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Creating Failures in the Market for Tax Planning

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CREATING FAILURES IN THE MARKET FOR TAX PLANNING

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I. INTRODUCTION

Although most people recognize the necessity of taxes, few people like to pay them. Governments expend costs to collect taxes; people expend resources to avoid paying them, engaging in tax planning activities that are, for the most part, socially wasteful. The government knows that people will engage in such activities; a benevolent government aiming to maximize social welfare should take the costs of such activities into account when designing tax policy. Tax policy thus best maximizes social welfare if it limits taxpayers' costs incurred in developing and using methods to avoid or minimize taxes[1] while also limiting lost revenue. Our article develops two related normative corollaries of this insight.

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[1] In the literature, some commentators distinguish between tax planning and tax shelters. For our purposes, we assume that all costs of both activities are wasteful social costs. In this regard, David Weisbach argues that tax planning is "almost always positively bad for society." *See* David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222 (2002). Weisbach does discuss arguments to the contrary; those arguments carve out (without precise specification) a category of legitimate tax planning activities. *Id.* at 220 n.1. We consider in Part V how the possibility of some tax planning activity being deemed legitimate might affect our analysis.

In Part II we highlight some stylized facts and working assumptions in order to develop a simple model. In Part III we elaborate our first normative proposition, concerning the government's optimal attitude towards tax planning activities. We suggest that given the tax revenue constraint that governments face, tax policy should be designed keeping in mind the two interrelated costs of tax planning: the costs arising from existing tax planning methods and the costs associated with the taxpayers' search for additional ones. In this article we identify an interesting tradeoff between these two costs.

Our article relates to the existing literature on optimal taxation.[2] In particular, it identifies an additional variable which may be relevant in the application of Samuelson's rule on public good provision. In its simplest form, the Samuelson rule[3] states that when deciding how much of a public good to supply, governments should supply it up to the point where the marginal cost of its provision equals the sum of the marginal benefits across all affected individuals. Scholars have since restated Samuelson's rule explicitly to include among the costs of public good provision the deadweight loss of taxation.[4] In this article we suggest that consideration of these other indirect costs of public good provision may lead to a more lenient attitude towards tax planning activities.

In Part IV we elaborate upon the second normative corollary of our article, concerning the use of governmentally-created market failures to combat tax planning activities. The literature typically discusses traditional legal approaches: increasing expected sanctions by increasing the severity of penalties and/or the likelihood of detection and enforcement. In this article we consider a different conceptual approach. Tax planning can be discouraged *by creating failures in the market for tax planning activities*. In the presence of market failures, the incentives for tax planning may be undermined.

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[2] For a review of the optimal taxation literature, *see* Andrés Erosa & Martin Gervais, *Optimal Taxation in Infinitely-Lived Agent and Overlapping Generation Models: A Review*, 87 J. FED. RES. BANK RICH. Q. 23 (2001).

[3] Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954).

[4] *See*, e.g., Raymond G. Batina, *Public Goods and Dynamic Efficiency: The Modified Samuelson Rule*, 41 J. PUB. ECON. 389 (1990); Robin Boadway & Michael Keen, *Public Goods, Self-Selection and Optimal Income Taxation*, 34 INT'L ECON. REV. 463 (1993); Mario Nava, Fred Schroyen, & Maurice Marchand, *Optimal Fiscal and Public Expenditure Policy in a Two-Class Economy*, 61 J. PUB. ECON. 119 (1996); Dan Usher, *Tax Evasion and the Marginal Cost of Public Funds*, 24 ECON. INQUIRY 563 (1986).

Paradigmatically, legal intervention is aimed at *correcting* market failures; here, we contemplate the possibility that market failures may be purposely created and utilized as instruments of tax policy.[5] We consider the conventional categories of market failure — externalities, asymmetric information, public goods, and monopoly[6] — in light of such a possibility. We consider ways the law might create market failures, and discuss the extent to which any such failure can be used as an instrument to disrupt markets for tax planning.

In Part V we contextualize the analysis, looking at practical applications of our theory of optimal governmental action. We first present two examples in which the government decided to allow particular tax planning methods; we consider the examples in light of our argument that some tax planning *ought* to be allowed. We next explore how the government might create failures in the market for tax planning activities, thereby reducing such activities. We proceed with a critical appraisal of our theoretical framework for feasibility and desirability. In this regard, there have been various developments and proposals along some of the lines we suggest, and we appraise the reactions thereto.

In a companion piece, we set forth a formal economic model to identify the optimal amount of tax planning the government should permit, and the features and effects of our hypothetical governmentally-created market failures.[7]

II. SETTING THE STAGE: OUR ASSUMPTIONS

We begin by noting the obvious: taxes are important to society, but people do not like to pay them.[8] Governments invest resources to collect tax revenue, and people expend resources to find ways to reduce their tax burden. Despite government's best efforts, it is unable to prevent people from developing and using methods to reduce their taxes: legislators are unable to write tax laws that do not

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[5] *See* Dan L. Burk & Brett H. McDonnell, *Patents, Tax Shelters, and the Firm*, 26 VA. TAX REV. 981 (2007) (discussing the desirability of impeding markets in tax planning methods).

[6] *See generally* MICHAEL PARKIN, MICROECONOMICS, 321–82 (7th ed. 2005).

[7] Philip A. Curry, Claire Hill & Francesco Parisi, *Optimal Government Responses to Tax Planning: A Mathematical Model* (draft on file with authors).

[8] While this assumption is commonly held and sufficiently realistic for our purposes, in the real world people have differing attitudes towards paying tax. Some people are more inclined to expend efforts in order to not pay tax, whereas others may feel that it is their civic duty to pay tax. *See* Claire A. Hill, *Tax Lawyers are People Too*, 26 VA. TAX. REV. 1065 (2007).

have "loopholes."

