TAX AVOIDANCE IN LINEAR TRANSACTIONS: THE DILEMMA OF TAX SYSTEMS*

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1. INTRODUCTION

Taxpayer A wants to sell an asset to C. Taxpayer A also wants to minimize his tax liability on the income derived from the sale of the asset to C. Taxpayer A, therefore, first sells the asset to a related person B, with B in turn selling the asset to C. This structure, through which A minimizes his tax liability by using B as a conduit, is known as a "linear transaction."

How should tax systems respond to such multi-step schemes of a taxpayer in carrying out a transaction which is designed to minimize his income tax liability? Can the taxpayer's right of tax planning be reconciled with the treasury's right and duty to protect the collection of taxes and preserve the integrity of the tax system? When are the tax authorities justified in treating the above transaction as a single integrated sales transaction from A to C?

This is an old dilemma with no clear answer given by any modern tax system. Nevertheless, it is instructive to follow the responses of a few tax systems which share common principles and offer sensible guidelines. This Article focuses on three such tax systems, those of the United States, the United Kingdom, and Israel,¹ all of which have complex

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* All Israeli case law and statutory tax provisions have been translated and verified by the author and not the University of Pennsylvania Journal of International Business Law.

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¹ For a major survey of Israeli tax law, see Yitzhak Hadari, Tax Law in INTRODUCTION TO ISRAELI LAW (A. Shapira ed. forthcoming (1994)) (Introduction to the World Laws (Kluwer, forthcoming (1994))); Amnon Rafael, Business Operation in Israel, Tax Management Foreign Income Portfolios, (BNA) No. 967 (1990). As a short introduction, the current Israeli statute is called the Income Tax Ordinance of 1947 with an Israeli
tax statutes in addition to vast bodies of case law based on well established common law doctrines. The courts in the legal systems analyzed react in a like manner, even though the terminology and tax doctrines employed are different.

This Article proceeds from the basic premise that in all three legal systems, the taxpayer's use of a linear transaction is not criminal since it does not violate the tax law. Therefore, the question becomes whether the transaction is accepted as a legitimate form of tax planning or avoidance, or whether it is "inoperative" for taxation purposes. An "inoperative" tax avoidance scheme is one in which the steps that are taken are interrelated and, in fact, represent a single economic transaction for taxation purposes.

In addition, the various tax statutes do not contain a specific anti-avoidance provision with respect to the type of transaction under consideration. The three tax systems also

New Version of 1961 [hereinafter The Ordinance]. The Ordinance was introduced by the British during their international "Mandate" over then Palestine. The Ordinance was an adaptation of a model income tax statute drafted by the British for the enactment of income tax statutes in their colonies and "mandates." The Ordinance has continued in force in Israel since 1948. It was based on British concepts and common law principles but differed in its basic structure and many of its provisions. Following many Israeli amendments, a New Version was adopted in 1961 (Israel Laws, New Versions 120), and, since then, more than ninety amendments have been adopted. Israeli case law and tax theories were influenced by British tax law and until some two to three decades ago they had binding interpretory power. Since then British tax law has served as persuasive authority to be utilized over all sources of tax law, including U.S. case law, when interpreting a given statutory provision. Israel's current approach for interpreting a statutory tax provision is similar to interpreting any non-fiscal statute, and is based on the proper legislative purpose or intent in its broadest sense. See Kibbutz Hazor v. Assessing Officer, C.A. 165/82, 39(2) P.D. 70.

2 E.g., BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3.2, at 4-28 (2d ed. 1989 & Supp. 1993) ("Although the terms are occasionally used interchangeably, 'tax avoidance' and 'tax evasion' are usually differentiated—the former phrase denoting noncriminal modes of minimizing or avoiding tax liability; the latter, fraudulent behavior.").

3 The taxpayer might have disguised the real economic substance of the transaction, but the assumption is that he gave full disclosure of all relevant facts and did not attempt to commit fraud. Id.

4 For examples see I.R.C. §§ 269, 382, 482 (1986); see also Israeli Tax Ordinance §§ 82-85 (addressing taxation of income from the sale of stock not sold through an arms length transaction, assignment of income to minors, and other assignment of income transactions through which a taxpayer can
share common tax concepts in this area in the sense that the taxpayer is entitled, subject to various tax avoidance doctrines, to structure a transaction in a form that would require the payment of less taxes than another equally available form. However, if the transaction is structured only to avoid taxation, then the systems would tax the transaction regardless of the form selected, a result that is consistent with the meaning and statutory intent of the applicable tax provision.

For U.S. authorities, see Judge Learned Hand writing for the court in Helvering v. Gregory:

[A] transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one chose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.

69 F.2d 809, 810 (2d Cir. 1934), aff'd sub nom., Gregory v. Helvering, 293 U.S. 465 (1935). In another opinion, Judge Learned Hand also stated:

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.


Lord Tomlin of the House of Lords similarly held in Inland Revenue Commrs v. Duke of Westminster:

Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.


Similarly, Justice Barak of the Israeli Supreme Court used the phrase "legitimate tax planning" in Kahn v. Director of Land Appreciation Tax, C.A. 389/82, 39(1) P.D. 794, 796; see also Justice Vitkon's holding in Director of Land Appreciation Tax v. Tamir, C.A. 262/65, 20(1) P.D. 695, 699-700.

6 See, e.g., United States v. Phellis, 257 U.S. 156, 168 (1921); Weiner't Est. v. Commissioner, 294 F.2d 750, 755 (5th Cir. 1961); Helvering v. Gregory, 69 F.2d at 811; Gilbert v. Commissioner, 248 F.2d 399 (2d Cir. 1957). Judge Learned Hand dissented in Gilbert stating:

It is a corollary of the universally accepted canon of interpretation that the literal meaning of the words of a statute is seldom, if ever,
The three tax systems also share similar canons of statutory construction. That is, that tax statutes are not interpreted on the mere basis of the letter of the law,\textsuperscript{7} but rather, in accordance with the proper statutory intent. Such statutory intent is sometimes referred to, particularly in U.S. writings, as "tax policy."\textsuperscript{8} However, the U.K. and Israeli courts are more cautious in using the term "tax policy" in this context. In order to avoid the usurpation of the legislature's role by the courts,\textsuperscript{9} the latter two will title judge-made law "judicial legislation"\textsuperscript{10} as opposed to "tax policy." In any event, the outcome of the three legal systems ought to be similar, since each system shares exactly the same dilemma with no unique characteristics to any of them that would

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\textsuperscript{7} See supra note 6 in general (including the Gilbert quotation) and Chirelstein, supra note 6, at 472-73, in particular. For the Israeli approach to statutory construction of tax law, see Justice Barak's opinion in Kibbutz Hazor v. Assessing Officer, C.A. 165/82, 39(2) P.D. 70.


\textsuperscript{9} Lord Jauncey states in White:

I conclude my analysis ... by emphasizing that the Ramsay principle is a principle of construction, that it does not entitle the courts to legislate against specific acts of tax avoidance where Parliament has not done so and that at the end of the day the question will always be whether the event or combination of events relied on amount to a chargeable transaction or give rise to allowable relief within the meaning of the relevant statutory provisions.

\textsuperscript{10} See Graham Mansfield, The 'New Approach' to Tax Avoidance: First Circles Then Linked New, Moreover, 1989 Brit. Tax Rev. 5

As the United Kingdom courts wonder how to develop the new approach, it is hoped that they will be extremely wary of an enthusiastic adoption of United States doctrines. In that system a number of doctrines often overlapping and frequently insufficiently delineated, have been developed. . . . Once however one goes beyond such doctrines, the United States experience, at least as it has struck this writer, is that the court has no chance of demonstrating a firm intellectual foundation for what it is doing. Id. at 142.}

This Article will review the current tax avoidance doctrines as they apply to multi-step transactions and demonstrate, in general, that the doctrines work well. This Article also proposes that the courts are justified in using a case-by-case approach to multi-step transactions for lack of an alternative normative approach. Of course, it is likely that some of the cases, in any given jurisdiction, were erroneously decided. This is an inevitable result of the case-by-case method, which is not usually due to normative error, but instead can be attributed to a failure on the part of the courts to discern the relevant legislative intent and to apply it to the facts of the case.

Sections 2 and 3 of this Article focus on the taxpayer's motive, legislative intent and the resultant tax avoidance dilemma. Section 4 analyzes the various tax avoidance
doctrines of the three legal systems. Sections 5 and 6 analyze the tax avoidance doctrines as applied to the more difficult linear transaction cases.

2. TAXPAYER'S MOTIVE AND LEGISLATIVE INTENT

Many courts stress that the tax avoidance motive of a taxpayer is immaterial.12 A taxpayer has a right to legitimately minimize taxes.13 Thus, there is nothing to be gained in revealing the taxpayer's motive in the given transaction. What is relevant, however, is a court's interpretation of the statutory intent as applied to the particular transaction under review. By holding the taxpayer's motive immaterial and the statutory intent relevant to a given transaction, the examination of the transaction becomes objective rather than subjective.

The use of the term "taxpayer's purpose" may be more suitable in this context. For example, the "taxpayer's purpose" in a multi-step scheme is to achieve her final goal. Motive reflects the reason why she structured the transaction in such form. Motive is to be ignored, while the "purpose" is usually relevant. This is particularly true when, taken together, the motive and the purpose have the effect of achieving the desired result.14 As Justice Vitkon of the Israeli Supreme Court stated:

Nothing is to be gained by an investigation and search for the real motives [of the taxpayers]. It is an illusion to presume that the citizen is not aware of the fiscal consequences of his doings and misdoings, and to require him to be naive.15

The U.S. Supreme Court responded to the Internal Revenue Service's ("I.R.S.'s") emphasis on taxpayer motive

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12 See, e.g., Judge Learned Hand in Helvering v. Gregory, 69 F.2d 809, 810 (1934) (quoted at supra note 5).
13 See discussion supra note 5.
instead of intent by stating: "We must confess to some skepticism as to whether such a verbal mutation would be of any practical consequence."\(^{16}\) Where the form chosen by the taxpayer is accepted, there is no need to inquire into his motive and a decision of form versus substance in a given case is dependent upon the statutory intent or policy of the law in question.\(^ {17}\) As one commentator noted:

We may therefore wish to deny tax advantages where use of particular forms serve no adequate non-tax goals. While purpose is central in distinguishing between acceptable and unacceptable uses of forms, purpose here generally can be equated with function. Thus, it is possible largely to ignore state of mind considerations and to rely almost entirely on external factors.\(^ {18}\)

As Justice Holmes stated in 1930: "The fact that [the taxpayer] desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you may intentionally go as close to it as you can if you do not pass it."\(^ {19}\) Judge Learned Hand made a similar observation a few years later in the much-quoted language of *Helvering v. Gregory*.\(^ {20}\) Even a specific anti-avoidance tax


\(^{17}\) Blum, *supra* note 8, at 535. Blum is of the opinion that even the purpose of the taxpayer is not significant. *Id.* at 536. Lord Oliver in *White* stated:

It seems to me, therefore, that the first and critical point is to be [sic] borne in mind in considering the true ratio[nale] of *Dawson* is that it rests not on some fancied principle that anything done with a mind to minimizing tax is to be struck down, but on the premise that the intermediate transfer, whose statutory consequences would otherwise have resulted in payment of tax being postponed, did not on the true construction of the Finance Act [of] 1965, constitute a disposal attracting the consequences . . . [of] that Act . . . Lord Wilberforce [in *Ramsay*] was at pains to stress that the fact the motive of the transaction may be to avoid tax does not invalidate it unless a particular enactment so provides ([1981] 1 All E.R. 865 at 871).


