# Presumptions of Tax Motivation

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*ABSTRACT: Rebuttable presumptions are scattered throughout the Internal Revenue Code and the Treasury Regulations. In many cases, they are employed in service of determining a taxpayer's motive or state of mind. They are not, however, always utilized when motive or state of mind must be assessed. In some contexts, courts are called upon to examine all relevant facts and circumstances in order to divine a taxpayer's state of mind—which facts are relevant and the weight to be accorded to various facts are not specified ahead of time except to the extent set forth in judicial precedent. At the other extreme, in yet another subset of situations in which tax outcome turns on motive or state of mind, tax law provides that a given fact establishes an irrebuttable presumption of a given motive. In between the two extremes, tax law makes use of a variety of tools, including rebuttable presumptions. When a rebuttable presumption is at work, the proof of a specified fact is deemed to establish the existence of a given state of mind, unless the party who is disadvantaged by that state of mind determination presents sufficient evidence to overcome it.*

*Despite their prevalence, existing literature contains virtually no discussion of the use of rebuttable presumptions in tax law generally, or when used for the purpose of determining motive or state of mind. This Article begins to address the gap in the existing literature and focuses on rebuttable presumptions that guide the assessment of motive or state of mind. It analyzes the purposes that rebuttable presumptions can serve and uses that analysis to craft recommendations for making better use of them. The recommendations include supplementing some facts and circumstances tests with rebuttable presumptions, converting some irrebuttable presumptions into presumptions that are rebuttable in specific ways, and modifying the design of existing rebuttable presumptions to increase the odds of the IRS receiving relevant*

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*information and to provide clearer guidance regarding how the presumptions can be rebutted.*

# I. INTRODUCTION

Rebuttable presumptions pervade tax law.[1] They are used in various contexts and for various reasons. Often, rebuttable presumptions are employed in the service of determining a taxpayer's state of mind, which frequently affects a transaction's tax outcome.[2] In some circumstances, for instance, when a taxpayer is guided by an unduly weighty desire to avoid incurring additional tax liability, the taxpayer will not achieve his or her desired tax consequences.[3] Rebuttable presumptions guide the determination of whether a transaction was excessively tax-motivated in many cases.[4]

Rebuttable presumptions are not always utilized. In some settings, when courts must divine a taxpayer's state of mind, they are called upon to examine all relevant facts and circumstances in order to make that determination —which facts are relevant and the weight to be accorded to various facts are not specified ahead of time except to the extent set forth in judicial precedent.[5] However, in a subset of the situations in which motive or state of mind must be determined, the Internal Revenue Code or the Treasury Regulations provide that a specified fact will establish a rebuttable presumption that a taxpayer possesses a particular motive or state of mind.[6] In another subset of situations in which tax consequences turn on motive or state of mind, tax law provides that a given fact will automatically deprive the taxpayer of a desired tax outcome.[7] Stated differently, in these situations, the presence of a given fact establishes an irrebuttable presumption that a transaction is overly tax-motivated.

For example, when trying to discern whether a taxpayer engaged in two steps as part of a given plan, tax law often employs presumptions turning on timing.[8] If the two steps happen within some specified time of each other, the proximity in time establishes a rebuttable (or irrebuttable) presumption that the taxpayer planned to take both steps from the outset.[9] When a presumption is rebuttable, the party who is disadvantaged by it is given an opportunity to overcome the presumption by presenting countervailing evidence; not so in the case of an irrebuttable presumption.

1. *See infra* Section II.B.
2. *See infra* Section II.B.
3. *See infra* Section II.B.
4. *See infra* Section II.B.
5. *See infra* Section II.A.
6. *See infra* Section II.B.
7. *See infra* Section II.D.
8. The partnership disguised sale rules discussed in Section II.B.1 provide one example.
9. The partnership disguised sale rules discussed in Section II.B.1 provide an example in which a presumption based on timing is rebuttable and the wash sale rules discussed in Section II.D.2 provide an example in which a presumption based on timing is irrebuttable.

Existing literature contains much discussion of whether and when motive or state of mind should matter in tax law.[10] Existing literature also contains some discussion of which facts should be examined by courts when assessing motive or state of mind, as well as the specificity with which those facts should be announced to taxpayers ahead of time.[11] However, despite their frequent occurrence, existing literature contains virtually no discussion of the use of rebuttable presumptions in tax law generally, or when they are employed for the purpose of determining motive or state of mind.[12] This Article begins to address the gap in the existing literature and focuses on rebuttable presumptions that guide the assessment of motive or state of mind. In the process, it develops a framework for understanding the purposes served by rebuttable presumptions, and uses that framework to craft recommendations for making better use of them.

The selection and design of tools used for discerning taxpayer state of mind have several important implications. First, different tools have varying tendencies to trap unwary taxpayers—when faced with an irrebuttable presumption, for instance, a taxpayer who is uninformed about resulting tax consequences is more likely to make missteps that would not be as costly if the presumption were rebuttable.[13] Second, irrebuttable presumptions that favor taxpayers are more likely than rebuttable presumptions or facts and circumstances tests, to act as how-to-guides for taxpayers who aim to comply with law's technical requirements while evading its purposes.[14] Third, rebuttable presumptions offer opportunities to incentivize taxpayers to disclose information to the IRS.[15] Consider, for instance, a presumption that disfavors taxpayers and treats two steps that occur within a specified time of

10. *See, e.g.*, Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. REV. 131, 131–35, 141–45 (2001); Daniel Halperin, *Are Anti-Abuse Rules Appropriate?*, 48 TAX LAW. 807, 807–08, 815–16 (1995); Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 391–93 (2010); David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 880–81 (1999) ("The goal of anti-abuse rules is to identify violations of the implicit pact that uncommon transactions will not become common in response to simple rules. To identify these transactions, anti-abuse rules look at both the taxpayer's purpose and the purpose behind the statute. The statute's purpose is relevant because it allows us to identify which transactions the drafters contemplated in designing the simple rules and which they did not . . . . We look to the taxpayer's purpose to determine whether the reason for the transaction is to take advantage of the simple rules."). The focus of this Article is not on whether or when state of mind should be relevant but rather on the question of how motive or state of mind should be determined.

11. *See, e.g.*, Andrew T. Hayashi, *A Theory of Facts and Circumstances*, 69 ALA. L. REV. 289, 290–93, 300–25 (2017); Leigh Osofsky, *Who's Naughty and Who's Nice? Frictions, Screening, and Tax Law Design*, 61 BUFF. L. REV. 1057, 1059–61, 1082 (2013).

12. One article does examine the procedural effects of rebuttable presumptions in the tax litigation context. *See, e.g.*, John Gamino, *Tax Controversy Overburdened: A Critique of Heightened Standards of Proof*, 59 TAX LAW. 497, 498–99, 523–27, 529–38 (2006).

13. *See infra* Section III.B.

14. *See infra* Section III.B.

15. *See infra* Section III.E.

each other as part of a plan. If a taxpayer is afforded an opportunity to rebut the presumption only if the taxpayer had specifically disclosed the timing and occurrence of the transactions to the IRS at the time of the later transaction, the rebuttable presumption can be used as leverage to encourage disclosure.[16]

This Article will begin, in Part II, by describing various methods tax law employs to discern a taxpayer's motive or state of mind. While this Article's main focus is rebuttable presumptions, it is not feasible to analyze rebuttable presumptions in a vacuum without considering the other options on the table. The options run the gamut from standards to rules and include various hybrid instruments falling in between the ends of the spectrum. At the standard end of the continuum sit facts and circumstances tests, irrebuttable presumptions occupy the rule end of the continuum, and in between lie rebuttable presumptions and other hybrid instruments including safe harbors. As Part II will reveal, examples of each type of tool abound, and the tools are not entirely distinct categories—each type of test can lie closer to one end or the other, depending on its parameters.[17] Moreover, as Part II will illustrate, tax law uses different devices across contexts that are, in other respects, quite similar.[18] The use of different devices in similar contexts suggests that there might be less rhyme or reason to the selection of different tools than there could and should be.

With the aim of suggesting ways to bring more rhyme and reason to inquiries into taxpayer motive or state of mind, Part III will analyze various factors that should influence design choices, drawing upon the literature regarding rules and standards as well as the evidence literature. The factors considered by Part III include (1) whether lawmakers can identify a useful fact that is commonly relevant when assessing motive or state of mind; (2) the goals of mitigating overinclusion and underinclusion; (3) the goal of reducing uncertainty; (4) whether there is any principled basis for guiding application of a standard; (5) the parties' relative access to the evidence; (6) the risk of evidence fabrication; and (7) the risk of a court giving improper weight to certain evidence.

Finally, Part IV proposes concrete changes to the way that tax law assesses motive or state of mind. The proposals include recommendations to supplement certain facts and circumstances tests with rebuttable presumptions, suggestions to modify certain irrebuttable presumptions to make them rebuttable in specific ways, and advice to modify some existing rebuttable presumptions to increase the odds of the IRS receiving relevant

16. *See infra* Section III.E.

17. *See infra* Section II.E.

18. For instance, the facts and circumstances test used in Internal Revenue Code § 357(b) (discussed in Section II.A.2) addresses a type of tax-motivated transaction similar to the transaction addressed by different devices in the context of the partnership disguised sale rules (discussed in Section II.B.1).

information and to provide clearer guidance regarding how the presumptions can be rebutted.

## II. METHODS FOR DETERMINING TAXPAYER MOTIVE OR STATE OF MIND

In various contexts, courts are charged with discerning a taxpayer's state of mind without the guide of presumptions, safe harbors, or other devices that heighten the relevance of any particular fact.[19] In these contexts, courts engage in an examination of all relevant facts and circumstances.

In other settings, the Internal Revenue Code or the Treasury Regulations provide that the existence of a specified fact will establish a rebuttable presumption that a taxpayer possesses a given state of mind.[20] For example, when evaluating whether a taxpayer undertook two transactional steps as part of a unified plan, in some contexts, tax law employs presumptions based on the time between the steps. If the two steps occur within some specified time of each other, the closeness in time establishes a rebuttable presumption that the taxpayer planned to take both steps from the outset; and this is sometimes accompanied by a mirror image rebuttable presumption that the taxpayer conceived of the steps independently if they occur a specified time apart. The partnership disguised sale rules illustrate this approach.[21] Under these rules, in some cases, a contribution by a partner to a partnership and a distribution by the partnership to the partner will be treated as a sale by the partner to the partnership of the contributed property in exchange for the property distributed to the partner, rather than as two separate transactions. If the distribution and contribution occur within a two-year period, the closeness in time establishes a rebuttable presumption that the two transactions are part of a sale.[22] Conversely, if the distribution and contribution occur more than two years apart from each other, the lapse of time establishes a rebuttable presumption that the two transactions are not part of a sale.[23]

In a third set of cases, Congress or Treasury has promulgated safe harbors governing state of mind.[24] If a taxpayer meets the fairly clear requirements of a safe harbor, the taxpayer is assured of a determination that the taxpayer possesses a state of mind that entitles the taxpayer to potentially more beneficial treatment.[25]

In a final class of circumstances, Congress declares that a particular fact, in essence, establishes an irrebuttable presumption that a taxpayer is guided by a certain state of mind.[26] Here too, in some contexts, the fact is two steps

19. *See infra* Section II.A.
20. *See infra* Section II.B.
21. The partnership disguised sale rules are discussed in more detail in Section II.B.1.
22. Treas. Reg. § 1.707-3(c)(1) (2018).
23. *Id.* § 1.707-3(d).
24. *See infra* Section II.C.
25. *See infra* Section II.C.
26. *See infra* Section II.D.

happening within a specified time of each other, which establishes an irrebuttable presumption that the steps are part of a plan.[27]

This Part discusses examples of tax law's use of each of the four methods for divining taxpayer state of mind—facts and circumstances tests, rebuttable presumptions, safe harbors and irrebuttable presumptions (or per se rules). It concludes by observing that these four categories are not entirely distinct. Each category lies on a spectrum that ranges from devices that are more standard-like to devices that are more rule-like, and, depending on its particular parameters, any given facts and circumstances test, rebuttable presumption, safe harbor, or irrebuttable presumption may be closer to one end of the spectrum or the other.[28]

### *A. Unadorned Facts and Circumstances Tests*

Courts examine all relevant facts and circumstances in order to ascertain whether a transferor of property acts out of "detached and disinterested generosity"[29] and whether the principal purpose of a shareholder's contribution of encumbered property to a corporation is to avoid federal income tax or is otherwise not a bona fide business purpose.[30] Each example is discussed, in turn, below. The examples set forth below represent merely an illustrative sample and not an exclusive list of facts and circumstances tests employed in the tax context.[31]

#### 1. Gift Determination

When a taxpayer receives property as a gift, he or she can exclude the value of the property from his or her income.[32] In *Commissioner v. Duberstein*, the Supreme Court concluded that whether a transfer constitutes a gift for income tax purposes depends on the state of mind of the transferor.[33] In particular, the Court explained that whether a transfer is a gift turns on the transferor's intention, and the requisite intention is "detached and disinterested generosity."[34]

When litigating the *Duberstein* case, the IRS advocated for the adoption of clearer tests. In particular, the IRS argued that "[g]ifts should be defined as transfers of property made for personal as distinguished from business

27. *See infra* Section II.D.2 (using wash sale rules to illustrate this concept).

28. *See infra* Section II.E.

29. *See infra* Section II.A.1.

30. *See infra* Section II.A.2.

31. For discussion of various other examples, see Hayashi, *supra* note 11, at 295, 298, 307–13 (discussing other examples including "[t]he 'step transaction' doctrine," some of the provisions governing assessment of penalties, and certain aspects of the determination of whether an activity is a hobby).

32. *See* I.R.C. § 102(a) (2018).

33. Comm'r v. Duberstein, 363 U.S. 278, 285–86 (1960).

34. *Id.* at 285 (quoting Comm'r v. LoBue, 351 U.S. 243, 246 (1956)).

reasons."[35] Under the IRS' proposed test, transfers from employers to employees would, subject to certain exceptions, generally not be treated as gifts.[36] The Court rejected the IRS' approach, stating, "[w]e are of opinion that the governing principles are necessarily general . . . and that the problem is one which, under the present statutory framework, does not lend itself to any more definitive statement that would produce a talisman for the solution of concrete cases."[37]

When determining whether any given transfer is a gift, courts have examined a number of objective indicia of the transferor's intent, including: (1) statements made by the transferor at or close to the time of the transfer;[38] (2) the relationship between the transferor and transferee;[39] (3) the transferor's treatment of the transfer for tax purposes;[40] (4) whether the transferor has received or has an expectation of receiving an economic benefit from the transferee;[41] and (5) whether the transferee has already been adequately compensated for any economic benefit provided to the transferor.[42]

Subsequent to *Duberstein*, Congress adopted Internal Revenue Code § 102(c), which provides that any amounts transferred by an employer to an employee cannot be excluded from income as gifts.[43] Thus, the facts and

35. *Id.* at 284 n.6.

36. *Id.* at 287.

37. *Id.* at 284–85.

38. In *Duberstein*, for instance, it may have been relevant that when one individual transferred a Cadillac to another, he stated that he was doing so because information that the transferee had provided about potential customers had been very helpful. *Id.* at 280, 286. In *Runyon v. Comm'r*, 49 T.C.M. (CCH) 208 (1984), the court concluded that payments made by two individuals to another individual were gifts, and the court appears to have been influenced by the fact that one of the transferors stated to the transferee at the time that the payments were gifts for income tax purposes. *Id.* ("The statements of the declarants were statements of their then existing states of mind, made close enough to the event in question to give reasonable assurance that the statements were not contrived.").

39. *See, e.g.*, Mesinger v. Comm'r, 31 T.C.M. (CCH) 1127 (1972) (treating the rent-free use of an apartment as a gift in a case in which the transferor and transferee had "a close family friendship . . . spanning several years").

40. In *Duberstein*, for instance, the Court stated, "it is doubtless relevant to the over-all inference that the transferor treats a payment as a business deduction." *Duberstein*, 363 U.S. at 287. In *O'Connor v. Comm'r*, 104 T.C.M. (CCH) 571 (2012), the court concluded that the payor's issuance to the payee of a Form 1099-MISC, reporting the payment as taxable income, demonstrated that the payor did not have "donative intent" when it made the payment.

41. In *Hornung v. Comm'r*, 47 T.C.M. (CCH) 428, 440–41 (1967), for example, the court concluded that free use of cars provided to a Green Bay Packer by a car dealership did not constitute a gift because it seemed likely that the dealership believed that use of the car would act as a celebrity endorsement.

42. In *Runyon*, 49 T.C.M. (CCH) at 208, the court concluded that payments made by two individuals to another individual were gifts, and the court appears to have been influenced by the fact that the transferee had already been adequately compensated for services she provided in the past to a corporation owned, indirectly, by the transferors.

43. I.R.C. § 102(c) (2018).

circumstances test for whether something constitutes a gift is now supplemented by what, on its face, appears to be an irrebuttable presumption that employer to employee transfers are not motivated by detached and disinterested generosity. Arguably, in cases in which someone is not only an employer of the taxpayer but also bears another relationship to the taxpayer, it is possible that some transfers from that person to the taxpayer are not made under the employment relationship, so that § 102(c) would not apply. Indeed, in 1989, Treasury had proposed a regulation that stated, "[f]or purposes of section 102(c), extraordinary transfers to the natural objects of an employer's bounty will not be considered transfers to, or for the benefit of, an employee if the employee can show that the transfer was not made in recognition of the employee's employment."[44] Thus, it might be more accurate to describe § 102(c) as a presumption that is rebuttable but that can only be rebutted in certain limited circumstances.

In summary, if the transferor and transferee do not have an employer-employee relationship, the determination of whether the transfer is a gift is governed by a facts and circumstances test. If they do have an employer-employee relationship, that fact establishes a presumption that the transfer is not a gift, which may be rebuttable, but only in limited circumstances.

### 2. Contribution of Encumbered Property to a Corporation

In the gift context, state of mind is assessed for definitional purposes; the Supreme Court adopted a definition of "gift" that turns on the transferor's state of mind, hence, the necessity of determining state of mind.[45] In the case of certain contributions of encumbered property to a corporation, state of mind is evaluated for the purpose of policing transactions for excessive tax motivation.

When a shareholder transfers appreciated property to a corporation in exchange for stock in the corporation, the shareholder will not recognize any gain at the time of the contribution, provided that the shareholder (together with any others contributing property to the corporation as part of the same transaction) owns a sufficient stake in the corporation after the contribution.[46] If the shareholder receives cash or other property that is not stock in the corporation as part of the transaction, the shareholder will recognize some gain.[47]

44. Prop. Treas. Reg. § 1.102-1, 54 Fed. Reg. 627, 631 (Jan. 9, 1989). For further discussion of § 102(c) employee gift exclusion, see, for example, Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 448 (2003).

45. *See supra* notes 33–34 and accompanying text.

46. I.R.C. § 351(a).

47. *Id.* § 351(b).