Let us first consider how taxpayers would search for tax planning methods that would exploit loopholes. The greater their expected return, the more effort they would expend. Specifically, the more people believe they can save by finding a new tax planning method (or earn by selling the method to others), the harder they will search.[9]

What can we say about people's expectations of the return to be had? We begin by assuming that tax planning yields diminishing marginal returns. Effort spent on looking for tax planning methods is rewarded, but at a decreasing rate.[10] The benefit available from

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[9] Rent-seeking models study the economic behavior of actors outside the traditional productive, profit-maximizing framework, and they can provide a valuable key for the understanding of the behavior of individuals engaged in tax planning activities. In 1967 Gordon Tullock was the first to study to what extent self-interested parties would incur costs in the pursuit of "rents" (in our application, the rents would be given by tax savings). *See* Gordon Tullock, *The Welfare Cost of Tariffs, Monopolies and Theft*, 5 W. ECON. J. 224 (1967). Tullock's basic model was followed by other formulations by Becker, Krueger, Posner, Demsetz, Bhagwati, Tollison, and many others. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968); Jagdish N. Bhagwati, *Directly Unproductive, Profit-Seeking (DUP) Activities*, 90 J. POL. ECON. 988 (1982); Harold Demsetz, *Economics as a Guide to Antitrust Legislation*, 19 J. LAW & ECON. 371 (1976); Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291 (1974); Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975); Robert D. Tollison, *Rent-Seeking: A Survey*, 35 KYKLOS 575 (1982). Much of the literature focuses on how much effort each player expends and how the degree of rent dissipation varies with the value of the prize. Two quite different positions were reached during the early years of this debate. Most scholars (Becker, Krueger, Posner, Demsetz, and others) suggested that rent-seeking competition would generate equilibria similar to those generated by competitive markets, with a full dissipation of the available rents. Posner's full dissipation hypothesis became popular in the empirical literature and also had a strong appeal in the theoretical literature. In the subsequent years the literature analogized rents to profits, maintaining that both were likely to be competed away in the long-run equilibrium. According to this hypothesis, in a long-run equilibrium, expenditures in tax planning would thus yield the normal market rate of return. Gordon Tullock shook this conventional wisdom in the literature, showing that the full dissipation result would hold only under very narrow conditions. Gordon Tullock, *Efficient Rent-Seeking*, *in* JAMES M. BUCHANAN, ROBERT TOLLISON & GORDON TULLOCK, TOWARD A THEORY OF THE RENT-SEEKING SOCIETY, 97–112 (1980). According to Tullock, in most situations, some residual rent could be captured by the players and the rent would not be fully dissipated. According to this alternative hypothesis, in a long-run equilibrium, expenditures in tax planning could thus yield above-normal rates of return.

[10] As we discuss in the text, however, at a certain point the "rewards" may be negative, as the taxpayer's tax liability, use of tax planning techniques, or both become more likely to attract the government's attention.

identifying a second tax planning method will generally be lower than the benefit from the first one. Thus, the amount of money that people can save increases in the number of available tax planning methods, but at a decreasing rate. The loopholes the methods exploit can overlap, such that there is some redundancy in the second loophole. Later searches thus may yield methods that would shelter income or gains already partially or wholly sheltered. Taxpayers may be able to carry forward tax losses that exceed a particular year's taxable income; however, all else being equal, the less tax they pay, the more likely they are to be scrutinized by the government, potentially resulting in the disallowance of some of those losses. Beyond a certain point, then, the use of any additional tax planning methods may expose the taxpayer to increased chances of detection. It therefore follows that the more tax planning methods currently are allowed, the less effort taxpayers will exert looking for new ones.

Given that taxpayers will behave in this manner, how should the government proceed in designing tax policy? First, we note that tax planning efforts are for the most part unproductive, socially wasteful activities. When people engage in tax planning to reduce their tax burdens, they are not creating new wealth for society. They are simply putting (or keeping) money in their own pockets that would have gone to somebody else (specifically, the government). In economic terms, tax planning is a form of rent seeking behavior. Thus, a benevolent government should attempt to design government policy to take into account both the revenue raised and the wasteful efforts that people will expend to avoid taxes. Hereinafter, we shall refer to taxpayers' search and tax avoidance costs as "dissipation costs" and to the social deadweight loss from government's losses in tax revenue as "tax revenue losses."

Second, we assume that the government is trying to minimize the sum of dissipation costs and tax revenue losses. We also assume that governments design tax policy with imperfect foresight but with rational expectations. Even though, in any given year, there may be newly-discovered techniques that the government did not anticipate (imperfect foresight), the government fully anticipates that some tax planning techniques will be devised and that some tax revenue will unavoidably be lost through the use of those techniques (rational expectations). The government anticipates losing some revenue to tax planning — it just does not know the exact method by which the revenue loss will occur. The amount the government anticipates losing on account of tax planning activities is included in the government's policy plan. In the short term, the government cannot

simply change its tax regime to make up the revenue it loses to tax planning activities. Thus, the government's own cost-benefit calculations limit the amount of revenue it can feasibly raise under any current tax regime.

Finally, we assume that the marginal social cost of a dollar of lost tax revenue is increasing. That is, we assume that the social costs of lost revenue are increasing at an increasing rate. Under these assumptions, it is not cost-effective for the government to seek to eliminate tax planning activities entirely. At a certain point, the cost of the additional search effort that taxpayers will exert outweighs the additional revenues the government might obtain. It is therefore optimal for the government to allow some amount of tax planning.

III. TAX POLICY AND OPTIMAL GOVERNMENTAL ACTION: ENDOGENIZING "ILLEGITIMATE" TAX PLANNING

The above description of a basic model allows us to consider the following scenario. The government enacts a tax policy. Somebody immediately develops a tax planning method to reduce her tax burden. The government has to decide what to do with respect to the tax planning method. Should it close the loophole the method exploits, declaring the method illegitimate, or should it allow use of the method in the future?[11]

Our model of governmental action allows us to endogenize the distinction between "legitimate" and "illegitimate" tax planning activities. Although all tax planning activities are undesirable for the government, the government chooses to target only some of them as illegitimate. Notwithstanding our assumption that social welfare positively depends on the government's success in collecting tax revenue, our analysis leads to the (presumably controversial) conclusion that, all else being equal, social welfare may be increased if the government allows some forms of tax planning. People will look for additional loopholes regardless of whether the existing loopholes are closed, but, all else equal, will look harder the smaller the possible tax savings are from existing loopholes. Thus, the amount of wasteful search efforts is directly affected by the government's decision.

