical model would embody a minimum of distinctions and hence a minimum of rules, and in this respect, it would be the ultimate in simplicity. However, a

allow substance to prevail over form can make tax law more intuitive (and, thus, simpler, in a sense, for taxpayers who act without considering tax consequences), but, at the same time, impose costs on taxpayers who do plan.

At the other end of the substance-form spectrum, some tax law measures advanced under the heading of "simplification," achieve their purported simplification objective by prioritizing form over substance. A quintessential example of this approach is the use of tax elections.[42] In many situations, a taxpayer can make an election that will affect the tax consequences of a transaction.[43] Elections available to taxpayers include those that determine how certain business entities are classified,[44] various partnership tax elections that determine how tax items are shared among partners[45] or that determine the tax consequences following transfers of partnership interests or partnership distributions,[46] and elections that affect the tax consequences of certain corporate acquisitions.[47]

Regardless of whether a tax election is made, the nontax results of a transaction will remain the same.[48] In other words, due to a purely formal distinction, one transaction will lead to very different tax consequences than another transaction. The only difference between the transactions is that the taxpayer makes a particular tax election with respect to one transaction but does not make the same tax election with respect to the other transaction. Because the only dissimilarity between the transactions is one of form, by granting the ability to make a tax election, lawmakers give form a preeminent role.

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tax law that approached perfect neutrality in this sense would carry with it great administrative burdens."); McClure, *supra* note 4, at 42 ("There are cases in which provisions that complicate rules or compliance lead to transactional simplicity.").

42. For further discussion of tax elections, see generally Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 HARV. J. LEGIS. 21 (2010), and Edward Yorio, *The Revocability of Federal Tax Elections*, 44 FORDHAM L. REV. 463 (1975).

43. This article uses the term "tax elections" to refer to explicit elections, or opportunities for a taxpayer to obtain different tax treatment without changing any of the nontax features of his or her behavior or transactions. Taxpayers can also make implicit elections because tax law affords opportunities for a taxpayer to obtain different tax treatment by changing some nontax features of his or her behavior or transactions. For further discussion of explicit tax elections, see generally, Field, *supra* note 42, and Yorio, *supra* note 42.

44. Treas. Reg. § 301.7701–2.

45. Treas. Reg. § 1.704–3.

46. I.R.C. § 754.

47. I.R.C. § 338.

48. *See, e.g.*, Field, *supra* note 42, at 30 ("Explicit elections, by definition, affect taxes only; they lack non-tax legal impact.").

A commonly offered justification for tax elections is simplification.[49] There are three respects in which the argument may have merit. First, by making tax consequences turn on form, tax elections grant certainty—by simply filing a given form or reporting in a certain way on a tax return, a taxpayer generally can be assured of receiving specified tax treatment.[50] Second, explicit tax elections obviate the need to make implicit tax elections that might be costlier—an implicit tax election involves a taxpayer obtaining more desirable tax treatment by making changes to the nontax form of his or her transactions that might be more significant than the change of form (such as checking a different box) that an explicit tax election entails.[51] Third, some elections ease compliance costs by offering taxpayers an option that is computationally simpler and involves less recordkeeping.[52]

The first two effects of tax elections offer benefits at the planning stage to taxpayers who contemplate the tax consequences of transactions prior to acting. However, by making form preeminent, tax elections also make law less consistent with intuitive expectations. When tax elections are available, a taxpayer who does not contemplate tax law prior to acting runs the risk of forgoing more favorable tax consequences unless the default treatment provided by law to taxpayers who do not make an election is more favorable.[53] In other words, as others have observed, tax

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49. *See*, *e.g*., Dean, *supra* note 1, at 412–21 (discussing how this justification has been offered in the context of the entity classification rules and observing that the entity classification rules could better be described as representing deregulation rather than simplification).

50. *See, e.g.*, Field, *supra* note 42, at 49–50 ("Explicit elections can simplify the classification process for taxpayers by eliminating the detailed inquiry required by a facts and circumstances test. . . . In addition, classification via an explicit election increases taxpayer certainty regarding a desired classification—taxpayers need not rely on a judgment made after weighing facts and circumstances, which might put them in tenuous positions in close cases.").

51. *See*, *e.g*., Field, *supra* note 42, at 37 ("Accordingly, using explicit elections to alleviate discontinuity reduces taxpayers' incentives to alter their business decisions regarding the structure of a business or business transaction in order to obtain specific tax treatments. Thus, explicit elections enable taxpayers to focus on the non-tax business and legal consequences, rather than the tax ones, when planning and effectuating transactions. This can enhance efficiency by relieving taxpayers of the need both to waste resources to restructure a desired transaction and to use a transaction structure that is suboptimal from a business perspective in order to obtain a particular tax treatment.").