For example, assume Rebecca owns land that she purchased previously for $40,000. The land is currently worth $100,000. Rebecca contributes it to a corporation in exchange for stock in the corporation worth $100,000 and no other consideration. Assume, after the contribution, Rebecca owns at least 80 percent of the corporation's only class of stock outstanding. As a result of this transaction, Rebecca will not recognize any gain.[48] If Rebecca were to subsequently sell her stock in the corporation for $100,000, at that time, she would recognize $60,000 of gain,[49] and, if the corporation were to subsequently sell the land for $100,000, at that time, the corporation would recognize $60,000 of gain.[50] However, no gain is recognized by Rebecca at the time of the contribution, and, as a result, she will not bear any resulting tax liability at that time.[51]

Now assume that, in lieu of receiving solely stock in the corporation, Rebecca receives stock with a fair market value of $80,000 and $20,000 cash, but, in all other respects, the transaction is the same. As a result of her receipt of cash, Rebecca will recognize $20,000 of gain at the time of the contribution.[52] If Rebecca were to subsequently sell her stock in the corporation for $80,000, at that time, she would recognize an additional $40,000 of gain,[53] and, if the corporation were to subsequently sell the land for $100,000, at that time, the corporation would recognize $40,000 of gain.[54] Thus, when Rebecca receives $20,000 cash, she recognizes $20,000 of gain attributable to the land's $60,000 increase in value at the time of the contribution, and she can defer recognition of the remaining $40,000 of gain until a later sale of her stock.

If a shareholder contributes property subject to debt to a corporation and otherwise meets the applicable requirements, generally the debt taken on by the corporation does not cause the shareholder to recognize gain.[55] Without more, this treatment of debt would leave open a route for taxpayers to circumvent the tax treatment of the receipt of cash.

To demonstrate, imagine Paula owns land that she purchased previously for $40,000. The land is currently worth $100,000. Paula would like to contribute the land to a corporation in exchange for stock and some cash. However, she also aims to avoid recognizing any gain at the time of the

48. *Id.* § 351(a).

49. Her basis in the stock will be $40,000, and, as a result, a sale of the stock for $100,000 will produce gain of $60,000. *Id.* §§ 358(a)(1), 1001(a).

50. Its basis in the land will be $40,000, and, as a result, a sale of the land for $100,000 will produce gain of $60,000. *Id.* §§ 362(a), 1001(a).

51. *Id.* § 351(a).

52. *Id.* § 351(b).

53. Her basis in the stock will be $40,000, and, as a result, a sale of the stock for $80,000 will produce gain of $40,000. *Id.* §§ 358(a)(1), 1001(a).

54. Its basis in the land will be $60,000, and, as a result, a sale of the land for $100,000 will produce gain of $40,000. *Id.* §§ 362(a), 1001(a).

55. *Id.* § 357(a).

contribution. If it were not for § 357(b),[56] Paula might borrow $20,000 from a third party secured by the land, and, shortly thereafter, contribute the land subject to the newly incurred debt to a corporation in exchange for stock worth $80,000. Assume, after the contribution, Paula owns at least 80 percent of the corporation's only class of stock outstanding. As a result of this transaction, if it were not for § 357(b), Paula would not recognize any gain.[57] If Paula were to subsequently sell her stock in the corporation for $80,000, at that time, Paula would recognize $60,000 of gain,[58] and, if the corporation were to subsequently sell the land for $100,000, at that time, the corporation would recognize $60,000 of gain.[59] However, no gain would be recognized by Paula at the time of the contribution. Yet, Paula effectively receives $20,000 of cash from this transaction, given that she retains the $20,000 cash borrowed from a third party, and the corporation, rather than Paula, repays the obligation to the third party.

In order to combat such transactions, § 357(b) provides the corporation's assumption of debt will be treated as if it were cash paid to Paula "[i]f, taking into consideration the nature of the liability and the circumstances in light of which the arrangement for the assumption was made, it appears that the principal purpose of [Paula] with respect to" the corporation's assumption of the debt "was a purpose to avoid Federal income tax on the exchange, or . . . [otherwise] was not a bona fide business purpose."[60] When § 357(b) is applied to the previous example, the likely result is to cause Paula to recognize gain of $20,000 at the time of the contribution.[61] This brings the treatment of the transaction in line with a substantively equivalent transaction in which she contributed unencumbered land to the corporation in exchange for stock worth $80,000 and $20,000 cash.[62]

Whether or not § 357(b) will apply to any given transaction is governed by *all relevant facts and circumstances*; neither the Code nor the Treasury Regulations provide any clear guidance regarding when it will be invoked.[63]

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56. Absent § 357(b), it is also possible that this transaction could be successfully challenged under substance-over-form principles and recast as a cash payment by the corporation to the shareholder.

57. The corporation's assumption of debt would not be treated as money paid to her for purposes of causing her to recognize gain. I.R.C. § 357(a).

58. Her basis in the stock would be $20,000, so that sale for $80,000 would produce $60,000 of gain. *See id.* §§ 358(a)(1), 358(d)(1), 1001.

59. Its basis in the land would be $40,000, and, as a result, a sale of the land for $100,000 would produce gain of $60,000. *See id.* §§ 362(a), 1001.

60. *Id.* § 357(b)(1).

61. *See id.* §§ 351(b), 357(b).

62. For discussion of the tax consequences of that transaction, see *supra* notes 52–54 and accompanying text.

63. *See, e.g.*, Richard G. Greiner, Paul L. Behling & J. Denny Moffett, *Assumption of Liabilities and the Improper Purpose—A Re-Examination of Section 357(b)*, 32 TAX LAW. 111, 117 (1978) ("[T]he

Factors examined by the courts include: (1) when the liability was incurred; (2) "the purpose for incurring the liability"; and (3) the purpose for having the corporation assume the liability.[64] The closer in time the borrowing was to the contribution, the more likely that § 357(b) will apply, particularly if the proceeds of the borrowing were used to pay personal expenses of the shareholder.[65]

### *B. Rebuttable Presumptions*

As discussed above in Section II.A, in various contexts, courts are tasked with discovering a taxpayer's state of mind based on all relevant facts and circumstances, unaided by any guidance from Congress or Treasury regarding which facts are particularly relevant to the inquiry. In other situations, Congress or Treasury provides that a given fact will establish a rebuttable presumption that a taxpayer does (or does not) possess a given state of mind. As is true outside the tax context, a rebuttable presumption exists when the proof of one fact is deemed to establish the existence of another fact, unless the party who is disadvantaged by the presumption presents sufficient evidence to overcome it.[66] In many cases, the statute or regulation that sets forth a rebuttable presumption regarding taxpayer state of mind specifies that the effect of the presumption is to shift the burden of proof to the party who is disadvantaged by the presumption and further provides the standard of proof that must be met.[67] For example, as discussed below, the Treasury Regulations provide that when a contribution to a partnership and a distribution from a partnership occur within two years of each other, the proximity in time of the transactions establishes a rebuttable presumption

regulations leave the taxpayer at precisely the same point as does the language of the Code; for further enlightenment the taxpayer must resort to the interpretation placed on such language by the courts.").

64. *Id.* at 123.

65. *Id.* ("[W]here loans are made immediately prior to the assumption, the courts have not hesitated to find a tax avoidance or nonbusiness purpose. Where, however, a satisfactory business reason for the loan is shown the courts have permitted the nature of the liability to overcome the otherwise questionable timing. While some courts have ruled that the application of the loan proceeds is not significant, most courts consider it in conjunction with the purpose of the loan." (footnotes omitted)).

66. *See, e.g.*, Harold A. Ashford & D. Michael Risinger, *Presumptions, Assumptions, and Due Process in Criminal Cases: A Theoretical Overview*, 79 YALE L.J. 165, 165 (1969) ("Most are agreed that a presumption is a legal mechanism which, unless sufficient evidence is introduced to render the presumption inoperative, deems one fact to be true when the truth of another fact has been established."); Mason Ladd, *Presumptions in Civil Actions*, 1977 ARIZ. ST. L.J. 275, 277; Edmund M. Morgan, *Further Observations on Presumptions*, 16 S. CAL. L. REV. 245, 245 (1943); Roy Robert Ray, *Burden of Proof and Presumptions*, 13 TEX. L. REV. 33, 52 (1934) ("A presumption is the assumption of the existence of one fact from the existence of another fact.").

67. *See, e.g.*, Gamino, *supra* note 12, at 503 ("[S]ubstantive Code provisions imposing presumptions almost always speak to the burden of persuasion.").

that the distribution and contribution were part of a sale.[68] The regulations further provide that the presumption can be rebutted by the taxpayer if the facts and circumstances "clearly establish" that the transfers do not constitute a sale.[69] When the Code or Regulations contain a rebuttable presumption, but do not specify its effect in any detail, all that is known for certain is that, if the disadvantaged party presents no countervailing evidence, a court would have to conclude the presumed state of mind exists.[70] The outcome when some countervailing evidence is presented is unclear.[71]

Tax law employs rebuttable presumptions in the service of divining taxpayer state of mind in varied contexts, including—determining whether a contribution of property to a partnership and a distribution by the partnership to the contributing partner were conceived of as part of a plan to sell the property to the partnership,[72] ascertaining whether a corporation was formed or availed of for the purpose of avoiding shareholder-level tax,[73] and uncovering whether the swap of real estate between related parties followed by the sale of real estate by one of the parties was principally motivated by the avoidance of federal income tax.[74] Each of these examples is discussed, in turn, below, and each entails an assessment of state of mind for purposes of ferreting out excessively tax-motivated transactions. Many other rebuttable presumptions can be found, scattered throughout the Internal Revenue Code and Treasury Regulations—some, but not all, of which are also aimed at determining taxpayer state of mind.[75]

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68. *See infra* Section II.B.1.

69. *See infra* Section II.B.1.

70. *See, e.g.*, Gamino, *supra* note 12, at 528–29. This effect would follow from the presumption shifting to the party who is disadvantaged by it the burden of production. For discussion of this effect generally, see, for example, Ronald J. Allen, *Presumptions, Inferences and Burden of Proof in Federal Civil Actions—An Anatomy of Unnecessary Ambiguity and a Proposal for Reform*, 76 NW. U. L. REV. 892, 893 (1982); Jerome A. Hoffman, *Thinking About Presumptions: The "Presumption" of Agency from Ownership as Study Specimen*, 48 ALA. L. REV. 885, 896–97 (1997); Ladd, *supra* note 66, at 278–79; and Kaitlin Niccum, Note, *Ethics and Presumptions: Lying to Burst the Bubble*, 25 GEO. J. LEGAL ETHICS 715, 721 (2012).

71. *See, e.g.*, Gamino, *supra* note 12, at 528–29 ("What is to be done with a Code section that creates a presumption but is silent as to the standard of proof for rebuttal? . . . [T]he situation is not . . . a simple yes-or-no proposition." (footnote omitted)).

72. *See infra* Section II.B.1.

73. *See infra* Section II.B.2.

74. *See infra* Section II.B.3.

75. Other examples of rebuttable presumptions include: (1) Treas. Reg. § 1.6015-3(c)(3)(iii) (2014) (providing for a rebuttable presumption that the principal purpose of a transfer of assets from a non-innocent spouse to a spouse who obtains innocent spouse relief was to avoid tax or payment of tax if the transfer occurs during the 12-month period before the mailing date of the first letter of proposed deficiency or at any time after the mailing date unless the transfer was made pursuant to a divorce or separation instrument); (2) Treas. Reg. § 1.881-3 (2010) (setting forth various rebuttable presumptions in the context of conduit financing arrangements); (3) Treas. Reg. § 1.704-1(b)(2)(iii)(b), (c) (2005) (providing that if allocations in a partnership agreement produce certain effects that fact will establish a rebuttable

### 1. Partnership Disguised Sale Rules

Imagine the following facts. Two individuals, Mindy and Danny, own interests in the MD partnership. Mindy owns a parcel of land that has appreciated in value. Mindy would like to dispose of her interest in the land, and the MD partnership would like to acquire it. If Mindy sells the land to the MD partnership for cash, the transaction is fully taxable; Mindy would recognize and be subject to tax on gain from sale of the land at the time of sale.[76]

Absent the disguised sale rules, the parties might instead engage in the following transaction—Mindy would contribute the land to the MD partnership and, shortly after the contribution, Mindy would receive a distribution of cash from the MD partnership in an amount equal to the value of the land at the time of the contribution. This transaction has the same non-tax effects as Mindy selling the land to the partnership for cash—under both transactions, Mindy receives cash from the MD partnership and Mindy transfers the land to the MD partnership. However, but for the disguised sale rules and potential recast of the alternative transaction under substance-over-form principles, the alternative transaction would receive more favorable tax treatment. In particular, Mindy would not recognize gain upon contribution of the land to the partnership or upon receipt of the cash distribution.[77]

The "disguised sale rules," however, potentially provide otherwise. In particular, Internal Revenue Code § 707(a)(2)(B) provides that if the contribution by Mindy of the land, and the distribution to Mindy of cash "when viewed together, are properly characterized as a sale or exchange of property," then the transaction will be treated as a sale of land by Mindy to the partnership.[78] The regulations under § 707 provide that the transaction will be treated as a sale if, based on all the facts and circumstances, the distribution to Mindy would not have been made but for Mindy's contribution

presumption that those effects were strongly likely to occur as of the time the allocations became part of the partnership agreement, for purposes of testing whether the allocations are shifting allocations or transitory allocations that lack substantiality); (4) I.R.C. § 183(d) (2012) (establishing a rebuttable presumption that an activity was engaged in for profit if the activity has been profitable for three or more of the last five years—or a different time period in the case of certain activities); (5) Treas. Reg. § 1.1041-1T(b)(2), Q&A (7) (2012) (establishing a rebuttable presumption regarding whether the transfer of property "is related to the cessation of the marriage"); and (6) Treas. Reg. § 56.4911-2(b)(5)(ii) (2013) (establishing a rebuttable presumption regarding whether certain advertisements constitute grass roots lobbying).

76. I.R.C. § 1001 (2018).

77. This is true assuming that the cash distribution did not exceed Mindy's basis in her interest in the partnership. *See id.* § 721(a) (providing for non-recognition of gain on the "contribution of property to the partnership"); *id.* § 731(a)(1) (providing for non-recognition on the distribution, provided that the amount of cash distributed does not exceed the partner's basis in his or her interest in the partnership).

78. *Id.* § 707(a)(2)(B)(iii) (citing *id.* § 707(a)(2)(B)(i), (ii)).

of the land (getting at the parties' state of mind) and the distribution to Mindy is not dependent on the entrepreneurial risks of partnership operations.[79]

The regulations provide a rebuttable presumption that a distribution and contribution that occur within a two-year period constitute a sale.[80] The presumption can be rebutted if "the facts and circumstances clearly establish that the transfers do not constitute a sale."[81] The regulations contain a requirement for taxpayer disclosure in this case.[82] The regulations also contain a rebuttable presumption that a distribution and contribution that occur more than two years apart from each other do not constitute a sale.[83] This presumption can also be rebutted if "the facts and circumstances clearly establish that the transfers [do] constitute a sale."[84] The regulations also contain a list of relevant facts and circumstances and examples illustrating cases in which the presumptions are and are not rebutted.[85] As applied to the example above, the relevant facts include: whether the timing and amount of the distribution to Mindy were determinable with reasonable certainty at the time of Mindy's contribution of land, whether Mindy had a legally enforceable right to the subsequent cash distribution, whether Mindy's right to the cash distribution was secured, and various facts bearing on the partnership's likely ability to make the subsequent distribution to Mindy.[86]

The two-year presumptions are ostensibly based on the belief that, if the transfers occur close in time, they are more likely to be part of a unified plan. In other words, it is more likely that the reason for making the distribution to Mindy was to pay Mindy for the land contribution. The closer in time the transactions occur, the more likely it is that they were part of a plan to sell the land to the partnership, in substance, without selling the land in form. Conversely, as the time between the transfers increases, it becomes less likely that the transfers were part of a unified plan to sell the land to the partnership. Thus, the disguised sale rules utilize rebuttable presumptions in the context of discerning a taxpayer's state of mind.

### 2. Accumulated Earnings Tax

When a business entity is treated as a "C Corporation" for tax purposes, its income is subject to two potential levels of tax—tax imposed on the entity

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79. Treas. Reg. § 1.707-3(b) (2014).

80. *Id.* § 1.707-3(c)(1).

81. *Id.*

82. *Id.* § 1.707-3(c)(2). The disclosure requirement is subject to certain exceptions. *Id.*

83. *Id.* § 1.707-3(d).

84. *Id.*

85. Treas. Reg. § 1.707-3(b)(2), (f) (as amended in 1992). For further discussion, see, for example, Mark P. Gergen, *Reforming Subchapter K: Contributions and Distributions*, 47 TAX L. REV. 173, 186–98 (1991).

86. *See* Treas. Reg. § 1.707-3(b)(2) (as amended in 1992).

as it earns income, and tax on its shareholders when they receive distributions from the entity or sell their interests in the entity.[87]

Although a second level of tax is imposed on income earned through a C Corporation, that tax is not imposed until the C Corporation makes distributions to the owners or the owners sell their stock.[88] Therefore, for tax reasons, it may be tempting to delay making distributions to the owners and for the owners to hold onto their stock for a long period of time.

A penalty tax, referred to as the "accumulated earnings tax," limits taxpayers' ability to use this strategy.[89] The accumulated earnings tax is an additional 20 percent tax levied on a corporation's earnings that are not distributed to shareholders if the corporation was "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders . . . by permitting earnings and profits to accumulate instead of being divided or distributed."[90] If the corporation's earnings "are permitted to accumulate beyond the reasonable needs of the business," that establishes a rebuttable presumption that the parties' purpose is to avoid the shareholder-level tax.[91] The corporation can rebut this presumption by meeting a "preponderance of the evidence" standard.[92]

### 3. Like-Kind Exchanges Between Related Parties

Imagine the following facts. Anne and David are siblings who own various real estate investment properties. Anne owns a shopping center with a basis of $70,000 and a fair market value of $100,000. David owns a farm with a basis of $20,000 and a fair market value of $100,000. A third party, Charlotte, approaches David about the possibility of acquiring the farm for $100,000. If David sold the farm to Charlotte for $100,000, David would recognize and be subject to tax on $80,000 of gain (the $100,000 selling price minus his $20,000 basis in the farm).[93]

A special provision in the Internal Revenue Code, § 1031, allows a taxpayer to not currently recognize gain when the taxpayer exchanges "real [estate] held for productive use in a trade or business or for investment" for other real estate held in that same manner.[94] In order to ensure that the gain that accrued in the taxpayer's old property is recognized on a later sale, the taxpayer will take a basis in the new property that preserves any gain that had

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87. I.R.C. § 11 (2018) (entity-level tax); *id.* §§ 301, 1001 (shareholder-level tax on distribution or sale). This is true assuming that the shareholders are not exempt from tax on the resulting dividend income or gain.

88. *Id.* §§ 301, 1001.

89. *Id.* § 531.

90. *Id.* §§ 531, 532. Some corporations are exempt from the tax. *Id.* § 532(b).

91. *Id.* § 533(a).