\(^{18}\) Blum, *supra* note 8, at 543-44.

\(^{19}\) Superior Oil Co. v. Mississippi, 280 U.S. 390, 395-96 (1930) ("evade" as used here means "avoid"); see BITTKER & LOKKEN, *supra* note 2, ¶ 4.3.2 n.16; see also *supra* note 2 and accompanying text.

\(^{20}\) *Id.* at 535 (quoted *supra* note 5).
provision with a reference to a taxpayer's motive or intent is in practice very difficult to implement, since it may include words such as "principal purpose of evasion or avoidance of federal income tax."\textsuperscript{21}

The same difficulty has been faced by the Israeli Supreme Court where the statute includes a general anti-avoidance provision,\textsuperscript{22} which was later amended by adding the phrase "if one of the principal purposes of a certain transaction is tax avoidance or the improper reduction of taxes," the tax assessor may ignore the transaction and tax accordingly. This phrase has not been interpreted as granting any meaningful authority to the Israeli Treasury.\textsuperscript{23} However, it may have a general interrorem effect on taxpayers and their tax advisers in causing them to become more scrupulous and more reluctant to adopt absurd artificial tax avoidance schemes. Thus, this language may contribute to the prevention of schemes which would fail to hold any water when tested by any knowledgeable tax agent or by any court which applies general legal standards.

However, from time to time a court will refer to the taxpayer's motive, and motive will play a role in the court's decisions. For example, the United States Supreme Court in Frank Lyon Co. v. United States,\textsuperscript{24} referred to the taxpayer's intent or motive in its discussion of Lyon's agreements, but at the same time stressed the factor of the non-tax "economic substance" of the agreements, or the requirement of a "change in the economic interests of the relevant parties."\textsuperscript{25} In many cases it is clear that the court's general impression of the taxpayer's motive of tax avoidance influenced the final outcome of the decision.\textsuperscript{26} When "deciding a fact issue[,] the courts will analyze and scrutinize with a special zeal where


\textsuperscript{22}See infra notes 41-56 and accompanying text.

\textsuperscript{23}Herzikovich v. Assessing Officer, C.A. 823/75, 30(3) P.D. 163, 167 (per J. Cohen, H.) also adopted in Adeler v. Assessing Officer, T.A. (J-M) 36/78, 10 P.D.A. 363, 369.

\textsuperscript{24}435 U.S. 561 (1978).

\textsuperscript{25}Id. at 571-72, 582-83; Newman v. Commissioner, 894 F.2d 560, 563 (2d Cir. 1990). One of the so-called "tests" for the step transaction doctrine depends upon the "intended" plan of the parties. See infra notes 85-86 and accompanying text.

\textsuperscript{26}BURGER & LORENZ, supra note 2, ¶ 4.3.2. n.23 and accompanying text.
tax avoidance appears as a motive."

3. THE DILEMMA OF THE TAX SYSTEMS

Modern tax statutes contain many formal routes and different avenues that allow taxpayers to achieve varied economic objectives or to readjust their businesses. Many of these routes are elective or optional statutory tax incentives operational at the taxpayer's will, provided that he is consistent with the form and procedures elected. This is a basic rule of tax planning. However, taxpayers must comply not only with the letter of the statutes, but also with the legislative intent as properly interpreted by the courts. Thus, the selection of the proper form and the adherence to the formalities and procedures of the law, while of vital importance, are only the beginning of sound tax planning and not the end. Since the form, formalities and procedures must conform to the legislative intent, the freedom of the taxpayer is somewhat illusory.

Legislative intent is difficult to ascertain and can only be described in general terms. Although many times referred to as legal doctrines, characterizations of legislative intent are at best general norms, and at worst elusive generalizations with very little practical value. This is an inevitable consequence of statutory construction, and the general doctrines of tax avoidance have adjusted well to most cases which provide the court with "a firm intellectual foundation for what it is doing." The main task for the court is to properly define the legislative intent of the relevant statutory provision and to apply it to the facts of the case.

Generally, however, when courts reject the taxpayer's choice of form, they often emphasize that the incidence of taxation reflects the substance of the transaction and that mere form is not controlling to the extent that the two do not coincide.

Naturally, the dilemma of the taxpayer's choice of form and

27 Paul, supra note 14, at 152.
28 See Tiley, Corporations and Conclusions, supra note 11, at 142 (expressing this criticism); cf. Chirelstein, supra note 6, at 472-74, and Paul, supra note 14, at 265.
the respective Treasury's authority to limit such choice should be resolved by a suitable accommodation between the conflicting needs of the two.  

4. DOCTRINES OF TAX AVOIDANCE

4.1. Basic Concepts in the Three Systems

U.K. law has developed one major doctrine for tax avoidance. Although the U.K. doctrine acknowledges the taxpayer's basic right to choice of form, it prescribes that the taxpayer is to be taxed on the basis of what he in fact did, and not on the basis of what he might have done in order to reach the same objective.  

The leading U.K. case dealing with this matter, Inland Revenue Comm'rs. v. Duke of Westminster, is still valid law, although qualified and distinguished under the so-called "new approach" of the House of Lords as pronounced in W. T. Ramsay, Ltd. v. Inland Revenue Comm'rs. Lord Wilberforce commented on the "new approach:"

To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable to enable the court to arrive at a conclusion which corresponds with the parties' own intentions ... [t]o say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is canceled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation

\[\text{https://scholarship.law.upenn.edu/jil/vol15/iss1/2}\]
is dealing with, is in my opinion well, and indeed essentially, within the judicial function.\footnote{Id. at 459.}

In White, Lord Oliver explained that in Ramsay the court decided to ignore the steps taken by the taxpayer with no business purpose whatsoever

other than the artificial manufacture of what was intended to be an allowable loss in such a way that the taxpayer suffered no loss at all in fact because, by another integrated and pre-planned transaction, the artificially contrived loss was balanced precisely by a non-chargeable gain. . . . But the fact was, as was plain to see, that those transactions not only were not intended to be interrupted or to stand in isolation but could not in fact have done so in the real world. They were totally dependent upon and integrated with other transactions whose purpose, and whose only purpose, was to nullify their effects and to leave the taxpayer in exactly the same position as they were before.\footnote{[1988] 3 W.L.R at 453-54 (per Lord Oliver).}

Likewise, Lord Oliver did not find a new doctrine in Ramsay, but rather stated:

What the case does demonstrate, as it seems to me, is that the underlying problem is simply one of the construction of the relevant statute and an analysis of the transaction or transactions which are claimed to give rise to the liability or the tax exemption. But it does not follow that because the court, when confronted with a number of factually separate but sequential steps, is not compelled, in the face of the facts, to treat them as if each of them had been effected in isolation, that all sequential steps must invariably be treated as integrated, interdependent and without individual legal effect.\footnote{Id. at 454.}

Thus, the court, some five decades later, reached the same conclusions as the U.S. Court in Gregory, although the terminology used in the two cases differed. The Ramsay court
used the same *business purpose* doctrine originated in *Gregory*, but simply did not refer to it as a "doctrine."³⁸

In *Gregory*, the taxpayer, in her personal capacity, wanted to sell securities held by her corporation. In order to avoid having the generated income taxed as dividends, she caused the corporation to transfer the securities to another newly established corporation and attempted to receive the securities as a part of a nontaxable liquidation of the new corporation, pursuant to the predecessor of section 368(a)(1) of the U.S. Internal Revenue Code ("I.R.C."). The Court refused to allow the taxpayer’s strategy, but decided

what actually occurred [was] ... [s]imply an operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner.³⁹

Judge Learned Hand further explained the doctrine as follows:

The doctrine of *Gregory v. Helvering* ... means that in construing words of a tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation.⁴⁰

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³⁸ See * supra* note 5; see generally BITTKER & LOKKEN, * supra* note 2, ¶ 4.3.4.


⁴⁰ Commissioner v. Transport Trading & Terminal Corp., 176 F.2d 570, 572 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950). See *Knetsch v. United States* where an elaborate tax savings scheme, which would yield substantial tax savings at a very small out-of-pocket cost for large interest payments, was ignored for tax purposes. The court stated that the taxpayer’s transaction could only yield him a tax deduction. See *Knetsch v. United States*, 364 U.S. 361 (1960). In a later decision, which presented another facet of the same transaction, the taxpayer was denied a loss deduction for a later year when the unsuccessful scheme was abandoned. The loss was not a loss incurred in a transaction entered into for profit as

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The same approach has been adopted by the Israeli court, although a general anti-avoidance provision appears in almost all Israeli tax statutes. For example, section 86 of the Tax Ordinance\textsuperscript{41} reads:

If the tax assessor is of the opinion that a certain transaction which reduces, or might reduce, the tax payable, is artificial or fictitious, or that a certain disposal is not effective, or if one of the principal purposes of a certain transaction is tax avoidance or the improper reduction of taxes, he is entitled to ignore the transaction or the disposal, and to tax accordingly. Avoidance of taxation, and the reduction of taxes could be viewed as improper even if they do not violate the law.\textsuperscript{42}

The main theory which has been advanced by the Israeli Supreme Court for interpreting the artificiality standard of section 86, and its counterparts in other Israeli tax statutes, is the business standard, which requires that the transaction have business purposes other than tax avoidance.\textsuperscript{43} The "other business purposes" must be of some significance and not merely act as a cover for tax avoidance purposes.\textsuperscript{44} It is not enough that the transaction could theoretically have a business justification if it did not have one in fact.\textsuperscript{45}

Section 86 of the Tax Ordinance also offers an alternative test to determine whether the transaction is "fictitious." A "fictitious" transaction is one that is "without reality or substance in the legal sense, which only appeared to be carried out in order to disguise the real transaction between or among the parties. A fictitious transaction is . . . without any real

\textsuperscript{41} The Tax Ordinance (New Version), \textit{supra} note 1.

