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Abstract

The philosopher Hans Kelsen is most famous for his "pure theory of law", expounded in his book of that name. For most of his scholarly life, Kelsen argued that, as part of the pure theory, two norms that contradict one another within the same legal system breach the philosophical principle of exclusion of contradictions and therefore cannot both be valid at the same time. On some occasions he went further and argued that neither of two such norms can be valid. Famously, Kelsen changed to the opposite opinion later in life.

Both Kelsen's original and his ultimate positions on the principle of exclusion of contradictions shed light on an area of law that he never considered: general anti-avoidance rules in income tax law, known as "GAARs". GAARs are increasingly common in tax statutes.

One cannot argue that GAARs give rise to what logicians call contradictions. Nevertheless, from a practical and substantive point of view the effect of a GAAR could loosely be described as akin to a contradiction of norms, in logical terms a breach of the principle of exclusion of contradictions. For instance, a GAAR may prevent a taxpayer from relying on a relieving provision in a tax statute, on the grounds that such reliance amounts in the circumstances to tax avoidance. For this kind of reason, people criticise GAARs because they are seen as breaching the principle of certainty, one of the foundations of the rule of law.

General principles in Kelsen's work shed light on the way in which GAARs operate and on the way in which they fit into the legal systems of which they form part. Although the effect of a GAAR has something in common with the effect of a breach of the principle of exclusion of contradictions, the unusual nature of tax law justifies the existence of GAARs.

Contents

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I. General anti-avoidance rules

General anti-avoidance rules are found in increasing numbers of taxation statutes. They are often known as GAARs. Broadly speaking, GAARs impugn the fiscal planning of taxpayers who avoid taxes without breaking the law. GAARs address the case where taxpayers' transactions and investment structures comply with the law, and the terms of the law in question provide for tax to be levied in a favourable manner and at a favourable rate, but in effect the outcome is to avoid tax. In these circumstances, GAARs provide that the transactions and structures in question must be treated as void for tax purposes. The result is that tax applies not to the actual legal transactions that taxpayers have undertaken, that is, not to the avoidance transactions, but to notional transactions that are closer in legal form to the economic effect to what taxpayers have done.

We ordinarily use the term "general anti-avoidance rules" to refer to legislated rules, but some jurisdictions develop judge-made rules that have a similar effect. A notable example is the substance-over-form rule of the United States of America, which Congress ultimately codified in March 2010 as §7701(o) of the United States Internal Revenue Code. In this chapter, "GAAR" refers both to legislated and to judicially created general anti-avoidance rules.

The first statutory GAAR appears to have been section 29 of the New Zealand Property Assessment Act 1879, carried forward into section 40 of the Land and Income Assessment Act 1891.[2]

[2] Since 2007 the New Zealand GAAR has appeared as section BG 1 of the Income Tax Act 2007.

Many countries enacted GAARs during the Twentieth Century, but several major economies did so only in relatively recent years: China 2007,[3] USA 2010,[4] as mentioned, United Kingdom 2013,[5] and India 2013,[6] to come into force in 2016.

In any discussion of tax avoidance it can be helpful to divide substantive provisions of income tax legislation into two categories, GAARs and everything else. In this context, "everything else" includes both charging provisions and permissive or relieving provisions. Most tax legislation includes other kinds of law as well, such as rules about procedures for resolving disputes and rules governing administration, but such rules are not relevant to the present discussion.

An example of a charging provision is a rule that imposes tax on the profits of businesses.[7] An example of a relieving provision is a rule that permits taxpayers when they calculate business profits to deduct sums to allow for the depreciation of capital assets used in the business.[8] Some rules are hybrids, at the same time both charging provisions and relieving provisions, such as a rule that charges capital gains with tax, but at a rate lower than the rate that applies to income.[9] For conciseness, this chapter uses "charging provisions" both in its literal sense and as a generic term that applies equally to all three categories: charging, relieving, and hybrid provisions. The chapter often has occasion to distinguish between charging provisions on one hand and GAARs on the other.

II. Example of avoidance using a tax shelter

Some of the most recognisable examples of tax avoidance involve structures known as "tax shelters". Tax shelters are designed to reduce the tax otherwise payable on other income that taxpayers derive. Commonly, they involve apparently business-like schemes that result in losses that

[3] Articles 47 and 120, Enterprise Income Tax Law of the People's Republic of China, Promulgation Order No 63, 16 March 2007.

[4] 26 United States Internal Revenue Code §7701(o), enacted March 2010.

[5] Finance Act 2013 Part 5, General Anti-Abuse Rule, ss 206 - 215.

[6] Income Tax Act 1961 ss 123, 124, 125, 154, 291, enacted by the Finance Act 2012.

[7] Eg, Income Tax Act 2007 s CB 1(1) (NZ), "An amount that a person derives from a business is income of the person".

[8] Eg, Article 101 of the Decree of the President of the Republic Italy of 22 December 1986, number 917 (The Italian Tax Code) (Art. 101, D.P.R. 22.12.1986 n. 917).

[9] Eg, Internal Revenue Code § 1(h) (USA) (26 U.S.C. § 1(h)); Income Tax Act ((*Einkommenssteuergesetz (EStG)*) § 32d (Gesonderter Steuertarif für Einkünfte aus Kapitalvermögen) (Germany).

for tax purposes can be set off against profits of other income, thus reducing the profits to be taxed and therefore the tax itself. Typically, the losses are losses for tax purposes only; taxpayers employing tax shelters do not ordinarily suffer economic costs or losses apart from transaction costs.[10] Other shelters operate by entitling taxpayers to claim a status that confers a reduction in tax. The structure that was the subject of the Australian High Court decision in *Cridland v Federal Commissioner of Taxation* (1977)[11] is an example.

Like many tax shelters, Cridland's scheme exploited a provision designed to mitigate certain unfairness in the tax system. The unfairness in question arose from the progression of the Australian income tax scale as the scale operates in the context of the sharp, climate-induced fluctuations typical in the income of many Australian farmers. Because of the structure of the rules for the taxation of trusts, this unfairness could bear particularly hard on beneficiaries of trusts that derived income from farming. A good year, where farming income had been taxed at a high rate on the progressive scale, might be followed by a poor year, with little or no income. But like most tax legislation, the Australian Income Assessment Act 1936 had no provision to shift income from good years into bad years, either forwards or backwards. The result was that beneficiaries who derived farming income could well be taxed at a higher average rate than people with similar income that was spread evenly from year to year.

