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Unauthorized Tax Elections

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ABSTRACT

Unauthorized tax elections are those devices and techniques that taxpayers employ to achieve sought-after objectives but that are not specifically endorsed under the Internal Revenue Code. Often evolving over time, they are a common feature of the nation's tax system. While unauthorized tax elections can prove subversive, in many instances, if properly and timely addressed, their existence can produce salutary benefits vis-à-vis their eradication or formal institutionalization.

This analysis explores the general contours of unauthorized tax elections and the critical signaling roles that they provide, alerting Congress and the Treasury Department to shortcomings and vulnerabilities in the Internal Revenue Code's statutory language and/or structural design. It concludes that both the legislative and administrative branches of government would be wise to not ignore these signals but instead to swiftly address them.

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INTRODUCTION

The Internal Revenue Code (Code) is replete with opportunities for taxpayers to make tax elections.[1] Some of these tax elections are transformative (e.g., sanctioning the ability to treat a corporate enterprise as a conduit entity),[2] and others are merely ministerial in nature (e.g., extending a tax-filing deadline).[3] Despite the differing and diverse nature of tax elections, the vast majority of them have two central elements in common: first, prior to an election being made, certain preconditions often must be met; and, second, taxpayers must submit an election form to the Internal Revenue Service (IRS).[4] As evidenced by their prevalence,[5] Congress tacitly applauds the virtues of these elections, which are easily and readily monitored, and the flexibility that they offer taxpayers.[6]

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1. Numerous scholarly articles have been written on the ubiquity of tax elections. For two of best, see Emily Cauble, *Tax Elections: How to Live with Them if We Can't Live Without Them*, 53 SANTA CLARA L. REV. 421 (2013), and Heather M. Field, *Checking In on "Check-the-Box*,*"* 42 LOY. L.A. L. REV. 451 (2009) [hereinafter Field, *Checking In on* "*Check-the-Box"*]. *See also* Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 HARV. J. ON LEGIS. 21 (2010) [hereinafter Field, *Choosing Tax*]; Heather M. Field, *Tax Elections & Private Bargaining*, 31 VA. TAX REV. 1 (2011) [hereinafter Field, *Tax Elections*]; Aubree L. Helvey & Beth Stetson, *The Doctrine of Election*, 62 TAX LAW. 335 (2009); George K. Yin, *The Taxation of Private Business Enterprises: Some Policy Questions Stimulated by the "Check-the-Box" Regulations*, 51 SMU L. REV. 125 (1997); Edward Yorio, *The Revocability of Federal Tax Elections*, 44 FORDHAM L. REV. 463 (1975).

2. *See* I.R.C. § 1362.

3. *Id.* § 6081(a).

4. *See, e.g.*, *id.* § 362(e)(2)(C) (enabling a taxpayer and a corporation to which the taxpayer contributed property to jointly elect to have the tax basis of the taxpayer's stock shares reduced by the amount of the embedded loss rather than reducing the tax basis of the contributed property).

5. Cauble, *supra* note 1, at 423 ("Tax elections are prevalent."); Field, *Choosing Tax*, *supra* note 1, at 24 ("Nevertheless, explicit elections are littered throughout the Internal Revenue Code . . . ." (footnotes omitted)).

6. *See* Field, *Choosing Tax*, *supra* note 1, at 57 ("When the tax law is designed to subsidize certain actions and incentivize taxpayers to undertake those actions, explicit elections advance that social policy goal by giving

But the same accolades accorded authorized tax elections cannot be conferred upon unauthorized tax elections. What exactly is an unauthorized tax election? In a nutshell, it is usually a product of a taxpayer voluntarily inserting technical language into a governing legal document with the intention of securing a tax outcome not explicitly permitted by Congress or the Treasury Department.[7] For example, a taxpayer may add a provision to a trust instrument permitting its beneficiaries to withdraw trust contributions; by adding this window period of withdrawal, such trust contributions thereby qualify for the gift tax annual exclusion.[8]

As described, unauthorized tax elections thus occupy a unique space. On the one hand, they are not the equivalent of abusive tax shelters that, if identified, the IRS can challenge and, at least in many instances, defeat;[9] on the other hand, they are not in the same camp as authorized tax elections, which the Code and Treasury regulations sanction

taxpayers power to plan their affairs so as to achieve the best combination of economic and tax consequences."). Tax elections foster taxpayer autonomy and may strengthen the overall tax system. Alice G. Abreu, *Taxes, Power, and Personal Autonomy*, 33 SAN DIEGO L. REV. 1, 63 (1996) ("[Tax elections] reflect[] the value of personal autonomy and the triumph of individualism over communalism.").