\textsuperscript{42} The quoted material was translated by Yitzhak Hadari. For a general discussion of Israeli tax avoidance law see Hadari, \textit{supra} note 1.

\textsuperscript{43} Mefi, Ltd. v. Assessing Officer, C.A. 265/67, 21(2) P.D. 593; Assessing Officer v. Ulpaney Hasrata Israel, Ltd., C.A. 11/74, 29(1) P.D. 297 (both per J. Vitkon) [hereinafter Mefi-Ulpaney Hasrata cases].

\textsuperscript{44} T.M.B. Ltd. v. Assessing Officer, C.A. 83/81, 40(3) P.D. 402, 410 (per J. Bach).

\textsuperscript{45} Grinberg Ltd. v. Assessing Officer, C.A. 495/88, 46(2) P.D. 243 (per Chief Justice Shamgar).
economic substance or legal substance." This quotation sounds as if it could have been taken from U.S. or U.K. jurisprudence. The "artificial" transaction test also mentioned in section 86 has been applied by the Israeli courts using U.K. or U.S. terminology.

The Israeli term "artificial" is sometimes interpreted as meaning a transaction which does not correspond with acceptable business standards, even though it is legally valid.

For example, in one Israeli case, the taxpayer turned his large single home into a condominium, with each room, or rooms with adjacent utilities, being registered as separate apartments, even though he continued to use the entire house as a single home. His only purpose in so doing was to minimize his property tax. The court acknowledged that the form selected by the taxpayer conformed to the substance of the transaction. Indeed, the house was registered and became a condominium in the full legal sense. Nevertheless, the entire exercise was useless for tax avoidance purposes because it did not conform to acceptable business standards and lacked any business purpose.

The court reviewed the case despite the fact that at the time the pertinent property tax statute did not have a general tax avoidance provision. The court decided the case on the basis of general tax avoidance theories, which were formerly adopted for income tax purposes and have long been a part of the Tax Ordinance statute.

Again, we observe that despite differences in terminology and statutory framework the U.S., U.K., and Israeli tax laws


47 See Gregory v. Helvering, 293 U.S. 465, 469 (1935); see Knetsch v. United States, 364 U.S. 361, 366 (1960); BITTKER & LOKKEN, supra note 2, ¶ 4.3.3.; supra notes 34-37 and accompanying text (quotations from Ramsay and White opinions).

48 See Minnesota Tea Co. v. Helvering, 302 U.S. 609, 613 (1938) ("[a] given result at the end of a straight path is not made a 'different result because reached by following a dubious path'," and referring to the unnecessary step as "transparently artificial"). For the United Kingdom, see Mansfield, supra note 10, at 15.

49 Assessing Officer v. Ismar, Ltd., C.A. 102/59, 14(3) P.D. 2165, at 2168.

50 See Spear v. Director of Property Tax, C.A. 734/74, 30(1) P.D. 271.
have been following similar anti-avoidance concepts. This

demonstrates that the precise tax doctrine or terminology used
by the U.S., U.K. or Israeli courts is of little significance because

the basic theories are similar. Although a lot has been written
pushing for a precise demarcation in the lines between the various
doctrines, a clear tax avoidance scheme has, in any event, been inoperative for tax purposes in all three systems. We have already observed that the three systems have common norms in this area, and the precise definition of each tax avoidance rule, or doctrine, does not always serve useful purposes. All the systems share the same dilemma when confronted with a multi-step scheme with an acceptable business purpose for the entire scheme, and sometimes with a business purpose for each separate step. This dilemma will be further elaborated upon below, but another Israeli example is instructive.

Under the Israeli Capital Gains Tax on Real Estate, there is a special exemption for the sale of a residential home inherited by the taxpayer, provided that his share in the home is less than 50%. In one such case a taxpayer and her sister each inherited precisely 50% of a certain home. With a view to a possible future sale of her portion of the house, although none was concrete at that point, each taxpayer made a taxable sale of 0.5% of her portion. Later, the taxpayer’s portion (i.e., 49.5%) was in fact sold, and she argued for the tax exemption. Justice Barak responded:

The court of the first instance was correct in holding that the transaction had contradicted acceptable standards of economic life and it had lacked any business purpose, and its only purpose had been to get around the obstacle of the . . . [pertinent] section of the law, in requiring that [an exempted] sale be less than

61 See BITTKER & LOKKEN, supra note 2, ¶ 4.3.5 nn.92-95.
63 See supra note 11.
50% of the house. We are not concerned here with legitimate tax planning but with an artificial transaction, that should be ignored.\textsuperscript{56}

It should be noted that the first step of the transaction was legally effective, the 0.5% of the house was sold and the title was transferred. However, since this step lacked any business purpose, except for the enjoyment of the tax exemption, the taxpayer's illegitimate choice of form was to be ignored for tax purposes without regard to the taxpayer's obvious motive. A U.S. tax court would have reached the same result whether it was based on the business purpose concept or the step-transaction theory.\textsuperscript{57} Despite difficulties with the interpretation of \textit{Duke of Westminster},\textsuperscript{58} U.K. courts would have ruled the same way, because of the new approach illustrated in \textit{Ramsay}.\textsuperscript{59}

4.2. \textit{Application to Clear Tax Avoidance Cases Via Linear Transactions}

U.S. courts have prevented unjustified and unwarranted tax avoidance schemes under various tax doctrines. The principal doctrines employed are: 1) general "tax avoidance," 2) the preference to be given to the "substance" of the transaction rather than the "form" selected by the taxpayer, and 3) the "business purpose" doctrine—the "step transaction" variation (under which pre-agreed or pre-arranged integrated steps of the same plan or scheme are to be considered as one economic transaction for tax purposes, as opposed to giving tax effect to each separate step).\textsuperscript{60} We can easily add to those doctrines the basic theory that those who earn income ought to be taxed for it, or the theory of assignment of income, under which the case is decided without specific reference to any of the above tax avoidance doctrines.\textsuperscript{61} All these theories "are so

\textsuperscript{56} Kahn v. Director of Land Appreciation Tax, C.A. 389/82, 39(1) P.D. 794, 796.

\textsuperscript{57} See Associated Wholesale Groceries, Inc. v. United States, 927 F.2d 1517 (10th Cir. 1991); see also Section 5 of text.


\textsuperscript{59} See Millet, \textit{supra} note 14.

\textsuperscript{60} See BITTKER & LOKKEN, \textit{supra} note 2, \S 4.3.1.

\textsuperscript{61} See Commissioner v. Court Holding Co., 324 U.S. 331 (1945) ([U]sually}
pervasive that they resemble a preamble to the Code, describing the framework within which all statutory provisions are to function. But these judicial presuppositions, like the canons of statutory construction, are more successful in establishing attitudes and modes than in supplying crisp answers to specific questions."\(^{62}\)

Consider again the *Gregory* case where the Court emphasized\(^{63}\) that the substance of the activity in question had no "business or corporate purpose."\(^{65}\) The Court decided that only in "form" was there a reorganization but not in "substance."\(^{66}\) Thus, the step transaction doctrine may be said to have originated with *Gregory*. The doctrine rendered the purported liquidation a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not one to reorganize a business or any part of a business, but to transfer a parcel of corporate [assets] to the petitioner.\(^{67}\)

The Court declined to "exalt artifice above reality" and thus ruled that there had been no reorganization within its statutory meaning.\(^{68}\)

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Although the opinion in *Gregory* combines the tax avoidance doctrines, its emphasis on the business purpose rule is very similar to the interpretation of an "artificial" or even "fictitious" transaction in section 86 of Israel's Tax Ordinance. This interpretation would cover transactions made for no other business purpose "except for tax avoidance," or any transaction which "disguises the real business between the parties." We find similar reasoning expressed by the House of Lords: "[T]here must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax... The inserted step had no business purpose apart from the deferment of tax, although it had a business effect."

In fact, the *Gregory* court correctly stressed the role of legislative intent in statutory construction. The legislature intended to allow corporate reorganization to adjust a taxpayer's form, but there was no legislative intent or policy to enable the tax-free channeling or distribution of corporate assets. The *Gregory* court thus defined the statute's purpose and properly applied it to the facts, with the inevitable outcome that the income was treated as taxable dividends.

In multi-step corporate transactions, the step-transaction doctrine is often applied by U.S. courts as a variation of the "substance and form" concept or even the business purpose concept. As noted by the court in *Associated Wholesale Groceries, Inc. v. United States*, generally,

[t]he step transaction principle derives from the classic tax case *Gregory v. Helvering* ..., and its progeny. In *Gregory*, the Supreme Court's analysis of the tax effect of a transaction involved ... [p]utting aside ... the
question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred. The analysis revealed a transactional step which the Court characterized as 'an operation having no business or corporate purpose.'

Though not called the "step transaction doctrine," the same approach is used by the House of Lords. For example, Lord Oliver stated: "[T]he absence of any commercial motive [i.e., purpose] underlies the artificiality of the interrelated transactions and entitles the court to disregard them because they are not intended to produce anything other than an artificial fiscal result."

In both the U.S. and U.K. systems, it is immaterial that the intermediate, interrelated step has permanent legal, practical and fiscal consequences attached to it. The Israeli Court, in Kahn, adopted the same approach, but without reference to the "step transactions" or "interrelated steps" terminology. Although the intermediate step was fully effective in all other legal respects, it was without tax effect because it lacked any business purpose other than tax avoidance. The court's approach was consistent with the legislative intent of the exemption in question.

The U.S. step-transaction doctrine and its corresponding U.K. and Israeli doctrines in the context of linear, interrelated steps of an integrated transaction are discussed below. The principal legal point here is that such transactions should be analyzed as a whole rather than analyzing each step separately. When an intermediate step is utilized by the taxpayer, it achieves the same tax result as when the step-transaction doctrine is linked to the general concept of assignment of income.

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74 Associated Wholesale Groceries, Inc. v. U.S., 927 F.2d 1517, 1522 (10th Cir. 1991). The court in Gregory, therefore, held there was no reorganization within its statutory meaning. See supra text accompanying note 68.

