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International Tax Planning and Anti-Tax Avoidance
Provisions – An Economic and Legal Analysis

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Declaration

This research paper is presented for the approval of Senate in fulfilment of part of the requirements for the HDip Tax qualification. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of HDip Tax research papers, including those relating to length and plagiarism, as contained in the rules of this University, and that this research paper conforms to those regulations.

Hila Zetler 12 February 2013
Note to the reader

Given my background as an Israeli advocate, I decided to approach this subject using Israeli law as a basis for my research. I thought such an angle might contribute to the available literature in South Africa. At a later stage, I hope to extend my research to include South African law and perhaps conduct a comparative study of the law in the two countries.
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1. Introduction

‘The avoidance of tax may be lawful, but it is not yet a virtue’ – Lord Denning

The famous English judge, Lord Denning, explained that the avoidance of tax may be legal, but it is not necessarily ethical. By said words, Justice Denning implied that, when a taxpayer avoids paying taxes through legal tax planning, he may, despite the ostensible legality thereof, nevertheless harm society. Assuming that such action does, indeed, involve an immoral act, should the legislature intervene?

Interestingly, the Israeli legislature believes that moral norms should be established in this situation, and it has determined, in s 86 of the Israeli Tax Ordinance, that the income tax assessing officer may disregard transactions where the objective is the ‘improper reduction of tax’. Prima facie, the intent was to require the taxpayer to act with bona fides when arranging his tax planning. However, since the defining of the criterion of ‘properness’ has presented difficulties, with the provision concerned having become a dead letter in fiscal legislation. Nevertheless,

1 Re Weston’s Settlements [1969], 1 Chap 223 245.
2 See ITA (Income Tax Appeal) (Jerusalem) 36/88 Shubert v Tax Assessing Officer Misim (Taxes) 5(5) H-95, where it is stated: ‘While it is true that section 86 permits a tax assessor to disregard transactions where the primary objective or one of the primary objectives is the avoidance of tax, but this is on condition that the avoidance is “improper” – ie … lack of bona fides.’ See also ITA 140(89) Dar v Tax Assessing Officer Haifa 4(4) Misim H-116.
3 Prof Glicksberg explains that the

‘difficulties in defining improperness constitutes the central reason for why the improper reduction has not gained popularity in fiscal life, and its effect on the limitations of tax planning is so marginal and perhaps negligible. These difficulties have also brought about, in case law and in the administration of tax, a blurring of the central line which distinguishes between this cause of action and a cause of action of artificiality. In court rulings, one may find a mixture of the “properness” cause of action with the “artificiality” cause of action.’

David Glicksberg The boundaries of tax planning (1990) 261. Thus, for example, in 8/95 Super Chips Marketing 1991 v Assessing Officer Ashkelon, Misim Online, it was said: ‘The respondent is of the opinion that the transaction which found expression in the agreement between the appellant and the previous company … is an artificial transaction whose primary objective is the improper reduction of tax.’ Likewise, in (1994) 29, Yoav Rubinstein & Co v Assessing Officer of Large Enterprises (June 1997) 11(3) Misim H-14 it was stated: ‘An assessing officer refused to recognize
we still need to clarify whether the taxpayer may avoid paying tax by setting up transactions in a specific way, where the sole objective is saving the taxpayer from being taxed, to the extent that, if the tax issue did not exist, the transactions concerned would have been carried out differently.⁴

Sophisticated corporations and taxpayers make extensive use of international tax planning, with the objective of reducing their tax liability to the absolute minimum. Corporations that are spread out across many countries have a greater prospect of reducing their overall tax liability than do local corporations.⁵ In fact, corporations currently have far more freedom with respect to the location of their commercial activities than they had in the past, and it has become more difficult for countries to collect tax revenues from them. Thus, for example, the low tax rates of tax shelters constitute an incentive to channel profits through said countries, and local states find it difficult to collect their share of taxes under such conditions.⁶

Many taxpayers have become global in terms of their business transactions, whereas states inherently remain national. As a result, those entities that are ‘global taxpayers’ manage to avoid paying taxes to the local tax authorities, thus hampering the tax-collecting ability of individual states. The situation concerned is bound to

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⁵ See, for example, S Leblang ‘International double non-taxation’ (1998) *Tax Notes International* 181-3.

⁶ For an elaborate discussion regarding tax shelters, see Avi Nov “‘Tax shelters” and new trends in the international order’ (April 2003) 17(2) *Misim.*
undercut tax revenues, resulting in many situations where such tax avoidance may even threaten the continued existence of the welfare state.

As individual states are aware of the taxation difficulties in an era of globalisation, they are currently trying to design a tax regime that will be compatible with the conditions of the new era, in which capital, humans and services move freely from state to state, while exploiting the taxation gaps existing between respective states. This paper presents two ways of coping with such difficulties; one of which is practised nowadays, whereas the other is a normative practice, which is preferable to the former. The method that is currently in use is one that interferes with the market and which sets norms that serve to neutralise tax planning (which is a concept that is hereinafter referred to as ‘anti-tax avoidance provisions’). The second method, which, in my opinion at least, is preferable to the other, is subject to the principle of ‘non-intervention’, and to the creation of negative incentives for tax planning. In terms of the above, a state that advocates a system of ‘market economy’ should avoid intervening in the market, meaning that it must avoid onerous regulation in connection with tax planning. In my opinion, it is possible to design a tax regime in such a way that it will reduce the incentive to engage in tax planning.

Individual states, including my native country, namely the State of Israel, seem to prefer to develop anti-tax avoidance provisions as part of their battle against tax planners (the first method) as opposed to implementing a method that reduces the incentive for taxpayers to implement tax planning (the second method). This choice, in my opinion, *inter alia*, shows a preference for fairness over economic efficiency. Within this framework of fairness, states seek to reduce any existing social and economic gaps through the enactment of their tax regime, thereby enlarging their tax receipts at the price of hampering economic efficiency (see further discussion of the practice in Chap Three below).

It is important to clarify, however, that even if the tax authorities should succeed in collecting their full onus of taxes from the ‘global taxpayers’ through the increased use of anti-tax avoidance provisions, there is no guarantee that the surplus tax revenues that are likely to accrue therefrom would be efficiently transferred for the purposes of the enhancement of welfare and the reduction of any existing social gaps. It is very possible that the monies that stand to be collected through such a change would be used to lower tax rates still further, which is an action that would,
ironically enough, mainly benefit the rich. Furthermore, anti-tax avoidance provisions inevitably incur a heavy price. From the perspective of the state, the cost of implementing such provisions may, indeed, outweigh the benefit to be gained therefrom, which would necessarily harm the efficient allocation of society’s resources. As a result of the above, I support the use of the second method, in terms of which the state is led to adopt various ways of reducing the incentive for taxpayers to engage in tax planning.

This research paper is structured according to the chapter layout provided in the current paragraph. In the second chapter, I shall discuss the essence of tax planning in general, and of international tax planning in particular. In the third chapter, I shall explain the significance of the taxpayer’s right to engage in tax planning, and the advantages that the state is likely to gain from tax planning. In the fourth chapter, I shall discuss the anti-tax avoidance provisions that are made available in a tax regime. For that purpose, I shall distinguish between general anti-tax avoidance provisions and specific anti-tax avoidance provisions. Similarly, I shall discuss the judicial anti-tax avoidance provisions, and the administrative anti-tax avoidance provisions. In the fifth chapter, I shall analyse the problems encountered with anti-tax avoidance provisions, and the failures that have to be coped with in implementing them, in the form of a legal economic analysis. In the sixth chapter, I shall suggest an appropriate solution to the problem identified.
2. What is tax planning?

2.1 General

For the purpose of this discussion, we shall define tax planning (or tax avoidance) as the use of legal means to reduce tax liabilities. Given the various possibilities for carrying out a certain activity, the tax planner compares various modes of operation and their respective tax results, with the objective of choosing the mode of operation that will yield the most favorable tax result for them.\(^7\) I do not agree with Glicksberg’s view, which states that the central characteristic of the tax planning phenomenon is the abuse of legal institutions and relations in order to minimise the tax liability.\(^8\) In many cases, the tax planner merely chooses the available option that will yield the lesser tax liability, without abusing any legal provision.

In the judgment in the Promdico case, Justice Procaccia explained that the current Israeli tax laws distinguish between legitimate tax planning and tax evasion, with the latter being forbidden under the law.\(^9\) In short, although tax evasion and tax avoidance are both designed to reduce the amount of tax that the taxpayer is required

\(^7\) See Ze’ev Holender ‘Tax planning before engaging in business with the United States’ (January 1988) 2(1) *Misim* A-59, Hollander explains:

‘tax planning is obviously important in the case of each new business, and it makes no difference where it is located. However, where it involves beginning commercial activities in a foreign state by an Israeli company, planning in general and tax planning in particular has many times greater importance, since the Israeli industrialist or service provider is liable to be subject to two factors: the local and the Israeli. Failure to tax plan is liable to affect the competitive ability of the Israeli, or even may remove him from the game. Just like every serious and organized business has to estimate in advance the expenses related to a new activity in order to examine whether the transaction in general is feasible, an Israeli company planning to begin to operate in the United States, must prepare a “business plan” in advance which also includes a description of the operational structure.’

\(^8\) D Glicksberg ‘The Reclassification Authority and the anti-avoidance rules’ (1990) 30 *Mishpatim* 546.