The Australian legislature addressed this unfairness by enacting Section 157 of the Income Tax Assessment Act 1936 (Cth), which allowed beneficiaries of trusts that derived income from primary production to average their income over several years, and to pay tax on the averaged sums. Where taxpayers qualified for this treatment, averaging applied to all their income, not solely to farming income derived via trusts.

Cridland was in a position of having income that fluctuated, or that would fluctuate, in that he was a university student in the modest circumstances typical of a student, but he hoped to find a well-paying position after graduation. To qualify himself after graduation to average his income for tax purposes Cridland purchased a unit (in effect, a share) in a unit trust that farmed cattle. The unit

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[10] Film production is a popular example. See, eg, *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] 1 AC 655, 64 TC 617 (HL) and *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433, (2005) 22 NZTC 19,098 (PC).

11 *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330 (HCA).

cost very little. The trust had been established to afford to students precisely such an opportunity. Its objective was to ensure that beneficiaries derived *some* income from primary production, albeit very little.

Armed with his unit, Cridland, now a salaried engineer, submitted his tax return with his salary spread back into his impecunious student years. The Commissioner declined to accept Cridland's calculations and taxed his salary according to the year when it was derived. The Commissioner relied on the Australian GAAR as it then stood, section 260 of the Income Tax Assessment Act 1936 (Cth), which read:

> Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly —
> (a) altering the incidence of any income tax;
> (b) relieving any person from liability to pay any income tax or make any return;
> (c) defeating, evading or avoiding any duty or liability imposed on any person by this Act; or
> (d) preventing the operation of this Act in any respect,
> be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

Cridland objected. The case made its way to the High Court of Australia where, surprisingly, at least to a non-Australian, Cridland won, on the basis that he did in fact derive income from primary production. It did not matter that hardly any of Cridland's income was from farming, nor that his claim to be a farmer was based on nothing of substance. One would think it clear enough that under section 260 Cridland's scheme was void against the Commissioner as, inter alia, an

> arrangement [that had] ... the purpose or effect of in any way, directly or indirectly —
> (a) altering the incidence of any income tax; [or of]
> (b) relieving any person from liability to pay any income tax

In the submission of the present author, the *Cridland* case is so much an egregious example of a tax shelter that it is almost a caricature of tax avoidance, albeit that Cridland was in fact successful before the courts. One result was that the Federal Parliament replaced section 260 in 1980 with a much more complex GAAR.[12]

[12] Part IVA, Income Tax Assessment Act 1936 (Cth).

III. The fundamental problem of GAARs

The major difficulty posed by a GAAR is that on one hand a provision of a tax code permits the taxpayer to do whatever it is that he or she purports to do and to enjoy the fiscal benefits that the provision affords (or that the general structure affords). On the other hand, a GAAR in effect prohibits the taxpayer from relying on the provision in question. This position obtains even though the GAAR's prohibition is expressed generally and that the permissive provision is specific. For instance, one rule may permit taxpayers to deduct certain expenses in calculating assessable income;[13] and another rule may permit taxpayers to rely on a defined status, being a status that confers tax benefits.[14] But a GAAR may purport to negate both those permissive rules, at least in the circumstances of the case in question. Worse, if the GAAR does override a permissive rule the overriding appears to breach the principle of statutory construction known as *generalia specialibus non derogant* (general provisions do not derogate from specific rules).

The *Cridland* case, discussed in section II of this chapter, illustrates the problem. According to section 157 of the Australian Income Tax Assessment Act 1936, Cridland qualified to spread his income back into earlier years because he derived income from farming, albeit very little. On the other hand, it is obvious to the present author that Cridland's scheme had no purpose other than tax avoidance, and therefore should have been held to be void against the Federal Commissioner of Taxation.

The present author has argued elsewhere that, despite its apparent contradictory nature and other defects, a GAAR is a worthwhile, even a necessary, component of a tax code, at least of an income tax code.[15] But this necessity

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[13] Eg, *Cecil Bros Pty Ltd v Federal Commissioner of Taxation* (1964) 111 CLR 430 (HCA, FC).

[14] Eg, *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330 (HCA, FC).

[15] Eg, Prebble, John, Rebecca Prebble & Catherine Vidler Smith, "Retrospective Legislation: Reliance, the Public Interest, Principles of Interpretation and the Special Case of Anti-Avoidance Legislation" (2006) 22 NZULR 271–299; Zoë Prebble and John Prebble (2010) "The Morality of Tax Avoidance" 20 Creighton Law Review (Symposium Issue: Estate Planning, Moral, Religious, and Ethical Perspectives) 693–745; Rebecca Prebble and John Prebble "Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study" (2011) 55 St Louis University Law Journal (Symposium Issue, Sanford E. Sarasohn Memorial Conference on Critical Theory in Taxation) 21–45. Amplified version in Susy Frankel (ed) Learning from the Past, Adapting for the Future: Regulatory Reform in New Zealand (LexisNexis, Wellington, 2011), all

does not make GAARs easy to apply. A fundamental reason, probably the fundamental reason, is that GAARs may appear to breach, and, as a matter of substance, arguably do in fact breach, the logic behind the principle of exclusion of contradictions, often called the "principle of non-contradiction".

IV. Aristotle

Aristotle explained the principle of non-contradiction in some detail, but for present purposes Gottlieb's simplified summary is sufficient:[16]

> According to Aristotle, first philosophy, or metaphysics, deals with ontology and first principles, of which the principle (or law) of non-contradiction is the firmest. Aristotle says that without the principle of non-contradiction we could not know anything that we do know. Presumably, we could not demarcate the subject matter of any of the special sciences, for example, biology or mathematics, and we would not be able to distinguish between what something is, for example a human being or a rabbit, and what it is like, for example pale or white. Aristotle's own distinction between essence and accident would be impossible to draw, and the inability to draw distinctions in general would make rational discussion impossible. According to Aristotle, the principle of non-contradiction is a principle of scientific inquiry, reasoning and communication that we cannot do without.

Gotlieb identifies three versions of the principle:[17]

> 1. It is impossible for the same thing to belong and not to belong at the same time to the same thing and in the same respect (with the appropriate qualifications) (*Metaph* IV 3 1005b19–20).
> 2. It is impossible to hold (suppose) the same thing to be and not to be (*Metaph* IV 3 1005b24 cf.1005b29–30).
> 3. Opposite assertions cannot be true at the same time (*Metaph* IV 6 1011b13–20).

We could usefully test the operation of a GAAR against any or all of the three versions, but the third seems to be the most apt. In the context of income tax law, the principle of non-contradiction seems to tell us that we cannot assert as true that a particular transaction is not taxable according to ordinary charging provisions of the statute but at the same time that the transaction is taxable

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available on the author's SSRN pages, http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=115459.

