REFORMING THE NON-DISAVOWAL DOCTRINE

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One well established feature of tax law is that, oftentimes, substance prevails over form. Therefore, the substance of a transaction will determine the transaction's tax consequences. For instance, tax consequences will not depend solely on the label that a taxpayer assigns to a given transaction. Instead, the IRS can examine the transaction's economic features to more accurately characterize it for tax purposes.

Also deeply entrenched in tax law is the notion that, frequently, the IRS experiences more success than taxpayers when invoking the concept that substance prevails over form. In other words, when substance matters, the IRS can freely assert that a transaction should be taxed based on its true substance rather than the form selected by the taxpayer. A taxpayer, by contrast, is less likely to succeed when making the same assertion. The resistance to taxpayers' attempts to invoke the substance-over-form doctrine is known as the "Non-Disavowal Doctrine."

Although the Non-Disavowal Doctrine's existence is widely acknowledged, the purposes of the doctrine have not been adequately theorized. This is perhaps not surprising given that court decisions invoking the Non-Disavowal Doctrine have been described as muddled and inconsistent. Courts and existing literature have offered various explanations for the doctrine, but the explanations that have been offered are not fully developed. This Article will examine potential rationales in detail. Providing a detailed analysis of the theory underlying the Non-Disavowal Doctrine serves two useful purposes. First, it helps to explain some of the factors upon which courts rely that might otherwise seem irrelevant. Second, it provides guidance for how and when courts should apply the doctrine to better serve its goals.

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Introduction

In tax cases, it is often true that the genuine substance of a transaction will triumph over the transaction's mere form for purposes of determining the transaction's tax consequences.[1] Thus, rather than being swayed by the formal aspects of a transaction selected by a taxpayer – such as labels employed by the taxpayer – a court will search for evidence of the transaction's true substance – such as the transaction's economic features – in order to determine its proper tax treatment.[2]

However, despite the preeminent position typically occupied by substance in tax law, taxpayers frequently fail in their attempts to argue that their transactions ought to be characterized based on their substance rather than their form.[3] For example, assume a taxpayer provides funds to a business in exchange for an instrument that the taxpayer labels "equity" despite the fact that the instrument's substantive features are debt-like. If the taxpayer reported the tax consequences of payments made on the instrument as if the instrument were equity, the IRS could challenge successfully the results claimed by the taxpayer because substance generally prevails over form in tax law.[4] By contrast, if the taxpayer reported the consequences of payments made on the instrument as if it were debt (based on its substance), the IRS could still challenge successfully the results reported by the taxpayer.[5] Despite the generally prominent role played by substance in tax law, a taxpayer often will be bound to the transactional form that he or she selects.[6] Courts' resistance to taxpayers' attempts to assert that the substance of their transactions should prevail over form has been named the "Non-Disavowal Doctrine."[7]

The Non-Disavowal Doctrine determines the outcome of many cases,

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[1] *See infra* Part I.A.

[2] *See infra* Part I.A. "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 transaction is undertaken) but also other aspects of a transaction or arrangement such as labels adopted by the taxpayer.

[3] *See infra* Part I.B.

[4] *See infra* Part I.A.

[5] *See infra* Part I.B.

[6] *See infra* Part I.B.

[7] *See infra* Part I.B.

causing taxpayers' claims to fail when they seek to set aside their transactional forms in favor of substance.[8] Nevertheless, taxpayers do not invariably lose when they characterize their transactions based on substance rather than form.[9] A taxpayer who succeeds in such a case often is able to provide a non-tax explanation for the form that he or she selected.[10] For example, if a taxpayer holds an instrument with debt-like substantive features that is labeled "equity," the taxpayer will have a greater chance at successfully characterizing the instrument based on its substance if the taxpayer can offer a non-tax explanation for the "equity" label that he or she adopted. Perhaps, for instance, the taxpayer labeled the instrument "equity" in order to avoid a conflict with state usury laws. If that is true, the taxpayer likely can overcome the Non-Disavowal Doctrine.

Although the Non-Disavowal Doctrine's existence is widely acknowledged, its purposes have not been adequately theorized. Courts and existing literature have offered various explanations for the doctrine,[11] but the explanations that have been offered are not fully developed. This Article contributes to existing literature by examining potential rationales in detail.

As the analysis in this Article reveals, two rationales could justify the Non-Disavowal Doctrine's existence. First, the doctrine may be employed to prevent a taxpayer from reporting the tax consequences of a transaction based on either its form or its substance, whichever leads to more favorable tax consequences based on information about the transaction's economic outcome that is not known until after the transaction commences (a strategy that this Article identifies as "Post-Transactional Tax Planning"). Second, the Non-Disavowal Doctrine may be invoked as a means of penalizing taxpayers who design transactions for the purpose of enabling Post-Transactional Tax Planning.

Providing a thorough analysis of the rationales that underlie the Non-Disavowal Doctrine serves two useful purposes. First, it helps to explain some of the factors upon which courts rely that might otherwise seem irrelevant. As discussed above, despite the Non-Disavowal Doctrine's

[8] *See infra* Part I.B.
[9] *See infra* Part I.B.
[10] *See infra* Part I.B.
[11] *See infra* notes 75, 79, 82, and 84.

existence, in some cases, taxpayers successfully characterize their transactions based on substance rather than form. In particular, a taxpayer is likely to win if the taxpayer can provide a non-tax explanation for the form that he or she selected. For instance, a taxpayer who holds an instrument with debt-like substantive features that is labeled "equity" is more likely to succeed in treating the instrument as debt for tax purposes if he or she selected the "equity" label in order to avoid a violation of state usury laws. At first glance, it may seem counterintuitive that courts are more likely to allow a taxpayer to disavow the form he or she selected in order to obtain more beneficial tax consequences if the form produced non-tax benefits. Indeed, perhaps in part for this reason, court decisions invoking the Non-Disavowal Doctrine have been described as muddled and inconsistent.[12]

However, this feature of law could be explained as an attempt by courts to identify taxpayers that are not engaged in Post-Transactional Tax Planning and allow those taxpayers to disavow their selected forms. If a taxpayer engages in a transaction and selects a form that differs from the transaction's substance, the taxpayer's choice of form might generally suggest that the taxpayer planned to leave open the option of engaging in Post-Transactional Tax Planning by reporting the tax consequences of the transaction based on either its form or substance, whichever, in hindsight, led to the most favorable tax consequences. If a given form was selected instead to produce some non-tax benefits (for instance, if an instrument was labeled "equity" to avoid violation of usury laws) that provides an alternative explanation for the taxpayer's chosen form, and the alternative explanation might help to rebut the conclusion that the taxpayer selected a transactional form in order to facilitate Post-Transactional Tax Planning.

[12] Michael E. Baillif, *The Return Consistency Rule: A Proposal for Resolving the Substance-Form Debate*, 48 TAX LAW. 289, 311 (1995) ("Not surprisingly, the various doctrines relating to the ascendancy of substance-form currently confronting taxpayers, the Service, and the courts, have created confusion. All too often the courts, based on a visceral reaction to the facts before them, arrive at a given holding which they proceed to support by spooning out liberal portions of substance soup or form fricassee. This potluck blends together various discrete and sometimes contradictory doctrines into an analytical hash which is quite perplexing and none too appetizing."); William S. Blatt, *Lost on a One-Way Street: The Taxpayer's Ability to Disavow Form*, 70 OR. L. REV. 381, 384 (1991) ("Despite its pervasiveness, the [Non-Disavowal Doctrine] is in apparent disarray. Courts are deeply divided over whether an appeal to substance should receive a different reception depending on whether the taxpayer or the government makes it.")

In addition to shedding light on certain aspects of courts' decisions, examining the theoretical justifications for the Non-Disavowal Doctrine is a useful exercise because it assists in providing guidance regarding how and when courts should invoke the doctrine to better serve its underlying goals. Under the method currently used by many courts, the Non-Disavowal Doctrine is sometimes invoked in cases that do not involve Post-Transactional Tax Planning and is not reliably invoked in all cases that do entail Post-Transactional Tax Planning. In particular, many courts implicitly (and, in some cases, inaccurately) assume that a taxpayer is engaging in Post-Transactional Tax Planning if the taxpayer selects a form that differs from a transaction's substance and cannot provide a non-tax explanation for the selected form. In some cases, such a taxpayer is not, in fact, engaging in Post-Transactional Tax Planning. Instead, he or she selected a given form simply because he or she was unaware of the tax consequences of doing so. At the same time, if the taxpayer can provide a non-tax explanation for his or her selected form, many courts automatically (and, sometimes, incorrectly) conclude that the taxpayer has not engaged in Post-Transactional Tax Planning. This conclusion is sometimes incorrect because a taxpayer can be driven by multiple motives – he or she could select a given form because it provides non-tax benefits and also because it facilitates Post-Transactional Tax Planning.

These results are particularly unfortunate because courts' current analytical methods disproportionately disadvantage unsophisticated taxpayers. An unsophisticated taxpayer will be especially likely to select a given transactional form without evaluating its tax (or non-tax) consequences. Such a taxpayer is unlikely to have any plans to engage in Post-Transactional Tax Planning. Nevertheless, he or she may find himself or herself ensnared by the Non-Disavowal Doctrine. Specifically, if the form selected happens to differ from the transaction's substance and if the transaction's form leads to less favorable tax consequences than the consequences that would follow from the transaction's substance, the Non-Disavowal Doctrine will bind the taxpayer to those unfavorable tax consequences, trapping an unwary taxpayer.

To remedy the errors currently made by courts, this Article proposes that courts should reform their analytical methods. In particular, anytime a taxpayer selects a form that differs from a transaction's substance that fact ought to establish a rebuttable presumption that the taxpayer plans to engage in Post-Transactional Tax Planning by characterizing the transaction based on either its form or its substance, whichever, in hindsight, leads to lower tax liability.

Providing a non-tax explanation for the selected form should no longer be necessary or sufficient to rebut this presumption. Instead, courts should consider other facts that more reliably and convincingly demonstrate a lack of Post-Transactional Tax Planning. For example, if a taxpayer has consistently reported the transaction's tax consequences based on its substance even in years in which doing so led to higher tax liability than reporting based on the transaction's form, the taxpayer should be able to successfully rebut the presumption. As another example, if based on all the facts and circumstances, a taxpayer can convince a court that he or she selected a given form simply because he or she was unaware of the tax consequences of a transaction and not adequately advised and if the taxpayer has always reported the transaction's consequences based on its substance, the taxpayer should be able to rebut the presumption that he or she is engaged in Post-Transactional Tax Planning. In addition, when a taxpayer engages in a transaction with a form that differs from its substance, the taxpayer ought to be given a new option to file a disclosure with the IRS, contemporaneously with the time the taxpayer initiates the transaction, indicating that the taxpayer plans to report tax consequences based on the transaction's substance. A taxpayer who files such a document should be able to rebut the presumption that he or she was engaging in Post-Transactional Tax Planning.[13] If the taxpayer succeeds in rebutting the presumption, the taxpayer should be able to report the consequences of the transaction based on its substance. If the taxpayer cannot rebut the presumption, the Non-Disavowal Doctrine should bind the taxpayer to his or her selected form.

This Article proceeds as follows. Part I describes the current state of law. It discusses the notion that generally substance prevails over form in tax law, it describes the Non-Disavowal Doctrine, and, for clarity, it contrasts the Non-Disavowal Doctrine with a related concept. Part II explores potential justifications for the Non-Disavowal Doctrine. Part III describes the implications of the justifications for the Non-Disavowal Doctrine. In particular, it illustrates how the justifications can explain

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[13] Other ways in which a taxpayer could rebut the presumption are discussed below in Part III.B.

certain features of court decisions, and it describes ways in which courts should reshape their decision-making to better serve the underlying rationales.

I. Substance over Form and Form over Substance: the Current State of The Law

Oftentimes, the substance of a transaction, rather than merely its form, will determine the transaction's tax consequences. For instance, tax consequences will not depend solely on the label that a taxpayer assigns to a given transaction. Instead, a court will examine the underlying economic features of the transaction to more accurately characterize it for tax purposes.

Although substance often prevails over form in tax law, the IRS can successfully invoke the substance-over-form doctrine more easily than a taxpayer. The resistance to taxpayers' attempts to rely upon the substance-over-form doctrine has been referred to as the "Non-Disavowal Doctrine." This Part will, first, describe the general principle that substance, rather than form, dictates tax consequences. Second, this Part will discuss the Non-Disavowal Doctrine and provide examples of when it applies. Finally, in order to provide a more complete portrayal of the Non-Disavowal Doctrine, this Part will briefly describe another, related but distinct, doctrine.