7. *See, e.g.*, Field, *Checking In on "Check-the-Box," supra* note 1, at 467–68 ("To a significant extent, the [check-the-box] regulations merely turned an implicit election regarding entity classification (whereby taxpayers could effectively elect entity classification through action, by including specific terms in a business entity's operating agreement) into an explicit election (whereby taxpayers choose their tax treatment by filing a form with the IRS) . . . ." (footnote omitted)).

8. Absent such a withdrawal provision, the contributed trust property would not qualify for the annual gift tax exclusion, and gift tax imposition would be appropriate. *See infra* Section II.A.

9. *See* Garrison Grawoig DeLee, Note, *Abusive Tax Shelters: Will the Latest Tools Really Help?*, 57 S. CAL. L. REV. 431, 431 (1984) ("The Treasury Department and Congress have earnestly attacked abusive tax shelters since the early 1970's." (footnote omitted)); Laura Jean Kreissl & Karyn Bybee Friske, *IRS Scores Recent Judicial Successes Against Tax Shelters*, 81 PRAC. TAX STRATEGIES 338, 341 (2008) (listing a whole string of judicial successes that the IRS was able to achieve against abusive tax shelters).

and the IRS may carefully monitor.[10] Left unchecked, unauthorized tax elections may subvert congressional intent, deplete the Treasury of revenue, and foment public contempt toward the Code.[11]

Sound tax policy therefore requires that Congress and the Treasury Department be attuned to the existence of unauthorized tax elections and address them. More specifically, once identified, on a case-by-case basis, the nation's legislative branch and the administrative agency charged with oversight should craft measures that explicitly either accept or reject them. By taking such steps, Congress and the Treasury Department would facilitate the achievement of the country's legislative goals, preserve the sanctity of the nation's coffers, and keep the Code's stature intact.[12]

This Article is the first of its kind to examine unauthorized tax elections, their effects, and the ways in which they should be navigated. Part I details the history and nature of unauthorized tax elections. With this background in mind, Part II presents two case studies of unauthorized tax elections that depict their overall gray nature—in other words, their mere existence cannot be readily categorized as either good or bad. Next, Part III offers a commonsense methodology of how Congress and the Treasury Department should identify and handle unauthorized tax elections. Finally, Part IV concludes.

10. *See, e.g.*, Emily Cauble, *Unsophisticated Taxpayers, Rules Versus Standards, and Form Versus Substance*, 52 LOY. U. CHI. L.J. 329, 344 (2021) ("In many situations, a taxpayer can make an election that will affect the tax consequences of a transaction. Elections available to taxpayers include those that determine how certain business entities are classified, various partnership tax elections that determine how tax items are shared among partners or that determine the tax consequences following transfers of partnership interests or partnership distributions, and elections that affect the tax consequences of certain corporate acquisitions." (footnotes omitted)).

11. *See infra* Section I.B.

12. *See infra* Part III.

I. THE GENESIS AND NATURE OF UNAUTHORIZED TAX ELECTIONS

In all likelihood, since the advent of the modern income tax more than a century ago,[13] unauthorized tax elections have been part and parcel of the nation's economic landscape.[14] Out of concern that the limelight might result in their elimination, tax practitioners have historically sought to maintain a low profile for unauthorized tax elections.[15] And this approach has served unauthorized tax elections well as they sometimes exist unchallenged for years and even decades.[16]

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13. Revenue Act of 1913, Pub. L. No. 63-16, § II, 38 Stat. 114, 166 (1913).