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[11] Of course, in the real world, the government has far more than these two stylized options. Other than expressly or by implicit acquiescence allowing the method, the government might simply use resources it knows to be insufficient to curtail the method's use. And of course, the government needs to know about the strategy to decide to do anything specifically targeted against it.

A benevolent government therefore faces a difficult tradeoff. By declaring a given tax strategy "illegitimate," the government boosts its tax revenue, but induces taxpayers to expend resources in the search for additional tax strategies. The government should also seek to reduce taxpayers' search, not only because it is through search that taxpayers find ways to minimize their taxes, but also because the ensuing dissipation costs represent social welfare losses. Our analysis suggests that, even assuming that the government could identify and close all loopholes, it should not do so. A benevolent government optimally should use soft intervention, restricting the scope of existing loopholes to varying degrees, without closing them entirely, anticipating and minimizing the dissipation that is likely to ensue from the arms-race between taxpayers and tax authorities.

Further, since the government seeks to maximize the total revenue it collects net of collection and dissipation costs, it wants to reduce both taxpayers' use of tax planning methods and their sale of such methods to others, who will also use the methods to minimize their taxes. The appropriate tax policy should consider that the taxpayers' interest in searching for new tax planning methods is not only driven by their desire to minimize their tax burden: under some circumstances, taxpayers' search may also be motivated by their interest to gain from the sale of tax planning methods to other taxpayers.[12]

IV. MARKET FAILURES AS TAX POLICY INSTRUMENTS

Dissipation deadweight losses increase in the amount of effort that taxpayers expend to reduce their tax burden (search). Search efforts increase in the expected private benefits that accrue to the finder of a new tax planning strategy and in the potential profits that could be made from selling the tax strategy to other taxpayers. Lost revenue costs are increasing in the number of new tax planning strategies that are identified (discovery) and in the number of people that use them (dissemination). In this part, we introduce basic concepts from price theory to consider the possible use of governmental intervention in reducing the search, discovery, and dissemination of tax planning strategies.

The fundamental idea is as follows: since the incentives for search, supply, and demand in the market can be negatively affected by

[12] David Weisbach makes closely related arguments. *See* David A. Weisbach, *An Economic Analysis of Anti-Tax-Avoidance Doctrines,* 4 AM. L. & ECON. REV. 88, 96–109 (2002); Weisbach, *supra* note 1, at 231–42.

market failures, the legal system can reduce the search, supply, and demand for tax planning strategies though the creation of governmentally-created market failures. In the presence of market failures, the market forces that normally allocate resources and create production incentives in our economy are defective or absent. Economists have identified four general categories of market failure, including monopoly, public goods, asymmetric information, and externalities. In such cases, markets may "fail" in the sense that they cannot ensure that the good is produced and consumed in the amounts in which it would have been produced and consumed had the market not failed.

While governments are generally involved in making markets run more smoothly, in this case the government prefers the market to be less efficient. How can the government introduce market frictions?

A. Creating Monopolies: Patenting Tax Planning Strategies

Monopoly is a standard case of market failure. A monopoly exists when there is only one supplier of a good in an industry and the good has no close substitutes. Patents and copyrights[13] are common examples of legally-created monopolies. Patents and copyrights give exclusive intellectual property rights to the discoverer or creator, preventing other individuals from competing with the patent or copyright holder in the exploitation of their intellectual property rights. According to economic theory, monopolists are price-makers, not price-takers. A monopolist can set prices above marginal cost, which places a wedge between the consumer's willingness to pay for the good and the producer's cost.

An increase in price implies that fewer goods will be sold. In the general case, this is undesirable because it results in lost social surplus (deadweight loss). Because monopoly firms reduce output below the socially efficient, competitive level, legislatures often pass laws to prohibit or regulate them. In the special case under consideration, if tax planning strategies can be patented, thereby granting exclusive rights to the discoverer, the resulting reduction in the quantity of

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[13] On patents and copyrights generally, *see* ROGER D. BLAIR & THOMAS F. COTTER, INTELLECTUAL PROPERTY: ECONOMIC AND LEGAL DIMENSIONS OF RIGHTS AND REMEDIES (2005); *see also* WILLIAM D. NORDHAUS, INVENTION, GROWTH AND WELFARE: A THEORETICAL TREATMENT OF TECHNOLOGICAL CHANGE (1969) (addressing patent law); William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989) (addressing copyright law).

available tax planning strategies may instead be desirable.[14] A social benefit, rather than a social loss, would result from monopoly underproduction. It follows that, unlike in the typical case, a monopoly over tax planning strategies should be promoted and protected, rather than prohibited and regulated.

The idea that the creation of a monopoly can be used as a policy instrument in the context of markets for tax strategies should be qualified at this point. Even though patents may result in an ex post restriction of supply, they may exacerbate ex ante search incentives.[15] If a person (or entity) obtains a patent on a tax planning method that he created, he can license the patent to others. His ability to earn fees from such a license should increase his incentive to search in the first instance; dissipation costs should therefore increase. The effect of introducing tax patents on tax revenue losses will depend on the relative magnitude of the two effects.

Price theory allows us to provide an additional qualitative assessment of the two effects under consideration. For example, if a monopolist can charge different prices to different consumers (price discrimination), then his total output will approach that of a perfectly competitive market. In this scenario, the property protection effect (i.e., the increase in search and discovery) will dominate the monopoly effect (i.e., the monopolist's restriction of output). In other words, if tax patents are available and tax patent holders or licensees can perfectly discriminate, the outcome for the government is the worst one possible. The market supply is efficient: the tax planning method becomes fully disseminated throughout the population, which maximizes lost revenue. Further, monopoly profits are maximized, meaning that the incentive to search for new tax planning strategies is at its peak, and dissipation costs will also be maximized.