A. The Substance-Over-Form Doctrine

In many cases, the tax consequences of a transaction are determined based on the underlying substance of the transaction rather than its form.[14] For example, assume an individual, Ms. Jones, owns 100%

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[14] *See*, *e.g*., Baillif, *supra* note 12 at 289 ("A fundamental principle of income tax law is that taxation should be based upon the substance, not the form, of a transaction."); J. Bruce Donaldson, *When Substance-Over-Form Argument Is Available to the Taxpayer*, 48 MARQ. L. REV. 41, 41 (1964) ("The gospel that the substance of a transaction, rather than mere form, controls the tax incidents is accepted by all."); Kenneth L. Harris, *Should There Be a "Form Consistency" Requirement? Danielson Revisited*, 78 TAXES 88, 89 (2000) ("It is a fundamental principle of federal income taxation that the tax consequences of a transaction turn on the 'substance' and not the 'form' of the transaction."); Robert Thornton Smith, *Substance and Form: A Taxpayer's Right to Assert the Priority of Substance*, 44 TAX LAW. 137, 137 (1990) ("A fundamental principle of . . . tax law is that taxation should be based upon the substance, and not the form, of transactions."). A

of the outstanding equity of Jones Corporation, an entity treated as a corporation for U.S. tax purposes. Assume Ms. Jones transfers $10,000 cash to Jones Corporation in exchange for a newly issued instrument labeled "debt." The resulting tax consequences of this transaction will depend on whether the instrument is actually treated as debt or, alternatively, is treated as equity for U.S. tax purposes.[15] If the instrument is debt for U.S. tax purposes, Jones Corporation will be entitled to deduct interest expense,[16] but if the instrument is considered equity for U.S. tax purposes, Jones Corporation will not be entitled to any deduction for payments made on the instrument.[17] The instrument will be treated as debt rather than equity only if the parties intend for Ms. Jones to have a definite right to be repaid a fixed amount at a certain time, regardless of the income of the corporation.[18] To determine the parties' intent, courts will examine underlying substantive factors rather than merely relying on the label given to the instrument by the taxpayer.[19] Substantive factors include: whether Jones Corporation is thinly capitalized, the liquidity of Jones Corporation's assets, the stability of Jones Corporation's revenues, the terms of the instrument (such as the length of the term to maturity), the fact that the "debt" is held by Jones Corporation's sole shareholder, and whether payments on the instrument are made when due.[20]

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complete discussion of substance-over-form in tax law is beyond the scope of this Article. For some further discussion on this topic, *see, e.g.*, Joseph Isenberg, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982); Jeffrey L. Kwall & Kristina Maynard, *Dethroning King Enterprises*, 58 TAX LAW. 1, 11 - 15 (2004); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365 (1988); Lewis R. Steinberg, *Form, Substance, and Directionality in Subchapter C*, 52 TAX LAW. 457 (1999).

[15] BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 4.01 (2d ed. 1989).

[16] *Id.* ¶ 4.01[2] ("Section 163(a) allows the payor corporation to deduct 'all interest paid or accrued within the taxable year on indebtedness,' but no comparable deduction is allowed for distributions to the corporation's shareholders.").

[17] *Id.*

[18] *See, e.g.*, Bauer v. Comm'r, 748 F.2d 1365, 1367–68 (9th Cir. 1984) ("The determination of whether an advance is debt or equity depends on the distinction between a creditor who seeks a definite obligation that is payable in any event, and a shareholder who seeks to make an investment and to share in the profits and risks of loss in the venture."); Tomlinson v. 1661 Corp., 377 F.2d 291, 299 (5th Cir. 1967); John Lizak, Inc. v. Comm'r, 28 T.C.M. (CCH) 804, 807 (1969); Schnitzer v. Comm'r, 13 T.C. 43, 60 (1949).

[19] *See Bauer*, 748 F.2d at 1367–68.

[20] *Id.* at 1368.

When substance matters, the IRS will often prevail if it argues that a transaction should be characterized consistently with its substance.[21] In the example above, if Jones Corporation deducts interest payments because the instrument was labeled "debt" and the IRS challenges this treatment citing to substantive factors such as thin capitalization, a very long term to maturity, and a history of payments not being made when due, the IRS's challenge likely will be successful.[22]

Whether an instrument is debt or equity for tax purposes is not the only determination that depends on substance. As another example, the analysis of whether an arrangement represents a partnership for tax purposes also depends upon substantive factors. Thus, the courts will not look solely to whether the parties file a partnership tax return or label their arrangement as a partnership. Instead, a partnership exists for tax purposes if the parties intend their arrangement to constitute a partnership.[23] To determine the parties' intent, courts will examine not merely formal indicia of the parties' intent (such as the labels used by the parties and returns and other paperwork filed by the parties) but also underlying substantive factors.[24] Substantive factors that tend to indicate the existence of a partnership among several parties include the exercise of joint control by the parties over operations,[25] sharing of profits[26] and

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[21] *See, e.g.,* Baillif, *supra* note 12, at 289 ("[T]he Service is routinely granted the right to look beyond the form of a transaction or its label on a tax return . . . ."); Harris, *supra* note 14 at 89 ("[T]here is little doubt that the government has the general authority to look through the form of a transaction to its substance in determining the tax consequences of a transaction.").

[22] *See supra* notes 18 - 20 and accompanying text.

[23] *See*, *e.g.*, Culbertson v. Comm'r, 337 U.S. 733 (1949).

[24] *See*, *e.g.*, Underwriters Insurance Agency v. Comm'r, T.C. Memo 1980-92 (1980) (holding that the arrangement between the parties was a partnership despite the fact that title to partnership property was held in the names of the individual partners rather than in the name of the partnership and stating, "We think [the taxpayer] has confused the issue of intent with the issue of label. The lack of a partnership label does not necessarily show a lack of intent to form a partnership. Whether or not the requisite intent exists is predicated on the presence or absence of evidentiary factors suggesting the joint carrying on of a business for profit.")

[25] *See*, *e.g.*, Luna v. Comm'r, 42 T.C. 1067, 1078 (1964) (mentioning the presence of mutual control as a relevant factor and concluding that an arrangement involving the sale of life insurance policies was not a partnership, in part, because the taxpayer had no control over the issuance of the policies); Mayer v. Comm'r, T.C. Memo 1954-14 (1954) (holding that the taxpayer was a creditor of a liquor store and not a partner, in part, because the taxpayer had no control over operations, in particular, stating, "Petitioner denied that she had any voice in the management or control of the stores. She denied

sharing of losses among the parties,[27] and the contribution to the venture of capital or services by the parties.[28] If a taxpayer adopts the partnership label for an arrangement, but the underlying substantive factors suggest that the arrangement is not, in fact, a partnership for tax purposes, the IRS can successfully assert that the arrangement should be characterized based on its substance.

B. The Non-Disavowal Doctrine

In the first example above, if Ms. Jones labels the instrument "debt" and claims, for tax purposes, that it is debt, but the substantive factors suggest that the instrument is equity, the IRS can challenge her characterization and successfully assert that the instrument is, in fact, equity for tax purposes. However, if Ms. Jones labels the instrument "equity" but claims, for tax purposes, that the instrument is, in fact, debt based on substantive factors, her claim could likely fail. The same is true for any taxpayer asserting that substance prevails over form in any area of tax law. In other words, a taxpayer will face significant opposition when arguing that a transaction should be characterized not in accordance with the form that the taxpayer adopted but rather by its true substance.[29]

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that she had any authority to act for them. There was no showing that she worked in the stores or had anything to do with their operation. … We believe that the lack of petitioner's services or management activities refutes the existence of a partnership with her as a partner.").

[26] *See*, *e.g.*, *Luna*, 42 T.C. at 1078 (listing factors relevant to the partnership analysis and including on the list whether the parties share an interest in net profits).

[27] *See*, *e.g.*, *Luna*, 42 T.C. at 1078 (including on the list of relevant factors whether the parties had an obligation to share losses and concluding that the taxpayer was not a partner, in part, because the taxpayer had no obligation to share losses).

[28] *See*, *e.g.*, Kelly v. Comm'r, T.C. Memo 1970-250 (1970) (holding that the taxpayer was not a partner, in part, because the taxpayer did not contribute any capital to the venture, and, unlike the partners in the venture, the taxpayer was not required to devote any time or render any services to the partnership).

[29] *See*, *e.g.*, Baillif, *supra* note 12 at 289 ("Although the Service is routinely granted the right to look beyond the form of a transaction or its label on a tax return, a taxpayer's right to assert the same privilege is, at best, uncertain."); Blatt, *supra* note 12 at 384 ("The principle that the government alone may appeal to the substance of a transaction pervades federal tax law. Every taxpayer seeking to disavow the form of a transaction must consider the possibility that substance arguments create a one-way street in favor of the government."); Donaldson, *supra* note 14 at 42 ("A considerable body of thought exists that the doctrine of substance is a sword available to the Commissioner, but that it may not be used as a shield by the taxpayer….While this homely bit of wisdom has much present currency, it is not wholly accurate as a matter of over-all case analysis."); Harris,

Courts' resistance to taxpayers' attempts to rely upon the substance-over-form doctrine has been referred to as the "Non-Disavowal Doctrine",[30] aptly named because it limits a taxpayer's ability to disavow the form that he or she chose.

The Non-Disavowal Doctrine can be illustrated by the facts and holding of *Maletis v. U.S.*[31] In *Maletis*, the taxpayer established an entity to operate a wine making business.[32] In form, the entity was owned by the taxpayer and his two sons because paperwork had been filed with the IRS and with state authorities indicating that the entity was owned by the three individuals and that all three had made contributions to the entity.[33] In substance, the entity was owned only by the taxpayer. His sons had not, in fact, made the claimed contributions to the entity and, apparently, had no real involvement in the business.[34] Thus, the arrangement lacked a number of the substantive factors that would indicate the existence of a partnership, such as contributions by the two sons of capital or services and joint control by the father and his two sons over business operations.[35]

In years when the business was profitable, the taxpayer filed tax returns in accordance with the form of the arrangement (in other words,

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supra note 14 at 89 ("[T]here is also a fundamental notion that where the taxpayer, and not the government controls the facts, the taxpayer should be restricted in its ability to assert that the substance and not the form controls for tax purposes…"); Nickolas J. Kyser, *Substance, Form, and Strong Proof*, 11 AM. J. TAX POL'Y 125, 125 – 26 (1994) ("The notion that tax consequences should flow from the substance rather than the form of transactions has been accepted by most courts….As one might expect, the courts have been rather skeptical about the use of this idea by taxpayers, who were in position to control the original form of the transaction and whose protestations that something else was intended are likely to be affected by the selectiveness of self-interested memory."); Smith, *supra* note 14 at 137 ("The Commissioner clearly is entitled to invoke [the substance over form principle], but a taxpayer's right to do so is problematic. At times, the courts have accepted a taxpayer's assertion of the priority of substance. At other times, however, they have concluded that a taxpayer is bound by the form of his transaction.")

[30] *See*, *e.g.*, Harris, *supra* note 14 at 89 (referring to this concept as the "Taxpayer Non-Disavowal Principle"); Smith, *supra* note 14 at 138 (referring to this concept as the "Non-Disavowal Principle").

[31] 200 F.2d 97 (9th Cir. 1952).

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] For discussion of the determination of whether an arrangement constitutes a partnership for tax purposes, *see supra* notes 23 - 28 and accompanying text.

the tax returns were consistent with the entity being a partnership owned by three individuals).[36] As a result, in years in which the business generated taxable income, that income was reported in part by the taxpayer and in part by his sons.[37] Presumably because the sons were subject to lower effective tax rates than the taxpayer, this reporting led to less total tax liability than what would have been the case had all taxable income been reported by the taxpayer.[38]

In a subsequent year in which the business generated a loss, the taxpayer claimed that, in substance, the business was owned entirely by him and not by a partnership in which his sons were partners.[39] As a result, the taxpayer asserted the right to deduct the entire tax loss, leading to lower tax liability given his sons' lower effective tax rates than what would have resulted had the tax loss been shared among the taxpayer and his sons.[40] The IRS challenged this treatment asserting that the taxpayer should be bound by the form he previously selected – that of a partnership.[41] The court held in favor of the IRS.[42] Thus, the taxpayer was prevented from disavowing the form he selected and was required to report tax consequences based on form rather than substance.

Although the taxpayer in *Maletis* did not prevail, taxpayers do not always lose when they invoke the principle that substance prevails over form. Taxpayers who succeed, oftentimes, are able to provide a non-tax explanation for the form they selected. Consider, for example, *Comm'r v. Proctor Shop*.[43] In *Proctor Shop*, a corporation received an advance from the father of the corporation's president.[44] In exchange, the corporation issued an instrument that it labeled "debenture preferred stock."[45] The corporation adopted this "preferred stock" label in lieu of labeling the instrument "debt" to avoid an adverse effect upon the credit rating of the corporation.[46] However, the father who advanced the funds was unwilling

[36] 200 F.2d 97 (9th Cir. 1952).
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] 82 F.2d 792 (9th Cir. 1936).
[44] *Id.*
[45] *Id.*
[46] *Id.*

to accept an instrument that was, in substance, stock because he aimed to receive a definite return on the funds that he provided.[47] The corporation treated the instrument as debt for tax purposes and claimed a deduction for interest paid on the instrument.[48] The IRS challenged this treatment, and the court held in favor of the corporation.[49] Thus, a taxpayer was able to disavow the "stock" label it had adopted and characterize the instrument, instead, based on its underlying substance. That taxpayer's success was likely attributable to its ability to provide a convincing non-tax explanation for why it had adopted a form (stock) that differed from the instrument's substance (debt). In particular, the aim of protecting its credit rating induced the taxpayer to select this form.