\(^9\) 55/96 The State of Israel v Promedico Ltd (February 1999) 13(1) *Misim* p H-45. Later on: ‘One of the hardest questions in the field of tax policy is where to draw the line between legitimate tax planning and forbidden tax avoidance. Involved in this question is the various policy considerations – from the field of law, economics and ethics.’
to pay, the distinguishing characteristic between the methods concerned is the
different means used for achieving one’s objective. One who avoids tax will
exclusively use legal means, and will, first and foremost, adopt a policy of full and
true disclosure of all the facts. The tax evader, in contrast, will achieve his objective
by way of breaching the law, mainly by way of concealing the facts and making
misrepresentations. According to the words of Justice Procaccia, the boundary that
separates tax avoidance from tax evasion at times wears very thin, but goes to the
root of the distinction between legitimate tax planning and tax evasion, with the
latter, as has previously been stated, being forbidden and constituting an offense
against the law.

2.2 International tax planning

‘International tax planning’ may be defined as using a legal means of organising
one’s international economic activities, with the objective of reducing the overall tax
liability arising from the activities concerned. Taxpayers, and especially
multinational entrepreneurs and/or corporations, tend to make use of international tax
planning mainly by transferring their activities to states with lenient tax policies,
using ‘transfer prices’ and exploiting the differences between taxation provisions
amongst the various international states.\textsuperscript{10} Through these various strategies, the
overall tax liability of an activity may be reduced from ordinary taxation levels (of
between 30 per cent and 40 per cent) to an effective tax rate of 10 per cent, or even
less.\textsuperscript{11}

International tax planning requires an extensive knowledge of taxation, both in
relation to the tax laws of the resident state, and in relation to those of the state of
origin. Said knowledge includes not only the law (legislation, regulations and case
law), but also the norms by which the tax authorities concerned abide. A
multinational corporation that is successful in efficiently reducing its final tax
liability is likely to be more attractive to potential investors, as a reduction in the
level of taxes that has to be paid proves the corporation’s ability to reduce costs and

\textsuperscript{10} See the whole discussion here and below.

\textsuperscript{11} A Levenson ‘Worldly planning for global firms’ (May 1999) \textit{Electronic News} 16.
to enlarge profits. Such is particularly the case when the ramifications of the taxes concerned are applied to public companies.12

In general, it is possible to distinguish between the following two primary international tax planning objectives:

A. **Reducing exposure to double taxation:** With respect to international transactions, a situation of double taxation is likely to be created if more than one country exercises its right to impose tax on the same revenue by virtue of its link to that revenue. A business that is spread over multiple countries is, therefore, required to carry out tax planning, so as to avoid the taxation of its revenues by both the state of residency and the state of origin, amounting to double taxation of the same revenues. Tax planning like this is required in situations where tax treaties do not provide a solution for the problem of double tax. For example, one of the accepted tax plans involved the exploitation of tax treaties by a taxpayer who was resident in a third state that was not party to the treaty, with the objective of enjoying the special benefits or tax relief that was made available through the treaty, to which, otherwise, the taxpayer concerned would not have been entitled. Said resident of the third state could achieve such tax relief by means of, for example, setting up a company in the treaty state. Doing so involved the practice that has previously been referred to as ‘treaty shopping’.13

B. **Reducing the tax burden:** A local business or taxpayer who is exposed to high tax rates in their state of residency is likely to make use of tax planning in order to reduce their overall tax burden. Said reduction is primarily achieved by transferring economic activities to states that offer tax relief. Similarly to traditional tax planning that is conducted within the state, the objective of international tax planning is to reduce the tax burden on the taxpayer. When he

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13 For an elaborate discussion regarding this, see Moshe Shekel ‘Treaty shopping – the authority of the assessing officer to lift the corporate veil on international transactions’ (February 2001) 16(1) *Misim* A-24.
makes use of transfer prices, or when the business activities are transferred to a tax shelter, the taxpayer claims that the income originated in another country and, therefore, is not liable for tax in his original place of residence. The use of tax arbitrage is slightly more complicated, with the objective of such use being to exploit the gaps that exist between the taxation provisions amongst the various states, and thus to reduce the tax burden.\textsuperscript{14}

For the purpose of achieving said objectives, it is customary to make use of two important strategies:\textsuperscript{15} tax shelters and transfer pricing. The two strategies are described below.

**Tax shelters:** An accepted form of tax planning is the use of foreign corporations that are registered in tax shelters. As an example of such a tax shelter, many individuals prefer to register companies in the British Virgin Islands (BVI)\textsuperscript{16} for various reasons, *inter alia*, the convenience of registering and incorporating companies, the low costs (approximately US$1 000), the political and economic stability, the advanced banking infrastructure, and the existence of a high level of local professional services in said territory.

There are two main advantages to registering a company in a tax shelter: the low corporate tax rate and the reduced exposure to deducting tax at source. In the event that the shareholders in the company decide not to withdraw a dividend, one


\textsuperscript{15}Other important strategies include, *inter alia*, using ‘thin financing’ and foreign trusts. A discussion of these strategies is beyond the scope of this article.

\textsuperscript{16}The British Virgin Islands are made up of 36 islands that are located in the Caribbean Sea. From a legal standpoint, the Virgin Islands enjoy complete autonomy from Britain, except for various issues, such as foreign affairs and defence.
may enjoy the advantages of deferring taxes (with deferred tax generally being considered to be saved tax). The monies concerned can be continued to be invested in other business activities, meaning that one then avoids paying taxes in the country of residence.

One of the uses of a company that is registered in a tax shelter is for the holding of intellectual property. The owner of the intellectual property (who, generally speaking, is from a state with high tax rates) transfers such property to a corporation in a tax shelter, with the latter granting the rights of use thereof. In this way, the owner of the revenues that are received from the royalties consequently benefits from the low rate of taxation imposed in the tax shelter.

A further use of a tax shelter concerns registering a ‘financing corporation’ in a tax shelter, in which case the sole objective is the provision of intergroup loans. As in the previous example, the owner of the revenues from the interest benefits from the low tax rate imposed. The recipient of the loans, who is, generally speaking, related to the corporation providing the loan, can benefit from the deduction of the interest expense. In certain situations, one may arrange a complex structure, resulting in a double deduction of the interest expense. For example, if a multinational parent company, residing in South Africa, obtains financing from a local bank, with the financing, in turn, being passed onto a corporation that is registered in a tax shelter, the latter may then lend money to the other subsidiary companies in the group. In such a case, both the parent and the subsidiary companies could potentially benefit from the deduction of an interest expense for tax purposes.

It should be noted that a corporation that is registered in the BVI would be considered as an ‘Israeli resident’ under the Israeli Income Tax Ordinance, in the event that the ‘control and management’ are performed in Israel\(^\text{17}\) (with the situation being similar to that in many other jurisdictions). In order for the company to qualify as a foreign resident, one must ensure that the control of the business and its

\(17\) Regarding the interpretation of the term ‘Control and management’, there are differences of opinion. For a summary of the various approaches in this regard, see 175/90 Solele Boneh Overseas Ltd, Solele Boneh Development (April 1994) 8(2) Misim H-8. Regarding the tests for establishing the main place of activities, see the interpretation file of the Income Tax Ordinance at A-10. See also ‘Guidelines for establishing control and management’ (2002) 8(2) Income Tax Circular 4, 16(2) Misim C-6.
management activities are not carried out in Israel. Such control includes the administration of the business, the preparation and management of the accounting function, and the passing of any company resolutions.

Great caution is, therefore, required when forming a company that is incorporated in a tax shelter. In the event that a company serves as a ‘conduit company’ (i.e. a company lacking any business or economic substance) for the conduct of international business activities, the tax authorities in various countries may tend to seek to disregard it, thus exposing the tax planning to collapse. This issue will be discussed in Chap Four below.

**Transfer pricing:** Another acceptable tax planning technique is the use of transfer pricing. In order to explain said technique, it should be noted that elements of the commercial activities of a multinational corporation are carried out within companies that are under identical ownership, or between companies that have a special relationship between themselves.

The transactions between related companies could include, *inter alia*, the provision of services, the sale of goods, the granting of licenses to use intellectual property, and the provision of financing. In all such cases, the transaction price does not necessarily reflect the market price. One of the objectives of the controlling shareholders of multinational corporations is to channel group revenues to the companies operating in the low tax rate jurisdictions, and to charge the expenses to the countries in the high tax rate jurisdictions. A further possibility is to channel the revenues to a company that has commercial losses that have been built up over a number of years. The low tax rates in tax shelters constitute an incentive to channel the revenues to said destinations. Therefore, the technique of combining the use of transfer pricing with the employment of tax shelters is commonplace for many global businesses.

The above-mentioned method of tax planning, entailing the channeling of revenues from one country to another, causes much anxiety for tax authorities worldwide. The optimal situation is where all states can impose tax on the real profit that has been produced within their borders. However, achieving said goal is a

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18 For an elaborate discussion of this issue, see Avi Nov ‘Transfer prices in an era of globalization’ (October 2004) 18(5) *Misim.*
complicated issue. It is important to remember that the prices that are set between the contracting parties do not necessarily attest to an improper reduction of tax. Likewise, there is great difficulty in revealing the ‘real (economic) price’ of a transaction. The problem is exacerbated by the fact that the tax authorities do not always have a clear policy in this regard, resulting in the issue becoming a battlefield between the authorities and the taxpayers, who try to convince the assessing officer that the prices that were used to transact were, in fact, ‘real’. There is no doubt that one of the ultimate tax planning tools for a multinational business is the use of transfer pricing, and, in the current context, it is clear that taxpayers hold an advantage of information over the respective tax authorities. It, therefore, appears, \textit{prima facie}, that, in an era of globalisation, it is almost impossible for tax authorities to prevent the misuse of transfer pricing.
3. The rights of the taxpayer to participate in tax planning

3.1 The importance of tax planning

Tax planning is one of the most important elements in the life of a business, and it would be negligent to make commercial decisions without paying due attention to the tax implications of the actions concerned, and, naturally, exploring the possibility of lowering the tax burden involved. Given said context, international tax planning is an important tool for enabling the significant lowering of the tax burden.