[16] Gottlieb, Paula, "Aristotle on Non-contradiction", *The Stanford Encyclopedia of Philosophy* (Spring 2013 Edition), Edward N. Zalta (ed.), http://plato.stanford.edu/archives/spr2013/entries/aristotle-noncontradiction/.

[17] Idem.

according to the GAAR. And yet, on the face of it, that contradiction is precisely the effect of applying a GAAR.

We sense intuitively that the argument in the previous paragraph may not be the last word on the subject. Aristotle's principle of non-contradiction is tolerably compelling in the field of facts. One can accept that it is at least improbable that something can at the same time both be a rabbit and not be a rabbit. But does the same reasoning necessarily apply to norms? There seems, somehow, more possibility that the norms "you ought not to kill" and "you may kill" could coexist than could the facts of rabbit and non-rabbit.

Our intuition is correct. To a non-philosopher the following two norms appear to constitute a logical contradiction: "The Commissioner ought to charge X tax on his income" and "The Commissioner ought not to charge X tax on his income". As section V of this chapter explains, Kelsen tells us that this situation is not strictly speaking a contradiction. The reason is that the conflicting statements are "ought" statements, not "is" statements. Since neither statement claims that something "is", the statements cannot contradict or be contradicted.[18]

While this may be the strict philosophical position there is more to say from a fiscal perspective. Take again the *Cridland* case, discussed in section II. The claim seems unmeritorious on its face. But the taxpayer has at least a semblance of a grievance if on one hand the statute allows him to spread his income for tax purposes and on the other hand denies him that right. The contradiction may not be a true contradiction in philosophical terms, but taxpayers can be forgiven for thinking that it is a kind of a contradiction that merits study. Such study is the purpose of the sections of this chapter that follow.

V. Kelsen

The question that terminates the previous paragraph of this chapter is an example of the kind of question that Kelsen addressed in his book, *Pure Theory of Law*,[19] published in English in 1967. *Pure Theory of Law* was a translation of the second edition of Kelsen's *Reine Rechtslehre*, 1960, being a completely revised edition of the first edition of 1934. Professor Max Knight, the

[18] Kelsen, Hans, *General Theory of Norms*, Trans Hartney, Michael (Oxford: Oxford University Press 1991) 163–164, 213–214, 219.

[19] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 73–74.

translator, explained Kelsen's mission in *Pure Theory of Law* in his "Translator's Preface". He said that Kelsen:[20]

> … attempts to solve the fundamental problems of a general theory of law according to the principles of methodological purity of jurisprudential cognition and to determine to a greater extent than before the position of the science of law in the system of the sciences.

Considering these overall objectives, it is not surprising that in Kelsen's opinion the issue of whether the principle of non-contradiction applies as well to norms as to facts was a question worthy of consideration. Among other things, answering the question should help to place the science of law in relation to the system of sciences that addresses facts. Kelsen had already addressed the question in *General Theory of Law and State*,[21] where he concluded:

> The judgments "*A* ought to be" and "*A* ought not to be" (for example, "you ought to speak the truth" and "you ought not to speak the truth" are just as incompatible with one another as "*A* is" and "*A* is not". For the principle of contradiction is quite as valid for cognition in the sphere of normative validity as it is in that of empirical reality. [Kelsen wrote of the "principle of contradiction", but it is clear that he used this expression to mean what others mean by the "principle of non-contradiction". When he came to *Pure Theory of Law* Kelsen used the more informative label, the "Principle of Exclusion of Contradictions".[22]]

By 1960 it seems that Kelsen had realised that this passage was an over-simplification and that logically he could not argue that the principle of non-contradiction applied in the same manner to norms as it does to facts. Although still writing in the magisterial tone that

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[20] Id, v.

[21] Kelsen, Hans, *General Theory of Law and State*, Trans Anders Wedberg (1945) Cambridge, Mass, 408.

[22] Kelsen used lower case initial letters for "principle of contradiction" in *General Theory of Law and State* (text accompanying previous footnote) but there are initial capitals for "Principle of Exclusion of Contradictions" in *Pure Theory of Law* (text at fn 27). It seems probable that it was Kelsen's idea to keep the capital letters in the style of the German language. Max Knight, the translator, was conscious that the style of *Pure Theory of Law* wears its origin on its sleeve. Knight wrote, "This translation, carefully checked by [Kelsen], represents a compromise between a contents-conscious author and a form-conscious translator. Kelsen's immense experience with misinterpretations of his works as a result of "elegant" translations had to be the deciding factor when seemingly repetitious or Germanic-sounding passages, expunged from or rephrased in an earlier draft of the translation as too literally mirroring the original, were restored." "Translator's Preface", Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, vi.

characterises *Pure Theory of Law* Kelsen refined and diluted his conclusion.[23]

In *Pure Theory of Law*, Kelsen started from the proposition that the canonical form of a legal norm is an ought statement in the form of, "If somebody steals he ought to be punished".[24] Kelsen resiled from the broad proposition quoted from *General Theory of Law and State*,[25] above, and conceded that:[26]

> Since legal norms, being prescriptions (that is, commands, permissions, authorizations), can neither be true nor false, the question arises: how can logical principles, especially the Principle of the Exclusion of Contradiction[27] … be applied to the relation between legal norms, if, according to traditional views these principles are applicable only to assertions that can be true or false? The answer is: logical principles are applicable, *indirectly*, to legal norms to the extent that they are applicable to the *rules of law which describe the legal norms* and which can be true or false. Two legal norms are contradictory and can therefore not both be valid at the same time, if the two rules of law that describe them are contradictory ….

Two clues to the import of this passage are the words, "indirectly" and the meaning that Kelsen gives to the expression "rules of law" (both italicised above). In using "indirectly" Kelsen admits that, logically, he must concede that he cannot apply the principle of non-contradiction to legal norms. The meaning that Kelsen gives to the expression a "rule of law" amplifies the reason. Kelsen explains that by "rule of law" he means not a norm, such as a law promulgated by a legislator, but a "statement formulated by the science of law … describing [the] norm,"[28] such as a description of the norm that a scholar might write. For example, a legislator might promulgate a norm may "prescribing execution against a person who does not fulfil a marriage promise and does not

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[23] In discussing the principle of non-contradiction, Kelsen did not mention Aristotle in either *General Theory of Law and State* or *Pure Theory of Law*, though the index to the former contains six references to Aristotle in other contexts.[23] No doubt Kelsen thought that he was writing for erudite readers for whom references to Aristotle's role in the development of Western philosophy would be supererogatory.