Similarly, in *Jones Syndicate v. Comm'r*, the taxpayer labeled an instrument "preferred stock," despite the fact that the instrument was debt in substance, in order to avoid a conflict with state usury laws.[50] The taxpayer characterized the instrument as debt for tax purposes and claimed interest deductions for payments made on the instrument.[51] The IRS challenged the claimed interest deductions, asserting that the instrument ought to be treated as equity for tax purposes, and the court held in favor of the taxpayer.[52] As a result, once again, a taxpayer successfully invoked the substance-over-form doctrine in circumstances in which the taxpayer could provide a non-tax justification for the form selected (namely avoiding usury laws).[53]

As discussed, taxpayers who successfully assert that a transaction's

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[47] *Id.*

[48] *Id.*

[49] *Id.* For additional discussion of the fact that the tax treatment of a transaction may differ from its non-tax treatment, *see* Grace Soyon Lee, *What's In a Name?: The Role of Danielson in the Taxation of Credit Card Securitizations*, 62 BAYLOR L. REV. 110, 112 (2010) ("[W]hen the Code discusses 'form,' it means form as used for tax purposes and not form as used in other areas, such as accounting.")

[50] 23 F.2d 833 (7th Cir. 1927).

[51] *Id.*

[52] *Id.*

[53] For other cases in which taxpayers win and can provide a non-tax explanation for the form that they selected, *see*, *e.g.*, U.S. v. Title Guarantee & Trust Co., 133 F.2d 990 (6th Cir. 1943); E.C. Gatlin v. Comm'r, 34 B.T.A. 50 (1936); Comm'r v. Bollinger, 485 U.S. 340 (1988); Rev. Rul. 78-397; Jones v. U.S., 659 F.2d 618 (5th Cir.1981). In some cases, taxpayers' attempts to assert that substance should prevail over form succeed even though the taxpayer cannot provide a non-tax explanation for the form selected. For an overview of the case law, *see*, *e.g.*, Blatt, *supra* note 12.

substance should prevail over its form, oftentimes, are able to provide a non-tax explanation for the form they selected. In some cases, the non-tax explanation is a non-U.S. tax explanation. In other words, the taxpayer selected a given form because it provided tax benefits in a non-U.S. jurisdiction. For example, in one such transaction, a U.S. corporation ("Parent") owned stock in a non-U.S. corporation ("Subsidiary").[54] To obtain tax benefits in the non-U.S. jurisdiction in which Subsidiary was organized, Subsidiary needed to declare and pay a cash dividend to Parent which Parent would then re-invest in Subsidiary in exchange for additional stock in Subsidiary.[55] If it was characterized based on its form for U.S. tax purposes, this arrangement would be treated as involving two separate transactions – a distribution of cash (which would be taxable as a dividend) and a contribution of cash to the corporation.[56] The taxpayer successfully obtained a ruling indicating the arrangement would be characterized based on its substance for U.S. tax purposes.[57] As a result, the separate steps (the distribution of cash and the contribution of cash in exchange for additional stock) were disregarded, and the transaction was treated as involving simply an increase in the stock held by Parent, a transaction that is not taxable for U.S. tax purposes.[58]

In summary, based on the Non-Disavowal Doctrine, a taxpayer will often lose when he or she attempts to disavow the transactional form that he or she selected and assert that the transaction should be taxed, instead, based on its underlying substance. Taxpayers do not, however, invariably lose in such cases. When a taxpayer successfully invokes the substance-over-form doctrine, the taxpayer is often able to provide a non-tax (or, at least a non-U.S. tax) explanation for the form that he or she selected.

C. A Related Concept: The Actual Transaction Doctrine

To further clarify the contours of the Non-Disavowal Doctrine, it is useful to distinguish it from a related, but distinct, judicial doctrine that has been referred to as the "Actual Transaction Doctrine."[59] The Actual

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[54] PLR 9835011.

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] *Id.* For a similar ruling, see Rev. Rul. 80-154.

[59] For additional discussion of the Actual Transaction Doctrine, *see*, *e.g.*, Bailiff, *supra* note 12 at 310 – 311; Emanuel S. Burstein, *The Impact of Form, and Disavowing Form, on*

Transaction Doctrine becomes relevant when a taxpayer can select among different transactional forms that lead to different tax consequences despite the fact that they all have the same underlying substance. In such a situation, the Actual Transaction Doctrine stands for the proposition that the 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.

The Actual Transaction Doctrine has relevance because, although the underlying substance determines the tax consequences of many transactions, the form of a transaction also has significance. A transaction with a given underlying substance can often be embodied in a variety of forms. Further, the tax consequences of one form may differ from the tax consequences of others. The taxpayer's chosen form will govern the resulting tax consequences when multiple forms lead to different tax consequences and when the forms are equally true to the transaction's underlying substance. Because the form selected is consistent with the transaction's substance, the IRS cannot challenge the selected form based on the substance-over-form doctrine.

The Actual Transaction Doctrine applies when form controls.[60] In cases involving the Actual Transaction Doctrine, the taxpayer attempts to claim tax results that would have followed from a form other than the one actually chosen. In such a case, the IRS can invoke the Actual Transaction Doctrine to defeat the taxpayer's claim.[61]

The Actual Transaction Doctrine can be illustrated by the facts and holding of *Glacier State Electrical Supply Co. v. Commissioner*.[62] To simplify the facts somewhat, in *Glacier State*, two individuals, "Exiting Shareholder"

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 (2012); Harris, *supra* note 14 at 106 – 08; Smith, *supra* note 14 at 141 - 43.

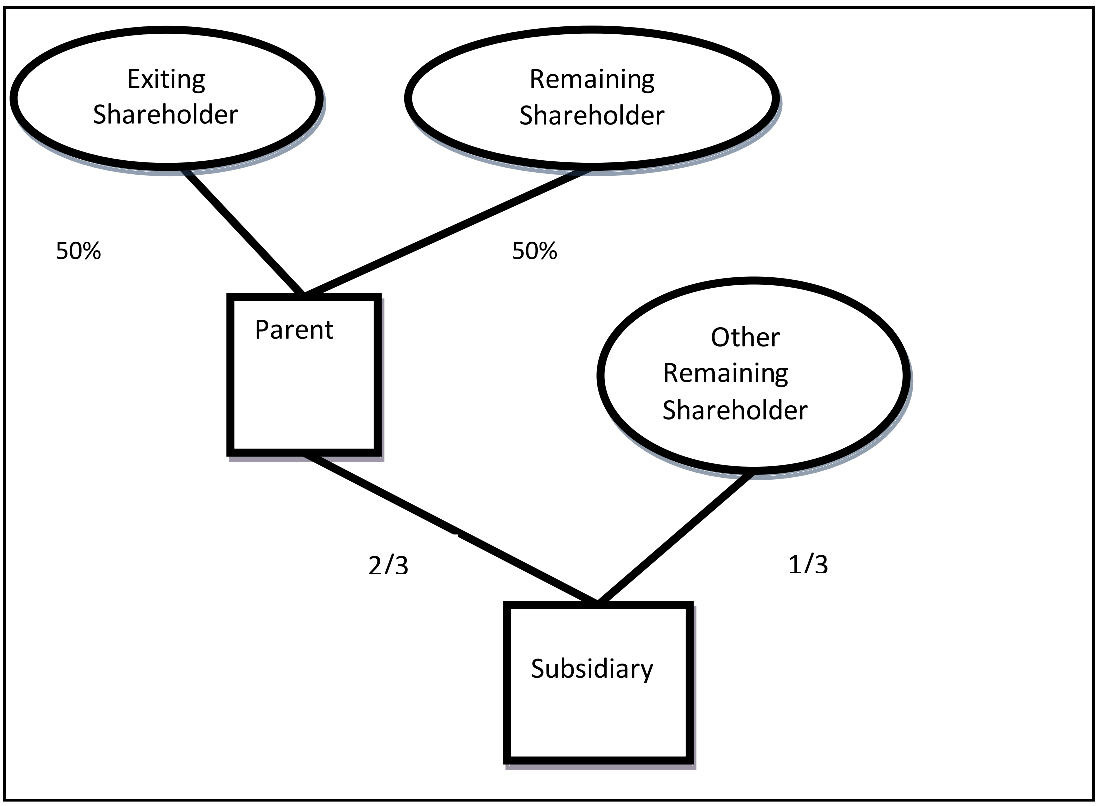
[60] *See also* Baillif, *supra* note 12 at 311 ("[T]he actual transaction principle does not pertain to a controversy about form versus substance. Instead, the principle applies when both the form and substance of a transaction correspond, but when a taxpayer argues for tax treatment based on a different transaction which she might have undertaken but did not.").

[61] *See* Baillif, *supra* note 12 at 310–11.

[62] Glacier State Elec. Supply Co. v. Comm'r, 80 T.C. 1047, 1049–54 (1983).

and "Remaining Shareholder," each owned 50% of the stock of Parent, an entity treated as a corporation for tax purposes.[63] In turn, Parent owned two-thirds of the stock of Subsidiary, another entity treated as a corporation for tax purposes.[64] The remaining one-third of Subsidiary's stock was owned by "Other Remaining Shareholder," a third individual.[65] This ownership structure is illustrated in Figure 1.

FIGURE 1. GLACIER STATE OWNERSHIP STRUCTURE



Upon Exiting Shareholder's death, Subsidiary redeemed one-half of the stock in Subsidiary held by Parent in exchange for a check and a note.[66] Parent, in turn, transferred the check and the note to Exiting Shareholder's

[63] *Id.* at 1049
[64] *Id.*
[65] *Id.*
[66] *Id.* at 1050 – 51.

estate to redeem the Parent stock held by Exiting Shareholder.[67] Under the tax law in effect at the time, the transaction undertaken by the parties led to less favorable tax consequences than an alternative, equivalent transaction.[68] In particular, the parties would have achieved more favorable tax consequences if Parent had first distributed half of its Subsidiary stock to Exiting Shareholder's estate in liquidation of Exiting Shareholder's interest in Parent and then subsequently Subsidiary had redeemed the Subsidiary stock held by Exiting Shareholder's estate.[69]

After the transaction was completed, the taxpayers claimed the tax consequences that would have resulted from the alternative transaction.[70] The court rejected the taxpayers' argument, relying on the Actual Transaction Doctrine.[71] The court stated, "in essence [the taxpayers are] merely arguing that since the transaction would have been nontaxable if cast in another form, we should grant similar treatment to the form [they] utilized. This we cannot do."[72]

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[67] *Id.*

[68] Both the stock in Parent that Exiting Shareholder held, and the stock in Subsidiary that Parent held, had built-in gains. As a result, the form of the transaction utilized by the parties resulted in recognition of two levels of gain for tax purposes. First, Parent recognized a tax gain upon receipt of a check and a note with a value that exceeded Parent's basis in the Subsidiary stock, and, second, Exiting Shareholder's estate recognized a tax gain upon receipt of a check and a note with a value that exceeded Exiting Shareholder's basis in the Parent stock. By contrast, if the parties had utilized the alternate form of the transaction, only one level of tax gain would have been recognized. The transaction occurred before the repeal of the "General Utilities" doctrine. Therefore, under the law in effect at the time, Parent would not have recognized any gain as a result of distributing the Subsidiary stock to Exiting Shareholder's estate, and Exiting Shareholder's estate would have obtained a fair market value basis in the Subsidiary stock. Exiting Shareholder's estate would have recognized one level of tax gain on the Parent stock when Exiting Shareholder's estate received Subsidiary stock with a fair market value that exceeded Exiting Shareholder's basis in Parent stock. However, because Exiting Shareholder's estate obtained a fair market value basis in Subsidiary stock, Exiting Shareholder's estate would not recognize any further tax gain upon receiving a check and a note in redemption of the Subsidiary stock. Structured in this manner, only the tax gain built into the Parent stock would be recognized, as opposed to both the tax gain built into the Parent stock and the tax gain built into the Subsidiary stock.

[69] *See supra* note 68.

[70] *Glacier State*, 80 T.C. at 1054.

[71] *Id.* at 1057–58.

[72] *Id.* at 1058. For other cases that apply the actual transaction doctrine, see Abrams v. United States, 797 F.2d 100, 105 (2d Cir. 1986); Television Indust., Inc. v. Comm'r, 284

Both the Actual Transaction Doctrine and the Non-Disavowal Doctrine prevent taxpayers from claiming tax consequences other than the consequences that follow from the form that the taxpayer selected. However, although the two doctrines serve similar functions, they apply in slightly different situations. In particular, when the Actual Transaction Doctrine applies, neither the taxpayer nor the IRS is able to argue for tax consequences other than the consequences that follow from the taxpayer's selected form. By contrast, when the Non-Disavowal Doctrine applies, the taxpayer would not be able to argue for tax consequences other than those following from the form selected by the taxpayer, but the IRS would be permitted to do so based on the substance-over-form doctrine.

In *Glacier State*, for instance, the alternative form later claimed by the taxpayer was no more true to the transaction's underlying substance than the form actually used by the taxpayer. Consequently, the IRS would not be able to impose the tax consequences that would have followed from the alternative form once the taxpayers selected the form actually used. Because of this, the Actual Transaction Doctrine, rather than the Non-Disavowal Doctrine, applies to prevent the taxpayers from claiming the tax consequences that would have followed from the alternative form once the taxpayers have selected the form actually used.