52. *See*, *e.g*., *id.* at 53–54 ("For example, a taxpayer's ability to choose between taking the standard deduction and taking itemized deductions is, very fundamentally, an election intended to provide simplicity—the availability of the standard deduction relieves a taxpayer from having to keep track of all of his itemizable deductions.").

53. *See*, *e.g*., *id.* at 31 ("Additionally, an election, while technically available to all eligible taxpayers, may be functionally available only to the wealthiest, most sophisticated group of taxpayers, who can best navigate the complexity of the election process. As with tax planning in general, other taxpayers may lack the knowledge or resources to pay for advice that would enable them to take full advantage of the election.").

elections can act as a trap for unwary taxpayers.[54] Because explicit tax elections can make tax law easier for taxpayers who act based on knowledge of law but potentially make law more complicated for taxpayers who do not do so, at least some tax elections represent simplification measures that cater to taxpayers who consider tax ramifications prior to acting but exacerbate the plight faced by taxpayers who do not do so.

IV. CONCLUSION

Standard-based and substance-driven aspects of tax law are often invoked to defend the tax system against potentially abusive tax planning strategies used by sophisticated taxpayers.[55] This Essay discusses another potential advantage of standard-based and substance-driven tax provisions—namely, their capacity to be more forgiving of unsophisticated taxpayers.

Bearing in mind the more forgiving nature of standard- and substance-based determinations, there are several steps lawmakers might consider taking in appropriate circumstances. First, in some sense, all rules that favor taxpayers are not strictly rules because overarching tax law doctrines and anti-abuse rules, in some sense, make the outcome of every rule that favors a taxpayer subject to potential challenge by the IRS.[56] If a transaction technically complies with the literal language of a rule but undermines its purpose, the IRS might successfully assert that a taxpayer is not entitled to his or her claimed tax consequences. This helps to address the concern that rules alone do not adequately defend the tax system against abusive tax planning strategies. To address the concern that rules trap unwary taxpayers, there might be more scope for allowing an unsophisticated taxpayer to overcome the results of a rule that disfavors the taxpayer in some circumstances.[57]

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54. *See*, *e.g.*, *id.* at 31 (discussing how, as a practical matter, some elections may be available only to wealthy taxpayers).

55. *See generally supra* note 38 and accompanying text.

56. For further discussion of these doctrines and rules, *see generally supra* note 38.

57. As an example, consider the wash sale rules. Imagine a taxpayer holds stock that has declined in value, and the taxpayer would like to deduct the loss for tax purposes but, for nontax reasons, would like to continue to own the stock. Absent the wash sale rules and assuming the transactions would not be recast under substance-over-form principles, the taxpayer could achieve both objectives by selling the stock to an unrelated party and repurchasing the same stock shortly thereafter. To prevent this type of tax motivated transaction, § 1091 disallows the deduction of the loss if the sale and purchase occur within a specified time of each other. If, within a period beginning 30 days before the date of the sale of stock or securities and ending 30 days after the date of such sale, a taxpayer has acquired, or has entered into a contract or option to acquire, substantially identical stock or securities, then no deduction is allowed for loss recognized on the sale. I.R.C. § 1091. Because engaging in a sale and purchase within 30 days results in an inability

Second, in some contexts, tax law may be inevitably form-driven. In these contexts, lawmakers can sometimes take steps that increase the odds that unsophisticated taxpayers can make informed decisions when selecting a form by allowing the selection of form to be made in connection with filing a tax return. Linking the selection of form to the filing of a tax return may help unsophisticated taxpayers because they may be more likely to receive expert advice in connection with filing a return than in connection with undertaking everyday transactions. Individuals are generally aware of the requirement to file tax returns, and if they cannot comply independently, they often seek assistance. By contrast, many taxpayers may be unaware of the myriad ways in which altering their behavior or transactions can affect tax consequences. Thus, at the planning stage, unsophisticated taxpayers are likely left to their own devices while they may be more likely to seek expert assistance at the tax filing stage. Ultimately, whether this is true is an empirical question. However, it is quite plausibly the case, and existing data provide at least some support.[58]

If it is true that unsophisticated taxpayers are more likely to benefit from expert advice at the tax return filing stage, in some cases, it might be advisable to allow for the selection of form at that stage and in a way that invites seeking advice about the decision in connection with