The case in which a tax patent holder cannot price discriminate is somewhat more promising. In this case, the knowledge of the tax planning strategy will not fully disseminate, so lost revenue costs will

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[14] *See e.g.*, Burk & McDonnell, *supra* note 5, at 986.

[15] One commenter noted, "[t]he fundamental purpose of providing patents, as I understand it, is to promote innovation. While no one can dispute this as a generally desirable goal, it would be hard to identify a subject less in need of further innovation than tax planning." *Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means*, 109th Cong. 109–77 (2006) (statement of Ellen Aprill, Associate Dean of Academic Programs, Professor of Law, John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles, California). Whether or not patents generally promote innovation is open to question. *See generally* BLAIR & COTTER, *supra* note 13, at 17.

not be as high.[16] Similarly, the value of having the patent will be lower because a non-discriminating monopolist is unable to capture the entire consumer surplus. Dissipation costs will therefore be lower than they would have been in the case where the monopolist could price discriminate.

Will tax patent holders be able to price discriminate? People who develop tax planning methods may very well be able to compute how much a buyer would pay. The patent effectively prevents the buyer from reselling and it is in both the developer (patent holder) and the buyer's interest to not have information about the transactions become too widely known. While the extent to which tax patent holders will be able to price discriminate is an empirical question, theory suggests that considerable price discrimination may be possible.

Which is better: to allow patenting of tax planning methods or not to do so? The answer depends on what would happen if patents are not allowed. Consider an environment in which there are many taxpayers, each of whom is able to search for new tax planning methods. Let us assume for simplicity that there are no property rights, whether through patents or by other means. Comparing this case to the one where there are patents but patent holders cannot perfectly price discriminate, we see that the patent case provides greater incentive to search (patent holders earn profits as well as reducing their own taxes), but the effect on lost revenue is ambiguous. Without property rights, the people who reduce their taxes are the ones who discover a tax planning method. With a patent, the people who reduce their taxes are those who are willing to pay the monopolist's price. We cannot say which effect is greater. So, if dissipation costs are not high and the monopolist is particularly inefficient, such that there is a large deadweight loss, then the government might do better if patents are allowed than if people cannot have property rights over their tax planning methods.

If the government could anticipate particular tax planning methods, it could use the ability to patent such methods to its advantage: it could simply patent the methods – easily regulating the extent to which the tax planning method is used (perhaps not at all) – by deciding who may use it, of course in exchange for a fee. Note that

[16] Of course, the assumption that people will keep their ideas to themselves in the absence of patents is not necessarily realistic. The law provides protection short of patents, in the form of trade secrecy laws. *See* Burk & McDonnell, *supra* note 5, at 987. Furthermore, markets have a habit of springing up, even in the absence of strong property rights.

the fee would defray the tax revenue losses of use of the method with the income earned from selling the right to use the technique. Of course, if the government could anticipate such methods, it should have considerable success simply prohibiting them ex ante. In any event, the government traditionally has not been successful in anticipating such methods.[17] The government might also be able to buy such a patent from the innovator who obtained the patent, thereby also regulating the extent to which the method is used. However, doing so would likely be more expensive than trying to curtail the method using more traditional sanctions.

The possibility of patenting tax planning methods suggests an interesting strategy. Somebody – the government, someone effectively subsidized by the government, or a group that was opposed to tax planning activity – might be able to patent one component of many strategies and either refuse to license it or license it only at very high fees.[18] In either case, those seeking to develop and market tax planning methods would find doing so more difficult and less lucrative than it otherwise would have been, given the need to either pay for use of the component or of finding ways to structure around it.[19] This would reduce both search and discovery and dissemination.

Another aspect of tax patents needs to be considered. Some tax planning methods will attract more government efforts to shut them down than others. Which ones do so may depend on fairly predictable factors, such as the amount of revenue lost, publicity arising about a particular transaction that yielded political pressure to take action, or serendipity. How might the possibility that a method may have a short shelf life affect the analysis? Patenting may, on the one hand, shorten the shelf life further, as the information disclosed in the

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[17] There are many reasons why this might be the case. One strong possibility is that the task requires resources beyond what the government has concluded it would be worthwhile to expend and the government has instead decided on a strategy of ex post enforcement against specific, already-developed methods and its arsenal of more general prohibitions.

[18] A non-governmental entity that received such fees could use them to fund its other activities or contribute them to a worthy cause. We thank David Weisbach for suggesting this possibility, as well as suggesting the idea that the entity itself, rather than the government or government-subsidized entity, might suitably carry out the strategy.

[19] In this regard, Burk and McDonnell discuss the possibility that an "anticommons" problem could arise if intellectual property rights needed for tax planning methods were too widely held; it might be impossible to negotiate with all the rights-holders necessary to develop and market the method. *See* Burk & McDonnell, *supra* note 5, at 996–99.

patent application gives the government information to disallow the method; however, patenting may also allow the method to yield more revenue as it is sold aggressively.

B. Public Goods: Creating or Exacerbating Free Rider Problems

Another type of market failure involves public goods. When goods are available free of charge, the market forces that normally allocate resources and create production incentives in the economy are absent. In the case of public goods, markets "fail" because they will not supply a sufficient amount of goods. The public goods problem is the effect of the so-called *free rider problem.* A free rider is a person who receives the benefit of a good but avoids paying for it. When goods are available free of charge and people cannot be excluded from enjoying the benefits of a good to which they have not contributed, individuals may adopt free riding strategies and withhold paying for the good hoping that others will pay for it.[20] Because there is no easy way to induce parties to reveal their valuation of the public good through the price system, markets do not supply sufficiently large amounts of public goods.

One of the market problems commonly associated with the search for new ideas is the free rider problem. New products and ideas are typically expensive to create, but easy to replicate. The legal system generally wants to establish incentives to increase the supply of public goods. Here, we are faced with the opposite concern and policy objective: the government would like to decrease the incentive to develop new tax planning methods.