92. *Id.*

93. *See id.* § 1001(a).

94. *Id.* § 1031(a)(1).

accrued in the old property and was not recognized at the time of exchange.[95] Were it not for a special provision within § 1031 dealing with exchanges between related parties, Anne and David might utilize § 1031 to obtain a much more favorable outcome than what would result from a simple sale of the farm by David to Charlotte for $100,000.

In particular, Anne and David would first engage in a § 1031 exchange in which they swapped the farm for the shopping center. At the time of exchange, neither sibling would recognize any gain.[96] After the exchange, Anne would hold the farm with a basis of $70,000 (she takes a basis in the farm equal to her basis in the shopping center, which preserves $30,000 of built-in gain in the farm in her hands—the same amount of built-in gain that existed in her hands in the shopping center before the swap).[97] After the exchange, David would hold the shopping center with a basis of $20,000 (he takes a basis in the shopping center equal to his basis in the farm, which preserves $80,000 of built-in gain in the shopping center in his hands—the same amount of built-in gain that existed in his hands in the farm before the swap).[98]

Subsequently, sometime after swapping the real estate parcels, Anne would sell the farm to Charlotte for $100,000. Absent a special rule regarding like-kind exchanges between related parties and assuming no recast of the transaction under substance over form principles, Anne would recognize and be subject to tax on $30,000 of gain (the $100,000 selling price minus her $70,000 basis in the farm).[99] Thus, instead of David recognizing $80,000 of gain as a result of the farm sale, Anne would recognize $30,000 of gain as a result of the farm sale. The parties would have avoided current recognition of $50,000 of gain.

The outcome just described, however, is likely precluded by § 1031(f) assuming that Anne's sale to Charlotte occurs within two years of her swap with David.[100] Section 1031(f) provides that if related parties[101] engage in a like-kind exchange and one of the related parties disposes of the property acquired in the exchange within two years, then, at the time of later disposition, both parties must recognize any gain or loss that was not recognized at the time of the earlier like-kind exchange unless the taxpayers establish that neither the like-kind exchange nor the later disposition had, as

95. *Id.* § 1031(d).
96. *See id.* § 1031(a).
97. *See id.* § 1031(d).
98. *Id.*
99. *Id.* § 1001(a).
100. *Id.* § 1031(f).
101. Related parties include not only family members, but also various related entities, as well as individuals and entities in which individuals own sufficient interests. *Id.* §§ 1031(f)(3), 267(b), 707(b)(1).

one of its principal purposes, the avoidance of federal income tax.[102] In the case of Anne and David, this provision has the likely result of making it so that, at the time Anne sells the farm to Charlotte, David recognizes $80,000 of gain from sale of the farm, and Anne recognizes $30,000 of gain from sale of the shopping center.[103]

In effect, § 1031(f) provides that the sale of property within two years of its receipt in a § 1031 exchange with a related party establishes a rebuttable presumption that the taxpayers conceived of the exchange followed by sale as part of a scheme to reduce tax liability. One could imagine the parties successfully rebutting this presumption if, for instance, the real estate swap followed by sale of real estate resulted in the parties incurring greater tax liability than what would have resulted from simply selling the real estate to the third party.[104]

If the transactions occur more than two years apart, § 1031(f) suggests that the transactions might still be vulnerable to attack by providing that § 1031's non-recognition treatment is not available to any exchange that is "part of a transaction (or series of transactions) structured to avoid the purposes of" § 1031(f).[105] This might be the case if, for instance, a third party is inserted into the exchange between Anne and David so that the § 1031 exchange does not occur directly between related parties.[106] This provision

102. *Id.* § 1031(f)(2)(C). The parties also do not have to subsequently recognize gain or loss in certain specified situations. *See id.* § 1031(f)(2)(A)–(B).

103. That is the amount of gain that each realized but did not recognize at the time of the like-kind exchange.

104. In the case of Anne and David, this would occur if the basis amounts were reversed, assuming the parties are subject to equivalent tax rates. In one private letter ruling, the IRS ruled that the principal purpose of a related party exchange and subsequent sale was not tax avoidance in part because the brother who subsequently sold property had a lower basis in the property than the taxpayer so that an exchange followed by sale did not reduce the amount of gain subject to tax. *See* I.R.S. Priv. Ltr. Rul. 105749-07 (Apr. 26, 2007). The legislative history accompanying the adoption of § 1031(f) also sheds some light on circumstances in which courts might conclude that the principal purpose of the related party exchange and subsequent sale was not tax avoidance. *See* STAFF OF S. COMM. ON FIN., 101ST CONG., REVENUE RECONCILIATION ACT OF 1989: EXPLANATION OF PROVISIONS APPROVED BY THE COMMITTEE 152 (Comm. Print 1989) ("It is intended that the non-tax avoidance exception generally will apply to: (i) a transaction involving an exchange of undivided interests in different properties that results in each taxpayer holding either the entire interest in a single property or a larger undivided interest in any of such properties; (ii) dispositions of property in nonrecognition transactions; and (iii) transactions that do not involve the shifting of basis between properties.").

105. I.R.C. § 1031(f)(4).

106. The legislative history accompanying the adoption of § 1031(f) provides a somewhat related example. *See* STAFF OF S. COMM. ON FIN., 101ST CONG., REVENUE RECONCILIATION ACT OF 1989: EXPLANATION OF PROVISIONS APPROVED BY THE COMMITTEE 152 ("For example, if a taxpayer, pursuant to a prearranged plan, transfers property to an unrelated party who then exchanges the property with a party related to the taxpayer within two years of the previous transfer in a transaction otherwise qualifying under section 1031, the related party will not be entitled to nonrecognition treatment under section 1031."). The IRS has also issued a revenue ruling concluding that a transaction was structured to avoid the purpose of § 1031(f) under

likely also contemplates a situation in which a time period longer than two years elapses before the subsequent disposition, but the parties commit to the subsequent disposition at or close to the time of the § 1031 exchange.

In summary, if a like-kind exchange between related parties and subsequent sale occur within two years of each other, the proximity in time of the events establishes a rebuttable presumption of tax avoidance motive. If the events occur more than two years apart, no presumption applies, and tax avoidance motive is assessed under a general facts and circumstances approach.

### *C. Safe Harbors*

When Congress or Treasury provides that a given fact established a rebuttable presumption that a taxpayer possesses (or does not possess) a given state of mind, the presumption can be overcome. When the resulting presumption is favorable to the taxpayer, for instance, the IRS can defeat the presumption with sufficient countervailing evidence. So too can the taxpayer in the case of a rebuttable presumption that favors the IRS.

In the case of a safe harbor, a given fact establishes that a taxpayer possesses a certain state of mind that results in favorable tax consequences, and, unlike in the case of a rebuttable presumption, the state of mind is conclusively established.[107] In other words, the IRS cannot counter the determination.[108] Moreover, if a taxpayer fails to meet the safe harbor's criteria, the taxpayer, nevertheless, has an opportunity to prove that he or she possesses the favorable state of mind under a background facts and circumstances test.[109]

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similar facts. *See* Rev. Rul. 2002-83, 2002-2 C.B. 927. In that ruling, two individuals, A and B, were related to each other and each owned real property. A owned Property 1 with a low basis, and B owned Property 2 with a high basis. An unrelated individual, C, was interested in acquiring Property 1. A, B, C, and a qualified intermediary (QI) who was unrelated to each of the individuals engaged in a series of transactions. A transferred Property 1 to QI, and QI sold Property 1 to C for cash. QI acquired Property 2 from B for cash, and QI transferred Property 2 to A. The ruling concluded that A's exchange of property with the QI was part of a transaction structured to avoid the purpose of § 1031(f), and, as a result, A was not entitled to nonrecognition treatment under § 1031.

107. For a general definition of safe harbors, see *infra* note 109 and accompanying text.

108. This sets aside the possibility of the IRS successfully asserting more general anti-abuse doctrines or principles that might be used to challenge the results claimed by the taxpayer. For further discussion of such doctrines, see *infra* notes 175–76 and accompanying text.

109. For a similar definition of safe harbors, see, for example, Emily Cauble, *Safe Harbors in Tax Law*, 47 CONN. L. REV. 1385, 1389 (2015) (explaining the "two defining features" of safe harbors); and Susan C. Morse, *Safe Harbors, Sure Shipwrecks*, 49 U.C. DAVIS L. REV. 1385, 1391 (2016) ("A safe harbor guarantees compliance for described behavior, without foreclosing the possibility that activities outside the safe harbor are also compliant. The activity described by the safe harbor is subject to a rule; other activities are subject to a standard." (footnote omitted)). The examples contained in this Article are not the only examples of safe harbors in tax law. Many other safe harbors exist—some of which are used for purposes unrelated to determining taxpayer state of mind. For other examples, see Cauble, *supra*, at 1394–98; Morse, *supra*, at 1393 ("Internal

In order to demonstrate, consider the tax treatment of the sale of a home.[110] Under certain conditions,[111] a taxpayer's home sale will receive more favorable tax treatment if it was prompted "by . . . a change in place of employment, health, or . . . unforeseen circumstances."[112]

The Treasury regulations contain various safe harbors that can be used for purposes of determining whether a home sale was motivated by these specified occurrences.[113] The regulations, for instance, provide that a home sale will be "deemed to be by reason of a change in place of employment" if the change in place of employment occurs while the taxpayer owned the home and used it as a principal residence and the taxpayer's new place of employment "is at least 50 miles" farther from the home than was the taxpayer's previous place of employment.[114] If the taxpayer does not meet the safe harbor's requirements, he or she can still claim the resulting benefits if, based on all relevant facts and circumstances, the home sale was motivated by the change in place of employment.[115] To guide this determination, the regulations contain a list of potentially relevant factors, including: (1) the closeness in time between the sale of the home and the change in place of employment; (2) whether the suitability of the home as the taxpayer's principal residence has materially changed; (3) whether "[t]he taxpayer's financial ability to maintain the property is materially impaired"; (4) how long

Revenue Service guidance provides that a constructive sale will not result if an owner retains exposure to the value of an underlying asset between 100% and 125% of the asset price at the time of a derivative transaction. This is a safe harbor."); and Morse, *supra*, at 1409 ("[C]onsider another safe harbor, which exempts an individual taxpayer from the disadvantageous passive activity loss tax rules if the taxpayer spends 500 hours a year on a business activity.").

110. Because a given tax outcome that is favorable for one taxpayer is often unfavorable for another, many examples of "safe harbor" provisions in tax law are safe harbors for some taxpayers but are what Professor Morse labels "sure shipwrecks" for others. *See* Cauble, *supra* note 109, at 1387 n.4; Morse, *supra* note 109, at 1392–93. A "sure shipwreck" is a provision that guarantees an unfavorable result when its criteria are met and leaves open the possibility that the same unfavorable result could follow under a background facts and circumstances test even if the sure shipwreck's criteria are not met. *See* Morse, *supra* note 109, at 1392. The home sale example is, for all taxpayers, either a safe harbor or neutral in effect. If a taxpayer benefits from applying § 121 to a home sale, the provision is a safe harbor. If the taxpayer does not want § 121 to apply (likely because the taxpayer wants to utilize § 121 for a different sale that occurs within two years), the taxpayer can always opt to not utilize § 121. I.R.C. § 121(f). In such a situation, the example is neutral in effect—it neither helps nor hinders the taxpayer's objectives.

111. A taxpayer's reason for selling a home becomes potentially relevant when the taxpayer has owned the home for less than two of the last five years, used the home as a principal residence for less than two of the last five years, or utilized § 121 to exclude from income gain from sale of another home within the last two years. *See id.* § 121(c).

112. *Id.* § 121(c)(2)(B).

113. *See infra* notes 114, 118–19 and accompanying text.

114. Treas. Reg. § 1.121-3(c)(2) (as amended in 2004). The regulations also provide a safe harbor that governs when there is no former place of employment. *Id.* ("[T]he distance between the qualified individual's new place of employment and the residence sold or exchanged [must be] at least 50 miles.").

115. *Id.* § 1.121-3(b).

"[t]he taxpayer use[d] the property as the taxpayer's residence during the [time]" the taxpayer owned it; (5) whether the change in place of employment was reasonably foreseeable when the taxpayer began using the property as a residence; and (6) whether the change in place of employment occurred during the time the taxpayer owned the home and used it as a principal residence.[116] The regulations also contain two illustrative examples of cases in which a sale motivated by change in place of employment can qualify under the general facts and circumstances test notwithstanding its failure to meet the safe harbor's criteria.[117] In addition, the regulations set forth safe harbors under which home sales will be deemed to be motivated by health[118] or unforeseen circumstances.[119]

### *D. Irrebuttable Presumptions (i.e., Per Se Rules)*

As discussed above, a rebuttable presumption exists when the proof of one fact is deemed to establish the existence of another fact, unless the party who is disadvantaged by the presumption presents sufficient evidence to overcome it. An irrebuttable presumption is at work when the proof of one fact is deemed to conclusively establish the existence of another fact. As has been noted outside the tax context, an "irrebuttable presumption" is not truly a "presumption" at all, given that no opportunity is afforded to overcome its conclusion.[120] Rather, it is merely a per se rule of substantive law.[121] In tax law,

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116. *Id.*

117. *Id.* § 1.121-3(c)(4), exs. 3 & 4. For discussion of the use of regulatory examples, see generally Susan C. Morse & Leigh Osofsky, *Regulating by Example*, 35 YALE J. ON REG. 127 (2018).

118. Treas. Reg. § 1.121-3(d)(2).

119. *Id.* § 1.121-3(e)(2).

120. *See, e.g.*, Kenneth S. Broun, *The Unfulfillable Promise of One Rule for All Presumptions*, 62 N.C. L. REV. 697, 700 (1984) ("Such rules describe the situation in which the substantive law has provided that the basic facts are all that need to be proved for a legal result to ensue. . . . No rule of evidence or procedure is involved. Despite the universal acceptance of this analysis of such rules, the label 'conclusive presumption' remains in use and is unlikely to go away."); Hoffman, *supra* note 70, at 896 ("Careful verbalists have, however, renounced the notion of 'irrebuttable' or 'conclusive' presumptions, recognizing them for what they are: rules of substantive law masquerading as rules of proof."); W. Page Keeton, *Statutory Presumptions—Their Constitutionality and Legal Effect*, 10 TEX. L. REV. 34, 34 (1931) ("This kind of a presumption is generally described with reference to its consequences as being irrebuttable or conclusive. It is obviously not a rule of procedure at all but only a maxim of substantive law with its true nature concealed by the adoption of a fiction.").

121. Indeed, there was a period of time in history when the Supreme Court upheld challenges to irrebuttable presumptions on due process grounds. *See, e.g.*, Bruce L. Ackerman, *The Conclusive Presumption Shuffle*, 125 U. PA. L. REV. 761, 769–71 (1977); John M. Phillips, Note, *Irrebuttable Presumptions: An Illusory Analysis*, 27 STAN. L. REV. 449, 453–56 (1975); Note, *The Irrebuttable Presumption Doctrine in the Supreme Court*, 87 HARV. L. REV. 1534, 1539–44 (1974). Later, the Supreme Court arrived at the view that such challenges were unworkable because any per se rule, with some discussion of the legislature's purpose, could be characterized as entailing an irrebuttable presumption. Thus, prior successful challenges were better explained as based on equal protection or other grounds given the particular rules involved. *See, e.g.*, Ackerman, *supra*, at 771–73.

a number of per se rules are designed to prevent taxpayers from obtaining favorable outcomes in certain, potentially overly tax-motivated transactions.[122] Given their purpose of curbing tax-motivated transactions, these rules could be described (if one is willing to forgive the technical misuse of the term "presumption") as creating "irrebuttable presumptions" that certain specified facts indicate excessive tax motivation. Examples include § 267(a)(1)'s disallowance of the deduction of a loss recognized on sale of property to a related party,[123] § 1091's prohibition of the deduction of a loss recognized on a wash sale,[124] and § 362(e)(2)'s prevention of the duplication of tax losses resulting from the contribution of built-in loss property to a corporation.[125] Each example is discussed, in turn, below.

#### 1. Sale of Built-In Loss Property to a Related Party

Section 267(a)(1) disallows the deduction of losses recognized on the sale of property to certain related parties.[126] In order to demonstrate, consider the following example. Mother acquires stock for $50. As a result, Mother's basis in the stock is $50.[127] Mother sells the stock to Daughter for $20 at a time when the stock is worth $20. Mother recognizes $30 of loss from the sale, but Mother cannot deduct the $30 loss.[128]

Disallowing the deduction of a loss recognized on sale to a related party is driven by the goal of preventing taxpayers from reaping the benefits of tax-motivated sales of built-in loss property in contexts in which the sale does not,

122. Virtually any "per se" rule that puts taxpayers into categories could be framed as an irrebuttable presumption of something—and what is presumed depends on the purpose of the rule. This Article focuses on state of mind determinations; therefore, the examples presented consist of rules arguably guided by the purpose of identifying overly tax-motivated transactions. When that is the purpose of a rule, the fact that triggers the rule's application can be framed as establishing an irrebuttable presumption of excessive tax motivation. Other rules could be framed as establishing irrebuttable presumptions of something else. For instance, if one were to frame graduated income tax rates as guided by the purpose of taxing at a higher rate individuals who have a greater ability to pay, one could frame the dollar thresholds for higher brackets as establishing irrebuttable presumptions that individuals who earn the specified levels of income have a greater ability to pay taxes than individuals who earn less.

123. *See infra* Section II.D.1.

124. *See infra* Section II.D.2.

125. *See infra* Section II.D.3. Many other examples of irrebuttable presumptions of tax motivation exist, including, among others: (1) various restrictions on the dividends received deduction contained in Internal Revenue Code §§ 246, 246A, 1059 (2018); (2) the holding period requirement for obtaining qualified dividend income treatment contained in Internal Revenue Code § 1(h)(11) (2018); and (3) rules disallowing the deduction of losses on certain corporate distributions of built-in loss property contained in Internal Revenue Code §§ 311, 336(d) (2018).

126. I.R.C. § 267(a)(1). Related parties include not only family members, but also various related entities, as well as individuals and entities in which individuals own sufficient interests. *Id.* § 267(b)–(c).

127. *Id.* § 1012.

128. *See id.* § 267(a)(1).

in substance, deprive the taxpayer of continued ownership of the property.[129] If a taxpayer holds an asset that has increased (or decreased) in value, generally, the taxpayer will not realize the resulting gain (or loss) for tax purposes until the taxpayer sells the asset for cash or exchanges it for other consideration.[130] If and when the taxpayer does sell or exchange the asset, the taxpayer will realize the resulting gain (or loss).[131] At that time, in the case of gain, the taxpayer generally includes the resulting gain in income, subjecting the gain to tax at the taxpayer's effective tax rate, and, in the case of loss, the taxpayer may be entitled to deduct the loss (saving tax at the taxpayer's effective tax rate).[132]

In the case of a loss, generally, a taxpayer would prefer to recognize the loss as soon as possible, so that the taxpayer can benefit from tax savings in the earliest possible year. Thus, when considering only the resulting tax consequences, a taxpayer would opt to sell assets with built-in losses early and often but retain ownership of assets with built-in gains for as long as possible. For non-tax reasons, however, a taxpayer may desire to retain ownership of an asset with a built-in loss.[133] If losses recognized upon sale to a related party were deductible, a taxpayer who held an asset with a built-in loss but desired to retain control of or economic benefits from the asset for non-tax reasons could achieve the best of both worlds by selling the asset to a related party. Doing so would allow the taxpayer to recognize the loss for tax purposes currently, while still maintaining indirect control over and benefits from the asset.[134] Section 267(a)(1), by disallowing the deduction of any loss recognized on sale to a related party, prevents this type of tax-motivated transaction, and the legislative history surrounding the enactment of § 267(a)(1)'s predecessor describes its purpose as the prevention of tax avoidance.[135]

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129. *See infra* notes 133–35 and accompanying text.