Lowering the tax burden contributes towards the profitability of a company in exactly the same way as does any other revenue component. Therefore, the rationale of ‘maximising profits’ applies equally to tax planning. In the case of directors and trustees, it appears that they have a fiduciary duty under the law to reduce, as much as possible and within the framework of the law, the tax liability of the company and of its beneficiaries, as the case may be.

It is generally universally agreed that the taxpayer has no duty, either ethically or patriotically, to choose to submit to the dictates of a high tax business structure. The question is whether creating a low tax structure attracts any problems. The then Israeli Supreme Court President – Shamgar – held that the rights, and even the duties of tax law experts, were to plan legal transactions in a way that there ‘will not be a high tax’19:

‘The very fact that the parties chose a low structure of taxes does not indicate that the structure was “artificial” or a “lie”. It is the right – and

19 4639/91 Director of Betterment Tax v Hazon 48(3) Piskei Din 156, 168. Later on Shamgar says:

‘The main rule, to my mind, is that a legal exemption or relief does not detract from their force and does not detract from their force and does not suspend their applicability with regard to a specific person merely because the involved party seeks cover under their wings in order not to pay tax. A person may exploit any provisions in the law which exempts him from tax or provides a relief since it was created for this purpose, and this is obviously so long as he does not by his actions attempt to pervert the intent of the legislature or do any deed which is unlawful in order to enter within the bounds of an exemption or relief which was not designed for him.’

I should note that, in the Hazon judgment, Justice Shamgar was in the minority opinion, but his opinion was accepted in a later opinion – in Boaz Levi v Director of Betterment T/2 Misim H-209.
even the duty – of tax experts to plan legal transactions in such a way that there will not be high taxes. The question as to where to place the limits of tax planning is a classic and eternal question which has been established pursuant to the specific circumstances in each and every case.’

Justice Shamgar based his view on the famous words of Justice Learned Hand in the Helvering v Gregory case:

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

A similar principle, which has been referred to as ‘The Duke of Westminster principle’, may also be found in English law. The principle, which was established by Lord Justice Tomlin, is given as follows:

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

3.2 The nature of the right to tax planning

In relation to the nature of the right, Prof Glicksberg is of the opinion that one must look upon the right to tax planning from a constitutional perspective. In his words, the tax authorities who gnaw at the wealth of the taxpayer through their demand to pay tax are no different, from a qualitative perspective, than any other governmental

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20 Helvering v Gregory 69 F.2d 809, 810 (2d Cir 1934) affd, 293 US 465 (1935).


22 Glicksberg supra note 3 at 29.
activities (such as expropriation) that harm the proprietary right.\textsuperscript{23} Since the very imposition of taxes constitutes harm to property, it needs to comply with the restrictions that were established in the Basic Law: Human Dignity and Liberty.\textsuperscript{24} Justice H. Cohen insists upon the above when he states:

‘Imposing taxes as lawful harm to the right to property has been accepted in all legal systems, in every place and in every period as a necessity which cannot be condemned. Even so, with regard to “necessary” harm the legislature is faced not only with the question of proportion if it does not “go beyond what is necessary”, but also with the question of purpose, if it is really “fitting” (section 8). Take, for example travel tax: if the purpose is to limit the freedom of movement abroad then one may suspect that the purpose is unfitting, and merely for the fact that this tax does not only harm property but also liberty (section 6); if its purpose is to increase revenues for the State, it is possible that the purpose will be considered fitting, taking into consideration the needs of treasury during that period.’\textsuperscript{25}

\textsuperscript{23} The former Israeli Supreme Court president Aharon Barak has said in this regard: ‘Taxation is a unique authority given to the public administration. The uniqueness of this authority stems from the fact that it allows the regime to harm private property and even grants it far reaching rights of investigation and enforcement for the purpose of reaching this objective.’ CAA 291/99 DND Jerusalem Stone Suppliers v Director of Value Added Tax 18(3) Misim II-78. For this reason, one may only impose tax within the confines of the Law, or by virtue thereof (s 1(a) of the ‘Basic Law: State Economy’). See also D Elkins ‘Tax as harm to property’ in Shamgar Book – essays (part 3 2003) 529. A Yoren ‘The constitutional revolution in Israeli taxation’ (1994) 23(55) Mishpatim.

\textsuperscript{24} Pursuant to the limitation clause (s 8 of the Basic Law), this law may harm a proprietary right upon the fulfilment of four cumulative conditions: (1) the harm must be done under the law, or in accordance with the law by virtue of the explicit authority therein; (2) the harmful law must befit the values of the State of Israel; (3) the harmful law is designated for a fitting purpose; (4) the law harms the human right to a degree that does not exceed that which is necessary.

\textsuperscript{25} Haim Cohn, ‘Values of a Jewish and a democratic state, studies of the Basic Law: Human Dignity and Liberty’, Haprlklt, Sefer Hayovel (1993) 42. Prof Yoren, likewise, believes that the ‘very imposition of tax is harmful to the property of an individual as it takes money away from him and transfers it to the regime. Taking away property needs to withstand the test of fitting purpose and a fitting measure.’ See A Yoren ‘The constitutional revolution in Israeli taxation’ Mishpatim 55 60. This viewpoint is accepted by the learned Robert Nozick and Richard Epstein from the United States. See R Nozik Anarchy, state and Utopia (1974). Richard Epstein Takings, private property
We may conclude that the right to tax planning stems directly from the basic constitutional right that grants protection to private property, since tax planning seeks to protect one’s property from expropriation by the governmental authorities. For said reason, one should relate with appropriate caution to tax planning, and to any governmental activity that is designed to deal with the tax planning of the taxpayer, as needing to comply with the constitutional limits.26

3.3 The advantages for the state to be gained from tax planning

Alongside the protection of the basic human rights, there are other considerations that support tax planning. Firstly, the reduction of tax causes a reduction in government expenses in general, and a reduction in the expenses on welfare, in particular. Thus, it emerges that tax planning constitutes a quasi means of pressure on the government to reduce redundant expenses, to streamline itself, and to focus on

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26 In said respect, Judge Vitkin has held that the courts need to adopt a neutral stance with regard to tax planning:

‘Why has there been anger against the taxpayer, who seeks to organize his lifestyle within the framework of the Law while taking into account the tax burden? It would be fitting if the courts adopted a neutral stance and did not look askance at legal activities even if they contained within them an exposure of the weak points of the Law’s provisions, just as we certainly would not feel that we had to assist the taxpayer to choose the path which ended with a tax charge at a time when he could have chosen a path that did not end with a tax charge.’

the narrow fields in which it needs to be active – mainly in the defence and the protection of property, and in the enforcement of tax obligations.27

Secondly, given the high tax rates imposed, tax planning enables a reduction of the tax burden, and is responsible for the fact that important investments are made in the economy. Clearly, it would be preferable for the tax rates to be as low as possible, so that they would allow only for the minimal and necessary financing of public expenses. However, since the above has not been made possible, due to the narrow nature of considerations (such as political influences), tax planning constitutes the last solution that enables the carrying out of said investments.28

Thirdly, tax planners tend to increase their amount of wealth by reducing their degree of exposure to their tax, and thus they tend to maximise their wealth. Pursuant to the liberal economic theory, a maximisation of private wealth necessarily leads to a maximisation of the wealth of society in general.29

Countries, generally speaking, do not accept the above-mentioned claims, leading to them adopting all means possible in order to prevent tax planning, while simultaneously preserving their inefficient tax regimes. In my opinion, the main reason for said opposition stems from their will to preserve the traditional role of the tax system as a reducer of social and economic gaps. Countries tend to believe that, over and above the role of the tax system to finance public resources, the system has a role to play in promoting the principles of social justice.30

27 Glicksberg supra note 3 at 62 does not accept this claim. Nevertheless, Glicksberg is of the opinion that, at times, tax planning does have positive effects. Since such planning is likely to create social discontent, as a result of the inequality experienced in bearing the tax burden, it is likely to prompt reform to take place in the tax structure, while, simultaneously, there is a reduction of tax rates, and an expansion of the tax base (ibid at 63).

28 Glicksberg supra note 3 62 does not accept this claim.

29 Glicksberg supra note 3 62 does not accept this claim, since, according to him, in reality there is no sophisticated competition.

30 In this regard, Aharon Barak states:

'...the purposes underlying tax legislation are the same objectives, values, interests, that the Tax Law has been designed to attain. In the close circle the objective is the assurance of revenue for the treasury of the Public Authority. This, for the main part is the immediate objective. It is not the sole objective. Against the backdrop of this immediate objective
The accepted claim is that, as long as the progressive tax system collects more tax than it has done in the past, it will be able to continue financing the state’s welfare expenses and so help to reduce the gaps between the rich and the poor.

It appears that states believe that they can realise the principles of social justice in relation to international tax planning, both by neutralising such tax plans and by creating equality between the tax planning group and those who are unable to plan. However, as I have already explained elsewhere, the international taxation arena makes it difficult to implement the principles of justice within a tax regime, and state intentions appear to be utopian.

there are likely to be other objectives of a societal nature. Tax is a social tool, through which society battles against phenomena which are conceived as negative. It encourages actions which we wish to encourage. It deters action which we wish others to be deterred from… it brings about a redistribution of the means of production. All these and many others are the goals of the tax laws.’


Regarding the matter, Glicksberg supra note 3 39 states:

‘Any tax planning that harms the break-even point chosen by the legislature between the principle of the ability to pay and the realization of social policy and/or economic policy, through the tax system, constitutes harm to the non planning group by the fact that it imposes upon it an additional tax burden, over and above the tax burden which was derived from the said break-even point.’