By contrast, in *Maletis*, for example, the taxpayer selected a form (the business being owned by a partnership in which the taxpayer and his sons were partners) that differed from the transaction's substance (the business was, in substance, owned by only the taxpayer), as discussed above.[73] Because the transaction's substance differed from the form selected by the taxpayer, if the taxpayer claimed tax consequences based upon the transaction's form, the IRS could challenge successfully the claimed tax consequences based on the substance-over-form doctrine. As a result, when the taxpayer claims tax consequences based on the transaction's substance, the taxpayer's assertion fails as a result of the Non-Disavowal Doctrine – not the Actual Transaction Doctrine.

F.2d 322, 325 (2d Cir. 1960); Lane v. United States, 535 F. Supp. 397, 401 (S.D. Miss. 1981); Dyess v. Comm'r, 65 T.C.M. (CCH) 2717, 2725 (1993); Battaglia v. Comm'r, 42 T.C.M. (CCH) 817, 822–23 (1981).

[73] *See supra* notes 31 - 42 and accompanying text.

II. Potential Justifications for The Non-Disavowal Doctrine

As discussed above, the Non-Disavowal Doctrine prevents a taxpayer from disavowing the transactional form that he or she selected and asserting that a transaction should be taxed, instead, based on its underlying substance.[74] This part will describe and evaluate potential rationales that might explain the Non-Disavowal Doctrine. In particular, this part will discuss three potential rationales.[75] First, the doctrine might

[74] *See supra* Part I.

[75] The Non-Disavowal Doctrine, in some circumstances, could serve other goals in addition to the three analyzed below. One such goal is encouraging consistent reporting among the parties to a transaction. If one party reports tax results in a manner that is inconsistent with the form actually used, he or she may also report tax consequences in a manner that is inconsistent with the way other parties to the transaction report tax consequences should they report tax consequences in a manner consistent with the form actually used. Yet, in some cases, this inconsistency will not occur because all parties to the transaction will seek to report results consistent with the substance rather than the form of the transaction. A second concern that can justify the Non-Disavowal Doctrine, in some circumstances, is that one party to a transaction could be unjustly enriched at the expense of another party to the transaction if the parties established the terms of the transaction on the assumption that tax results would be reported based on the form actually used and results are, instead, reported based on the transaction's substance. Although this may be a concern in some circumstances, as others have suggested, such unjust enrichment could perhaps best be addressed in a private civil action between the parties to the transaction. *See, e.g.*, Baillif, *supra* note 12 at 309–10. Furthermore, concerns regarding unjust enrichment are mitigated in situations in which all parties agree to report results consistently with substance because, in such situations, presumably no party would agree to the alternative reporting unless the party was adequately compensated for doing so. A third potential rationale for the Non-Disavowal Doctrine is avoiding inconsistent reporting by a taxpayer over time. In particular, without the doctrine, a taxpayer might report results based on the form actually used in some years and results based on substance in other years. This rationale, however, would not apply if a taxpayer had never reported results based on the form actually used. Moreover, a separate taxpayer consistency doctrine would apply in cases of inconsistent reporting, even absent the Non-Disavowal Doctrine. For further discussion of the taxpayer consistency doctrine, *see infra* note 97 and accompanying text. Fourth, others have justified the Non-Disavowal Doctrine based simply on the fact that the taxpayer was able to chose the transactional form used and, therefore, should be bound to it. *See*, *e.g.*, Donaldson, *supra* note 14 at 42 ("The rationalization supporting [the view that substance-over-form may not be invoked by the taxpayer] is that, since the taxpayer is originally free to choose the form, the Commissioner may appropriately be heard to say that the form does not comport with substance, but the taxpayer may not be heard to deny on hindsight the freely chosen form."). This rationale, however, begs the question of why having a choice justifies the result that the taxpayer is held to its chosen form. Finally, the

be explained on evidentiary grounds. Specifically, when the form selected by a taxpayer does not serve his or her tax interests, the form might provide credible evidence of how the taxpayer viewed a given transaction which could be relevant when a court must determine the transaction's underlying substance. Second, the Non-Disavowal Doctrine, in some cases, might be invoked in order to prevent Post-Transactional Tax Planning (a term that is used in this Article to refer to any steps taken by a taxpayer to achieve more advantageous tax results once the economic outcome of a transaction is known). Third, the Non-Disavowal Doctrine might be used in order to penalize taxpayers who engaged in transactions that provided enhanced opportunities for playing the audit lottery. Each of these three potential rationales is discussed, in turn, below.

A. Form as Evidence of a Taxpayer's Intent: Admissions Against Interest

In some areas of tax law, tax consequences depend on the intent of the taxpayer, and the courts determine a taxpayer's intent by examining objective factors. For example, as discussed above, ultimately what controls whether an instrument is treated as debt or equity for tax purposes is whether or not the parties intend the holder of the instrument to be entitled to a definite repayment of a fixed amount; if so, the instrument is debt, and, if not, the instrument is equity.[76] However, all of the relevant facts and circumstances must be examined to determine the parties' intent.[77] These factors include not just formal indicia of intent (such as how the parties label the instrument) but also substantive factors (such as whether the payor on the instrument is thinly capitalized, whether the yield on the instrument is debt-like or equity-like, whether payments have been made when due, and other substantive factors).[78]

Non-Disavowal Doctrine could reduce adjudication costs by sparing courts the task of considering the merits of taxpayers' substance-based characterizations of transactions. However, while the doctrine might reduce adjudication costs, it does so at the cost of imposing an outcome on some taxpayers that is incorrect as a matter of substantive tax law and that serves to trap unwary taxpayers in many cases as discussed below. See *infra* Part III.B.

[76] *See supra* note 18 and accompanying text.

[77] *See supra* notes 19 - 20 and accompanying text.

[78] *See supra* notes 19 - 20 and accompanying text.

Assume a taxpayer provides funding to a business and receives, in exchange, an instrument that the taxpayer labels "debt." If the taxpayer claims, for tax purposes, that it is debt, but the substantive factors suggest that the instrument is equity, the IRS can challenge the taxpayer's characterization and successfully assert that the instrument is, in fact, equity for tax purposes. However, if the taxpayer labels the instrument "equity" but claims, for tax purposes, that the instrument is, in fact, debt based on substantive factors, the taxpayer's claim might fail if the IRS utilizes the Non-Disavowal Doctrine to support a claim that the instrument should be treated as equity for tax purposes based on the label assigned by the taxpayer.

Perhaps this distinction could be explained by evidentiary considerations. In the former case, given that the taxpayer claims debt treatment for tax purposes and the IRS advocates for equity treatment, presumably debt treatment leads to more favorable tax consequences than equity treatment. Therefore, the fact that the taxpayer labeled the instrument "debt" may have been entirely tax-motivated and does not provide credible evidence that the taxpayer intended for the advance to be repaid in a debt-like manner.

In the latter case, given the position of the parties in litigation, it would again seem that debt treatment leads to more favorable tax consequences than equity treatment. Thus, the fact that the taxpayer labeled the instrument "equity" seems to be motivated not by tax considerations and may, instead, provide reliable evidence that the taxpayer intended the instrument to represent an equity-like interest in the business.[79]

To the extent that courts are using the Non-Disavowal Doctrine based on this rationale, however, use of the doctrine is flawed for three significant reasons. First, even if a label that is contrary to a taxpayer's tax

[79] For additional discussion of this rationale, see, Harris, *supra* note 14 at 114 ("[T]axpayers attempts to assert substance over form when the taxpayer followed the form on his original return will likely face difficulties when taxpayer intent is relevant to the analysis….Taxpayer intent may …be relevant under substance-based tax definitions; for example, whether the taxpayer intended to create a debtor-creditor relationship at the time of an advance will bear on whether the advance should be treated as debt or equity for federal income tax purposes. When taxpayer intent at the time a transaction is entered into is relevant to the taxpayer's asserted claim as to the substance of the transaction, the taxpayer's original reporting position ought to be accorded substantial weight in evaluating the taxpayer's intent at that time.").

interests might provide more credible evidence of how that taxpayer viewed an instrument than a label that was consistent with a taxpayer's tax interests, it is not the case that this label should outweigh other evidence (such as the substantive features of the instrument). However, the effect of the Non-Disavowal Doctrine is precisely to allow this one piece of evidence to trump all other evidence. Thus, use of the doctrine subverts the goal of giving correct weight to all reliable evidence.

Second, to determine whether a label may or may not have been tax-motivated, a court will need to assess the taxpayer's expectations for the economic outcome of a transaction as of the time the label was adopted by the taxpayer and not as of the time when tax consequences are reported. It is possible that a taxpayer could label an instrument "equity" for tax-motivated reasons because, based on the taxpayer's expectations for how the business will perform, equity treatment would lead to favorable tax consequences. If the taxpayer's expectations prove to be incorrect, it is possible that debt treatment, in fact, leads to more favorable tax consequences than equity treatment. As a result, the taxpayer might assert that the instrument is, in fact, debt for tax purposes, based on substantive factors. In such a case, if a court, based on the Non-Disavowal Doctrine, holds the taxpayer to equity treatment based on the form selected by the taxpayer, doing so might be based on a different rationale (namely, preventing Post-Transactional Tax Planning, as described below in Part II.B). However, the court should be aware of the fact that invoking the Non-Disavowal Doctrine, in this case, does not serve the goal of properly weighing evidence to discern the true character of the instrument. In particular, in this case, the Non-Disavowal Doctrine gives determinative weight to the label selected by the taxpayer even though that label was likely selected entirely for tax-motivated reasons and, therefore, does not provide credible evidence that the parties intended the instrument to have equity-like features.

Finally, invoking the Non-Disavowal Doctrine based on evidentiary considerations is questionable as a policy matter because its primary effect will be to trap unwary taxpayers.[80] When it is guided by evidentiary considerations, a court will apply the doctrine to a taxpayer who selected a

[80] For additional discussion of this concern, see Bailiff, *supra* note 12 at 298 ("[A] taxpayer may unknowingly adopt a given form of which she remains ignorant until the Service seeks to tax that form, rather than the substance as understood and reported by the unwary taxpayer.")

label that lead to unfavorable tax consequences, based on the theory that such a label is credible evidence of the taxpayer's intent. Taxpayers who select such labels will tend to be taxpayers who are ill-advised and lack adequate tax expertise. Thus, invoking the doctrine for evidentiary reasons will disproportionately disadvantage such taxpayers.

In summary, the Non-Disavowal Doctrine cannot be justified by evidentiary considerations. Use of the doctrine does not effectively result in courts considering the most relevant evidence, and using the doctrine for evidentiary purposes will disadvantage only taxpayers who are not sufficiently sophisticated to avoid creating evidence that will be used against them.

B. Preventing Post-Transactional Tax Planning

Typically, a taxpayer engages in tax planning before a transaction has begun. In other words, most tax planning consists of "Pre-Transactional Tax Planning." Consequently, tax planning often occurs when a taxpayer lacks complete information about the economic outcome of a transaction. For example, when a taxpayer engages in tax planning with respect to a given transaction, he or she may predict that the transaction will be profitable but might not know for certain if it will indeed yield any profits. This taxpayer likely engages in Pre-Transactional Tax Planning intended to lead to a favorable tax outcome if the transaction indeed proves to be profitable. If the transaction ultimately generates a loss, the Pre-Transactional Tax Planning undertaken in contemplation of profit may lead to less favorable tax consequences than those that would have resulted from tax planning that was based on an expectation of loss.

"Post-Transactional Tax Planning" occurs after a transaction has commenced and encompasses any steps taken by a taxpayer to achieve more advantageous tax results once the economic outcome of a transaction is known.[81] In the example in the preceding paragraph, Post-Transactional Tax Planning would include any step the taxpayer took to

[81] In an earlier article, I explored the topic of "Post-Transactional Tax Decisions," a term that I used to refer to a broader concept that included not only Post-Transactional Tax Planning (or steps taken by a taxpayer to obtain more favorable tax results once the economic outcome of a transaction is known) but steps taken by a taxpayer to obtain more favorable tax results in response to the acquisition of other new information, such as new information about tax law itself. *See* Cauble, *supra* note 59.

achieve more advantageous tax results after learning that the transaction generated a loss.

One potential rationale for the Non-Disavowal Doctrine is that it prevents Post-Transactional Tax Planning.[82] Considering the facts and holding of *Maletis* will help to illustrate this rationale.[83] As discussed above, in *Maletis*, the taxpayer established an entity to operate a wine making business. In form, the entity was owned by the taxpayer and his two sons. In substance, the entity was owned only by the taxpayer.

In years when the business was profitable, the taxpayer filed tax returns in accordance with the form of the arrangement. As a result, in years in which the business generated taxable income, that income was reported in part by the taxpayer and in part by his sons. Presumably because the sons were subject to lower effective tax rates than the taxpayer, this reporting led to less total tax liability than what would have been the case had all taxable income been reported by the taxpayer.