130. *See* I.R.C. § 1001(a).

131. *Id.*

132. *See id.* §§ 61(a)(3), 165.

133. The taxpayer might expect the asset to recover in value, or the taxpayer might require access to the asset for some reason.

134. *See* Robert I. Keller, *At a Loss: A Half Century of Confusion in the Tax Treatment of Transfers of Depreciated Property Between Related Taxpayers*, 44 TAX LAW. 445, 450 (1991) ("[I]n a system of voluntary realization, Congress can reasonably demand that before a taxpayer be allowed to recognize a loss . . . he transfer title to such property to a person or entity whose economic interests are not virtually identical to his own.").

135. *See id.* at 460 n.91 (discussing the legislative history and quoting from the Senate Report accompanying enactment of the predecessor provision: "Experience shows that the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding the income tax. It is believed that this provision will operate to close this loophole of tax avoidance.").

Section 267(a)(1) is designed as a per se rule—if the parties are related, no deduction is allowed. Taxpayers are not given an opportunity to rebut the implicit presumption that the sale is tax motivated.

### 2. Wash Sale Rules

The wash sale rules are driven by a concern similar to the reservation underlying the rule providing for non-deductibility of loss recognized on sale to a related party.[136] Imagine a taxpayer holds stock that has declined in value, and the taxpayer would like to deduct the loss for tax purposes but, for non-tax reasons, would like to continue to own the stock. Absent the wash sale rules and assuming the transactions would not be recast under substance over form principles, the taxpayer could achieve both objectives by selling the stock to an unrelated party and repurchasing the same stock shortly thereafter.[137] To prevent this type of tax-motivated transaction, § 1091 disallows the deduction of the loss if the sale and purchase occur within a specified time of each other.[138] As was true in the case of the sale of built-in loss property to a related party, the implicit presumption of tax motivation contained in the wash sale rules is not rebuttable. If, within a period beginning 30 days before the date of the sale of stock or securities and ending 30 days after the date of such sale, a taxpayer has acquired, or has entered into a contract or option to acquire, substantially identical stock or securities, then no deduction is allowed for loss recognized on the sale.[139]

### 3. Contributions to Corporations of Built-In Loss Property

When a shareholder, or group of shareholders, contributes property to a corporation in exchange for stock, the shareholder(s) will not recognize the gain or loss built into the property as long as the contributing shareholder(s) own a controlling interest in the corporation immediately after the contribution.[140] To ensure that any built-in gain or loss that is not recognized

136. For additional discussion of the purpose of the wash sale rules, see, for example, David Elkins, *The Myth of Realization: Mark-to-Market Taxation of Publicly-Traded Securities*, 10 FLA. TAX REV. 375, 395–96 (2010); and Osofsky, *supra* note 11, at 1086.

137. *See, e.g.*, Osofsky, *supra* note 11, at 1086 ("Indeed, a taxpayer may wish to sell built-in loss stock merely to trigger the tax loss, without truly divesting of ownership in the stock. Absent any rules preventing the taxpayer from doing so, such a taxpayer . . . might sell the stock to trigger the tax loss and then repurchase the stock (or similar stock), thereby obtaining the tax loss, without really divesting economically.").

138. I.R.C. § 1091 (2018).

139. One might characterize § 1091 as a "sure shipwreck" rather than a per se rule. If a taxpayer purchases exactly identical stock or securities within the specified time frame, denial of the loss is guaranteed. If the stock or securities purchased are not exactly identical, loss might still be denied under the background standard that examines whether the stock or securities are "substantially identical." *Id.* Regarding "sure shipwrecks," see *supra* note 110.

140. I.R.C. § 351.

at the time of the contribution is, instead, recognized at the time of a future transaction, the built-in gain or loss will be preserved.[141]

In order to demonstrate, imagine Jack acquires a parcel of land for $100. Over time, the value of the land decreases to $75. Jack contributes the land to a newly-formed corporation in exchange for all of the corporation's stock. Jack will not recognize any tax loss as a result of this exchange.[142]

Under law that existed prior to 2004, Jack's basis in the stock received would be $100 (the same as Jack's basis in the land),[143] and the corporation's basis in the land would be $100 (the same as Jack's basis in the land).[144] Thus, if Jack were to sell his stock for $75, Jack would recognize a $25 tax loss.[145] Likewise, if the corporation sold the land for $75, the corporation would recognize a $25 tax loss.[146] Therefore, Jack would have incurred one $25 economic loss (having acquired land that decreased in value by $25), but, rather than sell the land directly and recognize only one $25 tax loss, Jack could create two $25 tax losses—one to be recognized by Jack and one to be recognized by the corporation.[147]

In 2004, Congress enacted legislation to combat the prospect of a taxpayer contributing built-in loss property to a corporation in order to extract "two tax losses . . . from one" economic loss.[148] Under rules in effect since 2004, the built-in loss may be preserved at only one level.[149] Taxpayers can decide whether to preserve the loss at the shareholder level or at the corporate level.[150] In particular, if no election is filed, the built-in loss will be

141. *Id.* §§ 358, 362.

142. *Id.* § 351(a).

143. *Id.* § 358(a)(1).

144. *Id.* § 362(a).

145. *Id.* § 1001.

146. *Id.*

147. Even absent I.R.C. § 362(e)(2), this strategy could be subject to a potentially successful challenge by the IRS. In particular, if the asset were sold very shortly after the individual contributed the asset to the corporation, the Service could claim that the transaction should be treated as if the individual, rather than the corporation, had sold the asset, so that only one loss would be recognized.

148. *See* Douglas A. Kahn & Jeffrey H. Kahn, *Prevention of Double Deductions of a Single Loss: Solutions in Search of a Problem*, 26 VA. TAX REV. 1, 3 (2006) [hereinafter Kahn & Kahn, *Double Deductions*]. The legislative history surrounding the enactment of § 362(e)(2) also supports the conclusion that its goal was preventing duplication of an existing loss. *See* S. REP. NO. 108-192, pt. 1, at 125 (2003) ("The Joint Committee on Taxation staff's investigative report of Enron Corporation and other information reveal that taxpayers are engaging in various tax motivated transactions to duplicate a single economic loss and, subsequently, deduct such loss more than once. . . . [T]he Committee believes that a single economic loss should not be deducted more than once." (footnote omitted)); *see also* Kahn & Kahn, *Double Deductions*, *supra*, at 47 ("It seems to the authors that the objection centers on the potential for a manipulative transfer of depreciated assets to be made for the principal purpose of doubling the use of the excess basis.").

149. I.R.C. § 362(e)(2).

150. *Id.*

preserved at the shareholder level only.[151] Thus, in the example above, Jack's basis in the stock would be $100 (preserving a $25 built-in loss in the stock), but the corporation's basis in the land would be $75 (preserving no built-in loss in the land).[152] However, if Jack and the corporation both make an election under § 362(e)(2)(C), the built-in loss will be preserved at the corporate level only.[153] In the example above, if such an election were made, Jack's basis in the stock would be $75 (preserving no built-in loss in the stock), but the corporation's basis in the land would be $100 (preserving a $25 built-in loss in the land).[154]

Section 362(e)(2), in effect, operates as an irrebuttable presumption that contributions of built-in loss property are tax-motivated. Thus, when Jack contributes an asset that has a basis of $100 and a fair market value of $75, § 362(e)(2) conclusively presumes that Jack's contribution is tax motivated even though it is possible that Jack contributes the asset to the corporation principally for non-tax reasons.

### *E. Differences of Degree Not Kind*

The discussion above presented facts and circumstances tests, rebuttable presumptions, safe harbors, and irrebuttable presumptions as if they were distinct categories. They are not entirely distinct. They lie on a continuum that ranges from standards to rules. A "rule" specifies, clearly and in advance, the tax consequences resulting from various activities.[155] A "standard" provides only limited guidance to taxpayers before they act, deferring definitive determinations of tax consequences to after-the-fact analysis by courts.[156]

Facts and circumstances tests inhabit the standard end of the spectrum. Irrebuttable presumptions occupy the rule end. Rebuttable presumptions and safe harbors fall in between.[157] Facts and circumstances tests constitute standards—lawmakers do not specify ahead of time an exclusive list of facts

151. *Id.* § 362(e)(2)(A).

152. *Id.*

153. *Id.* § 362(e)(2)(C).

154. *Id.*

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

156. *See* Abreu & Greenstein, *supra* note 155, at 330 ("Application of a standard tends to be contextual and fact-sensitive."); Kaplow, *supra* note 155, at 560 ("A standard may entail leaving both specification of what conduct is permissible and factual issues for the adjudicator.").

157. *See also* Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953, 961 (1995) ("There is a continuum from rules to untrammeled discretion, with factors, guidelines, and standards falling in between.").

that will be relevant to the tax outcome or predetermine what the outcome will be under any given set of facts. Rather, decisions are left to the courts on a case-by-case basis. Irrebuttable presumptions constitute rules—lawmakers decide ahead of time that certain facts will lead to certain tax consequences. In the case of the most fully specified rule (or, to put it differently, the most rule-like rule) no after-the-fact, case-by-case analysis is required beyond determination of the facts and mechanical application of the rule.

Safe harbors fall on the continuum between standards and rules and could be thought of as rule-standard hybrids.[158] If a taxpayer meets the typically clear requirements of a given safe harbor, the law assures the taxpayer of receiving specific tax treatment. Thus, a safe harbor has rule-like qualities. If a taxpayer operates outside the boundaries of a safe harbor, he or she will not automatically forfeit the tax treatment accorded to taxpayers falling within the safe harbor. Rather, an underlying standard will determine the tax consequences imposed upon taxpayers who function beyond the limits of a safe harbor. Consequently, safe harbors operate as rule-standard hybrids.

Rebuttable presumptions, likewise, have rule-standard hybrid qualities.[159] The rebuttable presumption's rule-like nature stems from lawmakers' ex ante specification, typically in some clear detail, that a given fact will have heightened significance in the determination of tax outcome. For instance, lawmakers have specified that, in the absence of sufficient countervailing evidence, a contribution to a partnership and a distribution from a partnership that occur within two years of each other will be treated as part of a sale.[160] A rebuttable presumption's standard-like essence arises because after-the-fact, case-by-case analysis is still necessary and allowed to determine if the presumption is overcome in any particular case. With respect to transactions that meet its criteria, a rebuttable presumption is more standard-like than a safe harbor because a safe harbor only requires and allows after-the-fact, case-by-case analysis for transactions that do not meet the safe harbor's criteria, whereas a rebuttable presumption necessitates and permits case-by-case analysis even when its criteria are met.

Depending on the parameters of any particular facts and circumstances test, rebuttable presumption, safe harbor, or irrebuttable presumption, the device can shift closer to one end of the rule-standard continuum or the other.[161] Forces that can nudge a facts and circumstances test closer to the

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158. *See also* Cauble, *supra* note 109, at 1388; Morse, *supra* note 109, at 1387.

159. Cauble, *supra* note 109, at 1429–30; J. Harvie Wilkinson III, *Toward a Jurisprudence of Presumptions*, 67 N.Y.U. L. REV. 907, 908–09 (1992).

160. *See supra* Section II.B.1 (detailing the use of a rebuttable presumption that the transactions are part of one sale).

161. *See* Kaplow, *supra* note 155, at 561 ("The language of this Article will follow the common practice of referring to rules and standards as if one were comparing pure types, even though legal commands mix the two in varying degrees."); Kathleen M. Sullivan, *Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 61 (1992) ("These distinctions between rules and

rule end include any means of providing advance guidance that will govern future transactions. This includes the development of judicial precedent,[162] the inclusion of lists of potentially relevant factors in the Code or Treasury Regulations,[163] or examples contained in the Treasury Regulations.[164]

Various factors determine whether any given rebuttable presumption is more standard-like or more rule-like. As applied in litigation, a presumption could be strong (meaning it is seldom overcome) or weak (overcome as a matter of course),[165] and stronger presumptions are more rule-like while weaker ones are more standard-like. A presumption could be stronger if the party disfavored by the presumption must meet a higher burden to overcome it. It could also be stronger if it is more accurate—meaning that in most cases in which the fact that triggers the presumption is present, the presumed fact is also present.[166] As perceived by taxpayers at the planning stage, a presumption can also be stronger or weaker. In part, perception is likely influenced by how often the presumption has been overcome in litigation. However, particularly when there are few litigated cases, tax lawyers will judge the strength of the presumption based on other factors—including a sense of the presumption's accuracy. In some situations, a rebuttable presumption, at

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standards . . . mark a continuum, not a divide."); David A. Super, *Against Flexibility*, 96 CORNELL L. REV. 1375, 1399 (2011) ("[T]hese debates tend to artificially and unrealistically frame a continuum of options as a dichotomy: every rule requires some interpretation and every standard with practical relevance forecloses some options.").

162. *See, e.g.*, Kaplow, *supra* note 155, at 564 ("First, the analysis is reconsidered in light of the possibility that a standard might be converted into a rule through the creation of a precedent."). Regarding the limits on the ability of precedent to provide advance guidance, see Edward Yorio, *Federal Income Tax Rulemaking: An Economic Approach*, 51 FORDHAM L. REV. 1, 23 (1982) ("Since the outcome of each case turns on a balancing test involving a number of different facts, the precedential value of any decision is lessened.").

163. For instance, the Treasury Regulations contain a non-exclusive list of factors potentially relevant when determining the reason for a home sale. *See supra* text accompanying note 116; *see also* Sunstein, *supra* note 157, at 963–64 (describing the use of factors generally).

164. For instance, the Treasury Regulations contain examples illustrating when sale of a home will be treated as motivated by change of place of employment. *See supra* note 117 and accompanying text. *See generally* Morse & Osofsky, *supra* note 117 (discussing the use of regulatory examples).

165. *See, e.g.*, L.L. Fuller, *Legal Fictions*, 25 ILL. L. REV. 363, 394 (1930) ("[T]he difference between the rebuttable presumption and the conclusive presumption may, in some cases, become a matter of degree. Some of our rebuttable presumptions have, in the course of time, gathered about them rules declaring what is sufficient to overcome them."); Hoffman, *supra* note 70, at 896 ("[P]resumptions may differ in . . . resistance to rebuttal ('strong' or 'weak')."). For discussion of the weakness of the presumptions in the context of the partnership disguised sale rules, see Gergen, *supra* note 85, at 190–91.

166. For example, imagine that lawmakers adopted a rebuttable presumption that gratuitous transfers between close family members were motivated by detached and disinterested generosity so that such transfers constitute gifts for federal income tax purposes. Such a presumption could turn out to be a strong presumption if it is, in fact, the case that a large percentage of such transfers are motivated by detached and disinterested generosity.

the planning stage, might be treated as akin to a rule, if it is the most useful guidance available to the tax planner.[167]

A rebuttable presumption's proximity to a rule or a standard also depends on the criteria that triggers the presumption. In many cases, the fact that triggers a rebuttable presumption is a clearly specified fact. This is true, for instance, in the case of the disguised sale rules (turning on whether or not the time between distribution and contribution is more than two years).[168] In other cases, the fact that triggers a rebuttable presumption is, instead, a vague standard. This is true in the case of the accumulated earnings tax—if a corporation's earnings "are permitted to accumulate beyond the reasonable needs of the business,"[169] that establishes a rebuttable presumption that the parties' purpose is to avoid the shareholder-level tax.[170]

Safe harbors can also be more rule-like or more standard-like depending on whether they are permissive or restrictive (either in actual application or as perceived at the planning stage).[171] "[A] safe harbor [i]s 'permissive' when its outer bounds approach the likely outer bounds of the underlying standard, and . . . a safe harbor [i]s 'restrictive' when its outer bounds lie well within the likely outer bounds of the underlying standard."[172] Permissive safe harbors are more rule-like because a taxpayer who operates outside such a safe harbor will almost certainly receive tax treatment that differs from the treatment of taxpayers within the safe harbor, which is the same result that follows when the taxpayer fails to comply with a rule. Restrictive safe harbors are more standard-like because they specify ahead of time the tax consequences of a smaller subset of transactions—leaving open the possibility that many more transactions not covered by the safe harbor might, nevertheless, receive the same tax treatment. Safe harbors can also be more rule-like or more standard-like depending on the degree of specificity with which the safe harbor's criteria are defined.[173]

Irrebuttable presumptions can slide away from the rule end of the spectrum when the facts that trigger them are defined in a more open-ended way. For example, in the case of the wash sale rules, a loss deduction is denied if a taxpayer acquires, or enters into a contract or option to acquire,

167. *See, e.g.*, Kim E. Tobler & Richard S. Bobrow, *Proposed Regulations on Disguised Sales Provide Help but May Be Too Stringent*, 9 J. PARTNERSHIP TAX'N 21, 28 (1992) ("While probably not intended, the two-year presumption will likely evolve into a perceived safe harbor. This can be expected to occur because it is the most objective of the presumptions, making it easier to use for planning purposes.").

168. *See supra* Section II.B.1.

169. I.R.C. § 533(a) (2018).

170. *See supra* Section II.B.2.

171. *See* Cauble, *supra* note 109, at 1392; Morse, *supra* note 109, at 1412–14.

172. Cauble, *supra* note 109, at 1392; *see* Morse, *supra* note 109, at 1412–14.

173. *See* Cauble, *supra* note 109, at 1401 ("The outer limit of a safe harbor may be more rule-like or more standard-like.").

substantially identical stock or securities within a specified window of time.[174] The fact that the rules encompass not merely "identical" but "substantially identical" stock or securities leads to the wash sale rules taking on a bit of a standard-like flavor.

Finally, overarching tax law doctrines and anti-abuse rules, in some sense, make every safe harbor and every irrebuttable presumption that favors the taxpayer, in fact, rebuttable. When a given transaction technically complies with the literal language of a safe harbor or a per se rule but undermines its purpose, the IRS might successfully assert that a taxpayer is not entitled to his or her claimed tax consequences.[175] However, courts are not always receptive to the argument that anti-abuse provisions can override the results that follow from the application of clear rules.[176]

## III. DESIGN CONSIDERATIONS

As described above in Part I, across a multitude of different settings, tax law utilizes various tools to gauge taxpayer motive or state of mind. The tools range from facts and circumstances tests to irrebuttable presumptions, and, in between, lie rebuttable presumptions and safe harbors. In any given

174. *See supra* Section II.D.2.