14. A fairly old law review article described a set series of potential unauthorized elections. *See* Montgomery B. Angell, *Tax Evasion and Tax Avoidance*, 38 COLUM. L. REV. 80, 87 (1938) ("[F]or example, the creation of foreign personal holding companies in neighboring nations, the use of domestic holding companies where the stock is spread sufficiently to escape the statutory definition embracing such companies, the incorporation of yachts and country estates, and the creation of loans between a personal holding company and the stockholders with a view to the benefit of the interest deduction on the loans. It is impliedly if not directly charged that such activities involve moral turpitude, even though the transaction admittedly is quite legal in the sense that under the existing language of the statute the transaction is not within the taxable field."). Unauthorized tax elections are not unique to the United States and have probably existed for millennia. Consider the fact that in feudal France, taxes were collected based upon how many stories a structure had below the roofline. Some taxpayers thus "elected" to mitigate their taxes by constructing the top story of their homes above the roofline. Emma Ailes, *Hirsute Pursuit: Dodging the 'Beard Tax' and Other Historical Levies*, BBC NEWS (Apr. 11, 2016), https://www.bbc.com/news/uk-35997919 [https://perma.cc/4E33-HEA5] ("In France, houses with low Mansard roofs were designed to shelter their occupants from taxes as well as the elements. Property owners were taxed on the number of floors below the roof line. The Mansard roof made the top floor essentially tax free.").

15. By way of comparison, unlike attorneys advertising for personal injury lawsuits and criminal defense services that dominate television and internet advertising, there are no equivalent advertisements pertaining to unauthorized tax elections.

16. For example, in 1940, the U.S. Supreme Court ruled in *Helvering v. Clifford* that if a trust had too many indicia of taxpayer control, the trust should be treated as a grantor trust, and the income it generated should be treated as taxable to the grantor. 309 U.S. 331, 335–38 (1940). In 1946, the Treasury Department issued the so-called Clifford regulations, T.D. 5488, 1946-1 C.B. 19, which Congress subsequently codified into law in 1954. Internal Revenue Code

But unauthorized tax elections embody a characteristic unique among illicit activities. Unlike many illicit activities (e.g., a physician prescribing OxyContin for a minor ache), a number of unauthorized tax elections have favorable effects: many constitute welcome engraftments to the Code; others act as a signal to legislators that reform measures are in order.[17] Due to unauthorized tax elections' duality of nature (some being harmful and others being beneficial), Congress and the Treasury Department must thoroughly investigate and vet them, eradicating those that are problematic and institutionalizing those that are advantageous.

Securing a better grasp on the nature of unauthorized tax elections requires a deeper appreciation of their genesis and nature. Below, Section I.A details the general process of how unauthorized tax elections come into being, Section I.B examines the kind of damages that some unchecked unauthorized tax elections can produce, and Section I.C outlines the benefits that other unauthorized tax elections can yield.

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of 1954, Pub. L. No. 83-591, § 671, 68A Stat. 3, 226 (1954). The regulations and statute permitted taxpayers to form trusts that existed for more than ten years and avoided grantor trust status. For a thorough analysis of the use of the Clifford trust sections, see generally John W. Ervin, *Income, Estate and Gift Tax Problems in Planning Family Trusts Under the 1954 Internal Revenue Code*, 29 S. CAL. L. REV. 1 (1955). Essentially, by establishing and funding Clifford trusts, taxpayers could "elect" to have the income that their investments generated be taxable under the trust bracket rate structure. Four decades later, in 1986, Congress eliminated taxpayers' ability to make this unauthorized election to mitigate their income tax burdens. Tax Reform Act of 1986, § 1402, 100 Stat. 2085, 2711–12.

17. As Clifford trusts grew in popularity, see Frederick R. Schneider, *Which Tax Unit for the Federal Income Tax?,* 20 U. DAYTON L. REV. 93, 105 (1994) ("Prior to 1986, the use of Clifford Trusts was very popular." (footnote omitted)), Congress recognized that the very existence of such trusts constituted an existential threat to the integrity of the income tax system. *See* STAFF OF THE JOINT COMM. ON TAX'N, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 1248 (Comm. Print 1987) ("Congress was concerned about the tax benefits arising under the grantor trust rules of present law. . . . In order to reduce the tax benefits arising from the use of trusts, the Congress believe that the so-called '10-year rule' should be repealed so that a trust would be treated as a grantor trust in all cases were [sic] there is any significant possibility that interests and powers in the trust may become effective in the grantor after the creation of the trust.").