75 Craven v. White, [1988] 3 W.L.R. at 455-56; see also supra note 6.

76 Id. at 456.

77 Kahn v. Director of Land Appreciation Tax, C.A. 389/82, 39(1) P.D. 794.

78 See supra note 61 and accompanying text.
The tax consequences which arise from gains from a sale of property are not finally to be determined solely by means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant.\(^8^0\)

Similar reasoning in a linear multi-step, integrated transaction was advanced by the House of Lords in *Furniss v. Dawson*\(^8^1\) and *White*,\(^8^2\) although each case ultimately arrived at a different conclusion. Although the precise issue has not been reviewed, it is expected that a similar conclusion would be reached by the Israeli courts.

Finally, in all three tax systems, we have to be wary of generalizations. Although it is important to understand the above tax avoidance doctrines and attempt to apply them in analyzing specific cases and issues, their shortcomings are quite obvious. The doctrines are only the starting point of the analysis, and as Judge Learned Hand observed, their generality is their major limitation.\(^8^3\) They have very little practical use in resolving complex issues of fact and law. The exact findings of fact, as well as the analysis of the relevant statutory intent (i.e., policy) and its application to the particular facts are all vital.

It is from this perspective that the step transaction doctrine can play its role as a tool for analyzing the difficult fact patterns of linear transactions. Given certain findings of fact, the court can determine if the relevant statutory intent is met.\(^8^4\)

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\(^8^0\) Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945). *Court Holding* was based on a finding of facts by the lower court that the transaction was done by the corporation and not by shareholders. *See also supra* note 61; *cf.* United States v. Cumberland Pub. Serv. Co., 338 U.S. 451 (1950).

\(^8^1\) [1984] 2 W.L.R. 226.

\(^8^2\) [1988] 3 W.L.R. 423.


\(^8^4\) Lord Keith stated in *White*:

My Lords, in my opinion the nature of the principle to be derived from the three cases is this: the court must first construe the
5. THE APPLICATION OF THE STEP TRANSACTION DOCTRINE TO LINEAR CASES

As noted, the step transaction doctrine is often used by U.S. courts in analyzing multi-step linear transactions. The doctrine is a derivative of the broader tax concept that substance should prevail over form. Courts have developed tests determining when the doctrine should be applied, but have failed to define clearly the scope of the tests. One can view the tests as additional guidelines to be applied if they fit the given transactions. There are three main tests for invoking the doctrine, though it is unclear if all three tests, or only one test, must be met before the courts will utilize the doctrine.

One test, the "end result" test, is satisfied where the court finds separate steps or transactions constituting "component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." Courts have explained that this test, like the broader substance over form doctrine, fits situations where a single plan was intended from the outset to achieve a specific result but was to be performed by a series of transactions. In such a case all of the steps are to be viewed as a single transaction. What is meant by "intended" in this context is the "objective purpose." A second test, the "interdependent test," requires an analysis of whether on a reasonable interpretation of objective

relevant enactment in order to ascertain its meaning; it must then analyze the series of transactions in question, regarded as a whole, so as to ascertain its true effect in law; and finally it must apply the enactment as construed to the true effect of the series of transactions and so decide whether or not the enactment was intended to cover it. The most important feature of the principle is that the series of transactions is to be regarded as a whole.


86 See Kanawha Gas & Utils. Co. v. Commissioner, 214 F.2d 685, 691 (5th Cir. 1954); Atchinson, Topeka & Santa Fe R.R. Co. v. United States, 443 F.2d 147, 151 (10th Cir. 1971); Associated Wholesale Groceries, Inc. v. United States, 927 F.2d 1517, 1523 (10th Cir. 1991).

87 See discussion supra Section 2 "Taxpayer's Motive and Legislative Intent," in general, and supra notes 14, 25 and accompanying text, in particular.
facts the steps were so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series.\textsuperscript{88} The "interdependent test" focuses on the interrelation among the different steps, rather than on the "end result" of the series of steps, particularly when each step does not make business sense and would be fruitless without the completion of the rest of the integrated steps.\textsuperscript{89}

The third test, the "binding commitment" test, originated in \textit{Commissioner v. Gordon},\textsuperscript{90} and is usually not regarded as a precondition for the application of the doctrine.\textsuperscript{91} This test is the most restrictive, and it makes clear that a contractual obligation to carry out the entire series of steps is the best evidence justifying the application of the step transaction doctrine.\textsuperscript{92} Even cases requiring the binding commitment test agree that a sufficient showing of a general understanding or pre-arrangement of a business or financial commitment, or a showing of an intent to perform all the steps within relatively short time, will suffice to invoke the step transaction doctrine.\textsuperscript{93}

The Israeli Supreme Court did not apply the step transaction doctrine where a formal pre-agreement was missing, despite the existence of a "general understanding and oral consent."\textsuperscript{94} It is doubtful whether this precedent will be

\textsuperscript{88} Randolph Paul & Philip Zimet, \textit{Step Transactions}, in \textit{SELECTED STUDIES IN FEDERAL TAXATION}, 200, 254 (2d Series, 1938). This approach was adopted in cases such as \textit{King Enters.}, 418 F.2d 511, and \textit{Associated Groceries}, 927 F.2d 1517; see also Seymour S. Mintz & William T. Plumb, Jr., \textit{Step Transactions in Corporate Reorganizations}, 12 N.Y.U. INST. ON FED. TAX'N 247 (1954).

\textsuperscript{89} See McDonald's Restaurants of Ill., Inc. v. Commissioner, 688 F.2d 520, 524 (7th Cir. 1982); Redding v. Commissioner, 630 F.2d 1169 (7th Cir. 1980); Kauper v. Commissioner, 533 F.2d 152, 156 (6th Cir. 1976); Paul & Zimet, supra note 88.

\textsuperscript{90} 391 U.S. 83, 88 (1968).

\textsuperscript{91} \textit{King Enters., Inc. v. United States}, 418 F.2d 511 (1969); BITTKER & LOKKEN, supra note 2, ¶ 4.3.5.

\textsuperscript{92} See, e.g., Furniss v. Dawson, [1984] 2 W.L.R. 226.

\textsuperscript{93} See \textit{Kings Enters.}, 418 F.2d at 511; McDonald's Restaurants v. Commissioner, 688 F.2d at 525; see also infra notes 145-47 and accompanying text.

\textsuperscript{94} See T.M.B. v. Assessing Officer, C.A. 83/81, 40(3) P.D. 402. One ought to compare this approach with that of the U.K. court in Dawson: "The day is not saved for the taxpayer because the arrangement is unsigned or

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followed by future Israeli courts.

Courts in the United Kingdom do not employ any of the above mentioned U.S. tests. In cases where pre-planned tax avoidance schemes are evident, Lord Brightman in Dawson,\(^95\) stated:

> My Lords, in my opinion the rationale of the new approach is this. In a pre-planned tax savings scheme, no distinction is to be drawn for fiscal purposes, because none exist in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step in seriatim.\(^96\)

In addition, Lord Brightman noted that "Ramsay [held] that a fiscal result is to be no different if the several steps are preordained rather than precontracted."\(^97\) It should be emphasized that this approach was quoted with full approval by the court in White.\(^98\)

A scheme of multiple intermediate steps, which forms part of a pre-conceived or "preordained" plan,\(^99\) is not problematic for U.K. courts, when each step of the transaction is meaningless without the fulfillment of all the other interim steps. This is particularly so when all the steps are carried out concurrently\(^100\) or when later steps cancel former steps so that the first and the final steps reflect the real economic transaction. Thus, the U.K. courts did not have severe difficulty in rejecting such circular, self-concealing or self-defeating plans.\(^101\) The court could have rejected the plans contains the magic words ‘this is not a binding contract’." Furniss v. Dawson, [1984] 2 W.L.R. 226, 242 (per Lord Brightman).

\(^95\) [1984] 2 W.L.R. 226.
\(^96\) Id. at 242.
\(^97\) Id. at 242 (referring to Ramsay) (emphasis added).
\(^98\) [1988] 3 W.L.R. 423.
\(^100\) Id.
\(^101\) See W.T. Ramsay, Ltd., v. Inland Revenue Commr's, [1981] 2 W.L.R. 449; Inland Revenue Commr's v. Burmah Oil, Ltd., [1982] S.T.C. 30 (where the Ramsay approach was carried one step further, but "the salient features of the case were not essentially different," Craven v. White, 3 W.L.R. at 520.
pursuant to the U.S. tax avoidance theories, including the business purpose, substance over form, and step transaction. Under similar circumstances, U.S. courts will generally reach the same results as the U.K. courts utilizing these doctrines.\textsuperscript{102}

For more problematic cases the U.S. approach for applying the step-transaction doctrine could be helpful, provided the tests are treated as helpful guidelines rather than as rigid rules, since the tests are "notably abstruse—even for such an abstruse field as tax law."\textsuperscript{103} When analyzing a multi-step transaction, common sense and logic would dictate the use of the tests, but not as mandatory rules of law. Other considerations, such as the relative ease of administering the tax system in question should be taken into account.

6. APPLICATION OF TAX AVOIDANCE DOCTRINES TO DIFFICULT LINEAR CASES

6.1. U.K. Case Law

More difficult problems usually arise over the conflict of substance and legitimate choice of form. Thus, the U.K. court in Dawson\textsuperscript{104} extended the Ramsay\textsuperscript{105}-Burmah\textsuperscript{106} approach to certain linear transactions where business and legal effects could be attached to separate steps and to the entire transaction.\textsuperscript{107} Thus, it was unnecessary for the courts to utilize rules similar to the U.S. step transaction "tests."\textsuperscript{108}

\textsuperscript{102} See Rosenberg, supra note 52, at 426-27 n.177.
\textsuperscript{103} Redding v. Commissioner, 630 F.2d 1169, 1175 (7th Cir. 1980). After accepting this caveat, the court in McDonald's Restaurants correctly applied the test. See McDonald's Restaurants of Ill. v. Commissioner, 688 F.2d 520, 524 (7th Cir. 1982).
\textsuperscript{104} See supra note 11.
\textsuperscript{105} [1984] 2 W.L.R. 220.
\textsuperscript{107} This approach was initiated by Lord Diplock in Burmah, supra note 101, at 32 and continued in Dawson, supra note 11, where the generally legitimate business purpose of the entire plan did not achieve its tax-saving purpose. See Craven v. White, [1988] 3 W.L.R. 423, 428 (Lord Keith's opinion).
\textsuperscript{108} See supra Section 5 of text.
In *Dawson*, the taxpayers' "purpose" was to achieve the legitimate commercial goal of selling their shares of stock in two U.K. family companies to a third party. In order to defer capital gains, the taxpayers prearranged for an Isle of Man company under their control, Greenjacket, to purchase the shares. In exchange, the taxpayers would receive Greenjacket stock. In turn, the taxpayers immediately sold the stock to the third party buyer, Wood Bastow, while maintaining access to the consideration paid.