[24] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 75.

[25] Though *Pure Theory of Law* does not mention *General Theory of Law and State* in the context under discussion here.

[26] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 74, emphasis added.

[27] In *Pure Theory of Law*, Kelsen adopted this more expansive label for what he had called simply "the principle of contradiction" in *General Theory of Law and State*. See passage quoted at fn 21 of this chapter.

[28] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 73.

compensate for the damage,"[29] whereas a scholar's description of this norm might say, "… that execution [that is, civil execution, such as a bailiff's seizure and sale of the goods of the defendant] ought to be carried out against a person who does not fulfil a marriage promise and does not compensate for the damage."[30]

The discussion just described occurs on pages 73 and 74 of *Pure Theory of Law*. Kelsen returns to the Principle of Exclusion of Contradictions on pages 205–207 with more confidence, and asserts that:[31]

> [L]ogical principles in general and, and the Principle of the Exclusion of Contradictions in particular, are applicable to rules of law describing legal norms and therefore indirectly also to legal norms. Hence it is by no means absurd to say that two legal norms "contradict" each another. And therefore only one of the two can be regarded as objectively valid. To say that *a* ought to be done and at the same time ought not to be done is just as meaningless as to say at the same time that *a* is and at the same time that it is not. A conflict of norms is just as meaningless as a logical contradiction.

For Kelsen, a conflict of norms within a single legal system was a serious matter. One norm, or the other, or perhaps both, must be invalid.[32] It behoves us, therefore to resolve the conflict if at all possible, either by applying the principle of statutory interpretation, *lex posterior derogate priori*[33] or by construing the two apparently conflicting norms to understand that they are in fact separate, with one norm creating an exception to the other.[34] Nevertheless[35]

> If neither the one nor the other interpretation is possible, then the legislator creates something meaningless; we have then a meaningless act of norm creation and therefore no act at all [that is, nothing that can be called a norm] whose subjective meaning can be interpreted as its objective meaning; no objectively valid legal norm is present ….

Serious matter though this outcome may be in theory, is it a matter for serious concern? One bears in mind that Kelsen's argument reaches this outcome, by his own admission, only "indirectly", and only by almost re-defining his terms from "legal norms" to a special meaning of "legal rules" that Kelsen seems to invent for the

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[29] Idem.

[30] Idem.

[31] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 206.

[32] The present author's deduction by implication from Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 206.

[33] A later [inconsistent] law overrides an earlier law.

[34] Id 206–207.

[35] Id 207.

occasion. Further, while they are logically correct, the examples that Kelsen gives are not particularly realistic, for instance a statute that stipulates both that "adultery is punishable and adultery is not punishable".[36] One suspects that if there are examples of true contradictions between legal norms they are most likely to have occurred by mistake. It is not surprising that later in life Kelsen changed his mind about his belief expressed in *Pure Theory of Law* that if legal norms contradict each other there is a breach of the Principle of the Exclusion of Contradiction, such breach resulting in invalidity of the norms in question.[37]

Nevertheless, there was more utility in the discussion of the Principle of Exclusion of Contradictions in *Pure Theory of Law* than Kelsen eventually claimed. The discussion might shed limited light on law in general, but the discussion contributes substantially to our understanding of general anti-avoidance rules in tax statutes.

VI. GAARs and the Principle of Exclusion of Contradictions

The world has increasing numbers of GAARs, each duly enacted by its legislature, and each recognised as law by courts that have jurisdiction in tax cases. GAARs are rarely attacked as unconstitutional, and such attacks generally fail.[38] Nevertheless, it is undeniable that at least at some level GAARs contradict charging or relieving provisions in income tax legislation. That is their purpose.

Return to *Cridland v Federal Commissioner of Taxation*,[39] the example discussed in section II of this chapter. The taxpayer, Cridland, was undeniably a beneficiary of a trust and he undeniably derived income from primary production via that trust. In the words of section 157 of the Income Tax Assessment Act 1936 (Cth) Cridland was therefore entitled to spread his income backwards from the current year to earlier years in order to take advantage of the lower rate thresholds of those years, lower rates that Cridland had not exhausted at the time because as a non-salaried student he then derived a lower income. On

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[36] Id 206.

[37] See section XI of this chapter.

[38] A leading example is *National Federation of Independent Business v. Sebelius*, 567 U.S. ___ (2012), 132 S.Ct 2566, 183 L. Ed. 2d 450. Even this attack was flanking rather than head-on, in that the taxpayer's primary argument was that the Obama health reforms, adopted in the same statute as the American GAAR, namely The Patient Protection and Affordable Care Act 2010, were unconstitutional.

[39] *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330 (HCA).

the one hand, the High Court of Australia vindicated Cridland, holding that he was entitled to benefit from his tax minimisation scheme.

On the other hand, the GAAR, section 260 of the same statute, quoted in full in section II of this chapter, said:

> Every … arrangement … shall so far as it has … the purpose or effect of in any way, directly or indirectly …
> (b) relieving any person from liability to pay any income tax …
> be absolutely void, as against the Commissioner ….

It is hard to think of any purpose that the arrangement had apart from relieving Cridland of liability to pay income tax. Cridland owned only one unit in the farming trust in question; so the arrangement was certainly not a business or investment proposition on his part. On the facts of the case, there was no other conceivable purpose for the arrangement.

As applied to the facts of the *Cridland* case, sections 157 and 260 of the Income Tax Assessment Act do appear to be in conflict, especially if we frame the conflict in terms of Kelsen's explanation of scholars' descriptions of rules of law. discussed in the previous section of this chapter. One rule, section 157, provides that in calculating his income tax liability Cridland may claim the status of primary producer, together with the reduction in tax that this status confers. The other rule, section 260, provides that Cridland ought not to claim this status and reduction in taxation. In 1977 the Australian High Court resolved the conflict by holding that section 157 prevailed, at least on the facts of that case.

It is not likely that the High Court would reach the same conclusion today, but what the *Cridland* case illustrates is more general than the court's actual conclusion. First, the case reminds us that, whatever the facts, a court must come to a conclusion in GAAR cases; courts are bound to decide GAAR cases just as they are bound to decide all cases. In this light, talk of conflict of norms somehow misses the point. No matter how conflicting two relevant norms seem to be, the court must resolve the conflict. But this conclusion is formal, even superficial. The problems with GAARs are much deeper.