‘The possibility of evading tax and the increasing competition between the various states for residents (especially when it involves multinational companies) alongside the possibility which has become more and more acceptable amongst individuals to transfer their domicile for tax consideration, have all turned the international taxation arena into a very problematic arena from the perspective of the existence of a just distribution of the tax burden amongst various groups within the state, and it places in doubt the very ability of the states to use the tax system as a tool for redistributing wealth in society.’
4. Anti-tax avoidance provisions

4.1 General

In the Promedico judgment, Justice Procaccia distinguishes between statutory anti-tax avoidance provisions and judicial anti-tax avoidance provisions:33

‘…the legislature and case law have created various avenues for coping with various situations of tax avoidance which use strategies to exploit lacunae in the law, and two of these avenues are: one – the product of legislation - deals with the question when a transaction becomes artificial or false which in its wake results in a forbidden tax evasion and what is the true transaction or true activities whose attributes need to serve as the basis for testing the tax burden. The second – the product of case law – which complements the first and applies also in the case where it does not involve a false or artificial transaction – places its objective at investigating the degree of authenticity of contractual provisions which underlie the transaction in the hope of neutralizing the fake provisions which do not accord with the true reality, and all of this in order to reach a point where one can investigate the true factual and legal reality which is supposed to serve as a basis for testing the tax liability.’

Another distinction exists between general anti-tax avoidance provisions and specific anti-tax avoidance provisions. The term ‘anti-tax avoidance provisions’ includes general, statutory or judicial anti-tax avoidance provisions that are found in the various tax regimes, and which are designed to deal with all types of tax planning, and specific statutory anti-tax avoidance provisions, which serve to delineate specific

33 State of Israel v Promedico Ltd (February 1999) 13(1) Misim H-45. Later, Procaccia holds:

‘The two stated ways of testing have as their goal lifting the veil, or laying bare the inauthentic external robes from the transaction or from commercial activities with the aim of investigating their authenticity, and all of this is done in order to examine the true transaction or the true activities which are occurring in reality and whether or not it creates a tax event, who are those with the tax liability, and what is the correct geographical location of the source of income.’

See also the decision in the appeal in 2602/99 Hurwitz et al v The State of Israel (October 2000) 14(5) Misim H-76.
factual infrastructures. In relation to international tax planning, one may identify the use of both general statutory anti-tax avoidance provisions and specific anti-tax avoidance provisions.

4.2 General anti-tax avoidance provisions

The existence of general anti-tax avoidance provisions changes from state to state. Thus, for example, such provisions are not acceptable in the United States, where the emphasis has been placed on the development of judicial anti-tax avoidance provisions. In Israel, where said provisions have not been developed, the use of general anti-tax avoidance provisions has assumed a main role in the tax system.

Section 86 of the Income Tax Ordinance of Israel establishes general anti-tax avoidance provisions. This section establishes, inter alia, that a transaction that was carried out by the taxpayer, and which was found to be artificial by the assessing officer, may be disregarded. The implications of being disregarded are that the transaction is now reclassified by the assessing officer according to its real nature, and a tax liability is established pursuant to the reclassification. Case law has dealt

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35 In this regard, see Cooper GS ‘International experience with general anti-avoidance rules’ (2001) 54 SMU Law Review 83-130.

36 In fact, s 86 establishes four causes of action for disregarding a transaction: an artificial transaction; a fictitious transaction; a certain disposition was not, in fact, carried out; or one of the principal objectives of a particular transaction is an improper reduction of tax. The last cause of action is not operable, because of the vagueness of the concept of ‘improper’. The existence of said concept, in fact, creates a vicious cycle, since the whole objective of s 86 is to define improprieness.

37 For a comprehensive survey of the case law, see A Raphael Income tax vol 5 (2002) 629-70.

38 David Glicksberg supra note 3 at 17. Glicksberg distinguishes between a ‘different classification’, which constitutes a previous proceeding from a chronological perspective, and a ‘reclassification’. At embarking on the proceeding of a different classification, one implements the tax provisions without having to rely on anti-tax avoidance provisions, and only in the second stage does one implement a reclassification (ibid at 18). Likewise, see A Yoren ‘Different classification of a transaction for tax purposes and the correct location of an artificial transaction’ 20 Mishpatim 43, 48:

‘Only if the implementation of the definitions of civil law and of tax laws with regard to the facts of the relevant tax leads to a result, where it is not possible to classify the
a great deal with the question of how to establish the nature of an artificial transaction. In Glicksberg's opinion, the dilemma of classifying, or of distinguishing between, the real transaction and the artificial transaction is very difficult.

39 Case law has developed various tests to establish the artificiality of a transaction. At the beginning of such law, the accepted modes test was established (CA 102/59 Assessing Officer Jerusalem v Ismar Investments and Trading Ltd 14 Piskei Din 2165). Later on, the ‘transaction purpose’ test was adopted as the test for testing artificiality (Mapi case CA 265/67 Mapi Ltd v Pashmag 21(2) Piskei Din 593). Judge Vitkin noted, in a later case, that the reason that is required is not just any kind of reason, but must be a commercial reason (CA 11/74 Assessing Officer for Large Enterprises v Israeli Film Studios Ltd 29(1) Piskei Din 297, 302). See the summary of the laws in this regard in CA 3415/97 Assesing Officer for Large Enterprises v Yoav Rubinstein and the Building Developing and Financing Partnership Company Ltd 17(4) Misim H-59. In said judgment, it was also stated that a similar concept guided the American courts, which drew the dividing line between legitimate tax planning and illegitimate tax planning, pursuant to the commercial objective of the transaction (see Gregory v Helvering 293 US 465, 55 SCt p 266 [1935]; Commissioner v Estate of Bedford 325 US 283 65 SCt p1157 [1945]; National Carbide Corp v Commissioner 336 US 422 69 SCt p 726 [1949]).

40 With regard to the difficulties of distinguishing between a fictitious and artificial transaction, see 4051/95 Assessing Officer v Barzany 52(2) Piskei Din 269.
within it. The legislature did not define what “artificiality” is and left that
difficult task to the judiciary….”41

The courts have developed various tests in order to establish the artificiality of
transactions.42 Nowadays, the common trend in case law is to examine the purpose
underlying the transaction, while focusing on the reasons for performing it, the way
in which it was performed, and whether there were commercial/economic reasons for
it to be performed, over and above the tax considerations concerned.43 The principle
concerned was enunciated in the Ta'as Mor judgment by the then Associate Justice
Barak:

‘In light of all the considerations taken into account when interpreting the
aforementioned section 84 (and similar provisions may also be found in
other Tax Laws) the following criterion has been adopted in order to test
whether artificiality has been proven, which in turn permits the
intervention of the tax authorities: if a credible reason is cited for
performing the transaction in a specific way, and this reason is not the wish
to evade paying tax, then no permission shall be given, i.e. the tax
authorities shall not then be permitted to disregard the (split) form which
the transaction or transactions assumed….’44

Nevertheless, in my opinion, there is a constitutional problem with accepting such an
interpretation. The problem involves, prima facie, a subjective test: it is sufficient for
the taxpayer to cite a specific reason for having performed the transaction in the way
in which he chose, which is not the wish to have evaded paying taxes, allowing for
his ‘rescue’ from the anti-planning provision. Where the transactions are not tested

41 Glicksberg supra note 3.

42 It is important to clarify that the anti-planning provisions in s 86 are so general and vague that the
courts have been forced to fill the lacunae in this provision with content through its interpretive
work. Judge Vitkin has, in this regard, held that the ‘provision is rich in its emotional power, but
poor in its conceptual content”; Alfred Vitkin ‘Problems with interpreting tax laws’ 3 Mishpatim 10.

43 See, for example, 252/87 Gachelet Investments Company Ltd v Director of Customs 45(1) Piskei
Din Yisraeli 245, 248; A Yoren, ‘Different classification of a transaction for tax purposes and the
correct location of an artificial transaction’ 20 Mishpatim 43, 47.

44 Ta’as Mor v Director of Betterment Tax 37(1) Piskei Din 441.
by objective parameters, a situation is likely to be created where two taxpayers, who
are carrying out similar transactions, to whom the same tax liability, *prima facie*,
should apply, would, in practice, be treated, unjustly, differently from each another.
Such a situation is bound to arise where taxpayer A ‘invents’ a commercial reason
that is acceptable to the tax authorities, whereas taxpayer B does not declare the
‘correct’ objective, or his claim is dismissed. It is appropriate, regarding this matter,
to quote from the words of Judge Vitkin, rendered in the Mapi case:

‘On more than one occasion I have expressed my doubts regarding the
principle contained in the provision of section 86, which authorizes an
assessing officer to disregard an artificial transaction. I always saw danger
in the fact that a provision such as this is bound to teach the citizen
hypocrisy. He need only invent some serious reason for his actions aside
from the reason to reduce the tax burden, and he would then escape the
provision’s decree. In the majority of cases, a transaction will have several
different reasons, and we cannot examine the true intentions of each person
in order to establish what the definitive reason was.’

4.3 **Specific anti-tax avoidance provisions in the field of international taxation**

Many states have established specific anti-tax avoidance provisions in their
legislation, in order to cope with well-known types of tax planning. In the field of
international taxation, specific anti-tax avoidance provisions have been adopted by
many different states around the world.

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45 Mapi v Assessing Officer of Large Enterprises 21(2) *Piskei Din* 593. Justice Shamgar in the Ta’as
Mor case, ibid relies on these words of Vitkin, and holds:

‘There is a difficulty in establishing the exact fields when one comes to pass judgment on
whether a transaction is artificial, and in the entire constitutional arrangement there is a
latent danger that the person obligated to pay tax will hide his true intentions and will
raise false reasons in order not to reveal that in fact it is aimed at not paying taxes, and
thereby this indirectly teaches the citizen to act hypocritically.’
The first type deals with the rules governing controlled foreign corporations (CFC), and the second with the issue of transfer prices. Said two provisions were inserted into the Israeli Income Tax Ordinance in the wake of the comprehensive tax reforms that took place in 2002.