The intermediate step with the Isle of Man company was quickly arranged during the negotiations between the taxpayers and the third-party buyer. The entire negotiation process was "perhaps . . . all over in time for lunch."\(^{109}\)

The *Dawson* case presented an extreme situation which justified attributing the income to the taxpayers on the basis of the general attribution of income theory. This would be similar to the U.S. Supreme Court's decision in *Commissioner v. Court Holding.*\(^{110}\)

The *Dawson* decision could also be justified on the basis of the step transaction doctrine as espoused in U.K. law. For example, Lord Brightman stated:

*Ramsay* says that the fiscal result is to be no different if the several steps are pre-ordained rather than precontracted. For example, in the instant case[,] tax will, on the *Ramsay* principle, fail to be assessed on the basis that there was a tripartite contract between the Dawsons, Greenjacket, and Wood Bastow, under which the Dawsons contracted to transfer their shares in the operating companies to Greenjacket in return for an allotment of shares in Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. . . . *Ramsay* says that this fiscal result cannot be avoided because the pre-ordained series of steps are to be found in an informal arrangement instead of a binding contract. The day is not saved for the taxpayer because the arrangement is unsigned or contains the magic


\(^{110}\) 324 U.S. 331 (1945); see also supra notes 61, 79, 80 and accompanying
words 'this is not a binding contract.'

First, according to Lord Brightman, it is sufficient that a preordained series of transactions, forming a single composite transaction, exists. This composite transaction may achieve a legitimate business purpose. The transaction in Dawson achieved the sale of shares of the operating companies by the Dawsons to Wood Bastow. It did not in Ramsay. Second, to be disregarded for tax purposes, there must be steps inserted which have no business purpose except for the avoidance of taxes, even if they have "business effect." Finally, the court must look at the end result. In Dawson, the inserted step was the use of Greenjacket to buy stock from the Dawsons and to sell it to Wood Bastow.

The formulation, therefore, involves two findings of fact: first, whether there was a preordained series of transactions, i.e. a single composite transaction; second, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage. Those are facts to be found by the commissioners. They may be primary facts or, more probably, inferences to be drawn from the primary facts.

Note, however, that the Dawson case did not establish any rules. Rather, it set forth the circumstances under which several transactions should be treated as one. There is a close resemblance between the U.S. step-transaction doctrine and the U.K. concept of the treatment of multiple preordained transactions as a whole. In both systems it is necessary to interpret the relevant statute for its intent and to analyze the given series of transactions in their entirety in order to characterize the transactions in tax law. Both the U.S. and U.K. tax systems apply the statutes to multiple-step transactions in order to determine if they fall within the given legislative intent.

Neither Ramsay nor Dawson sets forth any new concepts

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111 Dawson, [1984] 2 W.L.R., at 242 (per Lord Brightman with whose opinion the rest of the Justices agreed).

112 Id.

113 See supra note 84 (quoting Lord Keith).
of law which would negate an otherwise legitimate choice of form allowed by statute. The U.K. statute allowed for the transfer of shares to the Isle of Man company and for the Isle of Man company to sell the shares to a third party. It is important to emphasize that tax planning of this nature is not fatal. What was fatal in Dawson was the taxpayer's complete control over the end result because of the manner in which the transaction was pre-planned and executed. The time factor could not be ignored, given that the entire series of transactions was completed "in time for lunch."\footnote{114}

It is true that time factors of this sort are not a part of any sound tax norm and the short time between steps is mainly proof of a single transaction.\footnote{115} However, we cannot expect a sound system of tax law and efficient tax administration to follow a series of transactions for several tax years in order to determine retroactively if they comprise a single transaction. Such a norm would badly damage a taxpayer's certainty and predictability even while enhancing sound tax policy.

Therefore, it is not surprising that the Dawson outcome is reserved for extreme situations only. It is not a general norm under which all pre-planned series of transactions will be treated. Because Dawson did not propose a norm, the court in White,\footnote{116} when faced with a different factual situation, reached the opposite result, surprising many commentators.\footnote{117}

In White, there were a series of linear transactions using an Isle of Man company in a manner similar to Dawson. In contrast to Dawson, however, before the transaction with the ultimate buyer was complete, it was discovered that legal and practical obstacles to the deal existed. The taxpayers then made their choice of form and chose to use an Isle of Man company for any future transactions. This choice was accepted

\footnote{114 See Dawson, [1984] 2 W.L.R. at 242.}
\footnote{115 Craven v. White, [1988] 3 W.L.R. 423, 573 (Lord Goff's dissenting opinion).}
\footnote{116 See id.}
by the parties although the intermediate company, fully controlled by the taxpayer, made the transaction under terms close to those originally negotiated by the parties, allowing the taxpayer to enjoy the use of the proceeds. The time which lapsed between the two transactions was relatively short, just a few months. However, the parties did not complete the transactions "in time for lunch."\footnote{118}

Criticism can be leveled at what seems to be the bottom line and the majority opinion: "that practical certainty, whatever it may mean, is now the test."\footnote{119} To the contrary, this is not the test. Rather, the test is whether the original taxpayer completed the entire transaction or whether there was another transaction completed by another person, independent enough to be accepted by the courts.\footnote{120}

The court in White, although by a narrow three to two majority, decided that the final transaction was not part of a preordained series of transactions, but rather an independent transaction. There was no disposal of income by the English taxpayers to the third-party purchaser for capital gains tax purposes. A similar conclusion was reached by the court where no connection was found between the taxpayer's sale to an intermediary company and the later sale by the intermediary company to a third party.\footnote{121}

\footnote{118} Referring again to Lord Brightman's statement in Dawson, [1984] 2 W.L.R. at 242.
\footnote{119} Tiley, \textit{supra} note 117, at 25.
\footnote{120} See Lord Goff's dissent in \textit{White}. Lord Goff stated:

In the end, the question whether or not the overall transaction constitutes for present purpose a composite transaction is very much one of common sense, which the commissioners, are well equipped to decide. I do not for myself regard this as giving rise to any unacceptable uncertainty in practice. I have no doubt that, in practice, the animal is easily recognizable.

\footnote{121} The cases were conjoined appeals with Craven v. White, [1988] 3 W.L.R. at 472.

Craven v. White, [1988] 3 W.L.R. 423. One case, \textit{Baylis v. Gregory}, involved negotiations between the taxpayer and a third party which later broke off. Promptly thereafter an Isle of Man company was formed and there was exchange of stock with the taxpayer. Finally, after two years the interim company made the sale to a totally different buyer. \textit{See id.} In the other case, \textit{Inland Revenue Comm'rs v. Bowater}, the taxpayer transferred land to related companies during negotiations with a prospective buyer of the land. However, a contract for the sale of the land to the buyer never materialized. Negotiations were later destined with a third party buyer which culminated in a sale of the
The dissenting justices apparently would have applied a general theory of taxation under which any choice of the proper form for carrying out a final sale is to be attributed to the taxpayer. This would be so if all steps were undertaken with a view to the avoidance or reduction of taxes on an anticipated transaction, even when it is not the "taxpayer's transaction" at all. However, such an approach would be contrary to the legislative intent.\(^\text{122}\)

The majority opinion restricted the \textit{Dawson} approach by stating that \textit{Dawson} would be applicable "only if at the time when the first [in a series of step transactions] is entered into, the taxpayer is in a position for all practical purposes to [ensure] that the second [step] also is entered into."\(^\text{123}\) Thus, court decisions are highly dependent upon findings of fact, and any attempt to formulate bright line rules suffers from the same shortcomings as the U.S. rules.\(^\text{124}\)

As Lord Oliver put it, \textit{Dawson} requires that the taxpayer have "a degree of certainty and control over the end result at the time when the intermediate steps are taken."\(^\text{125}\) This standard does not require absolute agreement and certainty, between the taxpayer and third party buyer, of all the terms of the final transaction, but agreement on principal terms and the practical likelihood of the final transaction being consummated is essential.\(^\text{126}\) In addition, it would not be sufficient that the final transaction which occurs is a

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\(^{122}\) See supra Sections 2 and 3 of the text. If Lord Templeman restricts his view to cases where negotiations with the final buyer are underway when the second step is taken, there is no conceptual or real world approach to such a theory. A tax expert is usually not consulted until the negotiations with the third party have begun. From a general tax policy viewpoint, it makes no difference if the consultation is called shortly before the commencement of the negotiations. In fact, Lord Templeman even contradicted himself when he joined the majority of the court in the \textit{Bowater} case, unless he was really focusing only on subtle variations in the facts (i.e., whether or not the initial negotiations "broke off" prior to their resumption).

\(^{123}\) Craven v. White, [1988] 3 W.L.R. at 431 (per Lord Keith). The second transaction does not have to be identical to the one prearranged, see infra notes 124-25 and accompanying text.

\(^{124}\) See supra note 11, Section 5 of text in general, and text at supra note 103 in particular.

transaction of the kind that is then envisaged by the taxpayer.\textsuperscript{127} For example, if the final buyer and terms of the sale are unknown at the time of the intermediate step, but the taxpayer knows there will be a sale of the asset, under \textit{Dawson} it would be impossible to analyze the steps as a single composite transaction.\textsuperscript{128} As Lord Jauncey stated:

Lord Wilberforce [in \textit{Ramsay}] referred to two types of schemes[,] namely, one where there was an accepted obligation [or complete control] to carry out all steps in the scheme once it started and the other where there was an expectation that it would be so carried through and no likelihood in practice that it would not.\textsuperscript{129}

In other words, in a linear transaction where the taxpayer does not have control over the third party, a mere "contemplation or intention" by the taxpayer, at the time of completion of the first step, that the final transaction will be completed is not sufficient to view the series of transactions as a single transaction.\textsuperscript{130} It is in cases such as \textit{Dawson}, where all further steps were practically certain at the time when the first step of the prearranged scheme took place, and the final transaction was completed within a very short time, that the \textit{Ramsay} rule, or the step-transaction doctrine, applies to linear transactions.\textsuperscript{131} Otherwise, the \textit{Ramsay-Dawson} approach

\textsuperscript{127} Id.  
\textsuperscript{128} Id. Lord Oliver's distinction might be too subtle and is subject to the same criticism leveled against Lord Templeman. \textit{See supra} note 122.  
\textsuperscript{129} Id. at 479.  
\textsuperscript{130} Id.  
\textsuperscript{131} Lord Jauncey would view a series of transactions as one composite linear transaction depending upon various factors, including: (1) the stage of negotiations reached when the first step ended; (2) the "nature" of such negotiations or arrangements; (3) the likelihood at the time of the first step that the rest of the plan will be completed; and (4) the extent to which all steps proceeded without genuine interruptions. \textit{Id.} at 480.  