A. *Unauthorized Tax Elections and Their Formulation*

Unauthorized tax elections are not a product of spontaneous generation. They usually come into being as a result of the following threefold process: (1) Congress enacts tax legislation, or the Treasury Department promulgates new regulations; (2) tax professionals respond to these legislative and administrative issuances; and (3) under the guidance of tax professionals, taxpayers make unauthorized tax elections.

Consider each step in the process.

Congress enacts tax legislation, or the Treasury Department promulgates new regulations. For public policy reasons, Congress decides to enact legislation designed to raise or lower taxes, broaden or narrow the tax base, encourage or discourage particular taxpayer behaviors, or accomplish a whole host of other possible goals (e.g., boost capital investments).[18] Congress presumably undertakes these legislative measures in an endeavor to raise sufficient revenue to meet its fiscal responsibilities,[19] harboring the expectation of taxpayer compliance with both the letter and spirit of the law.[20] Furthermore, the Treasury Department

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18. *See, e.g.*, M. Scotland Morris, Note, *Reframing the Flat Tax Debate: Three Not-So-Easy Steps for Evaluating Radical Tax Reform Proposals*, 48 FLA. L. REV. 159, 179 (1996) ("Scholars generally choose some combination of the following objectives: revenue-raising; fairness; efficiency; simplicity; economic neutrality; enactment of social policy; and implementation of economic policy.").

19. *See, e.g.*, Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 612 (1995) ("The political focus on balancing traditional tax policymaking concerns for improving equity and economic efficiency has been subordinated in recent legislation to reflect the overriding goal of insuring specific annual revenue effects of proposed tax policy changes over the 'budget period' . . . .").

20. When taxpayers fail to comply with both the letter and spirit of the law, tax loopholes emerge. Emily Cauble, *Presumptions of Tax Motivation*, 105 IOWA L. REV. 1995, 2032 (2020) ("To put the point more generally, one outgrowth of the underinclusivity of rules dictating unfavorable tax outcomes is the frequent lament that clear rules serve as a roadmap for taxpayers who want to engage in abusive transactions that comply with the letter, but not the spirit, of the law."); Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA.

issues detailed regulations to provide guidance to taxpayers in order for them to fulfill their civic duties and compliance obligations.[21]

Tax professionals respond to these legislative and administrative issuances. Tax professionals are not wallflowers that react passively to tax legislation and administrative rulings. Given the fact that the financial livelihood of tax professionals rests on how they can assist their clientele, they scrutinize the language of the law for vulnerabilities that would enable their clients to achieve a range of goals in the most efficient manner possible. As methods of means testing, tax professionals will sometimes lobby their clientele to submit private letter ruling requests and to take positions that they anticipate the IRS will challenge so that the matters will be adjudicated in court.

Taxpayers make unauthorized tax elections. When it comes to tax planning, the vast majority of taxpayers are like herded sheep: tax professionals render advice that most taxpayers treat as Gospel direct from the mouth of God.[22] Put somewhat differently, when clients consent to particular and often obscure provisions being added to the terms of their legal documents, most do not have the faintest idea of the

TAX REV. 1, 33 (2004) ("[P]romoters could easily concoct new abusive transactions that literally complied with the rule."); Andrea Monroe, *What's in a Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 CASE W. RSRV. L. REV. 401, 409 (2010) ("[T]hese flaws create a playground for those who engage in transactions that comply with . . . literal language, yet result in tax consequences that Congress did not contemplate.").

21. *See* I.R.C. § 7805(a) ("[T]he Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code] . . . ."). For an excellent discussion of how the regulatory process unfolds, see generally Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 EMORY L.J. 209 (2019).

22. *See, e.g.*, Heather M. Field, *Offshoring Tax Ethics: The Panama Papers, Seeking Refuge from Tax, and Tax Lawyer Referrals*, 62 ST. LOUIS U. L.J. 35, 37 (2017) (describing how many "[m]ajor U.S. law firms, such as Arnold & Porter, Kaye Scholer, Greenberg Traurig, and White & Case, and many U.S. accounting firms" rendered advice to taxpayers seeking to utilize offshore accounts to potentially avoid their U.S. tax obligations).

implications associated with such verbiage.[23] Nevertheless, as long as their tax professionals endorse these steps, taxpayers are usually willing participants and silently consent.[24]

The foregoing threefold process associated with the gestation of unauthorized tax elections is usually the product of tax professionals seeking to achieve one or more taxpayer objectives, including, but not limited to, tax mitigation,[25] administrative convenience and risk reduction,[26] and equity

23. *See, e.g.*, Paul J. Sax, *Lawyer Responsibility in Tax Shelter Opinions*, 34 TAX LAW. 5, 28 (1980) (speculating that the reason more malpractice suits were not brought against tax practitioners was because "of guilt at having invested in a deception, embarrassment at having been fooled, and the realization that a high-income investor caught in a tax scam holds little appeal to a civil jury").