The incentive to develop tax planning techniques depends on the aggregate benefit available to the developer. An important component of that benefit may be the ability to sell the technique to others. Others will not be willing to pay for it if they can get it for free; if they can get it cheaply they will not be willing to pay much. The less they have to pay, all else being equal, the smaller the benefit there is to searching for and developing the techniques. The legal system may develop ways to condition the use of a tax planning technique on disclosure. For instance, the government could force public disclosure of any tax planning method somebody used; others would therefore be able to use it for free. The result would be increased dissemination of the method, leading to greater lost revenue as more people use the method. But the incentive to search for and

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[20] *See* PARKIN, *supra* note 6.

develop the methods in the first instance would be far smaller. People could not get a return from selling the method; moreover, they would know that they might be able to use somebody else's method for free. If markets are efficient, the increased lost revenue would be small (perhaps even zero), but the reduction in dissipation costs could be very high.

C. Asymmetric Information

Another form of market failure reflects the fact that information is asymmetric: different people have access to different information. There are two main effects of asymmetric information: adverse selection and moral hazard problems. These effects are generally seen as socially undesirable, inasmuch as they negatively affect the allocative efficiency role, and possibly the existence, of markets. Transactions may be difficult to effectuate because each party believes the other may be hiding self-serving negative information. In the context of tax planning markets, these concerns turn into a hope, inasmuch as both of these effects can help disrupt the market for tax planning.

1. Adverse Selection: The Market for Tax Lemons

Adverse selection involves somebody who knows he has undesirable attributes dealing with others who may not be able to readily determine whether he has those attributes. The classic example is the used car: many buyers are reluctant to buy a used car because they suspect that, if the car is being sold, the seller must know something bad about it. This is also known as the *lemons problem.*[21] The basic story for the market for lemons is as follows. Suppose there are three quality levels for used cars: high, medium, and low. Car owners know what type of car they have, but they cannot credibly convey this information to buyers — all owner/sellers will want to say their car is high quality. Buyers are willing to pay an amount that reflects what they expect the car's quality to be. If the pool of available cars includes medium and low quality cars, buyers may only be willing to pay less than the amount that high quality car owners will accept. Thus, high quality cars will not be sold; all cars sold will be of medium or lower quality. Buyers, being rational, lower their expectations of the quality of cars available. Again, however, buyers

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[21] *See* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

are not able to tell which are of medium quality and which are of low quality; they base their willingness to pay on the expected quality. As before, this willingness to pay might be less than the amount that medium quality car owners need in order to be willing to sell. Thus the used car market would be comprised of only low quality cars, or *lemons*.

What would a lemons story look like in the context of tax planning? Tax planning methods, like cars, can be of differing quality. If buyers of tax planning methods cannot tell which type of method they are buying, the methods that are available for sale might all be lemons. Since buyers could not be sure that they were purchasing a high quality method, they would only offer a lemons price — a price the seller of the high quality method would be unwilling to accept. The high quality methods would therefore not be sold. Tax revenue would be higher since those methods would not be being used to reduce revenues. Incentives to search for tax planning methods would decline as well, since the rewards to search would be lower.

An essential component to the market for lemons is the uncertainty that the buyer faces at the time of purchase as to the quality of what she is purchasing. In the context of tax planning methods, the requisite uncertainty exists. Some tax planning methods are comparatively easy to appraise. However, even long-standing methods whose workings are well-known may face the risk of being declared illegitimate. Moreover, as methods are shut down, new ones are developed. Finally; the tax code changes frequently, giving rise to the development of new methods that exploit those changes. Frequent changes to the tax code, bemoaned as they are, thus might help to create socially desirable market failures.[22] Of course, the incentive to search decreases in the length of time that a tax policy has been in place, because the number of tax planning methods left to find decreases. Thus the optimal rate of change would be set by the tradeoff between these two considerations.

Exacerbating this standard adverse selection mechanism is an interesting feature of tax planning methods. The government is more likely to detect use of a tax planning method if more people are using it, more money is being saved on account of its use, or some combination of the two. For each sale, the probability that the method cannot be sold again will increase, as will the probability that the buyer cannot use the method. Thus, sellers will want to be paid

[22] A full analysis will also take into consideration the social costs of complying with new rules by taxpayers whose aim is actually to comply.

more, and buyers will want to pay less, than would be the case if the expected returns to use of the method stayed constant. Indeed, the better the method, the more divergent its valuation by the seller and buyer may become. A market for lemons dynamic thus should already exist; the government can strengthen it by announcing increased efforts to find the more popular or more effective methods.

2. Moral Hazard and the Principal-Agent Problem

Moral hazard[23] arises when a person whose behavior cannot be monitored has the ability and incentive to engage in behavior that is not in the interest of the individual or firm that will be affected by his or her actions. The moral hazard problem again entails asymmetric information. The basic story is as follows. Two parties enter into a contract. The value of the contract depends on the amount of effort that one of the parties expends. However, the other agent cannot observe how much effort is put forth. For example, an employer may not be able to tell exactly how hard an employee is working, or an insurance company may not be able to tell whether and how hard a customer is actually trying to avoid accidents. If it were possible to see how much effort is being exerted, one would simply reward that effort. Since it is not possible, the person will not expend as much effort as she otherwise would.

This form of market failure suggests other possible disruptions of the market for tax planning methods. There may be ways to limit a seller's or lessor's ability to assure the buyer or lessee of the method that the method is of high quality. The lemons problem discussed above could thus be exacerbated. But, going further, it may be possible to limit incentives for search for planning methods to be sold by limiting individuals' ability to be compensated for their efforts. In many firms engaged in developing tax planning methods, pay is gauged at least in significant part by performance. If tax rules provide sanctions to individuals developing such methods, the individuals will want to minimize the extent to which a method is associated with them personally; this should make infeasible a contract which rewarded the employee for his performance in developing the method, thus creating a moral hazard problem. It also should limit the efforts he spends in developing them.

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[23] *See* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION (1974).

D. Other Governmentally-Created Market Distortions

There are several other scenarios in which smooth functioning of the market is disrupted. In the following part we will briefly mention some of these scenarios. Once again, the situations that will be discussed are generally seen as socially undesirable insofar as they disrupt market functioning; however, in the context of markets for tax planning methods, disruption is the aim.