The U.K. and U.S. courts faced with the same dilemma regarding step-transactions formulated similar rules. In general, see Section 5 of text. Lord Jauncey even used the concept "interdependent," but he did not try to define tests. Instead, he correctly referred to them as "factors" or, as I prefer, "guidelines." \textit{See supra} Section 5 of text and \textit{infra} text accompanying notes 138-40.  

Lord Jauncey formulated the following conclusion:  

A step in a linear transaction which has no business purpose apart from the avoidance or deferment of tax liability will be treated as
is inapplicable.  

An interim conclusion is that, for linear transactions which extend beyond a tax year and for relatively longer periods, the degree of certainty with respect to all principal terms of the ultimate transaction is much greater than with respect to very short term multiple, pre-planned linear transactions. This conclusion reflects U.S. case law as well.  

Further attacks on the forms offered to taxpayers by statutes should be left to the legislature, as Lord Jauncey stated in the White case:  

I conclude my analysis of the three [joined] cases by emphasizing that the Ramsay principle is a principle of construction, that it does not entitle the courts to legislate at large against specific acts of tax avoidance where Parliament has not done so and that at the end forming part of a preordained series of transactions or of a composite transaction if it was taken at a time when negotiations or arrangements for the carrying through as a continuous process of a subsequent transaction which actually takes place had reached a stage when there was no real likelihood that such subsequent transaction would not take place and if thereafter such negotiations or arrangements were carried through to completion without genuine interruption.

_id. at 480-81.

But Lord Jauncey added, with intellectual honesty, that “I am conscious that this may well constitute too rigid an approach to the problems and I therefore put it forward as a tentative guide.” _id. at 481.

Consequently, the U.K. court did not apply the Ramsay principle in _Shepherd v. Lystress, Ltd.,_ [1989] S.T.C. 617 and _News International P.C. v. Shepherd_ [1989] S.T.C. 617, where there was a business purpose to the initial steps of the transaction, and where the subsidiaries that were formed realized gains from a sale against which they could offset their losses. The court found no gains went to the parent company which transferred the assets to its subsidiaries. In addition, the court found when the first steps were performed, the next steps had not been organized.

132 Consider _R. v. Inland Revenue Comm’rs.,_ [1992] S.T.C. 581 where taxpayer transferred certain stocks tax free to his spouse prior to a prearranged sale to a third party. A leading tax counsel (who gave a second opinion) believed that there was a risk that the transfer to the spouse would be ignored under the Ramsay-Dawson principle, and the court confirmed that there was such a risk (although no decision was rendered due to special facts involved in the case).

133 For a discussion of the “binding commitment” test and its relevance to short-term transactions per the McDonald’s court, see McDonald’s Restaurants of Ill, v. Commissioner 688 F.2d 520, at 525 and infra notes 134-43 and accompanying text.
of the day the question will always be whether the event or combination of events relied upon amount to a chargeable transaction or give rise to allowable relief within the meaning of the relevant statutory provisions.\textsuperscript{134}

In this respect one may observe that the White decision is not based on the U.S. "binding commitment" test as enunciated by the U.S. Supreme Court in Commissioner v. Gordon.\textsuperscript{135} In fact, the test is particularly applicable to transactions which span several years and thus are left open and uncertain for longer periods of time.\textsuperscript{136} For shorter periods of time within a single tax year, "[t]he degree of uncertainty that worried the Gordon court is absent."\textsuperscript{137}

White is at any rate justified under the requirements of the less controversial U.S. "end result" and "interdependent" tests.\textsuperscript{138} Under the former, doubts exist as to whether all the steps were components intended from the outset to achieve the ultimate result,\textsuperscript{139} because another option was just as viable. The latter "interdependent" test was not fulfilled. This may be obvious in that the first step of transfer to the Isle of Man company was not fruitless in and of itself and could be performed without the carrying out of the entire transaction.\textsuperscript{140}

6.2. U.S. Case Law

In reviewing close U.S. cases, one can see a similarity to the current judicial approach in the United Kingdom. For instance, in the recent case of Associated Wholesale Groceries, Inc. v. United States,\textsuperscript{141} it was the taxpayer who tried to avoid the non-recognition of gain or loss under section 332 of the I.R.C. through a tax free liquidation of a subsidiary into a

\textsuperscript{134} \textit{White}, [1988] 3 W.L.R. at 482.
\textsuperscript{135} 391 U.S. 83, 88 (1968); see also \textit{Associated Wholesale Groceries v. United States}, 927 F.2d 1517, 1522 (10th Cir. 1991).
\textsuperscript{136} \textit{McDonald's Restaurants}, 688 F.2d at 525.
\textsuperscript{137} \textit{Id.} at 525.
\textsuperscript{138} See supra note 131.
\textsuperscript{139} For the test, see Section 5 of the text.
\textsuperscript{140} See supra Section 5.
\textsuperscript{141} 927 F.2d 1517 (10th Cir. 1991).
parent. In order to enjoy a current loss deduction,\textsuperscript{142} the taxpayer sold stock of a subsidiary to a third party and immediately purchased most of the assets of the subsidiary. The court ruled against the taxpayer on the basis of the step-transaction doctrine (its "interdependence test") and the fact that the form of the transaction failed to obscure its real substance. The purchase of the assets took place prior to the liquidation of the subsidiary, and thus what the taxpayer purported to present as two separate agreements was viewed by the court as an integrated agreement and a composite transaction. The court found that the taxpayer's behavior was contrary to legislative intent, and, therefore, it had no effect on the sale of the stock for taxation purposes.

Likewise, in McDonald's Restaurants of Ill., Inc. v. Commissioner,\textsuperscript{143} the court applied the step-transaction doctrine at the request of McDonald's, which acquired a group of restaurants from a third party in exchange for McDonald's unregistered stock. The seller was interested in obtaining cash, but the whole plan was arranged by McDonald's (the buyer) in order to capitalize on a special accounting procedure. In order to obtain the benefit of the accounting procedure, the sellers merged into McDonald's, received their shares some five months later when market conditions permitted, registered the stock with the U.S. Securities and Exchange Commission ("S.E.C."), and then sold the stock immediately.

The McDonald's Restaurants court first noted that the step-transaction doctrine "is a particular manifestation of the more general tax law principle that purely formal distinctions cannot obscure the substance of a transaction."\textsuperscript{144} The court conceded the elusive character of the doctrine and of its several tests,\textsuperscript{145} but found that under any one of the tests

\textsuperscript{142} The court applied the pre-1986 version of § 332(b)(1), prior to its amendment in 1986, Pub. L. No. 99-514, § 1804(e)(6)(A) (1986).

\textsuperscript{143} 688 F.2d 520 (1982).

\textsuperscript{144} Id. at 524.

\textsuperscript{145} As noted in McDonald's Restaurants:

The commentators have attempted to synthesize from judicial decisions several tests to determine whether the step transaction doctrine is applicable to a particular set of circumstances .... Unfortunately, these tests are notably abstruse—even for an abstruse field [like] tax law.

\textsuperscript{142} McDonald's Restaurants, 688 F.2d at 524 (quoting Redding v. Commissioner,
the transaction was stepped together. Thus, under the “end result” test, all steps were taken to cash out the sellers, and it was McDonald’s who wanted to do so in such a way that enabled it to utilize the desirable accounting procedures.

The second test, “the interdependent” test, concentrates on the relationship among the steps rather than the end result. Here, the merger would not have taken place without enabling the sellers to sell McDonald’s stock.

The “binding commitment” test, as noted earlier, was found to be the most rigorous limitation on the step-transaction doctrine. Similar to the White decision, the court held that the test was formulated to characterize transactions which “spanned several tax years and could have remained ‘not only indeterminable but unfixed for an indefinite and unlimited period in the future, awaiting events that might or might not happen.’ ” In the given case, the court noted that the transaction was completed in six months and within the same tax year. The court held that the degree of uncertainty discussed by the Gordon court was absent in this case. It was enough that the sale of the sellers’ McDonald’s stock was intended to take place within a relatively short period of time, in order to satisfy “the spirit, if not the letter, of the ‘binding commitment’ test.” This is exactly the same conclusion drawn by the U.K. courts in Dawson and White. Because the transaction in the McDonald’s Restaurants case was in reality a straightforward sale of assets against cash (marketable securities), McDonald’s was allowed to treat the transaction as a “pooling of interests” with a stepped-up basis in the assets acquired. A different result would have been contradictory to the statutory intent of either the taxable exchange provisions for outright taxable sales or the non-taxable reorganization provisions. Therefore, the same

630 F.2d at 1175).

146 See supra notes 132-33 and accompanying text.

147 McDonald’s Restaurants, 688 F.2d at 525 (quoting Gordon, 391 U.S. at 96).

148 McDonald’s Restaurants, 688 F.2d at 525.

149 For an explanation of the accounting method, see id. at 521 n.2.

150 The term “reorganization” as used by the Code contemplates a readjustment of the corporate structure of the business and not a mere transitory holding or an insubstantial proprietary interest of shares. See id. at 526. McDonald’s Restaurants is a correct decision from the step-
step-transaction doctrine was successfully invoked by the taxpayer in this particular instance.

In a few recent U.S. court decisions, the step-transaction doctrine was ignored or expressly rejected under the factual situations that are of concern here. In *Anderson v. Commissioner*,\(^{161}\) the U.S. Tax Court accepted the form selected by the taxpayer, in which his corporation made a tax-free distribution to him of certain assets, and the taxpayer sold them several months after the beginning of the next tax year. Income was correctly attributed to the taxpayer and not to his corporation because, similar to the circumstances of the U.K. *White*\(^{152}\) case, the transaction was made by the individual taxpayer and not by his corporation. Despite the fact that the taxpayer controlled the corporation, an expectation of a tax-free transfer prior to the first step of immediate sale was not sufficient to attribute the sale to the corporation when the corporation did not participate in the final transaction. The Tax Court in *Anderson* did not find the *Court Holding*\(^{153}\) case applicable, and, as a consequence, did not explicitly discuss the step-transaction doctrine. The assumption of the Court in *Anderson* was that the taxpayer's decision was within the elections the statute allowed him to make.