In addition to such provisions, there are two other anti-tax avoidance provisions that were inserted at the same time into the Ordinance, which relate mainly to individuals. One deals with individuals who provide various services through corporations that they own. The tax planning that the provision was introduced to counter works as follows. The taxpayer is likely to establish a company abroad, through which he will carry out his occupational activities. The company will not be taxed in Israel (if the ‘control and management from Israel’ test does not apply to it), and the tax will be charged in Israel only if the taxpayer receives a dividend from the company, in which case it will be charged at a reduced tax rate (in the form of a tax rate of 25 per cent on the dividend, instead of in the form of a marginal tax rate on his income resulting from his occupation). Pursuant to s 5(5) of the Ordinance, in order to avoid the possibility of evading payment of tax on income received from the occupation abroad, through the activities of a foreign corporation, it has been held that a company with a minority ownership of foreign residents, where 75 per cent or more of one or more of the means of control in it is held by individual Israel residents who are the holders of an occupation or a profession designated by the Minister of Finance as an occupation for the purposes of this section, shall be viewed as if the control and management of its businesses were activated from Israel.

46 Concerning said rules, see Avi Nov ‘The transition to personal taxation and the CFC issue’ (April 2002) 15(2) Misim A-11.

47 For a broader treatment of the matter, see Avi Nov ‘Transfer prices in an age of globalization’ (October 2004) 18(5) Misim.


49 See Income Tax Circular: ‘Reforms in income tax’ – international taxation (IT 21/02) 17(1) Misim C 106.
Another provision is known as the ‘exit tax’. Section 100A, which was added to the Ordinance in the wake of the tax reforms, was introduced as a solution to the following situation:

‘An Israeli resident holds property overseas. If the asset is sold while he is still an Israeli resident this sale will be taxed in Israel under section 89(b) (1). In contradistinction if that Israeli resident becomes a foreign resident and only after that it sells the same asset, no tax liability will be incurred in Israel since the seller is a foreign resident and the asset sold overseas has no connection to Israel.’\(^{50}\)

To deal with said situation, s 100A(a) was added, which establishes: ‘The asset of a person who was an Israeli resident and ceased being an Israeli resident shall be deemed to have been sold one day before he ceased being an Israeli resident.’ In such a case, tax should be paid as if the asset had been sold for its market price. The taxpayer can choose not to pay the tax on the date that he changes his residence, but rather on the date of realisation (being the date on when the asset was actually sold). The Commissioner of Income Tax has clarified, that this alternate option has not deferred the tax event, but has merely deferred the date of payment.\(^{51}\)

The tax authorities believe that such provisions arm them with anti-tax avoidance tools that assist them in attacking the phenomenon of international tax planning. However, as I shall explain in Chap Five below, said provisions, and especially the first and second one (the CFC provisions and the transfer prices), do not deal with the problem that they were designed to tackle, with the lion’s share of the revenues successfully evading tax being applied to them. The reality is that such provisions are complicated and redundant, and that they may even miss their target.

### 4.4 Judicial anti-tax avoidance provisions

Alongside the statutory anti-tax avoidance provisions, over the years judicial anti-tax avoidance provisions have been developed that enable the courts to attack various tax

\(^{50}\) Ibid.

\(^{51}\) Ibid.
plans. The central rule, which has been developed in many countries, is the ‘Substance over Form Doctrine’, which has constituted the primary doctrine. Over the years, it has begat a number of secondary doctrines, such as the ‘Business Purpose Doctrine’, the ‘Economic Substance Doctrine’, and the ‘Step Transaction Doctrine’.


Thus, for example, Justice Blackmun has held: ‘In applying this doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed.’ The Court has never regarded ‘the simple expedient of drawing up papers’, Commissioner v Tower [1946], as controlling for tax purposes when the objective economic realities are to the contrary. ‘In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding…’ (Frank Lyon v US 55 LED 2d 550). See also: Allen D Madison ‘The tension between textualism and substance-over-form doctrines in tax law’ (2003) 43 Santa Clara Law Review 699; Joseph Isenberg ‘Musing on form and substance and form in taxation’ (1982) 49 Chi L Rev 859.

David Glicksberg supra note 3 at 122.


I should note that this doctrine was discussed in the TMB case, in which it was held that, if the assessing officer is of the opinion that the economic activities in fact constitute essentially one transaction that has artificially been split into a number of separate activities in order to avoid paying tax, the assessing officer can regard the transaction as one complete transaction 83/81 TMB v Assessing Officer, Haifa, 40(3) Peskei Din 402. A similar holding can be found in the Zohar case regarding s 84 of The Land Taxation Law, in which it was held that splitting a transaction into two agreements, with one for the purchase of the land, and with the other for building thereon, is an
The Substance over Form Doctrine, which was developed in the United States and in England, has been accepted into Israeli case law. Thus, for example, Judge Bracha Ofir-Tom, basing herself on the law that has become widespread in Israel holds that:

‘The description of the transaction in the agreement in proprietary terms that is supposed to place them prima facie within the definition of a tax relief provides us with no guarantee that this indeed is the true nature of that transaction. For the transaction to fall within the definition of the reliefs which apply to transactions of this type it is insufficient that it be done by the stroke of the pen of the drafters of the agreement, and by selective use of this or that legal term. For this purpose one needs to conduct an investigation of the transaction on its merits; and this applies even if the parties thereto genuinely believed that the use they were making of the various terms was correct and was in congruence with what had been agreed.’

In the judgment in the Chachkes case, Justice Beinish held: ‘Fiscal laws which have been designed to impose tax (such as the Land Betterment Tax Law and the Income Tax Ordinance) are based on the principle that tax should be imposed in accordance with the economic nature or economic content of the activities which the legislature

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58 See, for example, IRC v Burmah Oil Co Ltd [1981] 54 TC 200, Furniss v Dawson [1984] AC 474.

59 Dan Makov v Income Tax Assessor, Tel Aviv, (April 2002) 16(2) 4 Misim H-25, 183. See also 175/79 Director of Land Betterment Tax v Avivit Ltd 34(1) Piskei Din 802, 804; as well as Director of Land Betterment Tax v SAP Corp Ltd 41(3) Piskei Din 735, 738. It appears that a judicial anti-tax avoidance provision was first applied in Israel in the Shaffer case 734/74 Arnold and Maude Shaffer v Director of Purchase Tax 30(1) Piskei Din 271. In this regard, see also YM Edre’I ‘The theoretical basis for new trends in case law: the definition of income, rules for accepting and deducting interest expenses, a single transaction and offsetting losses; on the status of the salaried taxpayer’ (1996) 20(2) Iyuney Mishpat 283, 325.

60 14/95 Shlomo Sharon v National Assessing Officer (December 1988) 12(6) Misin H-12.
intends to tax. The above-mentioned principle involves rules that permit the reclassification of transactions, in a way that is distinct from the classification authority that is covered in s 86. Judge Bracha Ofir-Tom views said rule as part of the interpretive process, and, accordingly, she holds: “The clear trend prevalent today in the field of interpretation in general, and in the field of fiscal interpretation in particular is essentially the Substance over Form doctrine which disregards the external form of the transaction under discussion, while emphasizing the substance.” It is important to clarify that such treatment does not amount to a complete disregard, and should be done on a balance of probability.

61 3257/96, 4539/96 Donin D Chachkes Axelbord and Arad Eliyahu v Director of Purchase Tax Hadera District 12(6) Misim H-61.

62 Prof Yoren, in ‘Different classification of a transaction for tax purposes and the correct spotting of an artificial transaction’ Mishpatim vol 2 43, states that he believes that we only require the test of artificiality of a transaction within the definition of the aforementioned s 86 after it has been established as a factual holding, and that the terminology used by the parties to describe the transaction under dispute should fit its content. If it has been held that the transaction that was performed is different from the transaction that was described by the parties thereto, the transaction shall be taxed in accordance with the factual and legal reality, and there will no longer be a need to rely upon s 86. Such a position has been accepted in the judgment in 8522/96 Rochwerger Rothmans Building Corporation v Assessing Officer, Tel Aviv 1, (June 1997) 11(3) Misim H-3.

63 43/95 American-Israeli Gas Corporation Ltd v Assessing Officer of Large Enterprises (October 2001) 15(5) Misim H-109. In said context, it would also be apt to quote the words of Justice M Heshin in FCH 3017/91 Hazon v Director of Land Betterment Tax 49(2) Piskei Din Yisraeli 709, 730: “…we should examine the transaction in accordance with its economic content and not according to the legal cloth in which the parties clothed it, and even not according to the formal law which applies to it’.