1. Hold-Ups: Fostering Strategic Behavior

The hold-up problem concerns the possibility of opportunistic behavior in a transaction stemming from the transaction's timing.[24] Suppose that one person has to complete her side of the bargain before the other. Once the person does so, she is essentially at the mercy of the other, since there is nothing (other than the court action or reputational concerns) forcing the second person to complete her performance.

How might the hold-up problem apply to the market for tax planning methods? Consider our first story about the comparison of a market with patents to a market with no property rights. We assumed that people would not sell their ideas when there were no property rights; we later noted that the assumption might not be realistic. One way that people would try to create property rights in the absence of patents is through contracts. The buyer would agree that if he resells the idea, he would be subject to large penalties. If the government made such contracts unenforceable, a hold-up problem would exist. After the sale of a method, nothing would prevent the buyer from giving the information to friends or reselling the idea at a lower cost. People might therefore not sell their tax planning methods, especially if the probability of a method being shut down were to increase in the number of users.

2. Risk Misallocations: Allocating Risk to an Inferior Risk Bearer

The higher expected sanctions are, and the less those sanctions can be allocated to lower-cost bearers (people who can best diversify the risk that those sanctions impose), the higher the benefits must be to motivate additional searches for tax planning techniques. Thus, the search is likely to stop sooner if higher-cost risk bearers must bear the risk than if the risk could be allocated to lower-cost risk bearers.

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[24] *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, 62–63 (4th ed. 1992).

Higher expected sanctions (the sanction times the probability the sanction will be imposed) are a well-worn weapon in the traditional arsenal; the gloss here is to ensure that the sanction is imposed on somebody particularly ill-suited to bear it.

Contracts typically allocate risk to the cheapest cost avoider.[25] A party who, for instance, can more cheaply acquire insurance on property might assume the risk that the property will be damaged. The same is not infrequently true for risks the parties do not think to allocate: courts sometimes implicitly or even expressly use the principle of allocating risk to the cheapest cost avoider or best situated risk bearer when deciding ex post who should bear a particular risk.[26] The lower the aggregate costs of transacting, the larger the pie the parties will have to divide; thus, allocation of costs to the cheapest cost avoider (and the allocation of risks to the best situated risk bearer) should encourage contracting.

How could the government create risk and then place it on the most risk averse party? How might it be able to prevent allocation of known risks to the cheapest cost avoider? It is generally believed that people are more risk averse than firms. The government would therefore prefer to place risk on individuals rather than firms. What kinds of risk could there be? As we discussed above, for many tax planning methods, there is risk about whether the method will deliver the promised benefits, and if so, how many times it can be used. Suppose that to use a tax method, a person has to identify an individual as the developer of that method and include the individual's certification that the method works. Suppose further that the government prohibits as against public policy indemnities or reimbursement of the individual by his employer for any liabilities incurred to anyone on account of the tax planning method. The individual could be sued by the buyer of the tax planning method or, for that matter, by the government. The effect of targeting the individual rather than the firm should be that fewer sales would take place, reducing both lost revenue costs and search costs.

[25] *See* Claire A. Hill, *A Comment on Language and Norms in Complex Business Contracting*, 77 CHI.-KENT L. REV. 29, 43–51 (2001).

[26] *See* POSNER, *supra* note 24, at 89–137.

V. CONTEXTUALIZING THE ANALYSIS: GOVERNMENTAL INTERVENTION AND MARKET DISRUPTIONS IN PRACTICE

A. Allowing an Optimal Amount of Tax Planning

We argued above that it may be optimal for the government to allow some amount of tax planning. We noted that there are different ways for the government to proceed; one way is to simply legitimize a tax planning method. Two examples in which the government has done so follow:

1. Check-the-Box Regulations

One example is the "check-the-box" regulations for business entity designation. Corporations are subject to entity-level taxation — that is, there is tax when the corporation receives income and again when its shareholders receive that income in the form of dividends. Partnerships are pass-through entities: if the partnership earns income, the partnership itself is not taxed. Rather, the tax arises when each partner pays some share of the tax attributable to that income. At different times in history, the Internal Revenue Service (Service) had differing concerns as to which entity it sought to discourage; at a certain point, the Service disfavored the partnership entity, on grounds that partnerships were being used "as tax shelters." The Service originally sought to impose two tests: (1) a formal test pursuant to which an entity seeking to qualify as a partnership had to lack at least two out of four "corporate characteristics" and (2) a more discretionary test focusing on substance.[27] In 1976, a Tax Court decision gave some comfort to tax planners who met the formal test but perhaps ran afoul of the more discretionary test;[28] in 1979, the Service agreed to follow that decision. Lawyers got better and better at meeting the formal test, to the point where partnership treatment eventually became nearly elective.[29] Eventually, the Service adopted "check-the-box" regulations which effectively acknowledged that partnership treatment had become elective: an entity desiring such treatment could simply "check-the-box."[30]

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[27] *See* Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?*, 84 B.U.L. REV. 185, 212–18 (2004).

[28] *Id.* at n.202.

[29] *Id.* at 229.

[30] *See generally* Polsky, *supra* note 27. It could be argued, though, that in this example, the Internal Revenue Service (Service) was simply acknowledging the

2. Tracing

A corporation can deduct the interest it pays when it borrows money, but it is typically taxed when it earns income, including interest, on its investments. However, some investments generate tax-free income. The concern is that a corporation will use tax-deductible borrowing to earn tax-free income. A variety of statutes and regulations in fact prohibit this and related practices. But the regulatory scheme serves largely as a trap for the unwary. There are mechanical rules to be used to connect a loan with its proceeds so that the proceeds can be "traced" to the borrowing. But these rules can easily be circumvented. A leading casebook notes that: "the tracing approach of the regulations contains tax savings opportunities for those who plan their transactions carefully and tax increases or, more likely, random tax consequences for the unknown or unwary and people with better ways to spend their time."[31]

3. Discussion

The foregoing are examples in which the government has decided to let people structure their affairs so that they pay less tax than they otherwise might. Our account provides an argument about why and when it might behave in this manner — that is, when the returns to search are high because there are many additional tax planning methods to be found and the revenue cost of the ones being employed is within an acceptable range. An interesting area to consider in this regard involves multinational corporations arranging their transactions and, indeed, engaging in transactions to minimize their overall tax burden.[32] Here, too, the existence of the techniques is well known. The techniques are allowed to continue and, arguably, flourish given the increasing mobility of assets and operations.