In the context of a discussion about the Principle of Exclusion of Contradictions one such problem stands out: what is the relationship between the charging and relieving provisions of a taxing statute on one hand, and the statute's GAAR on the other? As McCarthy P said, a GAAR that avoids arrangements that have the purpose of avoiding tax or of simply relieving a taxpayer from tax "cannot be given a literal application, for that would … result in the avoidance of transactions which were

obviously not aimed at by the [GAAR]."[40] For instance, the GAAR would avoid a gift to charity made with a purpose of qualifying for a charitable deduction, which presumably cannot be the purpose of the GAAR. Lord Wilberforce made the same point, in more detail. Speaking of the then New Zealand GAAR, he said in 1971:[41]

> It fails to specify the relation between the section and other provisions in the Income Tax legislation under which tax reliefs, or exemptions, may be obtained. Is it legitimate to take advantage of these so as to avoid or reduce tax? What if the only purpose is to use them? Is there a distinction between "proper" tax avoidance and "improper" tax avoidance? By what sense is this distinction to be perceived?

GAARs, and relieving provisions against which avoidance litigaton juxtapose GAARs, do not contradict each other in the strict sense of which Kelsen speaks in *Pure Theory of Law*. Nevertheless, in a manner that is both substantive and practical, the tension between GAARs and relieving provisions is certainly a contradiction. The strict, logical, contradiction to which Kelsen refers may possibly be seen occasionally, though Kelsen gives no examples from history. Problems that may emerge from this kind of pure contradiction are largely hypothetical, like Kelsen's example of rules that punish and that do not punish adultery. As mentioned, if true contradictions of legal norms exist within jurisdictions they are most likely to have occurred by mistake.

In sharp contrast, the tension between GAARs and relieving provisions is an everyday conflict with which tax scholars, taxpayers, tax officials, and tax judges struggle daily, in many jurisdictions. The conflict between a GAAR and a relieving provision is far from a mistake; legislatures enact GAARs specifically to nullify transactions that would otherwise be unexceptionable.

Like most legal philosophers, Kelsen wrote, and probably knew, little about tax law. It is unlikely that it occurred to Kelsen that tax law might be different in kind from most other areas of law[42] and unlikely that he ever made the acquaintance of a GAAR, that unusual species of law that is designed with an in-built contradiction (using "contradiction" in a broad, substantive, sense). This is our loss. Legal science would most certainly have benefited from Kelsen's thoughts. Nevertheless, although we cannot profit from thoughts that Kelsen undoubtedly would have

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[40] *Commisioner of Inland Revenue v Gerard* [1974] 2 NZLR 279, 280 (CA).
[41] *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591, 602 per Lord Wilberforce (dissenting) (PC).
[42] See papers cited at fn 15 and fn 70.

had about GAARs specifically, his general, if somewhat hypothetical, thoughts about contradictory norms and about the Principle of Exclusion of Contradictions shed welcome light on this complex area of law. To summarise, GAARs and relieving provisions do contradict one another, even if only substantively and not in strict logic. Courts must struggle to resolve that contradiction. It helps, as a start, at least to recognise the nature of the problem.

A good example of mischaracterisation of the problem occurred in the New Zealand Supreme Court case of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009),[43] a case about a tax shelter. The New Zealand Supreme Court was inaugurated in 2004 to replace the Judicial Committee of the Privy Council as New Zealand's final court of appeal. *Ben Nevis* was the Court's first tax avoidance case. Speaking for the majority, McGrath J explained that it was desirable to settle the approach to be applied to resolve the:[44]

> continuing uncertainty about the inter-relationship of the general anti-avoidance provision with specific [taxing and relieving] provisions". [He continued:[45]]
>
> It is accordingly the task of the Courts to apply a principled approach which gives proper overall effect to statutory language that expresses different legislative policies. It has long been recognised those policies require reconciliation.[46]

McGrath J's words are a candid judicial statement that explicitly recognises a general category of contradictions between legal norms, being contradictions that are explained by contradictory policies (taxation or relief from tax on one hand, and the frustration of avoidance on the other). But can we agree with the attempt at reconciliation of the inconsistency? McGrath J adopted the metaphor of a tandem, and said:[47]

> We consider Parliament's overall purpose is best served by construing specific tax provisions and the general anti-avoidance provision so as to give appropriate effect to each. They are meant to work in tandem. Each provides a context which assists in determining the meaning and, in particular, the scope of the other. Neither should be regarded as overriding. Rather they work together.

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[43] *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 (SC).
[44] Id [100] per McGrath J.
[45] Id [102] per McGrath J.
[46] *Commisioner of Inland Revenue v Gerard* [1974] 2 NZLR 279, 280 (CA), per McCarthy P and *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513, 549 (CA and PC), per Richardson J, also reported as *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155 (PC). (Court's footnote amplified.)
[47] Id [103] per McGrath J.

One is reduced to repeating "tandem" without managing to illuminate McGrath J's meaning. To unpick the metaphor, assume that the front wheel and rider represent a charging or relieving provision, or an investment structure, relied upon by a scheme of minimisation of tax (using "minimisation" as a neutral term that may or may not entail the avoidance that is the target of a GAAR). The rear wheel and rider represent the GAAR. Assume further, that in the case at bar the correct conclusion is that the GAAR annihilates the scheme of tax minimisation as an arrangement that has a purpose of tax avoidance. What has happened to the tandem? Have the rear rider and wheel overtaken the front rider and wheel? Where a scheme for tax minimisation has fallen to a GAAR as an arrangement to avoid tax it is stretching things to say that the GAAR and the provisions on which the scheme to minimise tax work "together". On the contrary, the GAAR switches off the benefit-conferring rule on which the tax planner relied.

The discussion of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* reveals that even though GAARs do not give rise to breaches of the Principle of Exclusion of Contradictions in the strict sense in which logicians use that expression, the tension between GAARs and relieving or other tax laws presents legal reasoning with challenges that are both similar to and dissimilar from the challenge of a conflict of norms: similar, in that we must resolve a conflict; dissimilar in that the challenges of GAARs are both practical and frequent, in comparison with true contradictions as Kelsen describes them, which are so rare as to be almost hypothetical. *Ben Nevis* demonstrates, further, that resolving the problem of GAARs is a problem worthy of Kelsen himself.

VII. Resolving conflicts between GAARs and other rules of tax law

As explained in the previous section of this chapter, the problem of resolving conflicts between GAARs and other rules of tax law does not map precisely onto the problem of repairing a breach of the Principle of Exclusion of Contradictions. Nevertheless, our approach must be similar. Kelsen does not explain what is to be done about such breaches, apart from recommending endeavours to interpret rules so as to avoid them.[48] The reader infers that if a breach occurs it is probably necessary to resort to

[48] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 206.

extra-legal remedies. In a curious way, the same happens with GAARs.