64 In said regard, Amnon Raphael establishes that the tax authorities’ examination of the transaction from the perspective of its economic content while ignoring the way in which it is worded and the form which it is given does not fall in line with the doctrine of honoring the “transaction as it was performed” perspective of its economic content while ignoring the way in which it is worded and the form which it is given does not fall in line with the doctrine of honoring the “transaction as it was performed”. Just as it has been held that one should not accept the taxpayer’s claim in terms of which the significance of the transaction should be interpreted differently from the significance that has been granted to it by the form in which he chose to perform it, when such form has made tax more onerous, merely because it could have been performed in a different way, there is also a difficulty in accepting a similar claim (made in the opposite direction), when it is made by the tax
4.5 Administrative and other anti-tax avoidance provisions

Tax authorities in various countries have understood that, in addition to the anti-tax avoidance provisions that were surveyed (and which amounted to a direct attack), tax planners must be contended with in other ways (by means of indirect attack). The tax authorities hope that, through an ‘indirect attack’, it would be possible to block many different types of tax plans. The indirect ways of fighting against tax plans include the following:

(1) The battle against tax advisers. In the United States, there is a regulation that requires attorneys and accountants who sell tax plans to their clients to deliver a report to the tax authorities concerning the potential tax plan, before they can sell the tax plan concerned to a client. In February 2003, the United States tax authorities published regulations, by virtue of art 6011, 6111 and 6112 of the Federal Income Tax Act of 1986, which require reporting in relation to different types of specific tax planning and in terms of various criteria, including tax plans that are based on ‘exploiting losses’ above a specific amount. Likewise, advance reporting is required for tax plans in which there is a significant gap between the amount of profit recorded in terms of the tax laws and the amount of profit recorded in terms of the generally accepted accounting principles.

(2) Restrictions on participating in government contracts. In some of the states in the United States, such as California and North Carolina, certain rules restrict the governmental authorities from signing agreements with companies that are registered in tax shelters. Likewise, federal legislation restricts

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65 For an elaborate discussion in this regard, see Stephen G Vogelsang ‘The final tax shelter disclosure rules: reporting, registration, and list maintenance requirements’ (May 2004) Florida Bar Journal.

entering into a contract with American companies that have ‘immigrated’ to the 
tax shelters.67

(3) Restrictions on deducting expenses. Various countries, including 
Belgium, Spain, France, and Portugal, have established that, in certain cases, the 
tax authorities will not recognise a deduction for expenses that are paid to 
corporations that are registered in tax shelters.

(4) Exchanging information between countries on tax issues. In the event 
that a specific country offers an attractive tax regime to residents of other 
countries, and it does not reveal information to the tax authorities in the other 
countries in relation to the taxpayers concerned, the latter are likely not to 
collect tax from said taxpayers.68 A state that does not provide information to 
other states is, in fact, assisting the taxpayers from said states to evade tax. 
Exchanging information between states, in the context identified, assists 
countries to inspect the international tax planning affairs of the taxpayers 
concerned, to attack their legality, and also to prepare to deal with such a 
phenomenon in advance, from a legislative and regulatory perspective. The 
information issue is one of the most important components in the battle that 
countries have conducted against tax planners. The mutual exchange of 
information between countries on tax issues that are of common interest could 
be conducted in three main ways: by means of an agreement between two states 
(ie a bilateral treaty), by means of an agreement between the countries that are 
located within a specific region, as well as by means of a global agreement 
between many different countries (ie a multilateral agreement).

67 Homeland Security Act of 2002, Pub L no 107-296, s 835(a) [2002].

68 For an elaborate discussion of said matter, see Avi Nov ‘Exchanging information between states on 
5. The problem with anti-tax avoidance provisions

5.1 Failures related to anti-tax avoidance provisions

For the purpose of analysing the problem with anti-tax avoidance provisions, one should distinguish between general anti-tax avoidance provisions and specific anti-tax avoidance provisions. A tax legislator is required to determine when general anti-tax avoidance provisions are sufficient, and when one should add specific anti-tax avoidance provisions to tax legislation. Making such a choice is dependent, *inter alia*, on the distinction that is drawn in the legal world between standards and rules.69

When the legislature is required to establish a provision, there is some doubt as to whether to establish it through legal rules or through legal standards. Using either one of these methods has its advantages and disadvantages, and, therefore, the legislature is required to consider seriously which would be the more appropriate avenue to take.70 In tax law, the standards are flexible and, generally speaking, they

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69 For a distinction between the two, see, for example: Raz J ‘Legal principles and the limits of law’ (1972) 81 *Yale Law Journal* 823-54 (‘Rules prescribe relatively specific acts: principles prescribe highly unspecific actions.’). See also Menachem Mautner ‘Rules and standards in the new civil law – the question in legal theory of legislation’ 17 *Mishpatim* 321. Mautner establishes: ‘As is well known, legal provisions are not made of one stripe. One of the branches of legal theory deals with locating the non-technical characteristics of the provisions and in trying to study the link between these characteristics and the content of the provisions. One accepted distinction in this context is between provisions which may be classified as a rule and a provision which may be classified as a standard. A typical provision which may be classified as a rule and a provision which may be classified as a standard is that which conditions a specific legal result on the occurrence of one or a few specific factual pre-conditions, where the question of whether it has occurred may be easily settled. In contradistinction the typical provision which may be classified as a standard is a provision which conditions a specific legal result on the activation of a criterion (which generally speaking embodies a specific value). The main difference between a rule and a standard is expressed therefore in the degree of precision of the content which has been delivered through the legal provision.” See also Mary C Daly ‘The dichotomy between standards and rules: a new way of understanding the differences in the perceptions of lawyer codes of conduct by U.S. and foreign lawyers’ (1999) 32 *Vand J Trasnat’l L* 1117; Russell B Korobkin ‘Behavioral analysis and legal form: rules vs. standards revisited’ (2000) 79 *Or L Rev* 23; Sullivan ‘Foreword: the justices of rules and standards’ 106 *Harv L Rev*.

tend to be interpreted broadly.\textsuperscript{71} In contrast, the rules, generally speaking, tend to establish conclusive presumptions, which, in certain circumstances, render tax planning invalid.\textsuperscript{72} The general anti-tax avoidance provisions constitute a ‘standard’, whereas the specific anti-tax avoidance provisions constitute a ‘rule’. The above consideration involves making a value judgment between two different approaches, of which each has its own advantages and disadvantages. So, for example, preferring a standard to a rule in a tax regime shows that one’s intention is to provide flexibility and dynamism therein. In contrast, preferring a rule to a standard shows a desire to provide certainty and stability in a tax system.

It appears that, from a constitutional perspective, there is a preference for rules (in the form of specific anti-tax avoidance provisions), since using standards increases the risk of a discriminatory application of the tax provisions concerned.\textsuperscript{73} Since the central component of rules is conclusive presumptions, naturally the discretion of the tax clerk is narrower, in comparison with the standards. Furthermore, the broader and vaguer wording of general anti-tax avoidance provisions, as opposed to the wording of specific anti-tax avoidance provisions, causes a fair amount of uncertainty with taxpayers, who are unable to know in advance how a provision will be interpreted by the tax authority and the courts. The broad discretion of the tax authorities in relation to such provisions is also bound to cause the passing of arbitrary decisions. Furthermore, said broad discretion, in the given context, is bound to lead to decision-making that discriminates between the various taxpayers concerned, despite them being in similar situations. The problem increases where the tax regime is not transparent, and where it enables the tax authorities to pass arbitrary and discriminatory decisions, while hampering the right of the taxpayer to know in advance how the authority will exercise its power. The result is that such provisions are likely to harm the rule of law.

In relation to the specific anti-tax avoidance provisions, it appears, \textit{prima facie}, that the problem of arbitrariness and discrimination does not apply. Nonetheless, the

\textsuperscript{71} See Glicksberg ‘The limits of tax planning’ at 98.

\textsuperscript{72} Ibid at 99. See also DA Weisbach ‘Formalism in tax law’ (1999) 66 \textit{University of Chicago Law Review} 860-87.

\textsuperscript{73} Glicksberg ibid at 100.
existence of such provisions is likely to lead to a situation where the taxpayers concerned will do everything within their power to ‘circumvent’ them. Thus, the tax authorities may, indeed, win the battle, but they are, almost inevitably, likely to lose the war, since they will find it difficult to collect the outstanding tax from those sophisticated taxpayers whom the anti-tax avoidance provisions have tried to trap within the tax network.

One may, in fact, claim that the specific anti-tax avoidance provisions create an incentive to create a tax plan that is generally carried out through the use of the services of sophisticated tax planners. The existence of such an incentive is bound to have serious ramifications for the tax system involved. Thus, for example, the widespread phenomenon whereby wealthy taxpayers hire the services of tax planners tends to cause the broader public, who cannot afford to pay for the latter’s expensive services, much disgruntlement.74 Said phenomenon is bound to cause contempt for the tax laws concerned, and loss of the public’s trust in the tax system as a whole. Those who cannot afford to hire a tax planner are then likely to choose to evade tax and to resort to use of the black market.

The controlled foreign corporation (CFC) rules (which are covered by s 75(b) of the Ordinance) that constitute anti-tax provisions have not dealt with the problem for which purpose they were designed, and the lion’s share of the revenues has still managed to escape having tax applied to it.75

74 It is interesting to note that, after the judgment on appeal in the Promedico case, Eli Horovits, the then CEO of Teva, stated that, luckily, he could afford an attorney who could get him off the indictment that had been issued against him. See Itamar Levin Globes (13 September 2000).