175. A discussion of anti-abuse rules and doctrines is beyond the scope of this Article. Such rules and doctrines include the substance-over-form doctrine, the step transaction doctrine, the economic substance doctrine, and a number of anti-abuse rules applicable to specific areas of tax law such as the partnership anti-abuse rules. Literature discussing these doctrines and rules is extensive. *See generally, e.g.*, Ellen P. Aprill, *Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines*, 54 SMU L. REV. 9 (2001); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5 (2000); Gergen, *supra* note 10; Halperin, *supra* note 10; James S. Halpern, *Putting the Cart Before the Horse: Determining Economic Substance Independent of the Language of the Code*, 30 VA. TAX REV. 327 (2010); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235 (1999) [hereinafter Hariton, *Sorting Out the Tangle*]; David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 TAX L. REV. 29 (2006); Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982); Jeffrey L. Kwall & Kristina Maynard, *Dethroning* King Enterprises, 58 TAX LAW. 1 (2004); Lederman, *supra* note 10; Martin J. McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters*, 94 TAX NOTES 1017 (2002); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365 (1988); David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312 (2001); Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325 (2002); David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 VA. TAX REV. 971 (2007); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215 (2002) [hereinafter Weisbach, *Ten Truths*].

176. *See, e.g.*, Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1940 (2005) ("Recent litigation between taxpayers and the government has had mixed results, with taxpayers winning in more than a few instances by persuading the courts that 'rules are rules' and that Congress alone, and not the courts, must patch the leaky tire if Congress thinks a patch is needed."); David A. Weisbach, *The Failure of Disclosure as an Approach to Shelters*, 54 SMU L. REV. 73, 77 (2001) ("But I think a perusal of the cases shows that courts are often quite literal in their interpretation of the tax law, and if someone finds a winding path through dozens of complex, interacting code provisions that leads to a tax goodie, all the better for the taxpayer.").

situation, it is possible to imagine any other tool being substituted for the tool in use. The purpose of the following discussion is not, at this stage, to specifically propose any of these alternatives. Instead, my aim is to illustrate that there are many conceivable options. No particular design choice is foreordained.

To further imagine possible alternatives, consider that existing facts and circumstances tests could be supplemented by rebuttable presumptions, for instance. Conceivably, § 357(b)[177] could be accompanied by rebuttable presumptions—if the debt was incurred within two years of the corporation assuming the debt, the proximity in time could establish a rebuttable presumption that the taxpayer's purpose was tax avoidance, while if the debt was incurred more than two years prior to its assumption by the corporation, the lapse of time could establish a rebuttable presumption that the taxpayer's purpose was not tax avoidance. After all, a similar scheme is utilized by the partnership disguised sale rules, which are aimed at a comparable type of tax abuse.[178]

In lieu of adopting rebuttable presumptions to supplement § 357(b), lawmakers could adopt a per se rule—if the shareholder incurred the debt within the two-year period preceding the corporation's assumption of the debt, § 357(b) would apply, but, otherwise, § 357(b) would not apply. Alternatively, lawmakers could adopt a safe harbor but allow transactions that fall outside the safe harbor to be governed by a facts and circumstances test —if the borrowing occurred more than two years before the corporation's assumption of the debt, § 357(b) would not apply, but if the borrowing occurred within two years of the corporation's assumption of the debt, all relevant facts and circumstances would be examined to determine whether the taxpayer's principal purpose was tax avoidance. As yet another hypothetical alternative, lawmakers could adopt a per se rule granting that § 357(b) would apply if the borrowing occurred within two years of the corporation's assumption of the debt, but allow transactions not governed by this rule to be examined under a facts and circumstances test (to adopt a term coined by Professor Morse, this device will be referred to as a "sure shipwreck").[179] Finally, lawmakers could use a safe harbor in conjunction with a sure shipwreck. For instance, if the borrowing occurred more than five years

177. For discussion of § 357(b), see *supra* Section II.A.2.

178. For discussion of the disguised sale rules, see *supra* Section II.B.I. In fact, the disguised sale rules provide even more generous treatment with respect to liabilities in the form of a safe harbor. In particular, if the only distribution to the partner involves the partnership assuming a liability, the debt assumption will not be treated as part of a sale as long as the liability is a "qualified liability." *See* Treas. Reg. § 1.707-5(a)(5) (1992). A liability is a "qualified liability" in various circumstances, including when the liability was incurred more than two years before the earlier of the date the partner agrees in writing to transfer the property to the partnership or the date the partner transfers the property to the partnership as long as the liability has encumbered the property during that two-year period. *See id.* § 1.707-5(a)(6)(i)(A).

179. For discussion of "sure shipwrecks," see *supra* note 110.

before the corporation's assumption of the debt, § 357(b) automatically would not apply; if the borrowing occurred within two years of the corporation's assumption of the debt, § 357(b) automatically would apply; and if the borrowing was incurred between two and five years before the corporation's assumption of the debt, the taxpayer's purpose would be assessed under a facts and circumstances test.

Other facts and circumstances tests could be modified in comparable ways. The gift determination, for instance,[180] could be supplemented with rebuttable presumptions, safe harbors, or sure shipwrecks—turning on facts such as the relationship between the parties. Conceivably, per se rules (although probably not very good per se rules) could also replace the facts and circumstances test used for purposes of determining whether a transfer is a gift.

As is true with facts and circumstances tests, the use of a rebuttable presumption in any given area is not unavoidable. Any given rebuttable presumption could be retired from use entirely, leaving behind merely an underlying facts and circumstances test to guide the courts. Moving in the opposite direction along the rule-standard spectrum, any given rebuttable presumption could be converted into a per se rule. When doing so leaves no transactions with unspecified consequences, the area would be entirely governed by rules. When doing so leaves some terrain to be governed by facts and circumstances, lawmakers will have utilized a safe harbor, a sure shipwreck, or both. As an example, consider the disguised sale rules.[181] As currently designed, if the contribution to the partnership and distribution to the partner occur within two years, the closeness in time gives rise to a rebuttable presumption that the two transactions constitute a sale, but if the contribution and distribution occur more than two years apart, the passage of time generates a rebuttable presumption that the two transactions do not represent a sale.[182] If both rebuttable presumptions were replaced with per se rules, the results of all transactions would be specified—nothing would remain for examination under a facts and circumstances test.[183] Alternatively, lawmakers might use a safe harbor (if the transactions occur more than five years apart, they are deemed to not represent a sale) in combination with a sure shipwreck (if the transactions occur within two years of each other, they are deemed to represent a sale), leaving some transactions (those in which the distribution and contribution occur within two to five years of each other)

180. For discussion of the gift determination, see *supra* Section II.A.1.

181. For discussion of the disguised sale rules, see *supra* Section II.B.1.

182. *See supra* Section II.B.1.

183. This is true except to the extent that general anti-abuse doctrines might apply. For discussion of these doctrines, see *supra* note 175.

to be governed by a facts and circumstances test. Instead, lawmakers might use only a safe harbor or only a sure shipwreck.[184]

The use of safe harbors in any given context could also be altered. A safe harbor could be eliminated entirely, leaving behind only a facts and circumstances test. A safe harbor could be made less "safe" by converting it into a rebuttable presumption. Moving in the opposite direction, closer to the rule end of the spectrum, lawmakers could more fully specify the tax consequences governing transactions that fall outside of the safe harbor.

Finally, per se rules could be replaced with devices closer to the standard end of the spectrum. Consider, for instance, § 267(a)(1)'s denial of the deduction of a loss recognized on sale of property to a related party.[185] Conceivably, this rule could be replaced with a rebuttable presumption—the loss would be denied unless the parties established that their principal purpose was not tax avoidance. Indeed, § 1031(f) utilizes a rebuttable presumption in a somewhat similar context.[186] More drastic changes are possible as well—per se rules could be replaced with facts and circumstances tests, for instance.

As the preceding discussion shows, many of the devices used for determining taxpayer motive or state of mind in various contexts might have been replaced or supplemented with other devices. Indeed, examples exist that illustrate lawmakers' selection of different tools across contexts that are, in other respects, quite similar.[187] The use of different devices in similar contexts suggests that there might be less rhyme or reason to the selection of different tools than there could and should be.[188] Lack of coherence across different contexts is not particularly surprising. Some tests were developed by courts while others have been developed by Congress or Treasury. Also, different tests were crafted by different persons at different points in time. Although the lack of coherence is not surprising, it is not necessarily desirable. With the aim of suggesting ways to bring more rhyme and reason to inquiries into taxpayer motive or state of mind, this Section will analyze various factors that should influence design choices. The analysis in this Part III will be applied in Part IV to develop concrete recommendations.

184. As yet another combination, it would be possible to use a rebuttable presumption in combination with a sure shipwreck or safe harbor. As an example of combining a sure shipwreck with a rebuttable presumption, lawmakers could provide that, if the transactions occurred more than two years apart, that would establish a rebuttable presumption that they are not part of a sale, but if the transactions occurred within two years of each other that would automatically result in sale treatment.

185. For discussion of I.R.C. § 267(a)(1), see *supra* Section II.D.1.

186. For discussion of I.R.C. § 1031(f), see *supra* Section II.B.3.

187. For instance, the facts and circumstances test used in § 357(b) addresses a type of tax-motivated transaction similar to the transaction addressed by different devices in the context of the partnership disguised sale rules. *See* discussion *supra* Sections II.A.2, II.B.1.

188. *See* discussion *supra* Sections II.A.2, II.B.1.

Factors that might influence design choice include: (1) whether lawmakers can identify a useful commonly relevant fact; (2) mitigating overinclusion and underinclusion; (3) uncertainty; (4) whether there is any principled basis for guiding application of a standard; (5) the parties' relative access to the evidence; (6) risk of fabrication; and (7) risk of giving evidence improper weight. This Part will discuss each factor, in turn.

### *A. Can Lawmakers Identify a Useful Commonly Relevant Fact?*

As a threshold matter, the decision to either stick with a facts and circumstances test for assessing taxpayer state of mind or instead venture into more rule-like territory should often be guided by whether it is possible to identify one or more commonly relevant and, at the same time, useful facts. By "commonly relevant," I mean that a fact is an accurate predictor of state of mind in some significant subset of cases.

The "commonly relevant" criterion ties into observations made in two existing strands of literature. In the rule-standards literature, scholars observe that utilizing rules rather than standards tends to be cheaper (taking into account costs of promulgation and enforcement) when the device will be applied frequently to similar fact patterns.[189] When a large number of similar fact patterns are involved, it is possible to identify commonly relevant facts. In the evidence literature, scholars have observed that many rebuttable presumptions are and should be probability based—meaning that the fact that triggers the presumption is an accurate predictor of the presumed fact in many cases.[190]

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189. *See* Kaplow, *supra* note 155, at 563 ("For chemicals used frequently in settings with common characteristics . . . a rule will tend to be desirable. If there will be many enforcement actions, the added cost from having resolved the issue on a wholesale basis at the promulgation stage will be outweighed by the benefit of having avoided additional costs repeatedly incurred in giving content to a standard on a retail basis. . . . Contrast this result to that in the case of chemicals used rarely, and in settings that vary substantially. Designing a rule that accounts for every relevant contingency would be wasteful, as most would never arise. . . . Thus when frequency is low, a standard tends to be preferable."); *see also* Morse, *supra* note 109, at 1425 ("[I]f persons subject to a legal regime are more numerous and/or homogenous, then an ex ante rule makes more sense, all else equal."); Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165, 167 (2015) ("[R]ules are considered most suitable for regulating recurrent and relatively homogeneous conduct."); Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349, 373 (1993) ("If a good enough proxy exists to cover the entire regulated population, then a rule may be sufficient without need for the general standard. If no good proxy exists for the desired behavior, then a standard will be the favored approach." (footnote omitted)).

190. *See, e.g.*, Edmund M. Morgan, *Some Observations Concerning Presumptions*, 44 HARV. L. REV. 906, 929 (1931) ("A great number of the recognized presumptions express the normal balance of probability."); Roy R. Ray, *Presumptions and the Uniform Rules of Evidence*, 33 TEX. L. REV. 588, 590 (1955) ("First, a large proportion of presumptions are based wholly or partly on probability. In certain recurring fact situations common experience has shown that when fact *A* is proved the existence of fact *B* is so probable that the courts may assume its truth.").

In order to demonstrate the "commonly relevant" criterion consider, for instance, § 267(a)(1)'s disallowance of the deduction of losses recognized on sale of property to related parties. In a world without § 267(a)(1), it could likely be the case that a higher percentage of sales to related parties are principally tax motivated than in the case of sales to unrelated parties—thus, sale to a related party is a "commonly relevant" fact. With a sale to a related party, a taxpayer can recognize a loss (absent § 267(a)(1)) and still retain indirect control over and benefits from the asset. Thus, such a sale might occur when a taxpayer wants to recognize a tax loss without, in substance, disposing of the asset. Selling to an unrelated party does not achieve the taxpayer's objectives as effectively because the taxpayer must give up ownership of the asset in order to obtain the tax loss.

In a world with § 267(a)(1), taxpayers who are well advised will no longer sell built-in loss property to related parties if the sale is principally tax motivated. A sale to a related party does not allow the taxpayer to achieve his or her desired loss deduction. Thus, sales to related parties that proceed in a world with § 267(a)(1) will, for the most part, be non-tax motivated. Some taxpayers who would have engaged in tax-motivated sales to related parties without § 267(a)(1) will simply no longer sell the assets, while others might engage in sales to unrelated parties instead.

Assume there are two taxpayers—Ilana and Abbi—who would each reap the same tax benefit from the sale of a built-in loss asset that each owns. Assume they each, also, have some desire to retain control of the asset. In a world without § 267(a)(1), they might each sell the asset to a related party. In a world with § 267(a)(1), if Ilana does not sell her asset at all while Abbi sells her asset to an unrelated party, that behavior suggests that Abbi was less resistant to the idea of parting ways with her asset than Ilana; in other words, it suggests that, of the factors considered by the parties when deciding to sell, tax consequences were a less significant factor (relative to other factors) in the case of Abbi than in the case of Ilana. Thus, the taxpayer whose transaction was more strongly tax motivated (Ilana) was deterred from engaging in it while the less strongly tax-motivated taxpayer (Abbi) proceeded with a modified version of the transaction.[191]

A rule treating sales to related parties as tax motivated is overinclusive (some sales to related parties are not tax motivated) and underinclusive (tax-

191. For similar analysis in the context of the wash sale rules, see Osofsky, *supra* note 11, at 1092–1100. *See also* Hayashi, *supra* note 11, at 291 (framing the usefulness of a fact for purposes of identifying tax motivation as turning on how costly that fact makes it for tax-motivated taxpayers to disguise their transactions as not tax motivated); Daniel N. Shaviro, *An Efficiency Analysis of Realization and Recognition Rules Under the Federal Income Tax*, 48 TAX L. REV. 1, 48 (1992) ("Assume, for example, that all taxpayers who, but for the wash sale rule, would buy the same loss stock within 30 days of the sale did so instead within 35 days. . . . Under this (perhaps unlikely) circumstance, the wash sale rule would plainly be undesirable. By contrast, the rule is desirable if it deters selective realization of loss to a sufficiently greater extent than it encourages waiting longer to repurchase the same stock.").

motivated sales to unrelated parties will occur), points that will be discussed in more detail in Section III.B below. However, the fact that a sale occurs between related parties is, nevertheless, commonly relevant. The analysis of § 267(a)(1) would apply, in a similar manner, to the examples in this Article in which timing is used to measure likely tax motivation including the partnership disguised sale rules,[192] § 1031(f),[193] and the wash sale rules.[194]

Supplementing or replacing a facts and circumstances test with something more rule-like may not be warranted every time a commonly relevant fact exists—the commonly relevant fact must also be useful. By "useful," I mean that the fact is sufficiently specific and sufficiently surprising so that it provides more guidance than what taxpayers would surmise under a general facts and circumstances test.

Consider, for instance, the determination of whether a transfer of property is motivated by detached and disinterested generosity, so that the transfer is considered a gift for income tax purposes.[195] The current facts and circumstances test conceivably could be accompanied by a rebuttable presumption that transfers to related parties constituted gifts.[196] However, such a rebuttable presumption likely fails the sufficiently surprising requirement. In other words, even when faced with merely a facts and circumstances test, taxpayers are able to ascertain that transfers to related parties stand a fairly strong chance of being treated as gifts absent countervailing facts,[197] and taxpayers' expectations regarding who is considered related would not likely diverge significantly from any predetermined list lawmakers might provide.

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192. For discussion of the partnership disguised sale rules, see *supra* Section II.B.1. The time between a contribution to a partnership and a distribution from a partnership is a commonly relevant fact because, in a world without the disguised sale rules, transactions that are part of a plan to sell property to a partnership are more likely to occur close in time to each other. Once the rebuttable presumptions are adopted, informed, tax-motivated taxpayers would either tend to wait more than two years or not engage in the transactions at all (although, because the proximity in time establishes a presumption that is rebuttable rather than triggering a per se rule, some tax-motivated taxpayers might engage in the transactions within two years and take their chances at rebutting the resulting presumption).

193. For discussion of § 1031(f), see *supra* Section II.B.3; and *infra* notes 219–21 and accompanying text.

194. For discussion of the wash sale rules, see *supra* Section II.D.2; and *infra* notes 202–07 and accompanying text.

195. *See supra* Section II.A.1.

196. *See also* Yorio, *supra* note 162, at 40 ("The Court consequently might have established rebuttable presumptions that a transfer within a family is a gift whereas a transfer in a commercial context is not a gift."). In a concurring opinion in *Duberstein*, Justice Frankfurter stated, "we should normally suppose that a payment from father to son was a gift, unless the contrary is shown." Comm'r v. Duberstein, 363 U.S. 278, 296 (1960) (Frankfurter, J., concurring).

197. For related discussion, see, for example, Morse & Osofsky, *supra* note 117, at 151–52 ("A regulatory example that gives an obvious answer in an easy case does not offer as much valuable legal content as an example that gives a result in a hard case." (citation omitted)).

In the accumulated earnings tax context, if a C Corporation's earnings "are permitted to accumulate beyond the reasonable needs of the business," that establishes a rebuttable presumption that the parties' purpose is to avoid the shareholder-level tax.[198] Here, while allowing earnings to accumulate beyond what is needed for business purposes is a reliable indicator that tax considerations may be at play, this fact fails the sufficiently specific test given that "the reasonable needs of the business" is, itself, a vague standard.

A rebuttable presumption that is based on unspecific or unsurprising criteria may not do any real harm—so elimination of it may not be warranted. However, such a presumption does not add any real value. Therefore, lawmakers should be in no hurry to supplement additional facts and circumstances tests with rebuttable presumptions based on unspecific or unsurprising criteria.