In a subsequent year in which the business generated a loss, the taxpayer claimed that, in substance, the business was owned entirely by him and not by a partnership in which his sons were partners. As a result, the taxpayer asserted the right to deduct the entire tax loss, leading to lower tax liability given his sons' lower effective tax rates than what would have resulted had the tax loss been shared among the taxpayer and his sons. The IRS challenged this treatment asserting that the taxpayer should be bound by the form he previously selected – that of a partnership. The court held in favor of the IRS.

Providing some insight into a potential rationale for the Non-Disavowal Doctrine, the court stated that without such a rule, "the taxpayer could commence doing business as a corporation or partnership and, if

[82] This rationale has been suggested by others. *See*, *e.g.*, Bailiff, *supra* note 12 at 298 ("[S]ome courts fear that permitting a taxpayer to disavow her own form might invite that taxpayer to engage in post-transactional tax planning. They worry that a taxpayer may decide alternatively to support or impeach a form based upon her post-transactional determination of the resultant tax liability"); Harris, *supra* note 14 at 97; Smith, *supra* note 14 at 144 ("Some cases reflect the concern that permitting a taxpayer to disavow its own form might entitle a taxpayer to engage in post-transactional tax planning and, depending upon his tax circumstance, support or impeach form.")

[83] For discussion of this case, see *supra* notes 31 - 42 and accompanying text.

everything [went] well, realize the income tax advantages therefrom; but if things [did] not turn out so well, [could] turn around and disclaim the business form he created to realize the loss as his individual loss."[84] In other words, one goal of the Non-Disavowal Doctrine is to prevent Post-Transactional Tax Planning.

In particular, the Non-Disavowal Doctrine appears to be intended to address the possibility that taxpayers could intentionally engage in transactions whose form differed from their substance to leave themselves the option of engaging in Post-Transactional Tax Planning once the results of the transaction were known. After the results of the transaction were known, the taxpayer would report results consistent with either form or substance depending on which lead to superior tax results. The diagram shown below in Figure 2 illustrates this pattern in the context of *Maletis*.

[84] *Maletis* at 98.

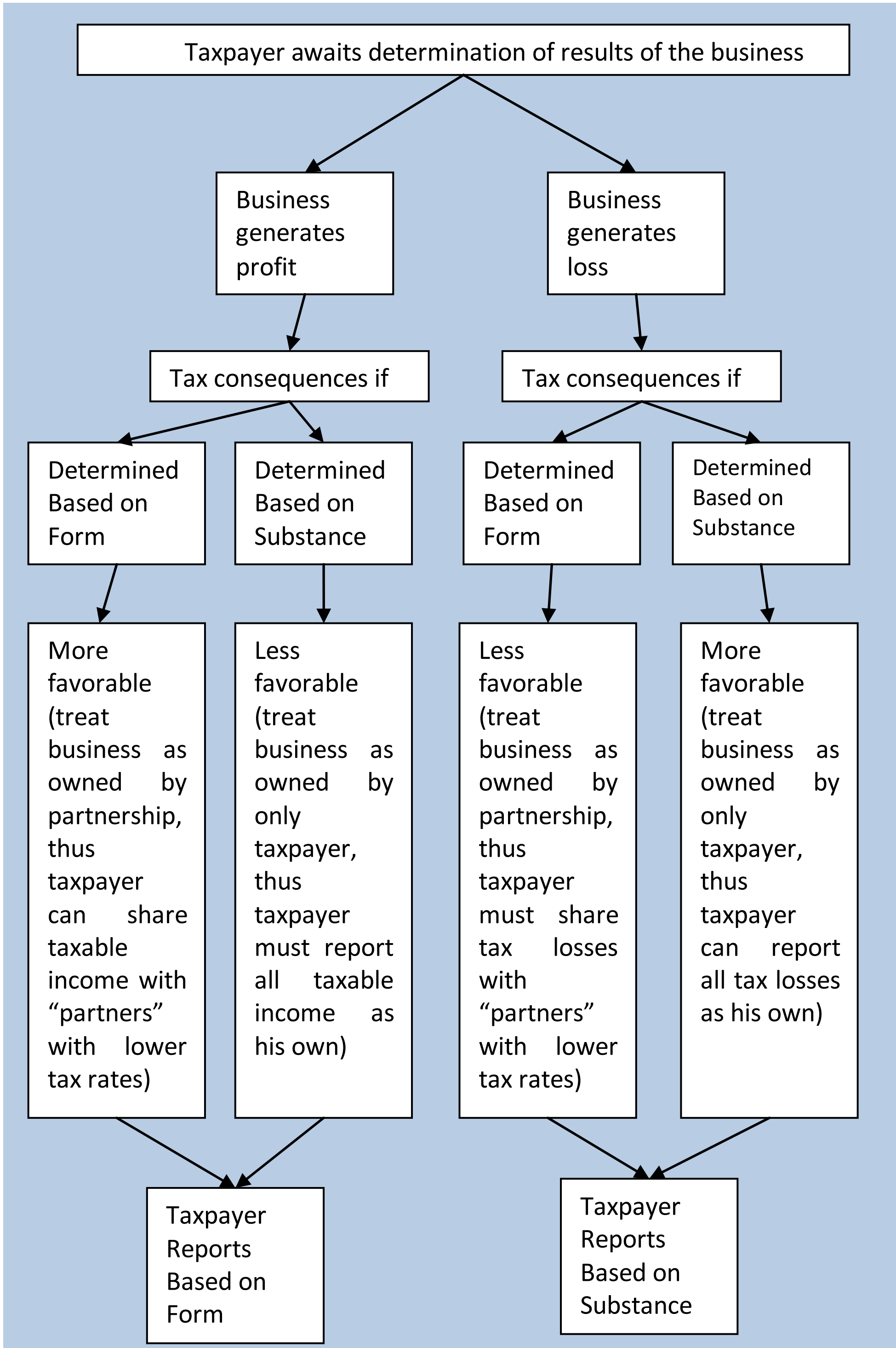

Figure 2. Maletis and Post-Transactional Tax Planning

Courts may seek to prevent Post-Transactional Tax Planning in order to serve three underlying policy goals: (1) preventing tax revenue erosion, (2) promoting fairness, and (3) fostering efficiency. Each of these underlying goals is discussed, in turn, below.

1. Preventing Tax Revenue Erosion

One objection to tax planning, generally, is that it erodes tax revenue.[85] Absent the Non-Disavowal Doctrine, transactions like the one in *Maletis* have the potential to erode tax revenue substantially by allowing a taxpayer to obtain a favorable tax outcome regardless of the economic outcome of a transaction.

In particular, if the Non-Disavowal Doctrine did not exist, taxpayers would have an even stronger incentive to intentionally arrange their transactions so that transactional form differed from substance.[86] Doing so would preserve for the taxpayer the option of reporting results based on either form or substance, whichever led to more favorable tax consequences given the economic outcome of the transaction. In *Maletis*, for example, if the business generated gains, the taxpayer would report the more favorable tax consequences that follow from the form of the transaction. The IRS could, in theory, challenge such reporting under the substance-over-form doctrine. However, as discussed below, the IRS may be unlikely to detect that anything is amiss when a taxpayer reports tax results consistently with form.[87] If the business generated losses, the taxpayer could report results based on substance, and, absent the Non-Disavowal Doctrine, the taxpayer could do so with impunity.

The Non-Disavowal Doctrine protects against tax revenue erosion in two ways. First, in years in which the taxpayer reports results based on substance because doing so results in lower tax liability, the doctrine leads directly to more tax revenue collection by providing the IRS with a basis for imposing the higher tax liability that follows from the transaction's form.

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[85] *See, e.g.*, Blatt, *supra* note 12, at 394 (listing as one goal of the Non-Disavowal Doctrine the need to preserve tax revenue); David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312, 1319 (2001)

[86] This discussion also assumes that the taxpayer consistency doctrine does not exist. For discussion of this doctrine, see *infra* note 97 and accompanying text.

[87] *See infra* Part II.C.

Second, it is possible that the Non-Disavowal Doctrine's existence might, indirectly, increase tax revenue by discouraging taxpayers from arranging their transactions so that form and substance were different. In particular, being held to the form selected might make a taxpayer think twice about selecting a form that differed from the transaction's substance because doing so could result in the taxpayer facing negative tax consequences regardless of the outcome of the transaction. When form and substance are different, in years in which the taxpayer reports tax consequences based on form because doing so leads to lower tax liability, the IRS could impose higher tax liability based on the substance-over-form doctrine. Furthermore, when form differs from substance, the taxpayer also stands to lose in year in which he or she reports based on substance because the IRS can impose the higher tax liability resulting from the form of the transaction based on the Non-Disavowal Doctrine. Faced with the prospect of a losing tax outcome in all cases, the taxpayer might select a form that coincided with the transaction's substance. Doing so ensures that, at least in years in which reporting based on substance (and form) leads to favorable tax consequences, the taxpayer can claim those tax consequences successfully without facing a challenge under the substance-over-form doctrine (because the reported tax consequences are consistent with substance) or the Non-Disavowal Doctrine (because the reported tax consequences are also consistent with form).[88] If the doctrine encourages taxpayers to select transactional forms that are consistent with substance, it protects against tax revenue erosion in years in which reporting based on the alternative form (a form that was inconsistent with substance) would have led to lower tax liability if undetected, and therefore unchallenged, by the IRS.

[88] Whether the Non-Disavowal Doctrine has this second effect of discouraging taxpayers from engaging in *Maletis*-type transactions is not free from doubt. As discussed in more detail in Part II.C., it is possible that taxpayers would still engage in a transaction whose form differed from its substance if the form leads to more favorable tax consequences when the transaction produces its expected economic outcome. Notwithstanding the existence of the substance-over-form doctrine, the taxpayer might plan to report consequences based on the transaction's form when doing so leads to a favorable tax outcome, essentially betting that the IRS will not audit the transaction. The Non-Disavowal Doctrine might not dissuade the taxpayer from selecting a form that differed from substance because the Non-Disavowal Doctrine only affects the taxpayer if he or she reports results based on substance, which the taxpayer does not plan to do unless the transaction's economic outcome is other than what the taxpayer predicts.

2. Promoting Fairness

Tax planning has also been criticized, generally, because of its potential to undermine fairness in the tax system.[89] Particularly if sophisticated, well-advised taxpayers are more likely to engage in tax planning, discouraging tax planning generally can promote fairness.[90] The Non-Disavowal Doctrine lessens the benefits that taxpayers can obtain when they engage in the type of tax planning involved in *Maletis*. Therefore, the doctrine can, to some extent, level the playing field by reducing the advantages achieved by sophisticated taxpayers who engage in tax planning.

3. Fostering Efficiency

Scholars have criticized tax planning, in general, because it potentially creates inefficiency and wastes societal resources.[91] In particular, a taxpayer who engages in tax planning may select a transaction that generates a lower pre-tax return than an alternative transaction, creating less societal wealth than would be produced had the taxpayer chosen a different transaction.[92]

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[89] *See, e.g.*, Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 HARV. J. ON LEGIS. 21, 23 - 24 (2010); Schizer, *supra* note 85, at 1319.

[90] *See, e.g.*, Schizer, *supra* note 85, at 1319 ("Since wealthy and well advised taxpayers have an edge in planning, limiting [tax planning] can lead to a more equitable distribution of tax burdens.").

[91] *See, e.g.*, Field, *supra* note 89, at 22–23 (generally, scholars conclude that tax planning is detrimental to societal welfare); Michael S. Knoll, *Tax Planning, Effective Marginal Tax Rates, and the Structure of the Income Tax*, 54 TAX L. REV. 555, 555 (2001) ("Tax planning not only creates harmful perceptions, it also is frequently harmful in its own right. . . . [T]ax planning leads taxpayers to invest in many projects that they would not undertake solely on the economics."); Schizer, *supra* note 85, at 1319 (stating that limiting tax planning reduces "social waste . . . as taxpayers refrain from tax motivated behavior"); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in Tax Law*, 84 CORNELL L. REV. 1627, 1632 (1999) [hereinafter Weisbach, *Line Drawing*] ("Taxing similar activities differently causes behavioral distortions . . . .").

[92] Additionally, scholars have observed that tax planning is wasteful because the time and resources devoted to tax planning could be put to better, more productive uses. *See, e.g.*, Knoll, *supra* note 91, at 555–56 ("From a societal standpoint, it would be better simply to reduce taxes and redeploy the time and talent devoted to tax planning to other more productive pursuits."); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222 (2002) [hereinafter Weisbach, *Ten Truths*]. ("Nothing is gained by finding new ways to turn ordinary income into capital gain, to push a gain offshore, or to

A numerical example illustrates this effect of tax planning. Assume in one transaction (Transaction A), a taxpayer would earn, over one year, a 14% pre-tax return, but a 12% after-tax return. By contrast, over the same time period, the taxpayer would earn a 15% pre-tax return, but a 10% after-tax return, by engaging in a different transaction (Transaction B). Assume both transactions involve similar risk. If the taxpayer engages in tax planning, he or she will consider tax consequences when evaluating the transactions and will likely opt for Transaction A because it maximizes the taxpayer's private wealth. From a societal standpoint, however, the choice to engage in Transaction A is wasteful. Investing $100 in Transaction A for one year yields a total of $114 instead of the $115 total from Transaction B. If the taxpayer engaged in Transaction A, he or she will pay only $2 in tax for a net profit of $12. When the taxpayer engages in Transaction B, he or she will pay $5 in tax for a net profit of $10. Therefore, although Transaction A generates more individual wealth, the total profit from Transaction A is $1 less than the total profit from Transaction B. These results are summarized in Table 1 below.