Likewise, in *Tandy Corporation v. Commissioner*,\(^{154}\) the Tax Court accepted the form chosen by the taxpayer where Tandy transferred assets to newly-formed subsidiaries, and in the following tax year spun off the stock of the subsidiaries to its stockholders. The court refused to integrate all the steps into a single transaction by which Tandy had directly

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transaction analysis. It is an odd decision which enabled taxpayers to achieve their purpose, though it is not clear that it was compatible with the desirable policy of all the relevant provisions and accounting procedures. The court simply forced the Commissioner to be consistent with the step-transaction theory whether or not the outcome is favorable to him or to the taxpayer. The reorganization in this case was taxable because it did not meet the "continuity of interest" requirement of section 1.368-1(b) of the income tax regulations and the merging party has been taxed because of its relatively prompt disposition. Consequently, the court did not allow the IRS "to saddle the taxpayers with the disadvantageously low basis that goes with the 'reorganization' label." *McDonald's Restaurants*, 688 F.2d at 528.


\(^{152}\) [1988] 3 W.L.R. 423; see supra notes 116-34 and accompanying text.

\(^{153}\) 324 U.S. 331 (1945).

\(^{154}\) 92 T.C. 1465 (1989).
transferred the assets to its stockholders. The court decided that the timing of the transaction had economic and business purposes. Although it was a close case, it was a case highly dependent upon its facts, and there is no reason to conclude that it represents any departure from the longstanding legal concepts.

Another recent U.S. case is *Esmark v. Commissioner*,\(^{155}\) in which the taxpayer intended to sell an appreciated subsidiary (Vickers). The Mobil Oil group agreed to participate in a plan, initiated and carried out by their investment bankers, in which Mobil made a successful cash tender offer to Esmark's stockholders and acquired roughly 50% of the stock. As pre-planned, when the tender offer was closed on the same day, Mobil Oil and Esmark completed the redemption of the newly acquired Esmark stock in exchange for the Vickers stock. In fact, Esmark substituted the tender offer and redemption for the outright sale and redemption, and Mobil's only purpose was the acquisition of Vickers stock in exchange for Esmark's stock. The court confirmed a non-recognition of gain or loss to Esmark, pursuant to the distribution in redemption, which would not have been granted if the stock had been sold for cash. The Tax Court decided that each step of the transaction had permanent economic effects, despite the fact that all steps were taken to enable the sale by Esmark (the "end result" test). The court also decided that all steps taken were interdependent, Mobil had only brief transitory ownership of the Esmark stock, and the transactions were carried out in order to create an outright cash sale by Esmark of Vickers' stock followed by a distribution of the sale proceeds to the stockholders. Under the court's broad interpretation, even the "binding commitment" test was met.\(^{156}\) The Seventh Circuit affirmed without comment.

Although the Tax Court mentioned all of the step-transaction "tests," it did not find unnecessary steps that should be ignored. It is hard to justify the *Esmark* decision. It either represents a real departure from all tax avoidance

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\(^{155}\) 90 T.C. 171 (1988), aff'd, 886 F.2d 1318 (7th Cir. 1989).

\(^{156}\) See Section 5 of text; McDonald's Restaurants of Ill. v. Comm'r of Internal Revenue, 688 F.2d 520 (1982), and its discussion supra notes 143-50 and accompanying text.
doctrines, an erroneous interpretation by the court of the relevant statute, or a case where step-transaction theory should have been found applicable. *Esmark* appears to fall within the U.K.’s *Dawson*¹⁶⁷ and the U.S.’s *Associated Wholesale Groceries*¹⁵⁸ and *McDonald’s Restaurants*¹⁵⁹ line of cases, but not within the U.K.’s *White*¹⁶⁰ or the U.S.’s *Anderson*¹⁶¹ or *Tandy*¹⁶² line of cases.¹⁶³ The parties simply did not comply with the statutory intent of the relevant non-recognition provision.

The court should have applied the general assignment of income doctrine or the step-transaction theory in order to attribute correctly the tax consequences of a cash sale of Vickers stock and the diversion, by way of redemption of the proceeds to its shareholders. The taxpayer in substance did not qualify for nonrecognition under a rule that applied to distribution in redemption, which is inapplicable to a sale of stock for cash.

It is sometimes difficult to distinguish between elaborately structured multi-step schemes which conform to the statutory intent and are within the taxpayer’s freedom of choice of form and schemes that disguise the real transaction where tax consequences should be attributed only to that transaction. The distinctions, however, do exist and should be acknowledged even in close cases, without introducing new tax avoidance theories.¹⁶⁴ Courts are sometimes misled when the taxpayer adheres to the statutory form in order to achieve his business purpose, but the particular form is not intended to confer tax benefits to the transaction in which the taxpayer

¹⁶⁸ 927 F.2d at 1517.
¹⁶⁹ 688 F.2d at 520.
¹⁶⁰ [1988] 3 W.L.R. 423. Any uncertainties at the time the first step was taken were within the prearranged plan as set forth by Lord Jauncey; *id.* at 540-41; *see also supra* Section 6.1.1 of text.
¹⁶¹ 92 T.C. at 138.
¹⁶² 92 T.C. at 1165.
¹⁶⁴ For additional opinions in this area, see Brown, *supra* note 117; *Jansen, supra* note 8.
engaged. The transaction falls outside of the taxpayer's legitimate choice of form.

6.3. Israeli Cases and Corporate Reorganization

The reluctance to introduce new tax avoidance theories also reflects the policy of the Israeli courts. The Israeli courts have had less experience in linear multi-step transactions than their U.S. and U.K. counterparts. However, the Israeli Supreme Court recently held\(^\text{165}\) inoperative an attempt by the taxpayer corporation to channel what was in reality salaries of its managing director and controlling shareholders, to a related family owned corporation, as management fees.\(^\text{166}\) In return, that corporation distributed equivalent amounts to its common controlling shareholder. This was clearly a step transaction, but that doctrine had not yet been adopted by the Israeli court. Nonetheless, Chief Justice Shamgar held that the diversion of the funds to the related family corporation was entirely artificial and engaged in for no business purpose whatsoever. The goal of the transaction was to avoid an employment tax, which during the relevant tax years was imposed on salaries and not on management fees. Indeed, the Israeli Grinberg court reached the correct conclusion where the U.S. Esmark\(^\text{167}\) court erred (although admittedly, the Esmark case involved a much more complex transaction—both in its multiple form and in substance).

In a somewhat similar manner, the Israeli Supreme Court combined two transactions into one for purchase tax purposes.\(^\text{168}\) In Taas Moor, Ltd. v. Director of Land Appreciation Tax,\(^\text{169}\) the issue was whether the costs of constructing the building, structured as a transaction separate

\(^{165}\) Baruch Grinberg, Ltd. v. Assessing Officer, C.A. 495/88 46(2) P.D. 243.

\(^{166}\) An eligible "family company" is taxed according to the specific statutory scheme outlined in § 64A of the Tax Ordinance which is somewhat similar to U.S. taxation of S corporations (taxation does not occur both at the corporate level and then again at the shareholder level, i.e. no double taxation).

\(^{167}\) 90 T.C. at 171.

\(^{168}\) Land Appreciation Tax Act of 1963, § 9. Section 9 taxes are imposed on the buyer of real estate and include attached structures.

\(^{169}\) C.A. 890/80, 37(1) P.D. 449.
from the purchase of the land a short time earlier, were subject to the purchase tax, or if the costs should be viewed as an independent transaction not involving any purchase of land rights and, therefore, not subject to the purchase tax. In other words, the issue was whether to accept the two contracts, one for the acquisition of the land and the second for the building contract, as reflecting two independent transactions, or to treat them as two steps of a single composite transaction (i.e., the purchase of the land with the building).

Justice Shamgar was prepared to accept the two-step transaction form chosen by the taxpayer. However, because the separation into two transactions lacked any reasonable economic or commercial purpose, Justice Shamgar held that it was artificial and inoperative. Justices Ben-Porat and Or reached the same conclusion, but by referring to the substance of the transaction over its form. According to Justices Ben-Porat and Or, even if the division into two steps had a business purpose, such as the taxpayer's alleged need to meet the requirement of foreign exchange controls law, the true substance was a single transaction, involving the acquisition of land and the building to be constructed on it. Although the U.S. terminology and exact tax avoidance doctrines were not used, the essence of the reasoning and the ultimate results of the Taas Moor court conform to the business purpose rule and the form versus substance or step-transaction doctrines.

In this regard, the troublesome Israeli decision is *T.M.B., Ltd. v. Assessing Officer.*170 In this case the Treasury argued the single coordinated transaction concept. However, because the concept was not argued in the lower courts or at the administrative appeal procedure level, the court refused to apply it at such a later stage. Although the court insisted that tax avoidance contentions should be argued on the basis of the above-noted general provision of section 86 of the Tax Ordinance (or its counterparts in other tax statutes),171 it decided the issue on the basis of section 95 of the Israeli Tax Ordinance, which was the Israeli counterpart of section 351 of the United States Code. Section 95 was repealed as of January 1, 1994.

170 C.A. 83/81, 40(3) P.D. 402.
171 See supra notes 43-56 and accompanying text.
In *T.M.B.* the taxpayer asserted that it was entitled to tax-free treatment for an exchange of capital assets for stock when it had the required section 95 statutory control of at least 90% of the voting stock for a month and a half following the transfer. The language of the Tax Ordinance required that the transferor of the property possess the necessary control "immediately" following the transfer. The treatment of the transfer turned on whether the "immediate" requirement was met where, after a month and a half, the transferor lost controlling interest of the company when the receiving company issued 50% of all its stock to a third party in exchange for cash. An additional significant factor was that the entire plan was agreed upon, or at least practically prearranged between all parties, when the first step was taken.

The Israeli court quoted U.S. section 351 cases in support of its conclusion that the statutory requirement of "immediate control" was satisfied simply because the six weeks of control following the transfer did not constitute "immediately." Notwithstanding the procedural question of what arguments could be heard on appeal, the court in *T.M.B.* reached an erroneous conclusion. The proper interpretation of the statute should have led to the opposite conclusion. The court should have first analyzed the statutory intent of section 95 and held that it was dependent on the continuity of interest theory. The court then should have analyzed the findings of fact and remanded the case to a lower court for further fact-finding if necessary.

However, there were sufficient findings of fact to satisfy even the "binding commitment" test within its U.S. Gordon court meaning, and its U.K. Ramsay-Dawson-White variation. The U.S. "end result" test was satisfied, as all steps were taken to allow the third party to become an equal shareholder in the newly-formed taxpayer's subsidiary, which received assets in exchange for stock. In

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172 See supra note 171 and accompanying text.
173 391 U.S. 83; see notes 91, 146-48 and accompanying text.
175 [1984] 2 W.L.R. at 226.
177 See supra notes 124-28, 130 and accompanying text.
addition, the U.S. “interdependent” test was also satisfied because it appeared as the first step in forming the subsidiary, and the transfer of assets in exchange for stock would not have taken place without the prearranged plan to issue 50% of the stock to the third party in exchange for cash. Only if the final transactions were not concluded when the first exchange took place or at least were uncertain with respect to their principal terms, as the U.K. Court pronounced in White, would these tests have supported the final conclusion of the Israeli Court in T.M.B.