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inevitable — that its costs in attempting to enforce its prohibition exceeded any revenues it was likely to obtain.

[31] MICHAEL GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION, PRINCIPLES AND POLICIES 348 (5th ed. 2005).

[32] Indeed, one of us, Hill, met someone casually on a plane who told her at some length, in a voice speaking at a normal volume, about his company's activities of this type, which he spearheaded; he also told Hill where he worked, demonstrating that he did not think he had much to fear.

B. Viewing Recent Regulatory Initiatives as Attempts at Disruption: Amendments to Circular 230, the Thompson (now McNulty) Memo, and Sarbanes Oxley

1. Amendments to Circular 230[33]

Tax planning methods used to effectively come with "insurance." If a law firm could give an opinion that the method passed muster (usually, that the tax position taken was "more likely than not" to prevail[34]) the client using the method could avoid penalties; in effect, the worst thing that could happen is that the client would have to pay the taxes he was trying to avoid, with interest. As amended, Circular 230 provides that clients can avoid the imposition of penalties only if the opinion they receive considers and discusses a great many items in detail. Many matters lawyers had previously dealt with by making assumptions now have to be thoroughly investigated. The lawyers may risk liability themselves if the firm gives an unsupported opinion; they may face monetary penalties and the loss of their ability to practice before the Service.[35] The firm and its lawyers also may face greater reputational costs. Moreover, for transactions identified by the Service as highly suspect, transactions in which the client agrees to maintain the confidentiality of the tax advice, or transactions in which the practitioner's pay is contingent on the promised tax savings, any opinion must be of this elaborate form, even if the client is willing to forego any protection against penalties. Some tax practitioners have advised their clients that issuing opinions that protect the clients from penalties will now be much more expensive;[36] indeed, such an effect is surely among those that the Service desired, and perhaps even expressly intended. It is not yet resolved whether the lawyer's analysis in providing the opinion — the very detailed analysis Circular 230 as amended now requires in many instances — is available to the government. If it is, the government will be able to get free of charge

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[33] 31 C.F.R. pt. 10. (2005). The 2005 amendments to Circular 230 are the ones of note for our purposes; the original Circular 230 was not specifically designed to address tax planning activities.

[34] *See generally* LEANDRA LEDERMAN & STEPHEN W. MAZZA, TAX CONTROVERSIES: PRACTICE AND PROCEDURE 15–24 (2002).

[35] David Schizer notes, however, that "the [Service] has not sought to impose this sanction yet, even in egregious cases, leaving the bar to wonder whether they can safely ignore this possibility." David M. Schizer, *Enlisting the Tax Bar*, TAX L. REV. (forthcoming 2007) (manuscript at 47, on file with author).

[36] *See, e.g.*, Claybrook & Assoc., IRS Circular 230 Compliance, http://www.msclaybrook.com/circ230comp.htm (last visited Mar. 18, 2007).

information that it presumably will find quite valuable in formulating its arguments against the tax planning method at issue and rebutting contrary arguments, as well as detecting other methods that presently exist or are in the process of being developed.[37]

It should be noted at this juncture that while the amendments to the Circular were principally aimed at tax shelters, not tax planning, the amended Circular's reach is quite broad – something that is not surprising given the lack of consensus as to what constitutes a shelter. We have thus far largely assumed away the distinction between tax shelters and tax planning; we turn shortly to a consideration of this issue.

2. The Thompson/McNulty Memo

The Thompson Memo, released in 2003,[38] set forth Principles of Federal Prosecution of Business Organizations. The Memo became quite controversial.[39] Among its most controversial provisions were those indicating that in charging a corporation, prosecutors should take into account whether the corporation had been cooperative, where cooperativeness was determined in part by the corporation's (a) waiving attorney-client privilege and work product protection and (b) refusing to pay its employees' legal bills.[40] The Thompson Memo

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[37] Considerable commentary exists on Circular 230, including law firm memos posted on the internet. See, *e.g.*, Terrence G. Perris, Squire, Sanders & Dempsey, LLP, Beyond the Legend: The Impact of New Circular 230 (Oct. 12, 2005), http://library.findlaw.com/2005/Oct/12/204044.html.

[38] Memorandum from Larry D. Thompson, Deputy Attorney Gen. on Principles of Fed. Prosecution of Bus. Org. (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm (hereinafter Thompson Memo). There is also an intervening memo, the "McCallum Memo." *See* Memorandum from Robert D. McCallum, Jr., Acting Deputy Attorney Gen. on Waiver of Corp. Attorney-Client & Work Product Protection (Oct. 21, 2005), *available at* http://lawprofessors.typepad.com/whitecollarcrime_blog/files/AttorneyClientWaiverMemo.pdf.

[39] *See, e.g.*, Ashby Jones, Thompson Memo Out, McNulty Memo In (Dec. 12, 2006), http://blogs.wsj.com/law/2006/12/12/thompson-memo-out-mcnulty-memo-in (providing a discussion of the Thompson Memo on the *Wall Street Journal* law and business blog).

[40] The Memo states:

> One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communication between specific officers, directors and employees and

was in force as KPMG was pursued by the government for its tax shelter activities. In the KPMG trial,[41] Judge Kaplan ruled that the Memo's prohibitions on paying employees' legal bills violated their Sixth Amendment right to counsel and their Fifth Amendment substantive due process right to "to obtain and use in order to prepare a defense with resources lawfully available to [the defendants], free of knowing and reckless government interference."[42]

Not surprisingly, in the McNulty Memo,[43] which superseded the Thompson Memo, the government retrenched. In pertinent part, the Memo states, as to the waiver of attorney-client privilege and work product protections:

> The attorney-client privilege is one of the oldest and most sacrosanct privileges under U.S. law.... The work product doctrine also serves similarly important interests.
>
> Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. However, a company's disclosure of privileged information may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure. Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement

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> counsel.... Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus... a corporation's promise of support to culpable employees and agents, either thought the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

Thompson Memo, *supra* note 38, at § VI.