Table 1. Numerical Example of Effects of Tax Planning

	TRANSACTION A	**TRANSACTION B**
Pre-Tax Return	14%	15%
Effective Tax Rate	14.29%	33.33%
After-Tax Return	12%	10%
$100 INVESTED FOR ONE YEAR:		
Total Profit	$14	$15
Tax Paid	$2	$5
Profit Retained by Taxpayer	$12	$10

Tax planning would be less prevalent if applicable laws were designed so that tax planning was less beneficial. In the example above, if Transaction A were subject to the same tax rate that applies to Transaction B, taxpayers would not benefit from tax planning. In particular, assume Transaction A is subject to the same 33.33% effective tax rate that applies

generate losses. No new medicines are found, computer chips designed, or homeless housed through tax planning.").

to Transaction B and assume the pre-tax return generated by each transaction equals the pre-tax return shown in Table 1. The result is that Transaction B will generate a higher after-tax return than Transaction A. Specifically, the taxpayer would earn a 9.33% after-tax return by engaging in Transaction A, but a 10% after-tax return by engaging in Transaction B. Thus, the taxpayer will opt for Transaction B because it maximizes the taxpayer's private wealth. Moreover, from a societal standpoint, the selection of Transaction B is also advantageous. By engaging in Transaction B, the taxpayer earns $10 of net profit and pays $5 in tax. Instead, if the taxpayer engaged in Transaction A, the taxpayer would earn $9.33 of net profit and pay $4.67 in tax. Thus, the total profit generated from Transaction B ($10 retained by the taxpayer plus $5 paid in taxes or $15 in total) is more than the total profit that would have been generated from Transaction A ($9.33 retained by the taxpayer plus $4.67 paid in taxes or $14 in total). These results are summarized in Table 2 below.

Table 2. Numerical Example of Effects of Discouraging Tax Planning

	TRANSACTION A	**TRANSACTION B**
Pre-Tax Return	14%	15%
Effective Tax Rate	33.33%	33.33%
After-Tax Return	9.33%	10%
$100 INVESTED FOR ONE YEAR:		
Total Profit	$14	$15
Tax Paid	$4.67	$5
Profit Retained by Taxpayer	$9.33	$10

Notwithstanding the example above, discouraging tax planning has an unclear overall effect on efficiency. In particular, restricting some tax planning might undermine efficiency rather than foster it. Specifically, limiting certain tax planning strategies could encourage taxpayers to refocus their efforts on even more wasteful strategies.[93] For example,

[93] *See, e.g.*, Schizer, *supra* note 85, at 1320 ("[E]ven if some planning is stopped, total planning waste could still increase if those who continue to plan face higher costs."); Weisbach, *Line Drawing*, *supra* note 91, at 1628–30, 1664–71; Weisbach, *Ten Truths*, *supra* note 92, at 239. *See generally* Philip A. Curry et al., *Creating Failures in the Market for Tax Planning*, 26 VA. TAX REV. 943 (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

subjecting Transactions A and B to the same tax treatment will not improve overall efficiency if other available, comparable transactions continue to yield lower pre-tax returns but higher after-tax returns than Transactions A and B.[94]

In summary, the effects that curbing tax planning have on efficiency are generally unclear and dependent on the surrounding circumstances. Likewise, restricting Post-Transactional Tax Planning has unclear

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strategies and (ii) costs arising from taxpayers' search for new tax planning strategies once the existing methods are attacked).

[94] To demonstrate this, Table 3 shows Table 1 modified to include a third possible transaction, Transaction C. If the results of three transactions are as shown in Table 3 and if the transactions involve similar amounts of risk and otherwise are close substitutes for each other, the taxpayer will select Transaction A because it generates the highest after-tax return. From a societal standpoint, this choice is not optimal because Transaction A generates a lower pre-tax return than Transaction B, but Transaction A is preferable to Transaction C from a societal standpoint.

TABLE 3.

	TRANSACTION A	**TRANSACTION B**	**TRANSACTION C**
Pre-Tax Return	14%	15%	13%
Effective Tax Rate	14.29%	33.33%	20%
After-Tax Return	12%	10%	10.40%
$100 INVESTED FOR ONE YEAR:			
Total Profit	$14	$15	$13
Tax Paid	$2	$5	$2.60
Profit Retained by Taxpayer	$12	$10	$10.40

Assume Transactions A and B are subject to the same effective tax rate and that Transaction C is a ready substitute for Transactions A and B. As shown in Table 4, Transaction C generates the highest after-tax return. Consequently, the taxpayer engages in Transaction C, which is wasteful from a societal standpoint. Given that Transaction C's pre-tax return is lower than Transaction A's pre-tax return, discouraging taxpayers from choosing Transaction A forces taxpayers into Transaction C, an even more wasteful transaction, thereby undermining the goal of improving efficiency.

TABLE 4.

	TRANSACTION A	**TRANSACTION B**	**TRANSACTION C**
Pre-Tax Return	14%	15%	13%
Effective Tax Rate	33.33%	33.33%	20%
After-Tax Return	9.33%	10%	10.40%
$100 INVESTED FOR ONE YEAR:			
Total Profit	$14	$15	$13
Tax Paid	$4.67	$5	$2.60
Profit Retained by Taxpayer	$9.33	$10	$10.40

ramifications with respect to fostering efficiency. Discouraging the type of tax planning involved in *Maletis* could prompt some taxpayers to abandon tax planning endeavors altogether and simply select a transaction, and a transactional form, that makes the most sense from a non-tax perspective. However, foreclosing the opportunity to engage in the type of planning involved in *Maletis* might induce other taxpayers to engage in alternative, even more costly tax planning strategies.

4. Summary

Although its effects on efficiency are unclear, preventing Post-Transactional Tax Planning can mitigate tax revenue loss and promote fairness. Because preventing Post-Transactional Tax Planning serves these worthy policy goals, use of the Non-Disavowal Doctrine may be warranted to the extent that it does, indeed, prevent Post-Transactional Tax Planning. As currently applied, however, the doctrine does not accurately sort between taxpayers who are and are not engaged in Post-Transactional Tax Planning. Thus, as proposed in more detail in Part III, if they seek to prevent Post-Transactional Tax Planning, courts ought to modify the manner in which they apply the doctrine to ensure that it serves this function.

C. Penalizing Taxpayers for Planning to Play the Audit Lottery

The facts of *Maletis* also illustrate another rationale that might underlie the Non-Disavowal Doctrine.[95] In *Maletis*, in the years in which the business generated a profit, the taxpayer reported tax consequences based on the form of the transaction. The IRS, if it had been aware of the transaction in time, likely would have been able to successfully challenge this treatment by invoking the substance-over-form doctrine.

However, the IRS may not have audited the particular taxpayer, and, thus, the taxpayer succeeded in claiming incorrect tax consequences based on the form of the transaction. Moreover, given that, oftentimes, indicia of form (such as labels adopted and paperwork filed) may be more apparent and indicia of substance (evidence of the underlying economic features of a transaction, for instance) less apparent, reporting the tax consequences of a transaction in a way that is consistent with the

[95] For discussion of *Maletis*, see *supra* notes 31 - 42 and accompanying text.

transaction's form may be unlikely to attract IRS scrutiny. Therefore, taxpayers like the taxpayer in *Maletis* who report tax consequences that are incorrect but consistent with form might be particularly successful at playing the audit lottery.

If a taxpayer like the one in *Maletis* experiences an unexpected economic outcome that prompts the taxpayer to report tax consequences that are consistent, instead, with substance, the IRS may be more likely to notice the discrepancy and audit the taxpayer. Forcing the taxpayer to report based on form in such a case leads to a result that might be incorrect as a matter of substantive tax law (after all, in *Maletis*, there really was no partnership, but the Non-Disavowal Doctrine had the effect of requiring the taxpayer to report the tax consequences of the transaction in loss years as if there were a partnership). However, imposing an incorrect and unfavorable tax outcome upon the taxpayer might be explained as a penalty for the taxpayer's early reporting that can no longer be penalized directly (if, for instance, challenging reporting in earlier years is barred by the statute of limitations).[96]

More precisely, the Non-Disavowal Doctrine could be described as a means of penalizing a taxpayer for merely structuring a transaction so that it provides an increased opportunity to play the audit lottery even if the taxpayer has never, in fact, had the chance to make use of the opportunity by engaging in inaccurate reporting. If a taxpayer, like the taxpayer in *Maletis*, has, in fact, reported results that were inaccurate in early years based upon the form adopted by the taxpayer, the IRS does not need to rely on the Non-Disavowal Doctrine to prevent the taxpayer from reporting based on substance in later years. Instead, in most cases, the IRS could

[96] A somewhat similar rationale has been offered for the taxpayer consistency doctrine. *See*, *e.g.*, Steve R. Johnson, *The Taxpayer's Duty of Consistency*, 46 TAX L. REV. 537, 539 (1991) (noting that some courts have rejected the taxpayer consistency doctrine based on the concern that the doctrine represents "an impermissible attempt by the Commissioner to circumvent the statute of limitations by recovering, in an open tax period, a deficiency that should have been collected with respect to an earlier period now closed to assessment."). *Id*. at 546 (arguing that this objection to the taxpayer consistency doctrine is unsound because "[t]he consistency doctrine merely allows facts deemed to have been established in a closed tax period to be used in determining tax liability in an open tax period. There is no violation of the statute of limitations because the assessment is made only with respect to the open period."). However, as discussed below, the Non-Disavowal Doctrine potentially penalizes different behavior than what is captured by the taxpayer consistency doctrine. *See infra* note 97 and accompanying text.

make use of another tool – namely, the taxpayer consistency doctrine.[97] The taxpayer consistency doctrine applies when a taxpayer has reported the results of a transaction in an earlier year in an incorrect manner that lead to unduly favorable tax results and the statute of limitations prevents the IRS from challenging the consequences claimed in that earlier year. If the doctrine applies, the IRS can prevent the taxpayer from reporting the results of the transaction in a later year in an manner that is inconsistent with the taxpayer's earlier reporting, even if reporting in that inconsistent manner would more accurately reflect the results of the transaction in that later year. Thus, for instance, in *Maletis*, because the taxpayer reported the results of the transaction as if the business were owned by a partnership in which he and his sons were partners in early years, the taxpayer consistency doctrine would apply assuming that the statute of limitations prevented the IRS from challenging the results claimed in those early years. As a result, in a later year, the IRS could utilize the taxpayer consistency doctrine to prevent the taxpayer from reporting the results of the business as if it were owned by only the taxpayer even if that is a correct characterization of the arrangement based on substantive tax law.

To illustrate the unique function served by the Non-Disavowal Doctrine, imagine facts similar to those in *Maletis* except assume that the business generated tax losses beginning in the very first year of operations. Under those modified facts, the taxpayer would have always reported the results of the transaction based on its substance because doing so would lead to lower tax liability than reporting the results based on the

[97] For discussion of the taxpayer consistency doctrine, *see*, *e.g.*, Stephanie Hoffer, *Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 UTAH L. REV. 317, 319-325; Johnson, *supra* note 96. As summarized by Professor Johnson, courts have not always been consistent in their approach to the taxpayer consistency doctrine. *Id*. at 539 – 544. However, many take the approach of applying the doctrine when three requirements are met. These three requirements are "(1) The taxpayer made a representation of fact or reported an item for tax purposes in one tax year; (2) the Service acquiesced in or relied on that fact for that year; and (3) the taxpayer desires to change the representation, previously made, in a later tax year after the first year has been closed by the statute of limitations". *Id*. at 542. In a case like *Maletis*, if the taxpayer has reported tax consequences in an earlier year based on the form of the transaction, the taxpayer consistency doctrine would ordinarily prevent the taxpayer from reporting the results based on substance in a later year, provided that the statute of limitations prevents the IRS from challenging the results claimed in the early year. If the IRS is still able to challenge the results claimed in the earlier year, then the IRS could do so directly and would not need to rely on the taxpayer consistency doctrine or the Non-Disavowal Doctrine.

transaction's form. In particular, reporting based on the transaction's substance entails treating the business as if it were owned entirely by the taxpayer so that the taxpayer reports all tax losses. Reporting based on the transaction's form involves treating the business as owned by a partnership in which the taxpayer and his sons are partners so that tax losses are shared among the taxpayer and his sons. Given that the taxpayer has a higher effective tax rate than his sons, the former method of reporting leads to lower tax liability.

If the taxpayer has always reported results as if the business were owned solely by the taxpayer, the taxpayer consistency doctrine will not prevent the taxpayer from continuing to report the results in that manner. However, given that the taxpayer reports results that are inconsistent with the form selected by the taxpayer, the Non-Disavowal Doctrine still applies, and, based on this doctrine, the IRS could require the taxpayer to report results based on the form of the transaction, so that the tax losses are shared among the taxpayer and his sons. In such a case, the Non-Disavowal Doctrine does not penalize the taxpayer for playing the audit lottery by reporting results that were wrongly form-driven because the taxpayer has always reported results based on substance. Instead, the Non-Disavowal Doctrine might be viewed as an attempt to penalize the taxpayer for structuring a transaction so that its form differed from its substance in order to enable the taxpayer to play the audit lottery by reporting form-driven results if doing so proved to be beneficial. In the hypothetical variation on *Maletis* just described, for instance, in years in which the business generates losses, the Non-Disavowal Doctrine subjects the taxpayer to an unduly unfavorable tax result as a means of penalizing the taxpayer for his presumed plan to report unduly favorable tax results if the business had generated gains.