to the deduct the loss, sales and purchases that, notwithstanding § 1091, occur within 30 days will, for the most part, not be tax motivated. As Professor Osofsky observes, wash sales that occur within this window might result when a taxpayer sells stock for nontax reasons (because the taxpayer anticipates the stock will decline in value further, for instance), but then, within thirty days, something occurs that prompts the taxpayer to repurchase the stock (the taxpayer revises his or her projections about the stock's future performance, for instance). *See* Leigh Osofsky, *Who's Naughty and Who's Nice? Frictions, Screening, and Tax Law Design*, 61 BUFF. L. REV. 1057, 1086–87 (2013) (illustrating the screening problem with tax planning). A sale and repurchase within 30 days might also result from certain common, non-tax-motivated market transactions such as sales by mutual fund investors who continue to own an interest in the mutual fund and are enrolled in an automatic dividend reinvestment plan, as Professor Osofsky observes. *Id*. at 1097. The propensity of the wash sale rules to trap unwary taxpayers could be ameliorated by providing taxpayers with an opportunity to deduct a loss if they could show that the transactions were not tax-motivated (by, for instance, convincingly demonstrating that the later transaction was not contemplated at the time of the earlier one). Alternatively, common non-tax-motivated transactions that can produce wash sales (such as purchase of stock or securities pursuant to an automatic dividend reinvestment plan) could be carved out from the rules, for instance. For further discussion, see Emily Cauble, *Presumptions of Tax Motivation*, 105 IOWA L. REV. 1995 (2020), and Osofsky, *supra*, at 1099 ("[T]he wash sale rule may be a sharper screening mechanism for tax planning if the rule excluded certain passive sale and repurchase transactions . . . .").

58. In particular, although data about the extent to which taxpayers seek assistance at the planning stage is lacking, existing data does show that a significant number of taxpayers seek assistance at the tax reporting stage. For example, in 2001, 67% of lower-income taxpayers claiming the earned income tax credit (EITC) used paid preparers. *See* Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 WIS. L. REV. 1103, 1115 (2006) (reporting that, in 2001, 67% of EITC claimants used paid preparers, compared to 59.4% of the general population).

completing a tax return. This suggests, for instance, that explicit tax elections that must be filed at the time of the tax return (particularly if they are part of the return) are less problematic than tax elections with earlier deadlines (or even tax elections with the same deadline that are separately filed).

In the case of form-driven tax consequences that do not involve explicit tax elections, it may also be possible to offer some relief to unsophisticated taxpayers. In various ways and for various reasons, tax law is generally hostile to efforts by taxpayers to argue against the transactional form they have selected. One case law doctrine that demonstrates this hostility has been referred to as the "actual transaction doctrine."[59] According to this doctrine, a taxpayer must report the tax consequences that follow from the actual transaction undertaken rather than the tax consequences that would have followed from some hypothetical, equivalent transaction that the taxpayer did not pursue.[60] In some circumstances—for instance, as long as the taxpayer can convincingly demonstrate that he or she selected a given transactional form instead of the alternative solely because of inadequate planning,[61] as long as the taxpayer has not already reported the tax consequences of the transaction, and as long as all parties to the transaction agree to report in a consistent manner—granting relief to report the more favorable results of the alternative

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59. For further discussion of the actual transaction doctrine, see Michael E. Baillif, *The Return Consistency Rule: A Proposal for Resolving the Substance-Form Debate*, 48 TAX LAW. 289, 310–11 (1995) (discussing the history and applicability of the doctrine); Emanuel S. Burstein, *The Impact of Form, and Disavowing Form, on Characterization of Sales Transactions*, 66 TAXES 220, 224 (1988); Emily Cauble, *Rethinking the Timing of Tax Decisions: Does a Taxpayer Ever Deserve a Second Chance?*, 61 CATH. U. L. REV. 1013, 1021–44 (2012); Kenneth L. Harris, *Should There Be a "Form Consistency" Requirement?* Danielson *Revisited*, 78 TAXES 88, 106–08 (2000); Robert Thornton Smith, *Substance and Form: A Taxpayer's Right to Assert the Priority of Substance*, 44 TAX LAW. 137, 141–43 (1990).

60. For example, if a mother were to sell an asset to a third party and shortly thereafter make a gift of the cash proceeds to her daughter, the actual transaction doctrine would stand in the way of an attempt by the mother and daughter to claim the tax consequences that would have resulted had the mother, instead, given the asset to her daughter and her daughter had sold it to the third party. Conversely, if a mother were to give an asset to her daughter and, shortly thereafter, the daughter sold the asset to a third party, the actual transaction doctrine would stand in the way of an attempt by the mother and daughter to claim the tax consequences that would have resulted had the mother, instead, sold the asset to the third party and given the proceeds to her daughter.

61. The taxpayers would have to convincingly establish that their situation is *not* one in which they chose a given transactional form because they determined that form produced more favorable tax consequences given the transaction's expected economic outcome but now that the economic outcome is different than expected they are trying to claim the tax consequences of an alternative form that is more favorable in light of the actual economic outcome. *See* Cauble, *supra* note 59, at 1064–70 (proposing changes to the law, including no longer applying the actual transaction doctrine when certain circumstances are met).

transaction may be warranted.[62] All of these measures could help address the concern this Essay highlights, namely that form-driven and rule-based aspects of tax law may make the law more complex for taxpayers who do not attempt to ascertain the content of law prior to acting.

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62. For further discussion of a proposal to grant relief in such circumstances, see Cauble, *supra* note 59, at 1064 (describing the proposal).