A court of final appeal may possibly resolve an issue of apparent conflict between norms with a response that can hardly be called "law". The decision will be binding on the parties, but it may not solve a deep conflict between norms. Such a result is indeed often the position for cases that turn on GAARs, cases that are notoriously inconsistent.[49]

The reason is that conflict between a charging or relieving provision of tax law and a GAAR logically cannot be resolved by reasoning that is strictly legalistic; if there are conflicting provisions of law of similar status the conflict can be resolved, if at all, only by reference to criteria that are outside the conflicting provisions. By definition, in the case that this chapter considers there are no legal provisions superior in the hierarchy of norms of the state in question to which the conflict can be referred for resolution. (If there were such superior norms we could not speak in terms of a conflict of norms.) Ultimately, it turns out that the criteria that have been mentioned, that is criteria that are outside the conflicting provisions, are not criteria of law but criteria of economic substance, or sometimes of morality, as will be explained.

All this is not to say that courts do not try to resolve conflicts between charging provisions and GAARs by reference to rules of law. Indeed, the judicial history of GAARs is largely a history of just that phenomenon. Courts are forever thinking of rules to resolve these conflicts. A good example is the so-called doctrine of choice, which the High Court of Australia invented in *W.P. Keighery Pty Ltd v Federal Commissioner of Taxation.*[50] Their Honours explained the doctrine thus:[51]

> Whatever difficulties there may be in interpreting s. 260, [the then Australian GAAR] one thing at least is clear: the section intends only to protect the general provisions of the Act from frustration, and not to deny to taxpayers

[49] Eg, Canadian Supreme Court cases on the Canadian GAAR cannot be reconciled in any satisfactory manner. Compare, for example, *Canada Trustco Mortgage Company v Canada* 2005 SCC 54 with *Mathew v Canada* 2005 SCC 55. In the respectful view of the author, the reasoning of the Supreme Court of Canada is inconsistent between the two cases. For an excellent analysis of the cases, albeit an analysis the is more charitable to the Court, see David G. Duff, "The Supreme Court of Canada and the General Anti-Avoidance Rule" 60 *Bulletin of International Taxation* 54 (February 2006).

[50] *W.P. Keighery Pty Ltd v Federal Commissioner of Taxation* [1957] 100 CLR 66 (HCA, FC).

[51] Id, [20] 86, per Dixon CJ, Kitto, and Fullagar JJ. McTiernan J agreed, 96.

> any right of choice between alternatives which the Act itself lays open to them.

On its face, this passage is entirely plausible. But a moment's thought shows that if the doctrine of choice is indeed a rule of law, then, at least in principle, a GAAR could have no effect. The reason is that wherever a GAAR is relevant to a transaction it follows that there must be at least two ways in which the legal structure of the transaction can be arranged, one attracting less tax than the other.

This situation is not a matter of cause and effect. The existence of a GAAR is not caused by, nor does it cause, a transaction to be able to take more than one possible legal form. Rather, the only cases where authorities may need to call on a GAAR are cases of transactions that permit two or more legal forms. For instance, in the *Cridland*[52] case, discussed in section II of this chapter, the taxpayer could have earned his salary in the same guise as everyone else, or he could have (as he did) pretended to be an earner of farming income. If there is only one possible legal form for a transaction then employing that form cannot be stigmatised as tax avoidance. But where there are two possible forms, the doctrine of choice would say that the taxpayer may choose the option that is fiscally cheaper without triggering the GAAR.

Broadly speaking, a GAAR may apply if (a) the taxpayer chooses the option that is fiscally cheaper and if (b) that option has some quality or other that may be impugned and that may thereby attract the GAAR: undue complexity, artificial valuations, and so on. In short, when a case is such that the GAAR may apply then that will be a case where the doctrine of choice potentially applies; the doctrine of choice maps onto the cases where the GAAR applies. The two have the same preconditions. But where the preconditions apply, and where, therefore, potentially both the GAAR and the doctrine of choice apply, then the GAAR is ousted. *Ex hypothesi*, it is ousted by the same conditions that are necessary for it to operate at all. It is perhaps for this reason that countries with mature GAARs have rarely seen courts applying the doctrine of choice since about 1990. Not that the doctrine is dead: in what looks suspiciously like agency capture, a GAAR in a Draft Directive for a Common Consolidated Corporate Tax Base for the European Community (2011) made the doctrine of choice a central element:

> *Article 80 General anti-abuse rule*

[52] *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330 (HCA).

> Artificial transactions carried out for the main [sole] purpose of avoiding taxation shall be ignored for the purposes of calculating the tax base.
>
> The first paragraph shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts.

It seems that someone spotted the problem, and in 2012 the Danish Presidency proposed that the second paragraph should be changed to:

> The first paragraph shall not apply to genuine commercial activities carried out for valid commercial reasons.

The preceding paragraphs of this chapter have considered the doctrine of choice not because it is important in the jurisprudence of GAARs (though it is significant in that context) but in order to illustrate by example that one cannot reconcile a conflict of norms between a GAAR and a charging provision by referring to legal norms.

VIII. Principles of economic substance

Except when they operate what may be called a "candid" GAAR, judges seldom expressly articulate the point, but being unable to refer to legal rules to resolve cases of avoidance and GAARs courts turn instead to principles of economic substance.

In this chapter, a candid GAAR means a GAAR that explicitly directs the court, or sometimes tax inspectors, to determine avoidance cases by reference to economic substance. Candid GAARs may be compared with standard GAARs, which generally have much the same effect in the end, but which are framed in terms such as, for example:[53]

> A tax avoidance arrangement is void as against the Commissioner for income tax purposes.

A recent candid GAAR, enacted in 2014, is Article 556-1 of the Tax Code of Kazakhstan. Unusually from a Western perspective, Article 556-1 is directed to tax authorities rather than to courts or to taxpayers, but this difference of drafting does not appear to lead to any substantial difference in effect. The article reads:[54]

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[53] Income Tax Act 2007, s BG 1 (New Zealand).