To the extent that this line of thinking underlies the Non-Disavowal Doctrine, the effectiveness of the approach is doubtful. It may be that taxpayers give little weight to the possibility that the transaction's outcome will be different than expected (for instance, the taxpayer in *Maletis* might not have considered the possibility of losses).[98] If this is

[98] In the behavioral law and economics literature, for instance, research suggests that people's decisions tend to be affected by "optimism bias" – they underestimate the likelihood of experiencing bad outcomes. *See*, *e.g.*, Daniel Kahneman and Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, in Kenneth J. Arrow, et al, eds, BARRIERS TO CONFLICT RESOLUTION 44, 46-50 (Norton 1995); Christine Jolls & Cass R. Sunstein, *Debiasing*

true, then a penalty that will be imposed only in the event that the transaction's economic outcome is unexpected (in *Maletis*, for instance, the Non-Disavowal Doctrine penalizes the taxpayer only in years in which the business unexpectedly generates losses and not in years in which the business is profitable) may do little to deter the taxpayer from establishing a form that differs from the transaction's substance in order to claim unduly favorable tax consequences in the event that the transaction produces its expected economic outcome. Nevertheless, to the extent that taxpayers give some weight to the possibility that a transaction will produce an unexpected result, the Non-Disavowal Doctrine could have some deterrent effect.

III. Implications for the Contours of the Non-Disavowal Doctrine

As discussed above in Part II, several underlying rationales might support use of the Non-Disavowal Doctrine. However, one rationale, at least, does not survive closer scrutiny. In particular, at first glance, the doctrine might be explained on evidentiary grounds. When the form selected by a taxpayer does not serve his or her tax interests, the form might provide credible evidence of how the taxpayer viewed a given transaction which could be relevant when a court must determine the transaction's underlying substance. However, upon more thorough examination, the Non-Disavowal Doctrine cannot be justified by evidentiary considerations because use of the doctrine does not effectively result in courts considering the most relevant evidence and using the doctrine for evidentiary purposes will disadvantage only taxpayers who are not sufficiently sophisticated to avoid creating evidence that will be used against them.

Secondly, the Non-Disavowal Doctrine, in some cases, might be invoked in order to prevent Post-Transactional Tax Planning. Preventing Post-Transactional Tax Planning serves the worthy policy goals of halting tax revenue erosion and promoting fairness. Therefore, use of the Non-Disavowal Doctrine may be warranted to the extent that it does, indeed, prevent Post-Transactional Tax Planning.

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through Law, 35 J. Legal Stud. 199, 204 - 05 (2006); Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. Chi. L. Rev. 1175, 1182 – 84 (1997). If this is true, a penalty that is imposed only in the event of a bad outcome may have an only muted effect on a taxpayer's behavior.

Finally, the Non-Disavowal Doctrine might be used in order to penalize taxpayers who engaged in transactions that provided enhanced opportunities for playing the audit lottery. The effectiveness of this use of the doctrine, however, is somewhat questionable. The doctrine imposes a penalty only in the event that a transaction produces an unexpected economic outcome. It may be that taxpayers underestimate the possibility that a transaction's outcome will be different than expected. If this is true, then the deterrent effect of the Non-Disavowal Doctrine will be somewhat dampened. Nevertheless, to the extent that taxpayers give some weight to the possibility that a transaction will produce an unexpected result, the Non-Disavowal Doctrine could have some deterrent effect.

In order to serve either of the last two goals, the Non-Disavowal Doctrine must effectively identify taxpayers who are, indeed, engaging in Post-Transactional Tax Planning (or who have established structures that enable them to do so). As currently applied, however, the doctrine does not accurately sort between taxpayers who are and are not engaged in Post-Transactional Tax Planning. Thus, as proposed in more detail in this Part III, courts ought to modify the manner in which they apply the doctrine to ensure that it serves this function. This part will proceed by, first, illustrating how the goal of preventing Post-Transactional Tax Planning might explain certain features of existing case law. Second, this part will propose ways in which courts should modify their application of the Non-Disavowal Doctrine in order to more accurately identify taxpayers who are engaging in Post-Transactional Tax Planning (or who have established structures to enable Post-Transactional Tax Planning).

A. Demystifying Aspects of Court Decisions

As discussed above, in some cases, taxpayers have invoked the substance-over-form doctrine successfully notwithstanding the Non-Disavowal Doctrine.[99] Oftentimes, in a case in which the taxpayer prevails, the taxpayer can provide a non-tax (or, at least, a non-U.S. tax) explanation for why the taxpayer adopted a form that was different from the transaction's substance.[100] For instance, the taxpayer labeled an instrument "equity," even though its substantive features were debt-like,

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[99] *See supra* notes 43 - 58 and accompanying text.
[100] *See supra* notes 43 - 58 and accompanying text.

in order to avoid violating usury laws,[101] or, in some cases, the taxpayer selected a given transactional form because doing so would produce tax benefits in a non-U.S. jurisdiction.[102]

At first glance, it may seem odd that courts are more likely to allow a taxpayer to disavow the form he or she selected in order to obtain more beneficial tax consequences if the form produced non-tax benefits. However, this feature of law could be explained as an attempt by courts to identify taxpayers that are not engaged in Post-Transactional Tax Planning and allow those taxpayers to disavow their selected forms.[103] If a taxpayer engages in a transaction and selects a form that differs from the transaction's substance, the taxpayer's choice of form might generally suggest that the taxpayer planned to leave open the option of engaging in Post-Transactional Tax Planning by reporting the tax consequences of the transaction based on either its form or substance, whichever, in hindsight, led to the most favorable tax consequences. If a given form was selected

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[101] *See supra* notes 50 - 52 and accompanying text.

[102] *See supra* notes 54 - 58 and accompanying text.

[103] This feature of current law might also be explained by some of the other potential rationales for the Non-Disavowal Doctrine. For instance, assume a court deems transactional form to be relevant when it provides evidence of a taxpayer's intent, as discussed above in Part II.A. Assume a taxpayer selects a given form for non-tax reasons. For instance, in order to avoid violating usury laws, a taxpayer labels an instrument "equity" despite the fact that it has debt-like features. The court might conclude that the "equity" label provides no evidence of the taxpayer's intent for the instrument to represent an equity-like instrument given that that taxpayer selected this label solely to avoid usury laws. For a similar observation, *see* Bailiff, *supra* note 12 at 298 ("The given legal form adopted for a transaction may be mandated by various regulatory requirements or business considerations. Such form, however, may not, in truth, reflect the conception of any of the parties involved as to the transaction's essence.") In addition, some courts and commentators have explained the Non-Disavowal Doctrine in a conclusory fashion, arguing that a taxpayer ought to be bound to the transactional form that he or she freely selected. *See supra* note 75. As discussed above, this rationale begs the question of why choice on the part of the taxpayer should lead to the conclusion that the taxpayer is bound to his or her chosen form. *See supra* note 75. If a court, nevertheless, finds this rationale to be persuasive, such a court may be less inclined to hold a taxpayer to the form selected when non-tax factors dictated the chosen form so that the taxpayer, in some sense, did not select it freely. For an explanation along these lines, *see* Donaldson, *supra* note 14 at 48 ("The common thread which unites [a group of cases in which taxpayers successfully assert substance over form] is the factor that the form of the transaction was either not wanted or not controlled by the taxpayer. Thus, the rationalization that taxpayers cannot be heard to complain of the consequences of their choice loses much of its force.")

instead to produce some non-tax benefits (for instance, if an instrument was labeled "equity" to avoid usury laws) that provides an alternative explanation for the taxpayer's chosen form, and the alternative explanation might help to rebut the conclusion that the taxpayer selected a transactional form in order to facilitate Post-Transactional Tax Planning.

This line of reasoning is not entirely illogical. However, this method of analysis will, in many cases, fail to accurately distinguish between taxpayers who are engaging in Post-Transactional Tax Planning and taxpayers who are not doing so, as discussed in detail in Part III.B below. Therefore, as proposed below, courts ought to employ a new, more reliable method of analysis.

B. Courts Should Not Apply the Non-Disavowal Doctrine (and its exceptions) Blindly

As discussed above, when a taxpayer successfully invokes the substance-over-form doctrine, the taxpayer typically can provide a non-tax (or, at least, a non-U.S. tax) explanation for why the taxpayer adopted a form that was different from the transaction's substance. If a taxpayer can provide a non-tax explanation for the form he or she selected, it appears that many courts are convinced that the taxpayer utilized the form for that non-tax reason and not to enable the taxpayer to engage in Post-Transactional Tax Planning. If a taxpayer cannot provide a non-tax (or, at least, a non-U.S. tax) explanation for his or her chosen form, the taxpayer's attempt to assert the substance-over-form doctrine will likely fail as a result of the IRS's use of the Non-Disavowal Doctrine.

This method of analysis is problematic in two respects.[104] First, in some

[104] The current analytical method might also be viewed as problematic because it facilitates regulatory arbitrage (engineering transactions that can be treated one way for purposes of U.S. tax law but treated another way for purposes of other regulatory regimes) or tax arbitrage (engineering transactions that can be treated one way for purposes of U.S. tax law but treated another way for purposes of non-U.S. tax law). The ability to engage in arbitrage, in turn, facilitates tax planning by reducing the frictions that might otherwise inhibit it. In particular, when arbitrage opportunities are available, a taxpayer can achieve his or her U.S. tax planning goals without sacrificing his or her regulatory objectives or non-U.S. tax objectives. Arbitrage might also be problematic if the goals of the U.S. tax system and the other regulatory regime or non-U.S. tax system coincide. In such a situation, if a transaction is characterized differently for different purposes, then the goals of one of the regimes are being undermined. This issue does not

cases, it results in courts mistakenly applying the Non-Disavowal Doctrine to hold taxpayers to their transactional forms even though the taxpayers have not engaged in Post-Transactional Tax Planning and did not intend to engage in Post-Transactional Tax Planning. Some taxpayers may select a given form that differed from a transaction's substance merely because they did not give adequate thought to the resulting tax consequences and did not seek tax advice at the time they selected the form. For instance, a taxpayer might hold an instrument that had debt-like features but label the instrument "equity" in various documents merely because the taxpayer did not evaluate the tax consequences of doing so. It is possible that this taxpayer had no plans to engage in Post-Transactional Tax Planning and would have reported the tax consequences as if the instrument were debt (because it is debt in substance) regardless of the transaction's economic outcome. In other words, even if the transaction's economic outcome was such that characterizing the instrument as equity for tax purposes would lead to more favorable tax consequences, the taxpayer would have faithfully reported the tax consequences as if the instrument were debt. Such a taxpayer has not engaged in Post-Transactional Tax Planning and never had any intentions to do so. Nevertheless, if this taxpayer characterizes the instrument as debt for tax reporting purposes in a year in which equity treatment would lead to more tax liability, the IRS can challenge the taxpayer's reporting based on the Non-Disavowal Doctrine. The taxpayer has no non-tax explanation to offer for the "equity" label that the taxpayer used, and, therefore, the taxpayer would likely lose.

Second, under the current approach, in another set of cases, some taxpayers who are engaging in Post-Transactional Tax Planning, or who did structure their transactions to facilitate Post-Transactional Tax Planning, will, nevertheless, successfully rely upon the substance-over-form doctrine. This is true because a taxpayer could have multiple motives for selecting a given form. For example, a taxpayer could label an instrument that has debt-like features "equity" in order to not only avoid usury laws but also in order to enable Post-Transactional Tax Planning. Perhaps for this reason, in order for a taxpayer to overcome the Non-Disavowal Doctrine, some courts have required that the taxpayer not only provide a non-tax explanation for the form he or she selected but also demonstrate

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arise, however, if the goals diverge so that a transaction could be characterized differently for purposes of different regimes without undermining the goals of either regime.

that he or she has reported the tax results of the transaction based on its substance consistently each year.[105]

However, even a taxpayer who can meet these requirements could, nevertheless, have engaged in Post-Transactional Tax Planning. This is so because it is possible that a taxpayer selects a transactional form that will produce more favorable tax consequences than the transaction's substance based on the taxpayer's predictions, at the time the form is selected, for the transaction's economic outcome. Yet, beginning in the first year in which the taxpayer is required to report the transaction's tax consequences, the transaction produces an unexpected economic outcome so that the taxpayer, even beginning in the first year, reports the transaction's tax consequences based on its substance rather than its form. This taxpayer has engaged in Post-Transactional Tax Planning despite the fact that he or she consistently reports the transaction's tax consequences based on its substance.[106]

In order to demonstrate, consider the following example. A taxpayer holds an instrument that is debt, in substance, but labels the instrument "equity". The taxpayer selects this label for non-tax reasons (perhaps to avoid conflict with usury laws). Based on the taxpayer's predictions for the transaction's economic outcome, characterizing the instrument as equity for tax purposes would also lead to more favorable tax consequences than characterizing the instrument as debt for tax purposes. However, in each and every year, the transaction has produced an unexpected economic outcome, and, as a result, characterizing the instrument as debt for tax

[105] See, e.g., Harris, supra note 14 at 101 ("In a distinct line of cases…, the rule has developed that a taxpayer is entitled to assert that the substance and not form of a transaction controls for tax purposes so long as the taxpayer has honestly and consistently reported the substance of the transaction.")