75 Avi Nov ‘The transition to personal taxation and the CFC issue’ (April 2002) 16(2) Misim A-11. This situation also exists in the United States, in which country CFC legislation was invented. There are many breaches in the American legislation, and every time an attempt is made to close a specific breach, ‘suddenly’ they discover other breaches. Harry Grubert, a former economist at the IRS, has claimed that, because of such findings, the legislation concerned is not effective and does not attain its goal (Harry Grubert, Tax planning by companies and tax competition by governments). Furthermore, some say that said legislation involves antiquated rules, and that the historical justification for the CFC rules has been significantly eroded by the growth in international trade and the impact of globalisation (in this regard, see Robert J Peroni, J Clifton Fleming Jr and Stephen E Shay ‘Getting serious about curtailing deferral of U.S. tax on foreign source income’ (1999) 52 Smu L Rev 455.
The reality is that such provisions are complicated and redundant, and that they also miss their target. In fact, even when applying the other specific anti-tax avoidance provisions, similar problems are encountered. Said provisions cause uncertainty for the taxpayers concerned, and cause them to incur many unnecessary expenses. For the reasons identified, I believe that the anti-tax avoidance provisions are redundant. In the next paragraph, I shall critique the judicial anti-tax avoidance provisions.76

5.2 The problematic application of anti-tax avoidance provisions

In recent years, there has been a noticeable trend for tax authorities to rely on judicial anti-tax avoidance provisions in order to be able to contend with international tax planning. The Commissioner of Income Tax, up until the date of the writing of the current paper, has published three circulars dealing with international tax planning, in which it recommends making use of the provisions. One of the circulars, which describes the foiling of tax planning that is based on treaties that are entered into with the intention of avoiding double taxation, states that the acceptable approach that is adopted in many countries involves the application of anti-tax avoidance provisions that originate in domestic law. According to the Commissioner, one may use s 86 of the Israeli Tax Ordinance to counter international tax plans that are based on tax treaties.77 However, the adoption of such an approach is bound to encounter legal difficulties, since, inter alia, it contradicts s 196 of the Income Tax Ordinance, in terms of which using the provisions of treaties to avoid double taxation takes precedence over conforming to the provisions of the Income Tax Ordinance.78

In the above-mentioned circular, it is further stated that using tax treaties solely in order to obtain tax benefits, in the absence of any substantive economic logic, and with the objective of receiving benefits stemming from the tax treaties, is also considered as a means of invalidly exploiting the tax treaties. The Commissioner

76 Criticism of the administrative anti-tax avoidance provisions could be discussed in a separate research paper.


78 Avi Nov ‘The relationship between tax treaties and the domestic law’ (March 2003) 52(1) Roeh HaHeshbon 441.
recommends, in said context, the adoption of judicial anti-tax avoidance provisions, which, for example, were developed in the Sheffer case, or the adoption of the ‘substance over form’ doctrine that is regarded as being acceptable within Anglo-American law. In my opinion, the above-mentioned stance of the Commissioner is also problematic, since it is easy to show economic reasons that lie beyond the boundary of tax considerations, in relation to the management of businesses through various corporations in numerous countries.

The Commissioner published another circular recommending ways of dealing with the tax plans that make use of a conduit company, meaning a company that has no real activities and that has been established solely in order to exploit the tax benefits granted by the treaties concerned. The circular in question establishes that one of the ways of preventing such tax planning is through the principle of ‘beneficial owner’. The circular establishes tests that can be conducted in order to examine whether the company involved is a conduit company. Under the tests mentioned, the conduit company is bound to be a company that conducts a minimal number of business activities, which are not substantive, and/or which is likely to have minimal assets, with the officer therein playing a limited role. In addition, the ownership in the company tends to be fleeting, with there being no justification for the existence of a structure of a chain of corporations, and the avoidance of business risk by that company, among a number of other distinguishing features. The circular establishes that, if it has been established that the tax plan under investigation involves a conduit company, then one may disregard it by means of use of the provisions of the treaty and the provisions of the domestic law, as well as by means of the use of judicial anti-tax avoidance provisions.

I should note that the preceding circular not only is of no assistance in the battle that is waged by the tax authorities against the tax plans, but, on the contrary, it actually assists the planners. The many tests that have been established are similarly likely to assist the tax planners in organising their economic activities in the conduit company in such a way that the company concerned would appear to be a company with economic and commercial substance. The Commissioner is, in fact, ‘teaching’

the taxpayers, through the circular, what to do in order that the conduit company should not be considered a conduit company that may be disregarded. To my mind, even if it should be established that the plan involves a conduit company, from a legal perspective it would not be easy to disregard the corporation concerned, and to reclassify the transaction.

The third circular issued by the Income Tax Commissioner deals with a tax plan that uses an LLC.80 In this circular, the Commissioner recommends that one employ s 86 to attack the tax plan concerned and that one should likewise make use of such judicial anti-tax avoidance provisions as the ‘substance over form’ doctrine and the ‘steps’ or ‘multistep transaction’ doctrine. As with the other circulars previously discussed, from a legal perspective it would not be easy to disregard the LLC from the corporate structure and to reclassify the transaction involved.

It is important to emphasise that the circulars dealt with above cover only a narrow range of international tax planning. One of the central issues in said field, where there is much more confusion than there is clarity, is the use of international trusts as a tax planning strategy.81 Yaron Shildo and Frieda Yisraeli, who have examined American case law with regard to the issue of disregarding the creation of a trust, explain that, in the American Zmuda judgment, it was held as follows:

‘A trust which was established for the sole purpose of evading tax shall not be considered a legal entity for tax purposes…in fact there are two tests to establish whether a tax authority can pierce the veil of an entity which has been set up: the business aim test…and the economic substance test…these two tests bring us to a situation in which substance is preferred over form, ie, despite the fact that the taxpayer has complied with the formal rules and

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80 Income Tax Circular 3/2002 – the Unit for International Taxation on the Subject: ‘L.L.C. Limited Liability Company’ 16(2) Misim C-1. For an elaborate discussion of the LLC regime in the United States, see Shimon Cohen and Shlomi Regev ‘LLC – were you there or was I dreaming?’ (February 2002) 16(1) Misim A-64.

81 In Israeli law, s 1 of the Trusts Law, 5739-1979 establishes: ‘A trust is a relationship to any property by virtue of which a trustee is bound to hold the same or to act in respect thereof, in the interest of a beneficiary or for some other purpose’. Section 2 of the Trusts Law establishes that ‘[a] trust is created under the law, in accordance with a contract with a trustee or under a deed of endowment’.
requirements of the Law, the tax authorities can negate the existence of a transaction, if its sole objective is the evasion of tax.\textsuperscript{82}

It appears that exercising anti-tax avoidance provisions in such a matter is problematic, since the tax authorities must show that the tax consideration was among the main considerations for establishing the trusts concerned, and they must assign this motivation to the creator of the trust, who transferred the assets into it. Rozenzweig and Aviram speculate that, in a situation in which a trust has been established mainly for the purpose of preserving a family’s wealth under specified conditions, or for purposes of planning a will, or with the objective of avoiding harm to the property upon a bankruptcy or the like, the commercial and social objectives are important and legitimate, and that it would, given such conditions, then be difficult, if not impossible, to apply s 86 of the Ordinance to oppose the establishment of the trust.\textsuperscript{83}

As at the time of writing, Israel has had no court ruling on such issues (namely treaty shopping, beneficial ownership, the LLC and foreign trusts), and it is difficult to speculate as to whether the courts will adopt the methods that are advocated in the professional circulars of the Commissioner, and whether they will make use of the judicial anti-tax avoidance provisions to attack international tax planning.

In the event that the courts decide to make use of the judicial anti-tax avoidance provisions, it should be possible, in my opinion, to attack these provisions with the claim of lack of jurisdiction. In practice, the judicial anti-tax avoidance provisions, in

\textsuperscript{82} Yaron Shildo and Frieda Yisraeli ‘Taxing activities through trusts – the current law’ in \textit{The tax reforms in the State of Israel as a result of Amendment 132 to the Income Tax Ordinance 5763 (2002)} 393. Shildo and Yisraeli distinguish between a revocable trust and an irrevocable trust:

‘A revocable trust – trust in which the trust creator has the ability to control the assets of the trust and/or its fruits, and has the right to purchase control, as stated, or the creator enjoys the fruits of the trust or he has the ability, under any circumstances to enjoy the fruits of the trust and may also revoke the trust. An irrevocable trust – a trust where the creator has no ability whatsoever to control the assets, including not having the ability to return the control, and he cannot enjoy their fruits in any manner. In practice the creator’s portion in the activities of the trust terminates on the day of creating the trust.’

\textsuperscript{83} Yehoshua Rozenzweig and Revital Aviram ‘Taxing irrevocable trusts’ (April 2003) 17(2) \textit{Misim} A-51.
constituting a quasi ‘judicial legislation’, harm the principle of separation of powers. In said context, the question may be raised as to how it could be possible to collect tax without an express legal provision to such effect.84 In relation to tax plans within the country, one may argue that the legislation should be interpreted in such a way that it should impose tax on the economic substance of the transaction. However, the making of such an argument is not valid in relation to international tax planning.

5.3 Anti-tax avoidance provisions and economic efficiency

A tax regime is considered inefficient from an economic perspective, in the event that it causes an inefficient allocation of resources. Thus, for example, the various tax burdens on equity and on foreign capital result in an investment of many financial resources that stem solely from the existence of a distinction between the two financing methods concerned.85 The taxpayer who aspires to maximise his profits will invest many of his funds merely in order to produce optimal results from a tax law perspective, instead of investing them in a business that is capable of producing the highest yield.86 From an economic perspective, there is a preference for investments from individuals to flow into a place that is the most efficient for it to be invested. Such a result can be attained in the event that the tax regime is neutral.87

84 We should recall that, under s 1(a) of the Basic Law: The State Economy (amended 1982): ‘Taxes, compulsory loans and other compulsory payment shall not be imposed, and their amounts shall not be varied, save by or under Law; the same shall apply with regard to fees.’

85 This effect is described in the article by D Glicksberg ‘The mini reforms, a model for the full integration and taxation of corporations in Israel’ Mishpatim 20 200.

86 According to D Glicksberg ‘The authority to reclassify anti-tax avoidance provisions’ Mishpatim 30:

‘Suppose the taxpayer is faced with a number of transactions with identical tax burdens and with the potential for identical tax planning. In these circumstances the taxpayer will choose a transaction with the highest, after tax, yield, and the tax system in this case will be neutral. However if one of the transactions has a higher tax planning potential, then the taxpayer is likely to take on that transaction despite the fact that from a commercial perspective he would have chosen another transaction.’