[54] Translation by Мария Джаембаева, Almaty, edited by the author; "(a)" and "(b)" added for clarity. The original Russian reads:

При выявлении в ходе налогового контроля случаев совершения налогоплательщиком (налоговым агентом) или группой налогоплательщиков (налоговых агентов) действия (бездействия), сделки, хозяйственной операции, в которых не содержится экономический смысл, повлекших уменьшение налогового обязательства, органы налоговой службы

> Tax authorities conducting taxation audits shall ignore any act or failure to act on the part of a taxpayer or group of taxpayers, including all business or other transactions, where such act or failure to act (a) lacks economic substance and (b) causes a decrease in tax liability; and the tax authorities shall ignore such act or failure to act in determining the liability of such taxpayers. For the purposes of this article "taxpayer" includes "tax agent".

Probably the most famous candid GAAR is §7701(o) of the United States Internal Revenue Code, which Congress inserted in March 2010. The core provisions of §7701(o) are:

> (o) Clarification of economic substance doctrine
> (1) Application of doctrine
> In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if-
> (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
> (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction. ….
> (5)(A) The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

This chapter quotes the Kazakh and American GAARs at some length to make the point that when judges are faced with reconciling conflicting norms, being charging rules and GAARs, they have no choice but to step outside the law and to test the facts of the case according to principles of economic and business substance.

Judgments in cases where standard GAARs are in play are much less explicit, but, particularly in jurisdictions that have had relatively long experience with GAARs, one often finds references to criteria of economic substance. For instance, in *Federal Commissioner of Taxation v Purcell* Knox C.J. said[55] that the provisions of the then Australian GAAR:[56]

> … are intended to and do extend to cover cases in which the transaction in question, if recognised as valid, would enable the taxpayer to avoid payment of income tax on what is really and in truth his income.

By these words, his Honour meant that the income in question was income of the taxpayer in a substantive,

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определяют налоговое обязательство таких налогоплательщиков (налоговых агентов) без учета указанных действия, сделки, хозяйственной операции.

[55] *Federal Commissioner of Taxation v Purcell* (1921) 29 C.L.R. 464, 466 (HCA, FC).

[56] Commonwealth of Australia Income Tax and Social Services Contribution Assessment Act 1936–1951, s 260.

economic, sense, even though legally he did not derive or own the income himself.

Sometimes courts illogically cling to the illusion of deciding a GAAR case according to legal rules, while at the same time determining the case according to economic substance. For instance, in the New Zealand case of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue,*[57] discussed in section VI of this chapter, the Supreme Court embarked on a "principled approach"[58] without in the end identifying any relevant principle of law, apart from that of giving "proper effect"[59] to relevant statutory language, something that we expect of a court as a matter of course. Ultimately, the case appears to have turned on questions of economic reality. The courts should:[60]

> … consider the use made of the [charging provision in question] in the light of the commercial reality and the economic effect of that use. The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond Parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.

It is instructive to consider this kind of argument in the more general terms that Kelsen employed. A good example is his sub-chapter, "Causal and Normative Social Science".[61] What happens, as he explains there, without specific recognition by legal scientists (or by judges in the passage just quoted) is that an argument such as that set out in that passage moves from "ought" to "is". There is no superior rule in the hierarchy of norms to resolve the conflict; in other words, the "ought" of positive, man-made norms is exhausted. The court turns instead to the "is" of the science of economics, a science that attempts to explain human behaviour causally, operating in the same manner as natural sciences and other social sciences. This invocation of "is", of fact, is of course anathema to the fundamental thesis of Kelsen's pure theory of law.[62]

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[57] *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 (SC).
[58] Id [13].
[59] Id [102].
[60] Id [109].
[61] Kelsen, Hans, "Causative and Normative Social Science", in Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 85 ff.
[62] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 4–10, 193, and *passim*.

IX. Principles of morality

As explained, when, together, the need to resolve conflicts between charging rules and GAARs, and the mandates of logic, require a departure from strictly legal rules, courts generally turn to economic reality, but occasionally they resort instead or as well to norms of morality. For instance, in *Elmiger v Commissioner of Inland Revenue*[63] Woodhouse J adopted the following passage from the United States Supreme Court case of *Higgins v Smith*:[64]

> Each tax according to a legislative plan raises funds to carry on government. The purpose here is to tax earnings and profits less expenses and losses. If one or the other factor in any calculation is unreal it distorts the liability of the particular taxpayer to the detriment of the entire tax-paying group.

Occasionally, a court will explain the operation of a GAAR in terms that appear to call on both morality and economic reality at the same time. Thus, in *Gregory v Helvering*, which turned on the American judge-made GAAR, the Supreme Court said:[65]

> The whole undertaking, though conducted according to the terms of [a particular provision of the United States tax code], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.[66]

Analytically, the shift from law to morality is a different kind of move from the shift from law to criteria of economic substance. As explained, the latter involves a move from law to fact. In contrast, going from law to morality is a shorter journey, from one normative system (law) to another (morals). Nevertheless, the pure theory of law sets its face against that journey just as resolutely as it does against moving from law to fact.

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[63] *Elmiger v Commissioner of Inland Revenue* [1966] 683, 687 (Woodhouse J), affd [1967] NZLR 161 (CA).

[64] *Higgins v Smith* (1940) 308 U.S. 473, 476–477.

[65] *Gregory v Helvering* 293 US 465, 469–470 (1935).

[66] Despite such observations, common law courts are adamant that morality has no place in judging whether tax avoidance has taken place. See, for example, *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 (SC) [15]: "[The judicial process of determining whether tax avoidance has occurred] must enable decisions to be made on individual cases through the application of a process of statutory construction focusing objectively on features of the arrangements involved, without being distracted by intuitive subjective impressions of the morality of what taxation advisers have set up."

X. Economic substance, morality, and the Pure Theory of Law

The mode of reasoning in applying GAARs described in the previous section of this chapter, deferring to criteria of economic substance or of morality, is wholly incompatible with Kelsen's pure theory of law.[67] Nevertheless, when it comes to GAARs the law has reached its boundaries. In order to resolve a conflict of norms where one norm is a GAAR courts must abandon the hierarchical climb towards the Grundnorm[68] and, bursting the bubble of law, must turn instead to norms that are outside law. Practice thus inevitably departs from Kelsen's theory and, where the norm is tested by reference to economic substance, practice departs from Kelsen's principle, "The reason for the validity of a norm is always another norm, never a fact".[69]

(There is an interesting parallel with Luhman's theory of autopoiesis, which posits that law is self-creating and autonomous, not part of other social systems and barely influenced by them.[70] Like Kelsen's pure theory of law, Luhman's theory of autopoiesis also breaks down when it tries to account for GAARs, and breaks down for similar reasons.[71])

These conclusions lead to several reflections. First, although it fails to account for GAARs, Kelsen's pure theory is nevertheless a powerful explanatory tool, a tool that for the most part depicts the nature of law accurately. At the same time, the failure of the pure theory when it comes to GAARs contains a lesson: that we cannot expect a GAAR to yield to standard legal reasoning, autonomous from considerations of economic substance and even of morality. In turn, this lesson shows that from the perspective of Kelsenian analysis (more precisely, the mirror image of Kelsenian analysis) fundamental theory

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[67] Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 195–278 and *passim*.