The T.M.B. case, and decisions following its reasoning, can only be justified when all the integral transactions, taken into consideration as a single transaction, are compatible with the statutory intent of section 95 of the Tax Ordinance. If the transactions are compatible with section 95, it is irrelevant whether there is a tax minimization plan, or a tax avoidance plan.

The impetus for section 95’s 90% control requirement, immediately following the exchange, or the U.S. section 351 80% control requirement, is found in the legislature’s desire to accord non-recognition treatment to mere changes of a taxpayer’s form of operation in order to facilitate business readjustments. The mere change of form rationale requires non-recognition treatment whenever the transferor assumes in advance the required control. The same result is achieved pursuant to the similar, but not identical, theory of mere change of form facilitating necessary desirable business readjustments, without a change of control. Under these theories, section 351 accords non-recognition treatment to mere changes of form as opposed to exchanges which are the equivalent of disposals or sales.

The current approach in the United States is that the statutory requirement of sections 351 and 368(c) of the I.R.C. is not satisfied if the transferor of the property agreed, when

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178 [1988] 3 W.L.R. 423; see also supra notes 116-40 and accompanying text.
179 C.A. 83/81, 40(3) P.D. 402.
180 For an analysis of the § 351 rationale, see Jensen, supra note 8, at 375, 387-88 n.388.
the steps were taken, to transfer stock to a third party and consequently lose its controlling interest. The requirements are also not satisfied if such a transfer is an integral part of the plan of incorporation.\textsuperscript{182} Loss of control under section 368(c) would be treated the same under the above step-transaction doctrine\textsuperscript{183} as it would be treated under section 351.\textsuperscript{184}

Interestingly, it is the same step-transaction theory\textsuperscript{185} which could enable taxpayers to consolidate several steps to fulfill the control "immediately" following the entire series of exchange requirement.\textsuperscript{186} Thus, the necessary control is not being achieved simultaneously by all taxpayers and exchanges.

Pursuant to this theory, there is no taxable exchange if any additional funds or property exchanged for future stock interests, according to prior commitment or prearrangement at the time of the first exchange, are preserved with the corporation. Such a theory could meet the statutory intent of section 95 of the Israeli Ordinance or section 351 of the I.R.C., because they resemble the mere change of form of nontaxable exchanges. However, taxable exchanges can occur when there is a loss of control subsequent to an exchange or disposal at the shareholder level, i.e., shareholder A sells all or part of his controlling shares to shareholder B.

The T.M.B. case was not decided in favor of the taxpayer on the basis of the latter advanced theory, which gave preference to substance (integrated transactions) over form, when such substance was compatible with the statutory intent. Rather, T.M.B. was decided erroneously by ignoring the substance of the two-step transaction. The Israeli court could have decided the case in favor of the taxpayer, if the substance, i.e., the single economic transaction, would have met the statutory intent of section 95, which in fact it did not. Indeed, Justice Bach in the T.M.B. case engaged in this

\textsuperscript{182} BORIS I. BITTKER \& JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 3.09 at 3-31 (5th ed. 1993 Supp.).
\textsuperscript{183} See supra notes 85-104 and accompanying text.
\textsuperscript{184} See Jensen, supra note 8.
\textsuperscript{185} See supra notes 85-104 and accompanying text; see also McDonald’s Restaurants, 688 F.2d at 520.
\textsuperscript{186} BITTKER \& EUSTICE, supra note 182, at 3-31; Treas. Reg. 1.351-1(a)(1)
analysis in another context when he clearly addressed the substance of the transaction.\textsuperscript{187} Such an approach is in full accordance with the U.S. courts.\textsuperscript{188}

In conclusion, other than the possible support for the outcome of the \textit{T.M.B.} case, its line of reasoning is incompatible with the U.S. \textit{Gregory} case\textsuperscript{189} and its progeny, the U.K. \textit{Ramsay}\textsuperscript{190}-\textit{Dawson}\textsuperscript{191}-\textit{White}\textsuperscript{192} doctrines. Multiple transactions should be respected because each transaction and all the transactions, taken into consideration as a series of related transactions, are compatible with the statutory intent of section 95 of the Israeli Tax Ordinance and section 351 of the I.R.C.\textsuperscript{193}

\begin{itemize}
\item\textsuperscript{187} Offir v. Director of Land Appreciation Tax, C/A 552/82, 42(3) P.D. 508. \textit{Cf.} Bird v. Inland Revenue Comm'rs [1987] S.T.C. 168. There is a question as to whether the approach taken by the \textit{Bird} court is fully compatible with Lord Keith's passage in \textit{White} quoted \textit{supra} note 84.
\item\textsuperscript{188} McDonald's Restaurants, 688 F.2d at 520. For a discussion of \textit{McDonald's} see \textit{supra} notes 143-50 and accompanying text. Nonetheless, the U.S. Internal Revenue Service (the "IRS") approved \S\ 351 nonrecognition treatment when a shareholder transferred his business assets to a newly-formed corporation in exchange for 20\% of its stock, with the remaining 80\% being issued to a professional underwriter for cash. Under the plan, the underwriter intended to sell all his shares to the public. The IRS ignored the underwriter's transitory ownership of stock and granted nonrecognition when he acquired the stock. Rev. Rul. 78-294, 1978-2 C.B. 141; Jensen, \textit{supra} note 8, at 357-58. Thus, the IRS has deviated from the general step-transaction doctrine in the §§ 351, 368(a)(1)(D) cases. \textit{Id.} at 359-68.
\item\textsuperscript{189} 69 F.2d at 809
\item\textsuperscript{190} [1981] 2 W.L.R. at 449.
\item\textsuperscript{191} [1984] 2 W.L.R. at 226.
\item\textsuperscript{192} [1988] 3 W.L.R. 423.
\item\textsuperscript{193} The step-transaction doctrine should not be invoked and the court was correct only if at the time of the first step of transfer of property there was no arrangement for the later issue of more than 10\% of the stock (20\% under U.S. law) to an outsider party, within the meaning of \textit{White}. It should be noted that, effective January 1, 1994, the Israeli section 95 was replaced by a new detailed statutory arrangement for corporate reorganization, including mergers, spin-offs and transfer of assets against shares: Amendment to the Income Tax Ordinance (No. 94) of 1993 (Book of Statutes 190) [In Hebrew: Sefer Hahukin, p. 190].
\end{itemize}

Under the new law, the non-recognition treatment is conditional on the retention of 90\% control, of the transferrer of assets against shares, for at least two years following the exchange, subject to several exceptions (Section 104A of the Ordinance). Consequently, the old requirement of "immediate" control was generally replaced by a two-year requirement of control. Nevertheless, the \textit{T.M.B.} issue is still relevant under the new law. For example, the new Section 1.269(c)(3) requires that the fair market value of
7. CONCLUSION

This comparative analysis of the U.S., U.K. and Israeli tax systems has demonstrated that, although the terminology of precise tax avoidance doctrines is not identical, the legal systems share similar tax principles particularly in regard to linear transactions. The following passage by Lord Goff fully applies to the three systems:

We can see from this broad principle [of Ramsay\textsuperscript{194} - Burmah\textsuperscript{195} - Dawson\textsuperscript{196}] that a distinction has to be drawn between a composite transaction of that kind, and a series of independent transactions of which the first constitutes a step taken to prepare for the avoidance of tax, such avoidance being achieved by later, independent, steps. It is that latter type of scheme which is usually known as strategic tax planning, which must be distinguished from unacceptable tax avoidance caught by the Ramsay principle. So understood, the Ramsay principle can be identified as not merely consistent with the statute, but as achieving a result which is sensible in terms of policy.\textsuperscript{197}

A clear tax avoidance scheme is inoperative for tax purposes in all three systems. It is a mistake to consider the U.S. tests for step transactions as part of the normative U.S. law of tax avoidance. The tests simply serve as judicial guidelines, usually in order to resolve complex issues of multi-step transactions. The question becomes whether to treat the transactions as a single composite transaction or as several independent ones, and even while treating all steps as a composite transaction, does it achieve a legitimate business purpose? The final result of the analysis is the determination of whether the transactions fall within the statutory intent of

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the share issued to the transferor of the assets relative to the value of all outstanding stock of the company “immediately” following their issue, be identical to the value of the exchanged assets relative to the value of all corporate assets.

\textsuperscript{194} [1981] 2 W.L.R. at 449.
\textsuperscript{195} 1982 S.T.C. at 30.
\textsuperscript{196} [1984] 2 W.L.R. at 226.
\textsuperscript{197} White, [1988] 3 W.L.R. at 469.
the applicable statutory provisions.

This analysis is in fact derived from common sense and logical considerations. Such considerations should also include the relative ease of administering the tax system. Therefore, cases and commentaries to the contrary should be rejected. The step transaction doctrine is a variation of the general tax avoidance and attribution of income doctrines, and if the correct decision can be reached by invoking one of the general doctrines, there is no need to apply the step transaction theory. U.K. law has moved along the preferable path as evidenced by the Ramsay new approach (as extended in the Burmah and Dawson cases), but the relevant tax policy needs refinement in order to formulate better guidelines for close cases. Thus, decisions such as White would not surprise members of the tax bar. It should be clear, however, that neither Ramsay nor Dawson set forth any new tax theories which negate an otherwise legitimate choice of form allowed by statute.

Thus, the criterion set forth in White is not the certainty of the economic composite transaction being completed, but whether the original taxpayer completed the entire transaction or whether there was another transaction completed by another person independent enough to be accepted by the courts. This should also be the criterion under both the U.S. and Israeli tax systems.

Israeli law generally has adopted the necessary doctrines in order to combat tax avoidance, but lacks any guidelines for complex cases, such as those which are presented in the multiple transaction area. It is this shortcoming which culminated in the erroneous decision of T.M.B. The court even ignored one common sense guideline that was expressly admitted by the U.S. and U.K. courts: that a prearranged or preordained series of steps is usually equal to steps which follow a binding contract for tax purposes.

The proper guidelines should be flexible enough to accommodate difficult cases, but at the same time afford enough certainty and predictability of results in the tax planning area for the benefit of the business community and its tax advisors. In this context the length of time between each step is also relevant. Although it is not a tax norm, a relatively long time between each step cures an otherwise "fatal" series of multiple transactions.