87 This is also true in relation to value-added tax (VAT). In this regard, A Nimrod states in his article ‘Value added taxation of a commercial bank: reviews and recommendations’ (October 1995) 9(5) Misim A- 25,
meaning that it does not affect the private individuals’ decisions regarding where, and in what way, to carry out their investments.88 In this regard, we should note that, in the spirit of the Ben Bassat reforms,89 under the heading ‘economic efficiency’ it is stated that one of the primary concerns of taxation policy is to avoid, as much as is possible, harming, inter alia, the desire to invest in the establishment of factories. It is further stated, in said report, that taxation gaps are likely to divert resources that will be employed in evading tax instead of in more creative activities, and, thus, that the reduction of such distortions means a larger national body of resources.

It emerges that taxpayers invest large amounts of money in tax planning, which results in excess investments in tax planning instead of in involvement in activities that create real value. Thus, for example, the Joint Committee on Taxation at the American Congress, regarding Enron, issued a report that the latter paid 88 million dollars for advice on the subject of tax planning for the company between 1995 and

‘VAT is considered to be a neutral tax, which does not discriminate between the various sectors of the economy and between the various manufacturing bodies. Because of this VAT is considered an “effective” tax which does not harm the allocation of resources of the economy, and it does not have a negative effect on the economic behavior of the various units of the economy…since VAT is a neutral tax which is imposed on the added values of the manufacturing bodies, it does not interfere with setting the optimal combinations of manufacturing bodies, labor and capital. It does not discriminate between capital intensive or labor intensive products and services, and it also does not discriminate between alternative methods of funding the business, in other words, funding by equity or by foreign capital.’

88 This claim is also relevant to a tax regime that pertains to international taxation. See Z Dagan ‘National interests in international taxation’ 20 Iyuney Mishpat 5757:

‘…and upon the occurrence of open borders between the states, global investments will flow into that place which is the most efficient for investments, so that the sum total of the global pie will grow up to its maximum, and the benefit will grow for both states. This efficient allocation of resources will not be harmed if the tax method (in both states) is neutral, in other words it does not affect the decisions of the investors with regards to the question where to invest and the decisions required for capital with regard to the question from whom to loan it.’

The advice concerned involved 12 separate tax plans of which the objective of each was to circumvent various provisions in the tax legislation, in order that, ultimately, the company’s overall tax liability would be reduced. Enron did not pay taxes for many years, owing to its system of 900 subsidiary companies in states that are considered to be tax shelters. One of the interesting recommendations of said Committee was to make stricter the anti-tax avoidance provisions in the tax regime than they had previously been. Indeed, the typical response of countries around the world in relation to tax planners is to add provisions, and to tighten the current ones. The problem is that anti-tax avoidance provisions are so complicated that they can only be enforced at much cost.

Over and above the aforementioned facts, the taxpayers, for their part, are likely to invest in finding other tax plans, and, thus, a race is run between the taxpayers and the tax authorities, that, generally speaking, the taxpayers lead. The running of such a race, without a doubt, results in the inefficient allocation of resources and in the harming of society in general.

For a description of the Enron episode, see Eyal Solgenik and Amir Seraph ‘The Enron episode: policy consideration from a regulatory perspective’ (June 2002) 51(2) Ro’eh Haheshbon 438. In the article, it emerges that, in the period between 1996 and 1999, Enron had, in fact, not paid any income tax at the federal level. During that same period, its financial reports showed profits of US$2.3 billion, but reported losses for tax purposes of US$3.0 billion.
6. The appropriate solution

The anti-tax avoidance provisions are meant to fight against the actions of tax planners, to increase the collection of tax, and to facilitate the application of the principles of justice to the tax regime. Nevertheless, my argument is that, where the costs are higher than the benefits are, there is no place for such provisions in the tax regime.91 It appears that the tax legislator does not normally carry out a cost-benefit analysis, and that, therefore, he believes that independent states, including the State of Israel, should continue developing the anti-tax avoidance provisions concerned.

In my opinion, and in the light of the legal–economic analysis that I have presented in the current paper, it would be desirable to try a completely different track. The appropriate solution would be to promote a three-step reform. First and foremost, decisions should be made regarding how significantly to reduce the tax rates on corporations and on individuals. Clearly, such a process entails a reduction in public expenditure, and especially in payments that are intended for welfare. In the event that the tax regime should become attractive, relative to that of other states, then the interest of the taxpayer in terms of engaging in tax planning is likely to be reduced, and, as a result, the tax authorities could, then, reduce their use of anti-tax avoidance tools.

In the above-mentioned regard, it would be appropriate to rely on the experience of other countries. In Sweden, for example, the tax rates were significantly reduced in 1990, within the framework of comprehensive tax reforms, which, in turn, contributed greatly to reducing the incentive of taxpayers to engage in tax planning.92 Similarly, the tax reforms that took place in the United States in the 1980s, during the presidency of Ronald Reagan, prove that reducing tax rates can motivate taxpayers to reduce their use of tax plans and to pay more to the State Treasury.93 The experience in the aforementioned country has also shown that, in such a situation, taxpayers

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91 Regarding the difficulty in applying principles of justice to international taxation, see Avi Nov ‘Principles of justice in tax laws and in international taxation’ (December 2002) 16(6) Misim.


have an incentive to increase their creative activity, which then leads to an increase in tax receipts. 94

I, hereby, argue that taxpayers will be likely to invest relatively few resources in international tax planning, so long as the tax rates remain low and reflect the level of expenses required for financing public products and the benefits to be derived from them. 95

In addition to the above, I am also of the opinion that attempts to stop tax planning at the state level will cause people to find new tax plans and/or will cause the flight of companies to other countries. It would be appropriate, at the current juncture, to quote the words of Judge Dov Levin, who gave a speech at a study day that was devoted to the laws of income tax:

‘In a state which is desirous of obtaining capital investments from entrepreneurs and which encourages foreign and Israeli investors to contribute to the strengthening of the State’s economy; at a time when the captains of the state are both required and wish to release themselves from the economic recession and to break new ground for economic growth – it would appear that what is demanded and truly required is an openness to the distress of the citizen taxpayer, in his Don Quixote battle against the burdensome and frustrating taxation. What in my mind appears as urgent, important and vital to our economy is meaningful change to the taxation policy – a reduction of the tax burden and a practical simplification of the processes and of the tools. If grand, considered and appropriate effort is exerted in this field it will bode well for the state and will make it easier for the citizen. I shall not enter into any details, for many of the best people involved in our economy have already recommended this and have even

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94 It is important to note, in said context, that the increase in tax rates in 1993 under the presidency of Bill Clinton contributed to the opposite effect.

95 When the level of taxation is higher as the result of the need to finance the welfare budget, mobile taxpayers will prefer to transfer their economic activities to countries in which the level of taxation reflects the amount of benefit received from the public services. For an analysis of this type, see Michael I Luger ‘Federal tax reform and the interjurisdictional mobility impulse’ (1988) 23 J Urb Econ 235-6.
outlined the path to take, so that it would appear that there is no choice but to adopt the recommended policy and to apply it. There is no doubt in my heart that such a change would immeasurably improve the ethic of paying taxes, it would temper the conflicts between the citizen and the tax authorities and would increase mutual understanding. It appears that it would to a great extent negate the need for smart and complicated tax planning. Thus it is desirable – for all of us want a strong state and a strong welfare for its inhabitants\(^96\) (Emphasis mine –H.Z.).

In addition to reducing the tax rates imposed, the state must invest resources in simplifying the tax laws,\(^97\) and in increasing transparency throughout the tax system.\(^98\) Through promoting the three elements mentioned, it should be possible to design a tax regime in such a way that it will be attractive for taxpayers (both local and foreign), resulting in there being no incentive for tax planning.

The legal–economic analysis that has been conducted in the current paper has, therefore, shown that, as anti-tax avoidance provisions cause complications to a tax


\(^97\) See, for example, A Raphael ‘Do tax laws have to be complicated?’ (December 1988) 12(6) *Misim* A-28; see also K Krause ‘Tax complexity: problem or opportunity’ (2000) 28 *Public finance review* 395-414.

\(^98\) I refer here mainly to the publication of decisions that were made with regard to specific taxpayers. A practice has taken root amongst the members of the Tax Commission that there should be no publishing of settlement agreements with taxpayers, pre-rulings, etc, because an obligation of confidentiality applies thereto (see s 23(a) of the Ordinance, ss 232 and 234). The Commission has explained that the maintenance of secrecy is a means of realising the goal of collecting a true tax. The argument is that the immunity makes it easier for taxpayers to discharge the reporting obligations that have been imposed upon them, and it also makes it easier for the tax authority to carry out acts of supervision that have been imposed upon it, thereby, according to the respondent’s approach, it creates an infrastructure for the collection of true tax (see 207/70 Yahalomi v The Minister of Finance 25(1) *Piskei Din* 126, 128; Shechner v The Minister of Finance 37(3) *Piskei Din* 255). In my opinion, there is room for revealing the information by removing the names of the taxpayers, and this should be done for the sake of the transparency that is required of any administrative act, which is a transparency that enables one to test whether there is equality in the activities of the Authority, and which provides certainty to the tax regime.
system, they are bound to cause harm to the principles of equality and the rule of law. The costs of enforcing and complying with them are also high. Furthermore, I estimate that, despite the existence of such provisions, the redundant investments by taxpayers in tax planning will continue, instead of investing in activities that create real value, with the former necessarily leading to the inefficient allocation of resources.

This leads us to the conclusion that there is no benefit in applying anti-tax avoidance provisions, and, thus, it is recommended that they be rescinded. Instead of anti-tax avoidance provisions, it is recommended that the three-step reform (entailing the reduction of the tax rates, the simplification of the tax laws and the ensuring of transparency) that is described above be implemented.
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