24. This strategy of remaining uninformed and deferential sometimes can insulate taxpayers from potential criminal exposure. *See* Cheek v. United States, 498 U.S. 192, 199–200 (1991) ("The proliferation of statutes and regulations has sometimes made it difficult for the average citizen to know and comprehend the extent of the duties and obligations imposed by the tax laws. Congress has accordingly softened the impact of the common-law presumption by making specific intent to violate the law an element of certain federal criminal tax offenses. Thus, the Court almost 60 years ago interpreted the statutory term 'willfully' as used in the federal criminal tax statutes as carving out an exception to the traditional rule. This special treatment of criminal tax offenses is largely due to the complexity of the tax laws."). In *United States v. Murdock,* the Court recognized that

> Congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for the tax, as to his duty to make a return, or as to the adequacy of the records he maintained, should become a criminal by his mere failure to measure up to the prescribed standard of conduct.

290 U.S. 389, 396 (1933).

25. *See, e.g.*, John S. Dzienkowski & Robert J. Peroni, *The Decline in Tax Adviser Professionalism in American Society*, 84 FORDHAM L. REV. 2721, 2730 (2016) ("[Tax shelters] were designed by tax professionals and presented to their clients as ways to minimize tax liability, with the professionals supplying tax opinions supporting the validity of the transactions.").

26. *See, e.g.*, Frank J. Vari, *Practical Transfer Pricing Strategies in the COVID Environment*, 32 J. INT'L TAX'N 45, 46 (2021) ("Finance and tax professionals should perform a detailed review of their global business operations to mitigate transfer pricing risks and identify the transfer pricing opportunities to help management deal with their cash and operational concerns.").

attainment (as lower-income taxpayers seek economic parity with their higher-income taxpayer counterparts).[27] These driving motivations have made unauthorized tax elections ubiquitous throughout the tax system.[28]

B. *Damages Associated with Unauthorized Tax Elections*

The fact that these elections are unauthorized means that in some form or fashion, they violate the letter and/or spirit of the Code. Put in the vernacular of tax professionals, unauthorized tax elections constitute "work-arounds" designed to circumvent or skirt the law.[29] As such, unauthorized tax elections can have deleterious effects upon the nation's tax system. Such effects include subverting congressional intent; depleting the Treasury of much-needed tax revenue; and having a corrosive effect on the taxpayer psyche, as well as fomenting public contempt toward the Code.

Consider the fact that Congress is designed to be a deliberative body.[30] It is supposed to contemplate multiple

27. Instead of utilizing unauthorized tax elections to mitigate their tax burdens, some taxpayers simply fail to report their taxable income. *See* Richard L. Doernberg & Fred S. McChesney, *Doing Good or Doing Well? Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891, 917 (1987) (reviewing JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM (1987)) ("Seventy-five percent of the $100 million gap is due simply to nonreported income—the poor person's tax shelter—not manipulation or abuse of deduction provisions.").

28. Such unauthorized elections compete in popularity with their counterpart, namely, authorized elections. *See* sources cited *supra* note 1.

29. *See, e.g.*, Gladriel Shobe, *The Substance over Form Doctrine and the Up-C*, 38 VA. TAX REV. 249, 258 & n.37 (2018) ("The TCJA also created a new benefit associated with the Up-C . . . because Up-C structures have the option of paying compensation out of the Up-C's partnership rather than out of a corporation [and thereby securing a full compensatory deduction].").