### B. *Mitigating Overinclusion and Underinclusion*

When it is possible to identify a commonly relevant and useful fact, a per se rule that the presence of the fact indicates tax motivation or other state of mind while its absence indicates lack of tax motivation or some other state of mind will tend to be both overinclusive and underinclusive.[199] Consider, for instance, the example of § 267(a)(1). Treating all sales to related parties as tax motivated is both overinclusive and underinclusive. Regarding the rule's overinclusivity, in a world without § 267(a)(1), some sales of built-in loss property to related parties would not be principally tax motivated. In a world with § 267(a)(1), informed taxpayers who planned to engage in not principally tax-motivated sales to related parties might be discouraged from engaging in the transactions—even if a sale is not principally tax motivated, learning that the sale would result in adverse tax consequences (in particular, foregoing the ability to deduct a tax loss) might discourage the taxpayer from engaging in it. Thus, the rule's overinclusivity could deter some transactions that are not principally tax motivated. In a world with § 267(a)(1), some uninformed taxpayers who planned to engage in non-tax-motivated sales of property to related parties might proceed with the sales despite the adverse tax consequences even though, had they been informed about the resulting

198. I.R.C. § 533(a) (2018).

199. For discussion of this issue in the literature regarding rules and standards generally, see, for example, Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65, 72–74 (1983); John A. Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 WASH. L. REV. 1, 5 (1993) ("Put differently, 'rules achieve their "ruleness" precisely by . . . screening off from a decisionmaker factors that a sensitive decisionmaker would otherwise take into account.' This means that the aspect of law that renders it certain is also potentially a bar to individual justice." (quoting Frederick Schauer, *Formalism*, 97 YALE L.J. 509, 510 (1988))); Morse, *supra* note 109, at 1419–24; Parchomovsky & Stein, *supra* note 189, at 175 ("Any such rule will either be too narrow (underinclusive) or too broad (overinclusive)."); and Sunstein, *supra* note 157, at 992–93.

tax consequences, they would not have engaged in the transactions. In this way, the rule's overinclusivity can trap unwary taxpayers.[200]

Regarding the rule's underinclusivity, some sales of built-in loss property to unrelated parties will be principally tax motivated, but § 267(a)(1) will not prevent the deduction of the resulting tax loss from such sales. To put the point more generally, one outgrowth of the underinclusivity of rules dictating unfavorable tax outcomes is the frequent lament that clear rules serve as a roadmap for taxpayers who want to engage in abusive transactions that comply with the letter, but not the spirit, of the law.[201] Particularly in the

200. One might argue that standards are no better. Even when standards govern tax consequences, an unsophisticated taxpayer may fail to seek advice prior to acting, and therefore, may arrange his or her activities in a way that is different than what a tax lawyer would suggest. A standard may be "easier" for unsophisticated taxpayers because it may be more likely than a rule to coincide with a taxpayer's uninformed expectations. In a similar vein, Professor Kovach argues that unsophisticated advisors may fare better under standards than rules. *See* Richard J. Kovach, *Bright Lines, Facts and Circumstances Tests, and Complexity in Federal Taxation*, 46 SYRACUSE L. REV. 1287, 1315–16 (1996); *see also* Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257, 270–71 (1974) ("Many standards, such as efficiency (reasonableness), have a large intuitive element which makes them comprehensible without special training, while most legal rules are not understood unless studied."); Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 600 (1988) (discussing how crystalline rules in property law tend to disadvantage "fools" and favor "sharp dealers" and stating that fuzzier standards "will also reassure those of us who fear we may be made fools; we can go about our business and take part in the world of trade without cowering at home because we think we need to hire a lawyer and an accountant every time we leave the car at a commercial parking lot").

201. *See, e.g.*, Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 33 (2004) ("[P]romoters could easily concoct new abusive transactions that literally complied with the rule."); Hayashi, *supra* note 11, at 291 ("If the facts that create a favorable inference about a hidden factor are publicized in advance, they will provide a roadmap for well-advised individuals to create those very facts to induce factfinders to draw the inference those individuals want."); Calvin H. Johnson, *H.R. ___, The Anti-Skunk Works Corporate Tax Shelter Act of 1999*, TAX NOTES 443, 445 (1999) ("Loopholes can be created in any human tax system unless the system is defended and repaired. Shelters take razor-thin fissures of no material concern and turn them into gaping holes in the tax base."); Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 366 (2005) ("[I]t simply is not possible to write tax laws that are devoid of all unintended loopholes."); Martin J. McMahon Jr., *Beyond a Gaar: Retrofitting the Code to Rein in 21st Century Tax Shelters*, TAX NOTES 1721, 1722 (2003) ("The mechanical terms of specific rules . . . provide a tremendous temptation to treat the rules as an instruction manual for creating and structuring transactions outside the ordinary course of business or normal investments in which the taxpayer would not engage except as a result of the tax avoidance potential of the inventive transaction."); Andrea Monroe, *What's in a Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 CASE W. RES. L. REV. 401, 409 (2010) ("[T]hese flaws create a playground for those who engage in transactions that comply with . . . literal language, yet result in tax consequences that Congress did not contemplate."); Daniel N. Shaviro & David A. Weisbach, *The Fifth Circuit Gets It Wrong in* Compaq v. Commissioner, TAX NOTES 511, 512–13 (2002) ("Inevitably, there will be some unforeseen interaction of the tax rules so that, if one arranges one's affairs in just the right manner, magic happens."); Weisbach, *supra* note 10, at 860. For similar discussion regarding rules, generally, see, for example, Parchomovsky & Stein, *supra* note 189, at 179 ("Rules allow self-seeking individuals to 'walk the line' by engaging in conduct that runs against society's interest and would be prohibited by a standard."); and Sunstein, *supra* note 157, at 995 ("Because rules have clear edges, they allow

context of devices aimed at ferreting out tax-motivated transactions (which is true of most of the examples provided in this Article), avoiding creating a roadmap for tax abuse ought to be a predominant concern.

Devices that turn on the time between transactions—such as the wash sale rules—are also overinclusive and underinclusive. Taxpayers who plan to engage in a wash sale of stock in order to obtain a tax deduction without giving up ownership of the stock will not sell and repurchase the stock within 30 days if they are aware of the wash sale rules because they would know that such a sale would not produce their desired tax loss.[202] Thus, sales and repurchases that occur within 30 days will, for the most part, not be tax motivated. As Professor Osofsky observes, wash sales that occur within this window might result when a taxpayer sells stock for non-tax reasons (because the taxpayer anticipates the stock will decline in value further, for instance), but then, within 30 days, something occurs that prompts the taxpayer to repurchase the stock (the taxpayer revises his or her projections about the stock's future performance, for instance).[203] A sale and repurchase within 30 days might also result from certain common, non-tax-motivated market transactions such as sales by mutual fund investors who continue to own an interest in the mutual fund and are enrolled in an automatic dividend reinvestment plan, as Professor Osofsky observes.[204] Furthermore, the wash sale rules are underinclusive because, for instance, some tax-motivated wash sales will occur that fall outside the specified time window.[205]

One method for ameliorating the overinclusion or underinclusion produced by a rule is developing a more complex rule.[206] To some degree,

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people to 'evade' them by engaging in conduct that is technically exempted but that creates the same or analogous harms. Rules, in short, are under-inclusive as well as over-inclusive if measured by reference to their background justifications.").

202. For discussion of the wash sale rules, see *supra* Section II.D.2.

203. *See* Osofsky, *supra* note 11, at 1086–87.

204. *Id.* at 1097.

205. *See also id.* at 1093 ("A taxpayer can purchase the same stock . . . thirty-one or more days prior to the sale of the original built-in loss stock and still obtain the loss on the sale. . . . A taxpayer can purchase the same stock . . . thirty-one or more days after the sale of the original built-in loss stock and obtain the loss on sale. . . . Or, the taxpayer can obtain a substitute position for the built-in loss stock . . . within thirty days of the disposition, as long as the substitute position is not 'substantially identical' to the built-in loss stock within the ambit of the wash sale rule."). It is also underinclusive because it does not address the potential for tax-motivated wash sales producing gains. For further discussion, see, for example, Stanley Veliotis, *Do Tax-Motivated Wash Gain Sales Pass Economic Substance Muster?*, 71 TAX LAW. 391, 396–97 (2018).

206. *See, e.g.*, Kaplow, *supra* note 155, at 565 ("The focus is on the familiar suggestion that rules tend to be over- and underinclusive relative to standards. . . . [T]he suggestion is misleading because typically it implicitly compares a complex standard and a relatively simple rule, whereas both rules and standards can in fact be quite simple or highly detailed in their operation." (footnote omitted)); Sunstein, *supra* note 157, at 962 ("Rules may be *simple* or *complex*. A law could say, for example, that no one under eighteen may drive. It could be somewhat more complex, saying that people under eighteen may not drive unless they pass certain special tests. Or it could be quite complex, creating a *formula* for deciding who may drive.").

the wash sale rules could be a good candidate for this approach—common non-tax-motivated market transactions that can produce wash sales (such as purchase of stock or securities pursuant to an automatic dividend reinvestment plan) could be carved out from the rules, for instance.[207] However, as others have observed, there are limits on the ability to alleviate overinclusion and underinclusion by making rules more complex, generally and in tax law.[208] Taxpayers have an incentive to find and capitalize on taxpayer-beneficial ways in which rules are overinclusive or underinclusive, and, thus, rules are hopelessly so because each iteration of revising a rule to address one set of transactions not treated appropriately by the rule will be greeted by taxpayers developing new transactions.[209]

Safe harbors, sure shipwrecks, and rebuttable presumptions could be viewed as devices intended to mitigate a rule's overinclusivity, underinclusivity, or both, by combining the rule with a standard. None are foolproof solutions because, as applied, any device might result in overinclusion or underinclusion.[210]

Consider, first, a safe harbor, and, as an illustration, focus on the safe harbor providing that a home sale will be deemed to be motivated by a change in place of employment if the change in place of employment occurs while the taxpayer owned the home and used it as a principal residence and the taxpayer's new place of employment is at least 50 miles farther from the home than was the taxpayer's previous place of employment.[211] Compare this to a hypothetical alternative device—a per se rule based on the same criteria. Both the safe harbor and the per se rule are overinclusive in a way that potentially benefits taxpayers.[212] It is possible that a taxpayer could buy a home with the intention of renovating it and flipping it as soon as possible and happen to also obtain a new job that was located at a sufficient distance from the home to qualify for the safe harbor. Such a taxpayer's sale is deemed to be motivated

207. *See also* Osofsky, *supra* note 11, at 1099 ("[T]he wash sale rule may be a sharper screening mechanism for tax planning if the rule excluded certain passive sale and repurchase transactions, such as through mutual fund automatic dividend reinvestment programs.").

208. For discussion of this phenomenon in tax law, see, for example, Weisbach, *supra* note 10, at 861–62 ("[I]n the tax law, rules alone would have to be unduly complex to prevent avoidance."). For discussion of this phenomenon generally, see, for example, Parchomovsky & Stein, *supra* note 189, at 171–72 ("Fully specified rules may also be too voluminous and, consequently, too cumbersome to learn and to follow.").

209. For additional discussion, see *supra* note 201 and accompanying text.

210. *See, e.g.*, Diver, *supra* note 199, at 73 ("On the other hand, a more opaque rule, though facially congruent, may be under- or overinclusive in application, because its vagueness invites misinterpretation."); Kaplow, *supra* note 155, at 594.

211. For further discussion of this provision, see *supra* Section II.C.

212. The safe harbor is potentially less overinclusive than the rule if lawmakers would have established a different boundary for the device had it been a rule (such as 75 miles rather than 50 miles for instance). *See* Morse, *supra* note 109, at 1420 ("[A]s a practical matter, the problem of overinclusion may be less acute for safe harbors . . . compared to bright-line rules, if it is true that a policy maker tends to draft safe harbors . . . more narrowly compared to bright-line rules.").

by change in place of employment even though it may, instead, have been principally motivated by a pre-existing plan to sell the home. Both the safe harbor and the per se rule produce this result, and, thus, both are overinclusive.[213] As a result, both designs could serve as roadmaps for taxpayers who are intent on complying with the letter but not the spirit of the law.

By contrast, the rule alternative would result in underinclusion that can, in theory at least, be avoided by the safe harbor design.[214] Some taxpayers' home sales may be motivated by a change in place of employment even when they do not meet the 50-mile criterion. This could result, for instance, if a taxpayer obtains a new job with a lower salary that necessitates moving into a more affordable home, but the taxpayer does not meet the 50-mile requirement. If the device were designed as a per se rule, such a taxpayer's reason for the sale would be mischaracterized, resulting in less favorable tax treatment. Given that the device is, instead, designed as a safe harbor, such a taxpayer can still establish that he or she possesses the requisite motive under a background standard based on all the relevant facts and circumstances. Moreover, in circumstances in which taxpayers might alter their transactions in ways that ensure compliance with a given safe harbor or rule,[215] reducing underinclusivity translates into reducing the propensity to trap unwary taxpayers.

Consider, next, a sure shipwreck. For purposes of illustration, imagine a hypothetical variation on § 267(a)(1), providing that any loss recognized on sale to a related party cannot be deducted and any loss recognized on sale to an unrelated party will also not be deductible if, based on all facts and circumstances, the sale is principally tax motivated.[216] Like actual § 267(a)(1), such a device would still be overinclusive because it would treat all sales to related parties as tax motivated even though, given the existence of the loss disallowance, most would not be.[217] Thus, like the per se rule of § 267(a)(1), an equivalent sure shipwreck could trap unwary taxpayers. Unlike actual

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213. *See id.* ("As a matter of logic, in contrast to the suggestions in prior literature, the problem of overinclusion is equally acute for safe harbors . . . as for bright-line rules. That is, the problem is identical assuming that the line is drawn in the same place.").

214. Whether or not this is true in practice depends on how it is applied. *See supra* note 210 and accompanying text (discussing how standards, as applied, can be overinclusive or underinclusive).

215. This could be true in the home sale example if the taxpayer was choosing among multiple new employment opportunities at varying distances from the taxpayer's former home.

216. To some extent, in tax law, every per se rule that produces an unfavorable outcome is a sure shipwreck given the existence of various anti-abuse rules and doctrines that might be used to challenge transactions that fall outside of the bounds of the rule. For discussion of these rules and doctrines, see *supra* note 175.

217. *See* Morse, *supra* note 109, at 1420 ("As a matter of logic, in contrast to the suggestions in prior literature, the problem of overinclusion is equally acute for . . . sure shipwrecks as for bright-line rules. That is, the problem is identical assuming that the line is drawn in the same place.").

§ 267(a)(1), the sure shipwreck design would be less underinclusive because some tax-motivated sales to unrelated parties that produce deductible losses under the rule version of § 267(a)(1) would not produce deductible losses under the sure shipwreck design.[218] This reduction of underinclusivity accomplished by a sure shipwreck translates into blunting the tendency of clear rules to serve as a roadmap for taxpayers who want to comply with the letter, but not the spirit, of the law.

Finally, consider, a rebuttable presumption, which could be viewed as a device intended to mitigate both overinclusion and, provided that it supplements a background standard that governs transactions not covered by the rebuttable presumption, underinclusion as well. For purposes of demonstration, recall § 1031(f) which deprives of favorable tax treatment certain overly tax-motivated transactions.[219] As currently designed, § 1031(f) essentially establishes a rebuttable presumption that transactions are overly tax-motivated if a taxpayer sells real estate within two years of receiving the real estate in a tax-deferred swap with a related party. Contrast it with a hypothetical per se rule providing that when related parties engage in a tax-deferred swap of real estate followed by one of the parties selling the real estate the transactions will be deemed to be overly tax motivated if and only if the subsequent sale happens within two years of the swap.

The rebuttable presumption is less overinclusive than the hypothetical per se rule in two respects. First, if the per se rule were adopted, then the vast majority of transactions that occurred within the two-year period would, in fact, not be tax motivated. An informed taxpayer who planned to swap real estate with a related party and later sell the real estate as part of a tax driven plan would not engage in the transactions during a two-year period because doing so would sacrifice the desired tax outcome—the main goal sought by the overly tax-motivated taxpayer. Given that tax law employs a rebuttable presumption rather than a per se rule, it is possible that some informed tax-motivated taxpayers might sell real estate within two years of receiving it in a swap with a related party if they believe they stand a chance of rebutting the presumption of tax motivation. Thus, when the device employed is a rebuttable presumption rather than a per se rule, it might be the case that more taxpayers who meet its criteria possess the presumed tax motivation.

Second, and more importantly, because taxpayers can rebut the presumption of tax motivation, as applied, the rebuttable presumption can be less overinclusive than the hypothetical per se rule alternative. Taxpayers who meet its criteria but whose transactions were not principally tax motivated have the opportunity to demonstrate as much.

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218. Whether or not this is true in practice depends on how it is applied. *See supra* note 210 and accompanying text (discussing how standards, as applied, can be overinclusive or underinclusive).

219. For discussion of § 1031(f), see *supra* Section II.B.3.

The rebuttable presumption is also less underinclusive than the hypothetical per se rule alternative.[220] Under the per se rule alternative, transactions would be deemed to be not overly tax-motivated if the subsequent sale of real estate happened more than two years after its receipt in a swap with a related party. Such a per se rule would be underinclusive because some overly tax-motivated transactions would fall outside the two-year window. As designed, § 1031(f) explicitly withholds favorable tax treatment from any transaction structured to avoid its purpose.[221] Thus, even transactions that fall outside the two-year window may be deprived of favorable tax treatment if they are excessively tax-motivated under a general facts and circumstances test.

### C. *Uncertainty*

As lawmakers move away from the rule end of the spectrum to assuage concerns about overinclusion and underinclusion, one trade-off is reduced certainty of tax outcome. For purposes of illustration, imagine replacing the per se rule of § 267(a)(1) denying the deduction of a loss recognized on sale of property to a related party with a pair of rebuttable presumptions —sale of built-in loss property to a related party would establish a presumption that the sale was tax motivated but the taxpayer could rebut the presumption by showing otherwise, while sale of built-in loss property to an unrelated party would establish the opposite presumption, rebuttable by the IRS. As compared to the existing rule, this regime creates more uncertainty regarding when sales will be treated as tax motivated.

There are a number of reasons to care about reduced certainty. First, when tax outcome is not clearly specified, the IRS and courts have more

220. Although the discussion above uses § 1031(f) as an example, the same conclusion would hold for many other rebuttable presumptions. For instance, with respect to the disguised sale rules, if the distribution and contribution occur more than two years apart, they might, nevertheless, be treated as part of a sale because that lapse of time merely establishes a rebuttable presumption that they are not part of a sale. With respect to the accumulated earnings tax, the fact that the trigger for the rebuttable presumption (earnings accumulate beyond the reasonable means of the business) is, itself, standard-like can mitigate overinclusion and underinclusion. Finally, any background facts and circumstances test that accompanies a rebuttable presumption can alleviate underinclusion. Sometimes, as is the case with § 1031(f), the existence of a background facts and circumstances test is made explicit. However, even if the operation of a background facts and circumstances test is not expressly stated in the provision establishing a rebuttable presumption, general anti-abuse doctrines in tax law can potentially temper the underinclusion of any device intended to identify overly tax-motivated transactions. For further discussion of such doctrines, see *supra* notes 175–76 and accompanying text.