[41] United States v. Stein, 435 F. Supp. 2d 330, 362 (S.D.N.Y. 2006).

[42] *See generally* Irvin B. Nathan & Michael S. Lewis, *The Thompson Memo Ruling: Recent Decision May Have Little Effect on Other Cases,* 14 ALM BUS. CRIMES BULL. No. 2, Oct. 2006, *available at* http://www.arnoldporter.com/pubs/files/Irv_NathanandMichael_Lewis.pdf.

[43] Memorandum from Paul J. McNulty, Deputy Attorney Gen. on Principles of Fed. Prosecution of Bus. Org. (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

> obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation.[44]

On the payment of expenses for officers and employees, the Memo states:

> Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate.[45]

3. Sections 302 and 906 of Sarbanes Oxley

The Sarbanes Oxley Act of 2002, enacted in response to Enron, WorldCom, and other big corporate scandals, requires that a company's top officers provide personal certifications as to the company's filings.[46] Such certifications might conceivably encompass tax planning activity. An argument could be made that an officer providing such a certification might in effect be certifying that she has, after some investigation, no knowledge that the company is engaging in aggressive tax planning activities that could be disallowed and as to which significant penalties could be imposed. A knowingly false certification could be grounds for personal liability, including the imposition of criminal penalties.

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[44] *Id.* at 8–9.

[45] *Id.* at 11.

[46] The Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, §§ 302, 906 (2002).

4. Discussion

The foregoing suggests that the government, too, is thinking along the lines of focusing on individuals: it is going after individuals' ability to defend themselves or be insulated by their corporations and, in the case of tax professionals, their ability to practice before the Service.[47] Individuals are not well able to diversify against risks of this type. In requiring the types of legal opinions that it does under Circular 230, the government is also perhaps creating a means by which it can appropriate costly research done by people who are almost certainly highly motivated and highly intelligent to assist it in its efforts. Effectively, it is free riding off the efforts of others.

Also, as individuals face more risk being associated with tax planning activity, they may be less inclined to invest in building up reputations for their skills in the area, reputations which might improve their prospects. They thus should be deterred from such activities. The inability to profitably acquire and exploit such reputations, as well as their employers' difficulty in compensating them for their "performance" if that performance could lead to sanctions, should together provide individuals with an incentive to pursue other, possibly more lucrative, areas. It is not likely that firms will want to cultivate such reputations either.[48] The weaker the seller's reputation, the more of a lemons discount the buyer of tax planning methods will demand.

C. Discussion and Summary

In the preceding subsection, we considered how to make individuals, who are presumably less able to bear risk do so. We briefly discussed the possibility that firms might in effect be required to provide information on their methods for free.

Of course, a great deal more could be done along both these lines: individuals could be made to certify techniques, firms could be made to disclose their use in "plain language" in their public filings as a condition to being able to use them, contracts for tax planning could be denied enforcement on public policy grounds, and so on.

But these proposals are ultimately largely infeasible. One of the main difficulties faced by the government is one we assume away.

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[47] Schizer, *supra* note 35, makes some complementary arguments, especially as to the mechanisms by which Circular 230 will work.

[48] Indeed, the "tax shelter" bar is distinguished from the regular tax bar; the former is arguably subject to a stigma. *See* Hill, *supra* note 8, at 1066.

Notwithstanding some commentators' beliefs that all tax planning activities are undesirable and that there is no "right" to engage in tax planning,[49] many others believe in a principled distinction between tax planning and tax shelter activity. Nobody knows exactly where such a distinction might be and what might be the principle at issue – many possible principles have been tried on for fit, with no consistent success either in the courts or with commentators.[50] Approaches that discourage "too much" tax planning will therefore be infeasible, and those that target "tax shelters" have been hindered by the difficulty of drawing a principled distinction between tax shelters and tax planning.

Indeed, in this regard the recent proposal by Presidential candidate Barack Obama to deny patents for "inventions designed to minimize, avoid, defer, or otherwise affect liability for Federal, State, local, or foreign tax"[51] notwithstanding that patents are generally available for business methods, including tax planning methods. There has been considerable criticism of the proposal, on several grounds. Given how much difficulty the courts and legislators have in distinguishing between tax planning that is expressly allowed and tax planning that is disfavored – that is, planning that constitutes a "shelter" – it seems inconceivable that the patent office could readily make such a distinction. Thus, the proposal seems more likely to invite litigation than serve any other purpose.[52]

VI. CONCLUSION

We have presented an argument that governments, when designing their tax policy, should be aware of two distinct types of social costs: the cost associated with lost revenue and the cost that arises from taxpayers' search for new methods to reduce their tax burden. Inevitably, reducing one of these costs comes at the expense of increasing the other; the government faces a tradeoff. By recognizing these costs and the tradeoff the government faces, we can better understand current tax policy. Moreover, a wider recognition of

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[49] Weisbach, *supra* note 1, at 220.

[50] Consider, in this regard, the flurry of litigation cited by Kristin E. Hickman, *Of Lenity,* Chevron, *and KPMG*, 26 VA. TAX REV. 905 (2007). *See generally Symposium on Corporate Tax Shelters,* 55 TAX L. REV. 125 (2002).

[51] *See* Levin, Coleman, Obama Introduce Stop Tax Haven Abuse Act (Feb. 17, 2007), http://www.senate.gov/~levin/newsroom/release.cfm?id=269479.

[52] *See, e.g.*, Patent Reform: Tax Shelter Patents (Feb. 19, 2007), http://www.patentlyo.com/patent/2007/02/patent_reform_t.html (a discussion of the Stop Tax Haven Abuse Act on the Patently-O Patent Law Blog).

the tradeoff described above, and a systematic consideration of how to disrupt markets in tax planning activities, should lead to better tax policy.