[68] The Grundnorm, translated in Pure Theory of Law as the "basic norm", is a norm presumed by the pure theory of law as the ultimate authority for the norms of a legal system. Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 4–10, 193, and *passim*.

[69] Kelsen, Hans, *What is Justice*? 219. See also Golding, M.P. "Kelsen and the Concept of 'Legal System'" in Summers, Robert S (ed) More Essays in Legal Philosophy (Basil Blackwell, Oxford 1971) 69, 77.

[70] See generally, Geraldine Hikaka and John Prebble "Autopoiesis and General Anti-Avoidance Rules" (2010) 21 Critical Perspectives on Accounting (Symposium Issue, "Critical Perspectives on Taxation) 545–559.

[71] Idem.

did not support the turn that scholars observed[72] in United States avoidance jurisprudence towards formality and literalism, occurring from approximately 2001. In Kelsenian terms, that turn seemed to respond to the pure theory of law, but it was mistaken to do so. The courts should have hewed to the economic substance approach of earlier years.[73] This mistake took on even greater significance in 2010, when Congress codified the economic substance doctrine as a candid statutory GAAR.[74]

Secondly, does the failure of the pure theory to account for GAARs shed any light on Kelsen's change of mind late in his career on the principle of non-contradiction when applied to norms? The following section addresses that question.

XI. Validity of conflicting norms

From the 1960s, Kelsen took a different view on the application of the principle of non-contradiction to conflicts between norms. His last word on the subject was in *General Theory of Norms*, which appeared in 1991, eighteen years after his death. In that book, Kelsen wrote:[75]

> As far as conflicts between general norms are concerned, it is not the case–as I claimed in my *Pure Theory of Law*– that a conflict of norms which cannot be resolved by the principle *lex posterior derogate legi priori* makes no sense and that both norms are therefore invalid. Each of the two general norms makes sense and both are valid.

This new and opposite approach attracted criticism.[76] In favour of Kelsen's later opinion is that, broadly speaking, according to the pure theory of law the validity of a norm depends not on its content but on whether it is authorised by a norm that is superior in the hierarchy to which it belongs.[77] Against that approach is the consideration that even if two norms are properly

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[72] Eg Postlewaite, Philip, "United States: the Judicial Sham Doctrine" in Prebble, Zoe and John Prebble "Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law" [2008] Bulletin for International Taxation, 151, 165, §9.3 ff.. A notable example is *Compaq Computer Corp v. Commissioner* 277 F.3d 778 (5th Cir. 2001), discussed idem.

[73] Described Postlewaite, above n 27.

[74] See above, section VIII, "Principles of economic substance".

[75] Kelsen, Hans, *General Theory of Norms*, Trans M. Hartney (Oxford: Oxford University Press 1991) 214, discussed in Duxbury, Neil "The Basic Norm: and Unsolved Murder Mystery" LSE Law, Society and Economy Working Papers 17/2007, sssrn.com/abstract=1033331, 2.

[76] Eg, Raz, J. (1976) "Critical Study: Kelsen's General Theory of Norms", Philosophia 6, 495.

[77] Eg, Kelsen, Hans, *Pure Theory of Law*, Trans Max Knight (1967) Berkeley, Calif, University of California Press, 193 ff.

authorised, together they make no sense if they contradict each other.

This chapter is not the place to resolve that conflict. But what can be said is that the case of a GAAR and a conflicting charging provision may be advanced as an example of two norms that are both undeniably valid but that conflict with one another. That is, the norms conflict with one another in the sense that to resolve the conflict we must go outside the law and resort to considerations of economic substance and possibly of morality, as explained in section X of this chapter. Would Kelsen have taken comfort from this example? It is hard to say. Like most legal philosophers Kelsen gave very little attention to tax law[78] and it seems unlikely that he ever turned his mind to, or even heard of, the curiosity that is a general anti-avoidance rule. The best that we can say is that as a true scholar Kelsen would have been glad to encounter a legal norm of a kind that he had not previously met. But would his pleasure have been alloyed when he appreciated that it is in the core nature of GAARs that their conflict with charging provisions of taxation law is in the end resolved by resort to the extra-legal principles of economic substance and even of morality?[79] From this perspective, one is almost relieved on Kelsen's behalf that he never knowingly encountered a GAAR, a species of law that calls into question two fundamental foundations of the pure theory.

XII. Conclusion

On the face of it, the implications of these considerations are of no more than scholarly interest. But there is in fact more. These implications are important to the modern world. The author has argued elsewhere that although GAARs are odd as a form of law, and that although GAARs appear to breach a number of the requirements that we generally insist on as criteria of good law, GAARs are at worst a necessary evil, necessary to counteract the shortcomings that are inherent in income tax law. The modern state relies a good deal on income tax law and cannot afford the luxury of permitting taxpayers to avoid paying their share by exploiting income tax law's inherent weaknesses.[80]

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[78] There is an isolated example of Kelsen's thoughts on taxation in Hart, H.L.A., "Kelsen Visited" (1963) UCLA Law Review 709, 717–722.

[79] Sections VIII and IX above.

[80] See, eg, the papers cited above at note 5, and see generally Prebble, John, "Ectopia, formalism, and anti-avoidance rules in income tax law" (1994) in W. Krawietz N. MacCormick & G.H. von Wright (eds) *Prescriptive Formality and Normative Rationality in Modern Legal*

Systems, Festschrift for Robert S. Summers, Duncker and Humblot, Berlin, 367- 383; Prebble, John, "Philosophical and design problems that arise from the ectopic nature of income tax law and their impact on the taxation of international trade and investment", (1995) 13 *Chinese Yearbook of International Law and Affairs*, 111-139, reprinted as Prebble, John, "Ectopia, tax law, and international taxation" [1997] *British Tax Review* 383; Prebble, John, "Can income tax law be simplified?" (1996) 2 *NZ Journal of Taxation Law and Policy* 187; Prebble, John, "Should tax legislation be written from a principles and purpose point of view of a precise and detailed point of view?" [1998] *British Tax Review* 112; see also Prebble, John, "Why is tax law incomprehensible?" (1994) BTR 380-393.