221. *See supra* note 105 and accompanying text.

discretion when applying the law, which can lead to greater enforcement costs[222] and less uniform enforcement.[223]

Second, uncertainty may affect different types of taxpayers differently.[224] Taxpayers who merely want to follow the law may respond to additional uncertainty by structuring their affairs more conservatively and erring on the side of overreporting income. Taxpayers who seek to push boundaries and game the system as much as possible will try to take advantage of additional uncertainty by structuring their transactions more aggressively and erring on the side of underreporting income. In the § 267(a)(1) example, if the hypothetical rebuttable presumptions were adopted, a cautious, slightly tax-motivated taxpayer might refrain from selling built-in loss property to an

222. *See, e.g.*, Rachelle Y. Holmes, *Forcing Cooperation: A Strategy for Improving Tax Compliance*, 79 U. CIN. L. REV. 1415, 1437 (2011) ("Pre-filing certainty of outcomes . . . saves both taxpayers and the IRS the expenditure of significant amounts of time and money in anticipation of, preparing for, and in the process of post-filing battle."); Yorio, *supra* note 162, at 43 ("More importantly, a rule that places a heavy burden of proof on one of the parties will reduce the number of disputes between taxpayers and the government because parties with the burden are likely to realize in many cases that their chances for success are slim. Fewer disputes mean reduced transaction costs of negotiations and litigation. In addition, since a presumption makes the outcome of potential litigation more certain, settlement negotiations will be less time consuming and costly litigation less likely."). Also, more generally, Professor Kaplow observes that standards are more costly for courts to apply. Kaplow, *supra* note 155, at 562–63.

223. *See, e.g.*, Swire, *supra* note 189, at 372 ("An important source of uncertainty is the discretion of lower-level bureaucrats; the safe harbor rule can help senior officials confine that discretion.").

224. *See, e.g.*, Sheldon I. Banoff, *The Use and Misuse of Anti-Abuse Rules*, 48 TAX LAW. 827, 837 (1995) ("The effect of [some anti-abuse rules] . . . is to erase the bright line or relocate it for more cautious taxpayers. Those who are overly aggressive may use the vagueness and ambiguity of the rule as an indirect endorsement of their proposals. Thus, conservative practitioners may become more so, and aggressive planners will have a larger client base to solicit."); Gergen, *supra* note 85, at 196–97 ("But an approach that uses indeterminate standards . . . invites abuse by those who want to take advantage of the system. . . . At the same time, doubt is costly to those who want to comply with the law, since they must employ attorneys who can plumb the mysteries of the law to tell them what is safe." (footnote omitted)); Kovach, *supra* note 200, at 1303 ("Risk aversion can produce unnecessarily conservative determinations by practitioners. Yet if the risk of audit is perceived to be relatively slight, some professionals will ignore the ominous implications of a faulty facts and circumstances analysis in favor of taking a turn at the roulette wheel of the audit casino."); Logue, *supra* note 201, at 374–75 ("[U]sing such legal uncertainty in this way is a fairly imprecise tool for deterring aggressive tax planning, since some taxpayers will be induced to over-comply and others, the less risk-averse, will be inclined to take a chance and exploit the ambiguity."); *see also* Weisbach, *Ten Truths*, *supra* note 175, at 249–50 ("[T]hose arguing against uncertainty . . . would argue that taxpayers vary in their risk aversion, so that uncertainty affects taxpayers differently. . . . This, it might be argued, is unfair—uncertainty in the tax law helps the bad guys and hurts the good guys. It is not clear, however, why this is more unfair than disparate responses to other elements of taxation."). For a similar observation regarding standards in law generally, see, for example, Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 385 (1985) ("Because standards do not draw a sharp line between permissible and impermissible conduct, some risk-averse people will be chilled from engaging in desirable or permissible activities, and some risk-preferring people will be encouraged to engage in antisocial conduct.").

unrelated party in a circumstance in which the taxpayer would engage in the transaction under current law. In contrast, an aggressive, quite tax-motivated taxpayer might proceed with a sale of built-in loss property to a relative that would not be undertaken under current law. We might view this disparate effect of uncertainty as undesirable because it could contribute to the perception that taxpayers who exploit the system are not subject to the same rules that apply to the rest of us. This perception, in turn, could embolden more taxpayers to take aggressive reporting positions and cause more tax advisors to provide aggressive advice in order to compete for client business.[225]

### *D. Is There Any Principled Basis to Guide the Application of a Standard?*

As lawmakers move towards the standard end of the spectrum, the increased uncertainty and its resulting harms (including lack of uniform enforcement and varying taxpayer responses to the uncertainty) will be less significant if an underlying principle exists to guide courts and the IRS in their application of a standard. Conversely, when no such underlying principle exists, the increased uncertainty is exacerbated.[226]

In order to demonstrate, consider, again, the per se rule of § 267(a)(1) denying the deduction of a loss recognized on sale of property to a related party. Imagine replacing it with a pair of rebuttable presumptions —sale of built-in loss property to a related party would establish a presumption that the sale was tax motivated, but the taxpayer could rebut the presumption by showing otherwise. Conversely, sale of built-in loss property to an unrelated party would establish the opposite presumption, rebuttable by the IRS. If the abuse prevented by § 267(a)(1) is conceived of broadly, then much uncertainty would exist regarding when each presumption could be rebutted. For instance, one might describe § 267(a)(1), in broad terms, as aimed at preventing tax-motivated transactions that take advantage of the realization

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225. *See, e.g.*, Michael S. Knoll, *Tax Planning, Effective Marginal Tax Rates, and the Structure of the Income Tax*, 54 TAX L. REV. 555, 555 (2001) ("The specter of wealthy individuals and large corporations hiring legions of high-priced lawyers and accountants to develop and implement tax saving strategies creates the perception that the system is unfair."); Kovach, *supra* note 200, at 1306 ("Other professionals are able to view the numerous facts and circumstances tests as opportunities to take daring risks on behalf of grateful clients who are consistently interested in tax avoidance."); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1468–77 (2003) (discussing the effects of perceptions of fairness on tax compliance); Schizer, *supra* note 175, at 1319 ("Since wealthy and well advised taxpayers have an edge in planning, limiting this advantage can lead to a more equitable distribution of tax burdens. The average taxpayer's faith in the system is preserved, promoting voluntary compliance and the attendant savings in enforcement costs." (footnote omitted)).

226. *See, e.g.*, Weisbach, *supra* note 10, at 883 ("Third, the level of uncertainty created by an anti-abuse rule will vary with the context. For example, some have argued that the corporate tax rules are without purpose. One can only apply them as a formal system. If the argument is correct (and I am not sure that it is), the level of uncertainty created by an anti-abuse rule would be large, because references to the purposes of the statute would be highly ambiguous.").

doctrine—the doctrine under which, in general, a taxpayer does not realize gain or loss that has accrued in property until the taxpayer sells or exchanges the property. Policing abuse of the realization doctrine under a broad standard would be a fairly hopeless endeavor. Given the doctrine's existence, any decision to sell or not sell an asset may be partly driven by tax consequences, making it difficult to draw a principled line between permissible and impermissible degrees of tax motivation.[227]

When it is difficult to craft principled underlying standards, lawmakers might opt to use a rule even if it is underinclusive and overinclusive. Stated differently, lawmakers might consciously sacrifice the goal of accurately assessing whether or not all transactions are overly tax motivated in favor of using devices that are easier to administer, in which case the rules are better thought of not as irrebuttable presumptions of tax motivation, but instead as somewhat arbitrary rules.

In some cases, however, even when efforts to completely eradicate overinclusion and underinclusion would be fruitless, some progress is attainable by conceiving more precisely of the abuse at which the provision is aimed. Thus, ensuring that, at least with respect to identifying that type of abuse, the provision is more accurate. For instance, assume § 267(a)(1) is targeted at the specific abuse of the realization doctrine that entails taxpayers attempting to recognize a tax loss while continuing to enjoy the benefits of direct or indirect control over the asset by virtue of the identity of the person who acquires the asset. More fully specified rebuttable presumptions might be employed to serve this purpose in a way that is less underinclusive and less overinclusive than § 267(a)(1), without creating unmanageable uncertainty.

To demonstrate, imagine lawmakers provided that a sale of built-in loss property to a related party (as defined by § 267) gave rise to a rebuttable presumption that the loss deduction would be denied. Lawmakers further specified that a taxpayer could rebut the presumption but only by showing

227. *See, e.g.*, Elkins, *supra* note 136, at 395 ("The line separating acceptable from unacceptable rule manipulation in the context of the realization doctrine is not a matter of substance but rather a matter of degree."); Gergen, *supra* note 10, at 136–37 ("[I]t was not foreordained that the taxpayer in *Gregory* would lose, or that the banks would win in *Cottage Savings Association v. Commissioner*, when they swapped equivalent loan portfolios to take advantage of a tax loss. It is no coincidence that these are all realization cases, an issue on which tax law is especially soft." (footnote omitted)); Hariton, *Sorting Out the Tangle*, *supra* note 175, at 255 (discussing differing court opinions regarding the application of the economic substance doctrine to wash sales that fall outside the time frame covered by § 1091); Shaviro, *supra* note 191, at 3 (describing but not espousing the view that the boundaries of the realization doctrine are inherently arbitrary); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1634 (1999) ("The scope of the realization requirement is elusive. No underlying legal or economic concept serves as a touchstone."). The same criticism could be leveled at the disguised sale rules. *See, e.g.*, Gergen, *supra* note 85, at 181 ("Section 707(a)(2)(B) is poorly conceived because it requires distinguishing between normal contributions and distributions that incidentally shift interests in assets and transfers that are disguised sales. There is no good way to distinguish the two.").

that the taxpayer, after the sale, exercised no control over and received no benefits from the property. To guide the IRS and courts, lawmakers might generate a set of examples showing circumstances in which the presumption could be rebutted.

Conversely, lawmakers could specify that a sale of built-in loss property to a person who was not a related party (as defined by § 267) would give rise to a rebuttable presumption that § 267(a)(1)'s restriction on loss deduction would not apply. The IRS could rebut this presumption only by showing that the taxpayer, after the sale, continued to exercise control over or receive benefits from the property by virtue of the taxpayer's interactions with or arrangements with the property's new owner. Likewise, lawmakers could craft a set of examples showing circumstances in which the presumption could be rebutted.[228]

Section 1031(f)'s rebuttable presumption might, likewise, be viewed as an attempt to police tax motivation in an area in which underlying principles are somewhat murky. As described above in Section II.B.3, pursuant to § 1031(f), if related parties engage in a like-kind exchange and one of the related parties disposes of the property acquired in the exchange within two years, then, at the time of later disposition, both parties must recognize any gain or loss that was not recognized at the time of the earlier like-kind exchange, unless the taxpayers establish that neither the like-kind exchange nor the later disposition had, as one of its principal purposes, the avoidance of federal income tax. If the transactions occur more than two years apart, § 1031(f) provides that § 1031's non-recognition treatment is not available "to any exchange [that] is part of a transaction (or series of transactions) structured to avoid the purposes of [§ 1031(f)]."[229]

If the purposes of § 1031(f) are viewed broadly—as something like withholding favorable tax treatment from overly tax-motivated like-kind exchanges—application of § 1031(f) becomes unworkable. All § 1031 exchanges are guided by a degree of tax motivation—how much is too much? Applying § 1031(f) becomes manageable only by defining its purpose more precisely, and, arguably, Congress or Treasury should do so.[230] A more specific definition of the type of transaction at which § 1031(f) is aimed would be a transaction in which A receives real estate in a swap with B and then A (or B) sells the real estate received to C, in lieu of B (or A) having sold the real estate to C in the first place, in order to reduce the amount of tax liability incurred as a result of the sale to C.

228. A similar approach could be used in the context of the wash sale rules. *See infra* notes 253–56 and accompanying text.

229. I.R.C. § 1031(f)(4) (2018).

230. To some extent, legislative history can serve this function, but it lacks many details that could be clarified by statute or regulation. For discussion of the legislative history, see *supra* notes 104 and 106.

When A and B are related and the sale to C happens close in time to the swap, a rebuttable presumption of such a purpose arises. When the subsequent sale happens soon in time after the swap, it is more likely that the sale was contemplated at the time of the swap so that the two transactions were part of a tax reduction plan. When A and B are related, it is more likely that A would be willing to accommodate B's tax reduction plan. Elaboration on the purpose of § 1031(f) and the reasons for developing the rebuttable presumption suggest circumstances in which it could rebutted. Presumably, it could be rebutted, if the parties are able to introduce sufficient evidence to show that the subsequent sale was not contemplated at the time of the original § 1031 exchange.

Elaborating on § 1031(f)'s purpose also helps to guide analysis of when § 1031's non-recognition treatment should be denied because an exchange "is part of a transaction (or series of transactions) structured to avoid the purposes of [§ 1031(f)]."[231] This might arise, for instance, if the subsequent sale occurred more than two years after the exchange but it can, nevertheless, be shown that the sale was planned at the time of the exchange. This provision should also be implicated if the original § 1031 exchange did not, directly, occur between related parties—perhaps A and B are related but they engage in an exchange in which D, an unrelated party, acts as an intermediary. Finally, imagine A and B engage in a § 1031 exchange followed by a sale by A to C of the property in lieu of B selling the property to C in the first place. Section 1031(f) turns on A and B being related because a relationship between the parties would normally be necessary for A to willingly recognize gain in lieu of B recognizing gain to accommodate B's tax reduction plans. However, if A and B are unrelated but B compensates A for A's trouble, such a transaction could be the sort that is captured by the provision denying non-recognition treatment "to any exchange [that] is part of a transaction (or series of transactions) structured to avoid the purposes of [§ 1031(f)]."[232]

Defining a provision's purpose with more specificity, if taken too far, runs the risk of creating a roadmap for tax abuse.[233] Thus, the more specific description of purpose must necessarily maintain some level of generality. For instance, assume lawmakers intend for § 1031(f) to apply when a subsequent sale occurs more than two years after a § 1031 exchange between related parties as long as the subsequent sale was planned at the time of the exchange. In that case, lawmakers ought to avoid defining "plan" with too much particularity—a plan should include not just entering into a binding contract

231. I.R.C. § 1031(f)(4).

232. *Id.*

233. Although providing more guidance regarding § 1031(f)'s purpose, to some degree, inevitably raises the risk of charting out a course for aggressive taxpayers, when the provision's purpose is undefined, aggressive taxpayers can use the uncertainty as justification for creating their own roadmap for tax abuse that might be even more lenient than what lawmakers would provide.

for the subsequent sale but any other steps that show that the subsequent sale was contemplated at the time of the § 1031 exchange.

### *E. Access to the Evidence*

The parties' relative access to evidence is another factor that might justify supplementing a facts and circumstances test with a rebuttable presumption. To some degree, rebuttable presumptions that favor the IRS might be viewed as mapping onto what would occur under a facts and circumstances test even in the absence of the presumption. When a rebuttable presumption turns on a fact that is more readily accessible to the IRS and the facts that might rebut it are facts within the possession of the taxpayer, specifying that the existence of the readily available fact will lead to an IRS-favorable rebuttable presumption forces the taxpayer to bring forth any information in the taxpayer's possession that might rebut the presumption,[234] much as would be expected to occur even without the rebuttable presumption. Establishing the rebuttable presumption ahead of time could still have value—it might, for instance, lead to more uniformity in outcomes in litigated cases or to more uniformity in taxpayer expectations at the planning stage.

Given the relative access to evidence rationale for the use of rebuttable presumptions, taking steps to make sure that the fact that triggers the IRS-favorable presumption is, indeed, readily available to the IRS makes a great deal of sense. One way to provide a taxpayer with an incentive to make the fact readily available to the IRS is to only allow the taxpayer an opportunity to rebut the presumption if the taxpayer specifically disclosed to the IRS the fact that triggers the presumption. The partnership disguised sale rules require disclosure by a taxpayer who wants to rebut the presumption that a contribution and distribution that occur within two years are part of a sale.[235] A similar approach should be used in other contexts. For instance, a taxpayer could be allowed to rebut § 1031(f)'s presumption only if the taxpayer specifically disclosed that sold property had been acquired in a § 1031 exchange with a related party within two years.

234. The evidence literature highlights this potential information forcing role of rebuttable presumptions. *See, e.g.*, Ladd, *supra* note 66, at 281 (describing one of the uses of presumptions as "account[ing] for special means of access or peculiar knowledge of the facts by one of the parties"); Morgan, *supra* note 190, at 926 ("Other presumptions have their origin in considerations of the comparative convenience with which the parties can produce evidence of the fact in issue."); Ray, *supra* note 190, at 591 ("A fifth reason for creating a presumption is to require the party who has peculiar means of access to the facts to first produce evidence as to them.").

235. For discussion of the disclosure requirement, see, for example, Gergen, *supra* note 85, at 190 ("The greatest significance of the two-year presumption lies in the rule that the Service must be given notice of distributions within two years unless the distribution comes within the special rules for preferred returns and the like.").

### F. RISK OF FABRICATION

In some instances, a decision to adopt a per se rule that tends to favor the IRS rather than an IRS-favorable presumption that can be rebutted by taxpayers may be driven by the concern that the likely rebuttal evidence would be too easy for taxpayers to fabricate. For instance, one might be concerned that allowing taxpayers to rebut the presumption that a sale of built-in loss property to a related party was tax motivated would give rise to taxpayers concocting stories about the non-tax reasons for the transfer, which might be too easy to do when the other party to the transaction is a related party who is potentially more willing to be an accomplice to the fabrication. Indeed, concerns about potential fabrication have been raised as objections to tests turning on taxpayer state of mind more generally.[236]

While this concern has merit, it ought not always foreclose opportunities for taxpayers to bring forth relevant evidence. The self-interested nature of any claims made by the taxpayer or a related party can be taken into account when assessing the credibility of the claims. Moreover, in some cases, such as § 1031(f), taxpayers are given an opportunity to rebut an IRS-favorable presumption even though the parties to the transaction are related.

### G. RISK OF GIVING EVIDENCE IMPROPER WEIGHT

In some cases, lawmakers' decisions to not afford taxpayers with the opportunity to rebut a presumption of tax motivation may stem from the concern that courts would give too much weight to the likely rebuttal evidence. In particular, courts might not properly assess cases involving mixed motives by allowing any showing of non-tax motive to rebut the conclusion of tax motivation. Courts are not immune from making this type of error.[237] However, the concern might be better addressed by allowing a presumption to be rebutted while, at the same time, providing more guidance regarding the proper handling of mixed motive cases.

Consider, for instance, § 362(e)(2) discussed above in Section II.D.3. In effect, § 362(e)(2) conclusively presumes that any contribution of assets to a corporation that have a net built-in loss is tax motivated.[238] Because it is

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236. *See, e.g.*, Hayashi, *supra* note 11, at 300 ("[T]he problems with facts and circumstances tests are threefold. . . . [T]hey encourage dishonesty.").