[106] For this reason, some of the approaches proposed by other commentators would allow some taxpayers to disavow their selected forms even when they are engaging in Post-Transactional Tax Planning. For examples of such proposals, see, e.g., Baillif, *supra* note 12 at 289 – 90 ("The return consistency rule advocates that taxpayers should be bound by the representations made on their tax returns. In the event that those representations differ from the form of a transaction, taxpayers should be granted the right, commensurate with that of the Service, to assert substance over form."); Smith, *supra* note 14 at 165 - 66 ("But the evidentiary and post-transactional tax planning concerns would be minimized or eliminated where the taxpayer is relying solely on contemporaneous conflicting documentary evidence…and reports the transaction in accordance with the substance claimed in the first applicable tax return.")

purposes leads to more favorable tax consequences than treating it as equity. Each year the taxpayer reports the tax consequences as if the instrument were debt. These facts are summarized in Table 5 below.

Table 5. Facts of Post-Transactional Tax Planning Example

Form	Equity
Substance	Debt
Characterization that furthers non-tax aims	Equity
Characterization that would have furthered tax aims if transaction had produced its expected economic outcome	Equity
Characterization that furthers tax aims given that transaction produced an unexpected economic outcome	Debt
How reported by the taxpayer for tax purposes	Debt

In order to determine whether this taxpayer has engaged in Post-Transactional Tax Planning, a court needs to answer the somewhat impossible to answer counterfactual question – if the transaction had produced its expected economic outcome, how would the taxpayer have reported the transaction's tax consequences? If the answer to this question is that the taxpayer would have characterized the instrument as equity, then this taxpayer has engaged in Post-Transactional Tax Planning. If the answer to this question is that the taxpayer would have characterized the instrument as debt, then this taxpayer has not engaged in Post-Transactional Tax Planning.

Under current law, the approach used by many courts implicitly assumes that the taxpayer would have characterized the instrument as debt, provided that the taxpayer can provide a non-tax explanation for the selected form. By contrast, if a taxpayer cannot provide a non-tax explanation, courts assume the worst – that is, they assume that the taxpayer would have characterized the instrument as equity for reporting purposes if doing so led to more favorable tax consequences.

To more effectively guard against Post-Transactional Tax Planning, courts ought to use a different approach. In particular, anytime the form of a transaction differed from its substance, that discrepancy should establish a rebuttable presumption that the taxpayer is engaging in Post-Transactional Tax Planning – reporting the transaction's tax consequences based on either its form or its substance, whichever leads to lower tax liability. Taxpayers could rebut this presumption. However, offering a non-tax explanation for the form he or she selected would no longer be deemed sufficient to rebut the presumption, given that a taxpayer could operate with multiple motives – he or she could have selected the form both for non-tax reasons and in order to facilitate Post-Transactional Tax Planning.

Taxpayers could rebut the presumption in several ways. First, if a taxpayer has consistently reported the transaction's tax consequences based on its substance *even in years in which doing so led to higher tax liability than reporting based on the transaction's form*, the taxpayer should be able to successfully rebut the presumption.[107] Such a taxpayer is not engaging in Post-Transactional Tax Planning given that he or she did not take advantage of the opportunity to claim the more favorable tax consequences that would have followed from reporting the transaction's consequences based on its form. As a result, the Non-Disavowal Doctrine should not prevent the taxpayer from continuing to report the transaction's consequences based on its substance.

Second, if based on all the facts and circumstances, a taxpayer can convince a court that he or she selected a given form simply because he or she was unaware of the tax consequences of a transaction and not adequately advised and if the taxpayer has always reported the transaction's consequences based on its substance, the taxpayer should be able to rebut the presumption that he or she is engaged in Post-Transactional Tax Planning.[108]

[107] Consistent reporting based on substance, alone, is not sufficient to rebut the presumption of Post-Transactional Tax Planning if doing so has always led to lower tax liability that reporting based on form. For further discussion see *supra* notes 105 - 106 and accompanying text. In addition, a court might conclude that the presumption was not rebutted if reporting based on substance in some years had led to only insignificantly higher tax liability than reporting based on form.

[108] Some courts may already use an approach similar to this. *See*, *e.g.*, Frelbro Corp. v. Comm'r, 315 F.2d 784, 786 (2nd Cir. 1963) ("We do not believe that we are obliged, as the government urges upon us, to regard only the form of the transaction and to disregard its substance…. In the absence of any suggestion that tax-avoidance motivated

Third, when a taxpayer engages in a transaction with a form that differs from its substance, the taxpayer ought to be given a new option to file a disclosure with the IRS, contemporaneously with the time the taxpayer initiates the transaction, indicating that the taxpayer plans to report tax consequences based on the transaction's substance. A taxpayer who files such a document should be able to rebut the presumption that he or she was engaging in Post-Transactional Tax Planning and should be allowed (and required) to report the transaction's consequences based on its substance. It is crucial that the filing occur contemporaneously with the time the taxpayer initiates the transaction and not at the time the taxpayer files a return reporting the transaction's tax consequences for the first year. Filing at the time of the return would provide taxpayers with an opportunity to engage in Post-Transactional Tax Planning by awaiting receipt of information about the transaction's economic outcome during the first year before making the decision to report based on substance. It is worth noting that Internal Revenue Code Section 385(c) employs an approach that is somewhat similar to what this Article proposes in the context of the characterization of an instrument issued by a corporation as debt or equity. However, Section 385(c) allows the taxpayer to file a disclosure at the time of return filing rather than when the transaction is initiated. In particular, Section 385(c)(1) embodies the Non-Disavowal Doctrine by providing that, if a corporation characterizes an instrument issued by it as debt or equity, that characterization will bind the taxpayer but not the IRS. Section 385(c)(2) provides that the taxpayer's characterization of the instrument will not necessarily bind the taxpayer if

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the transaction, we believe that this is a case for application of the basic principle that 'the incidence of taxation depends upon the substance, not the form, of the transaction.'") One might object to this proposal on the grounds that an unsophisticated taxpayer could not avail himself or herself of the proposed relief because he or she would not be aware of the opportunity to assert more favorable tax consequences based on the substance of a transaction. In other words, for the same reasons that unsophisticated taxpayers do not seek tax advice prior to engaging in a transaction that would have alerted them to the benefits of structuring a transaction differently and consistently with its substance, they may not learn of the benefits of asserting substance over form after undertaking the transaction. Although this concern has merit, the proposed reforms will assist some unsophisticated taxpayers. In particular, even when unsophisticated taxpayers do not seek tax advice ahead of time, in some cases they will seek advice at the tax return preparation stage because they will be aware of the need to report tax consequences after a transaction occurs. At this stage, advisors could alert them to the benefits of claiming tax consequences based on the substance of a transaction.

the taxpayer discloses, on its return, that it is treating the instrument in a manner that is inconsistent with how the taxpayer characterized the instrument.

Fourth, a taxpayer could rebut the presumption if the form selected by the taxpayer was such that, regardless of the economic outcome of the transaction, reporting based on the transaction's substance would always lead to more favorable tax consequences than reporting based on the transaction's form. In such a case, the taxpayer is not engaging in Post-Transactional Tax Planning because, under no set of facts, would the taxpayer find it advantageous to have the option to report based on form.

Finally, if a transaction will have ongoing tax effects for multiple years and if there is a significant possibility that it will produce a different economic outcome in future years (such that, in future years, reporting the transaction's consequences based on its substance would lead to significantly higher tax liability than reporting based on its form), then the taxpayer should be able to rebut the presumption of Post-Transactional Tax Planning if the taxpayer has consistently characterized the transaction based on its substance for tax reporting purposes.[109] Once the taxpayer reports based on substance, he or she must continue to report based on substance because the taxpayer consistency doctrine requires it. Therefore, if there is a significant likelihood that reporting based on substance in a future year would be highly disadvantageous from a tax perspective, then it seems that the taxpayer's decision to report based on substance did not represent Post-Transactional Tax Planning. This is the case because, if the taxpayer were driven by Post-Transactional Tax Planning considerations, the taxpayer would likely report based on form in the earlier year to preserve the ability to obtain even greater benefits by reporting based on form in later years.

The new analytical approach proposed by this Article would remedy the over-inclusiveness and under-inclusiveness of the approach currently used by many courts. Many courts currently assume that taxpayers who can provide a non-tax explanation for their selected forms are not engaging in Post-Transactional Tax Planning (which results in some

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[109] Consistent reporting based on substance, alone, is not sufficient to rebut the presumption of Post-Transactional Tax Planning if doing so has always led to lower tax liability that reporting based on form. For further discussion see *supra* notes 105 - 106 and accompanying text.

taxpayers who are undertaking such planning slipping through the cracks). At the same time, courts assume that taxpayers who cannot provide a non-tax explanation for their selected forms are engaging in Post-Transactional Tax Planning (which traps many unwary taxpayers who are not). Under the new approach, courts would more accurately identify taxpayers who are engaged in Post-Transactional Tax Planning.[110] Furthermore, by allowing a taxpayer to disavow his or her selected form when the taxpayer is able to demonstrate that he or she selected a given form simply because he or she was unaware of the tax consequences of a transaction, the new approach would level the playing field by providing relief to unsophisticated taxpayers.

CONCLUSION

Pursuant to the Non-Disavowal Doctrine, taxpayers are often bound to the transactional forms that they select and prevented from asserting that their transactions should be characterized, instead, based on their true substance. Use of the Non-Disavowal Doctrine is justified to the extent that it prevents Post-Transactional Tax Planning or penalizes taxpayers for designing transactions to enable Post-Transactional Tax Planning. Under the method currently used by many courts, however, the Non-Disavowal

[110] This Article's focus is on proposing methods with the aim of most accurately determining whether or not taxpayers are engaging in Post-Transactional Tax Planning. It is also true that the current approach under which taxpayers are more likely to succeed when they adopted a given form for non-tax reasons facilitates regulatory or tax arbitrage (or engineering transactions that can be treated one way for purposes of U.S. tax law but treated another way for purposes of other regulatory regimes or non-U.S. tax law). For further discussion of regulatory arbitrage, *see*, *e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (201). A full discussion of whether and when arbitrage is problematic is beyond the scope of this Article. It is worth noting, as a preliminary matter, that in some cases it might not be problematic because a transaction could be treated differently for the purposes of two distinct regimes without undermining the purpose of either regime. In other cases, arbitrage would undermine the purpose of either or both of the regimes and, therefore, would be problematic. It is also worth noting that the ability to engage in arbitrage reduces non-tax impediments to tax planning (or "frictions"). For further discussion of frictions and tax planning, *see*, *e.g.*, Michael Knoll, *Regulatory Arbitrage Using Put-Call Parity*, 15 J. APPLIED CORP. FIN. 64, 73 (2005); Leigh Osofsy, *Who's Naughty and Who's Nice? Frictions, Screening, and Tax Law Design*, 61 BUFF. L. REV. 1057 (2013); Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. CHI. L. REV. 601, 639-41 (2007); Alex Raskolnikov, *Relational Tax Planning Under Risk Based Rules*, 156 U. PA. L. REV. 1181, 1239 (2008); David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312 (2001); Daniel Shaviro, *Risk-Based Rules and the Taxation of Capital Income*, 50 TAX L. REV. 643, 681-83 (1995).

Doctrine is sometimes invoked in cases that do not involve Post-Transactional Tax Planning and is not reliably invoked in all cases that do entail Post-Transactional Tax Planning. In particular, currently many courts implicitly (and, in some cases, inaccurately) assume that a taxpayer is engaging in Post-Transactional Tax Planning if the taxpayer selects a form that differs from a transaction's substance and cannot provide a non-tax explanation for the selected form. At the same time, if the taxpayer can provide a non-tax explanation, many courts automatically (and, sometimes, incorrectly) conclude that the taxpayer has not engaged in Post-Transactional Tax Planning.

To remedy the current misapplication of the Non-Disavowal Doctrine, courts should reform their analytical methods. In particular, anytime a taxpayer selects a form that differs from a transaction's substance that fact ought to establish a rebuttable presumption that the taxpayer plans to engage in Post-Transactional Tax Planning by characterizing the transaction based on either its form or its substance, whichever, in hindsight, leads to lower tax liability. Providing a non-tax explanation for the selected form would no longer be necessary or sufficient to rebut this presumption. Instead, courts should consider other facts that more reliably and convincingly demonstrate a lack of Post-Transactional Tax Planning. If the taxpayer succeeds in rebutting the presumption, the taxpayer should be able to report the consequences of the transaction based on its substance. If the taxpayer cannot rebut the presumption, the Non-Disavowal Doctrine should bind the taxpayer to his or her selected form.