237. *See, e.g.*, Emily Cauble, *Reforming the Non-Disavowal Doctrine*, 35 VA. TAX REV. 439, 443–44 (2016) ("[I]f the taxpayer can provide a non-tax explanation for his or her selected form, a court that uses the typical approach might automatically (and, sometimes, incorrectly) conclude that the taxpayer has not engaged in Post-Transactional Tax Planning. This conclusion is sometimes incorrect because a taxpayer can be driven by multiple motives—he or she could select a given form because it provides non-tax benefits and also because it facilitates Post-Transactional Tax Planning."); Lederman, *supra* note 10, at 417 ("A transaction motivated by a business purpose sounds like it lacks a tax-avoidance motivation . . . . However, that is a false dichotomy . . . . [M]any transactions have both tax and non-tax purposes . . . .").

238. *See supra* Section II.D.3.

possible that a shareholder contributes built-in loss assets to a corporation principally for non-tax reasons instead, the provision is overinclusive. To remedy this shortcoming, Professors Kahn and Kahn have suggested, among other potential solutions, that if a shareholder contributes built-in loss property to a corporation and the corporation sells the property within some fairly short period of time, those facts would establish a presumption that the contribution was tax motivated so that loss duplication would be disallowed; however, the presumption would be rebuttable rather than conclusive.[239] One potential objection to allowing taxpayers the opportunity to rebut the presumption is that courts might allow any credible showing of business purpose to overcome the tax motivation presumption. Instead of foreclosing the opportunity to rebut the presumption entirely, this concern might be better addressed by providing more specific guidance regarding how to address mixed motive cases.[240] For instance, Congress could provide that § 362(e)(2) applies when the contribution is principally tax motivated (making clear that the bar is not set as high as applying to only transactions that are solely tax motivated).[241] Thus, the presumption could be rebutted only if the countervailing evidence clearly established that the transactions were not principally tax motivated.

## IV. RE-ASSESSING CURRENT DESIGN CHOICES

As discussed in Part III, a number of factors could and should guide the use and design of facts and circumstances tests, rebuttable presumptions, safe harbors, or irrebuttable presumptions for purposes of divining a taxpayer's motive or state of mind. An examination of these factors reveals opportunities for making tangible improvements upon the methods currently used in various contexts. In particular, as this Part will discuss, first, some existing facts and circumstances tests could helpfully be supplemented by rebuttable presumptions. Second, certain irrebuttable presumptions should be made rebuttable—but the circumstances in which they could be rebutted should be defined with some precision. Third, existing rebuttable presumptions could be enhanced in various ways.

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239. *See* Kahn & Kahn, *supra* note 148, at 49 ("Congress could . . . create a rebuttable presumption that if a transferred depreciated asset is sold by the corporation within some specified time period, such as two years, the transfer to the corporation will be presumed to be tax motivated.").

240. *See id.* ("If Congress is concerned that the vagaries of factual determinations may permit too many taxpayers to establish a business purpose when none actually exists, Congress could impose a greater burden of proof on taxpayers on that issue . . . .").

241. For discussion of different approaches to mixed motive cases, see generally Andrew Verstein, *The Jurisprudence of Mixed Motives*, 127 YALE L.J. 1106 (2018).

### A. *Supplementing Facts and Circumstances Tests with Rebuttable Presumptions*

In the case of a number of the facts and circumstances tests (including the gift determination), the best course of action is likely to leave well enough alone. Given the difficulty of identifying a fact or set of facts that are reliable predictors of state of mind in a significant number of cases, but, at the same time, sufficiently specific and sufficiently surprising to provide taxpayers with useful guidance,[242] the cases that arise in some areas are best dealt with under facts and circumstances tests. However, in order to provide increased certainty (with its attendant benefits of more uniform enforcement, fewer and less costly disputes, and more consistent taxpayer expectations),[243] § 357(b) should be supplemented by a pair of rebuttable presumptions. As discussed above, § 357(b) currently requires the determination of whether, in connection with a corporation's assumption of a debt of a shareholder, the shareholder's principal purpose is tax avoidance or otherwise not a bona fide business purpose.[244] Whether or not the shareholder possesses such a purpose will be determined based on all relevant facts and circumstances.[245]

In the cases that arise, courts tend to examine a fairly small number of factors, and one factor that emerges across most cases is how soon before the contribution the borrowing was incurred.[246] Thus, timing appears to be a commonly relevant fact, and one that could be defined by lawmakers in a specific way. In particular, if the borrowing was incurred by the shareholder within a specified time (two years, for example) of the corporation's assumption of the debt, the closeness in time could establish a rebuttable presumption that the shareholder's principal purpose was tax avoidance or was otherwise not a bona fide business purpose.

Given that courts already examine timing in the cases that arise, rebuttable presumptions based on timing might seem to fail the "sufficiently surprising" criteria. However, while timing is already considered a relevant fact, at the planning stage, aggressive taxpayers and conservative taxpayers might have different expectations regarding where the line will be drawn in terms of how much time must elapse to achieve a likely finding of lack of tax motivation. Thus, the surprising aspect of the presumption would be the specific amount of time selected and not the fact that the presumption was based on timing generally.[247]

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242. For discussion of this difficulty, see *supra* text accompanying notes 195–98.

243. *See supra* Section III.C.

244. *See supra* Section II.A.2.

245. *See supra* Section II.A.2.

246. *See supra* Section II.A.2.

247. This could be contrasted with the example discussed above in which a presumption that transfers between related parties were gifts would not be particularly surprising—in that context, not only the general notion of a relationship between parties but also the specific relationships listed by lawmakers would not be particularly different from what taxpayers would surmise

In order to ensure that the timing of the borrowing was a fact readily available to the IRS, a shareholder ought to lose his or her opportunity to rebut the presumption if the shareholder did not follow designated procedures to specifically disclose the timing and facts related to the borrowing in the shareholder's tax return covering the year of the contribution.[248] The presumption would be rebuttable in order to mitigate overinclusion.

If the borrowing was incurred by the shareholder more than a specified time (two years, for example) before the contribution, the lapse of time could establish a rebuttable presumption that the shareholder's principal purpose was a bona fide business purpose and not tax avoidance. The IRS would be allowed the opportunity to rebut the presumption so that it would not become a roadmap for taxpayers aiming to comply with the letter but not the spirit of the law.

### *B. Making Irrebuttable Presumptions Rebuttable*

In a number of contexts, lawmakers have specified that certain facts, effectively, give rise to a conclusive presumption that a transaction was overly tax motivated. Such rules are both too broad (because they capture transactions that are not tax motivated) and too narrow (because they allow tax-motivated transactions to fall through the cracks). Narrowness is a serious flaw in the context of any provision aimed at ferreting out tax avoidance (which is true of all of the examples of irrebuttable presumptions discussed above in Section II.D) because it creates the very roadmap for tax abuse that tax avoidance provisions are designed obscure.[249] Therefore, at the very least, the provisions should be remedied to mitigate their narrowness—in other words, their underinclusivity.

As discussed in Section II.D.1, under current law, § 267(a)(1) disallows the deduction of a tax loss recognized on sale of property to a related party. The provision is both overinclusive (because, particularly in light of the provision itself, many sales to related parties are not principally tax motivated)

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without such guidance. The distinction here is, however, only a matter of degree. Without a presumption, different taxpayers might surmise different conclusions regarding whether or not less closely related individuals count. Indeed, in different contexts within tax law in which lawmakers have specified the types of individuals that are deemed "related," lawmakers have created different lists. One can contrast, for example, § 318(a)(1) with § 267(c)(4).

248. Requiring disclosure runs the risk of setting another trap for unwary taxpayers who may be unaware of the disclosure requirement. However, tying the disclosure in with the taxpayer's tax return may mitigate this risk to some degree. While many unsophisticated taxpayers may carry out transactions day-to-day without contemplating or seeking advice about resulting tax consequences, when it comes time to file tax returns, uninformed taxpayers will often seek expert assistance at the filing stage. This expert assistance can help the uninformed taxpayer navigate the disclosure requirements.

249. To some extent, the narrowness of the rules might be addressed by overarching anti-abuse doctrines. *See supra* note 175. However, given the reluctance of some courts to apply these doctrines, they will not always address the underinclusivity of the rules. *See supra* note 176.

and underinclusive (principally tax-motivated sales occur that fall outside the scope of § 267(a)(1)). At a minimum, steps should be taken to address underinclusion.[250] Mitigating overinclusion is also desirable because doing so would result in the provision trapping fewer unwary taxpayers. Both goals could be accomplished by replacing § 267(a)(1) with a set of rebuttable presumptions. In particular, the sale of built-in loss property to a related party would give rise to a rebuttable presumption that § 267(a)(1)'s loss deduction denial applied, while sale to a party who was not related would give rise to the opposite rebuttable presumption. Because of the difficulty of drawing principled lines between sales that are and are not overly tax motivated, lawmakers should provide some guidance regarding how the presumptions could be rebutted. In particular, a taxpayer could rebut the IRS-favorable presumption only by showing that the taxpayer, after the sale, exercised no control over and received no benefits from the property. For ease and consistency of administration, lawmakers might specify that continued control by the taxpayer would be conclusively presumed in the case of certain close relationships.[251] The IRS could rebut the taxpayer-favorable presumption only by showing that the taxpayer, after the sale, continued to exercise control over or receive benefits from the property by virtue of the taxpayer's interactions with or arrangements with the property's new owner.

Compared to current law,[252] the suggested approach entails less certainty with the resulting downsides of more costly and potentially less uniform enforcement and less consistent taxpayer expectations. However, these sacrifices are arguably outweighed by the gains. The suggested approach mitigates the underinclusivity of current law which, as discussed above, ought to be a predominant consideration in the context of provisions aimed at identifying overly tax-motivated transactions.

250. If lawmakers opted to address only underinclusion but not overinclusion, they could do so by converting § 267(a)(1) into a sure shipwreck. In particular, lawmakers could provide that deduction of a loss would be automatically disallowed any time that property was sold to a related party, as currently provided by § 267(a)(1). Lawmakers could further provide that, in the case of a sale to an unrelated party, a loss deduction would be denied any time the taxpayer, after the sale, continued to exercise control over or receive benefits from the property by virtue of the taxpayer's interactions with or arrangements with the property's new owner, judged under a facts and circumstances test.

251. Doing so would effectively amount to converting I.R.C. § 267(a)(1) into a sure shipwreck and might be warranted because, in the case of certain close relationships, the only evidence of control might be the relationship itself. If the primary reason for allowing taxpayers an opportunity to rebut the IRS-favorable presumption is to prevent trapping unwary taxpayers, the ability to rebut it might be limited to taxpayers with incomes below a certain threshold given that taxpayers with greater resources have the ability to seek advice in order to avoid traps for the unwary. Alternatively, the sophistication of the taxpayer could be taken into account when determining whether or not the taxpayer successfully rebutted the presumption.

252. I.R.C. § 267(a)(1) currently employs a per se rule that denies loss deduction on sale to a related party.

The wash sale rules might warrant a similar approach in order to address underinclusion and overinclusion.[253] In particular, deductions for losses recognized on wash sales would be disallowed. If, within a specified 61-day window,[254] a taxpayer has acquired, or has entered into a contract or option to acquire, stock or securities that are substantially identical to the stock or securities sold by the taxpayer, the facts would establish a rebuttable presumption that the taxpayer had engaged in a wash sale. If no such transaction has occurred within the specified 61-day window, the lack of such a transaction would give rise to a rebuttable presumption that the taxpayer has not engaged in a wash sale. Lawmakers should provide some guidance regarding how the presumptions could be rebutted. In particular, a taxpayer could rebut the IRS-favorable presumption only by showing that, at the time of whichever transaction occurred earlier, the taxpayer did not contemplate engaging in the later transaction.[255] The IRS could rebut the taxpayer-favorable presumption that arises when the relevant transactions occur outside of a 61-day window only by showing that the taxpayer, at the time of the earlier transaction, did contemplate engaging in the later transaction.[256]

Finally, as discussed above, § 362(e)(2) conclusively presumes that any contribution of assets to a corporation that have a net built-in loss is tax

253. As with I.R.C. § 267(a)(1), at a minimum, lawmakers should address underinclusion, and they could use a sure shipwreck design to do so. In particular, loss deduction would automatically be disallowed if, within the specified 61-day window, a taxpayer acquired, or entered into a contract or option to acquire, stock or securities that were substantially identical to the stock or securities sold by the taxpayer, as under current law. To current law, lawmakers would add that if the transactions fell outside the 61-day window, deduction of the loss would still be denied if, based on all the facts and circumstances, it appeared that the taxpayer contemplated engaging in the second transaction at the time of the first transaction.

254. The specified 61-day window is the "period [of time] beginning 30 days before the date of [the] sale" of the stock or securities "and ending 30 days after such date." I.R.C. § 1091(a) (2018).

255. The Treasury Regulations could also contain examples of situations in which the IRS-favorable presumption could be rebutted. Examples could include circumstances in which the repurchase occurred automatically under a dividend reinvestment plan or other circumstances in which the taxpayer can present credible evidence showing that the taxpayer did not contemplate the later transaction at the time of the earlier one. See *supra* notes 203–04 and accompanying text for discussion of situations in which non-tax-motivated taxpayers engage in wash sales.

256. The Treasury Regulations could also contain examples of situations in which the taxpayer-favorable presumption could be rebutted. They could include situations, for instance, in which the stock is sold to a friend and there is an informal understanding (not formal enough to rise to the level of a contract) that the friend will sell it back in the future for a price determined by the taxpayer. For related discussion, see Alex Raskolnikov, *Relational Tax Planning Under Risk-Based Rules*, 156 U. PA. L. REV. 1181, 1198–99 (2008), describing how a "Wash Seller" may choose to "sell[] the loss security to an old friend (the 'Wash Buyer')."

motivated.[257] The provision is underinclusive, in part,[258] because it applies on an aggregate basis when multiple assets are contributed as part of one transaction.[259] Thus, for instance, if a shareholder contributes one parcel of land with a basis of $20 and a fair market value of $100 and a second parcel of land with a basis of $100 and a fair market value of $20 as part of one transaction, § 362(e)(2) will not apply because, in aggregate, the total basis of both assets ($120) does not exceed the total fair market value ($120).[260] Yet, it is entirely possible that the shareholder's principal purpose for contributing the second parcel of land was to duplicate the tax benefit arising from the land's decline in value by allowing the corporation to recognize loss on sale of the second parcel of land and also allowing the shareholder to use the loss to reduce gain recognized on sale of the shareholder's stock.[261] At a minimum, lawmakers should remedy the provision's underinclusivity by testing for built-in loss asset-by-asset rather than on an aggregate basis. In the example above, for instance, this modification would make it so that § 362(e)(2) would apply to the second parcel of land because it, alone, has a built-in loss. If lawmakers also opt to address the provision's overinclusivity, they could provide that the contribution of a built-in loss asset establishes a presumption of tax motivation that a taxpayer can rebut by presenting countervailing evidence that clearly establishes that the contribution was not principally tax motivated.[262]

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257. I.R.C. § 362(e)(2); *see supra* Section II.D.3 (describing the irrebuttable presumptions associated with corporate contributions of built-in loss property).

258. Section 362(e)(2) is also flawed in the context of S Corporations where loss can be shifted from the contributing shareholder to other shareholders. *See, e.g.*, Martin J. McMahon, Jr. & Daniel L. Simmons, *When Subchapter S Meets Subchapter C*, 67 TAX LAW. 231, 245–46 (2014).

259. For further discussion, see, for example, Rodney P. Mock & Jeffrey Tolin, *What's Mine Is Mine: Taxing Pre-Contribution Gains*, 29 AKRON TAX J. 105, 130 (2014) ("If enough gain property is transferred, loss duplication is not restricted. Section 362(e)(2) does not apply when the aggregate fair market value of the transferred properties equals or exceeds the aggregate adjusted bases of the assets transferred.").

260. I.R.C. § 362(e)(2)(A)(ii).

261. The corporation's basis in the second parcel of land would be $100 (the shareholder's basis in the second parcel of land). *Id.* § 362(a). Thus, if the corporation sold the land for its $20 fair market value, the corporation would recognize loss of $80. The shareholder's basis in the stock would be $120 (the sum of the shareholder's basis in each parcel of land). *Id.* § 358(a)(1). Thus, if the shareholder sold the stock for its $120 fair market value, the shareholder would not recognize any gain. By contrast, if the shareholder had only contributed the first parcel of land to the corporation (with a basis of $20 and value of $100), the shareholder would have received stock with a basis of $20. *Id.* If the shareholder sold the stock for its $100 value, the shareholder would have recognized $80 of gain.

262. *See also* Kahn & Kahn, *supra* note 148, at 49 (suggesting that if a shareholder contributes built-in loss property to a corporation and the corporation sells the property within some fairly short period of time, those facts could establish a rebuttable presumption that the contribution was tax motivated).

### C. REFINING EXISTING REBUTTABLE PRESUMPTIONS

In addition to supplementing or replacing other tools with rebuttable presumptions in some contexts, some rebuttable presumptions already in use could be improved in various ways. First, rebuttable presumptions that favor the IRS present an opportunity to encourage taxpayer disclosure by only allowing taxpayers the opportunity to rebut the presumption if they specifically disclosed information about the transactions to the IRS. Thus, such presumptions should be accompanied by disclosure requirements.[263] For example, § 1031(f) should be modified so that taxpayers would be allowed to rebut the presumption of tax motivation only if he or she specifically disclosed that property sold had been acquired in a § 1031 exchange with a related party within two years. Likewise, the rebuttable presumptions suggested above in Section IV.B ought to be accompanied by similar disclosure requirements.

Second, many rebuttable presumptions guide courts in drawing the line between permissibly and impermissibly tax-motivated transactions in contexts in which drawing such a line is difficult. In order to facilitate more uniform application of the law and more uniform expectations of taxpayers, providing some advance guidance regarding the aim of the provisions may be desirable. This approach could be applied in the context of § 1031(f), for example, as described above in Section III.D.

## V. CONCLUSION

Tax law utilizes a variety of tools for assessing taxpayer state of mind, ranging from facts and circumstances tests to irrebuttable presumptions, and various hybrid instruments that fall in between these extremes, such as rebuttable presumptions and safe harbors. Tax law uses different devices across contexts that are, in other respects, quite similar. The use of different devices in similar contexts suggests that there might be less justification for selecting different tools than there could—and should—be. Inquiring into the purpose of using different tools to assess state of mind reveals opportunities to improve upon tax law's current methods. First, some facts and circumstances tests should be supplemented with rebuttable presumptions. Second, certain irrebuttable presumptions should be rebuttable in specific ways. Third, the design of some existing rebuttable presumptions should be modified to increase the odds of the IRS receiving relevant information and to provide clearer guidance regarding how the presumptions can be rebutted.

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263. A similar approach is used in the context of the disguised sale rules, which establish a presumption that a taxpayer is allowed to rebut; however, if the taxpayer wants to rebut the presumption, the taxpayer must specifically disclose the relevant transactions to the IRS. Treas. Reg. § 1.707-3(c)(2) (2014) (requiring disclosure if the distribution and contribution occur within two years and the taxpayer is not treating them as a sale). The disclosure requirement is subject to certain exceptions. *Id.*