30. Richard A. Epstein, *Why Parties and Powers Both Matter: A Separationist Response to Levinson and Pildes*, 119 HARV. L. REV. F. 210, 212 (2006) ("The hard-edged constitutional division between the Congress and the Executive arises because Congress is the deliberative body, while a single President can carry out its laws with energy and dispatch."); Gregory S. McNeal, *The Pre-NSC Origins of National Security Expertise*, 44 CONN. L. REV. 1585, 1598–99 (2012)

dimensions to a problem and respond to stakeholders' considerations, seeking to craft legislative initiatives that advance positive public policy initiatives.[31] The same psychology of accommodating the public's needs extends to administrative regulations promulgated by the Treasury Department. Such regulations are typically issued after exhaustive public hearings, which try to address the concerns of all those who might be affected and to guide the formulation of regulations accordingly.[32] Thus, when tax professionals devise strategies that attempt to circumvent legislative and administrative tax initiatives, they are often putting their clients' interests ahead of those of the nation.

The way in which tax professionals have made grantor trust status "elective" illustrates this dynamic.

("Accordingly, [the Founders] designed mechanisms within the Constitution to address the legitimate need for unity, speed and dispatch while recognizing that not all national security problems require expertise that is wielded with speed—some matters may be appropriately addressed by a deliberative body like the Congress.").

31. *See, e.g.*, Clifford J. White III, *New Fee Guidelines Enhance Transparency and Promote Market Forces in Billing*, AM. BANKR. INST. J., Aug. 2013, at 22, 53 ("The [U.S. Trustee Program] believes that these guidelines are correct as a matter of law and will continue to advance sound public policy as articulated by Congress in the Bankruptcy Code."); Park 'N Fly, Inc. v. Dollar Park & Fly, Inc., 469 U.S. 189, 193 (1985) ("Congress enacted the Lanham Act in 1946 in order to provide national protection for trademarks used in interstate and foreign commerce. . . . Because trademarks desirably promote competition and the maintenance of product quality, Congress determined that a sound public policy requires that trademarks should receive nationally the greatest protection that can be given them. Among the new protections created by the Lanham Act were the statutory provisions that allow a federally registered mark to become incontestable."(internal quotation marks and citations omitted)).

32. *See* Oei & Osofsky, *supra* note 21, at 220–21 ("The traditional wisdom is that the Administrative Procedure Act's (APA) notice-and-comment procedures help legitimize such agency rulemaking by infusing the process with public participation and deliberation, values that are lost when Congress delegates regulatory decisions. Due to this perceived importance to the regulatory state, notice and comment sits at the legal heart of agency rulemaking. Furthermore, the E-Government Act of 2002 subjects notice and comment to electronic publication requirements, in an effort to ensure that not only does the public have an opportunity to comment in the notice-and-comment period, but also that such commentary is electronically visible." (footnotes omitted)).

For years, taxpayers established trusts as mechanisms to skirt their income tax obligations.[33] More specifically, taxpayers would establish trusts and contribute income-producing assets to them. As a separate and independent entity, the income that such trusts generated would then be taxed at trust tax rates that yielded an overall lower tax burden;[34] nevertheless, the terms of the established trusts were designed so that taxpayers would have to sacrifice little in the way of control over the contributed trust assets.[35] On many occasions, the IRS would challenge the legitimacy of such trust arrangements, claiming that because the grantor retained control over the trust assets, the grantor, rather than the trust, should remain taxable on the trust income.[36]

IRS challenges to such taxpayer shenanigans are epitomized in the *Helvering v. Clifford* case.[37] In *Clifford*, the taxpayer established a short-term trust, named his wife as trustee, contributed income-producing investment assets to the trust, and essentially retained control over the entire

33. *See* Kermit E. Hundley, *The Clifford Trust and Other Grantor Trusts—From the Draftsman's Viewpoint*, 4 S. TEX. L.J. 16, 34–41 (1958) (explaining how taxpayers could utilize trust instruments to mitigate their income tax obligations).

34. *See id.* at 41–51.

35. Julian S. Bush, *Short-Term Trusts: Advantages and Dangers*, 24 N.Y.U. INST. ON FED. TAX'N 317, 327 (1966).

36. *See, e.g.*, Audano v. United States, 428 F.2d 251, 259 (5th Cir. 1970) ("Here, factors such as taxpayer's control of the affairs of the trusts, the short period in which legal title to the equipment was lodged in the trusts, the grossly excessive rentals, and the conveyance of the equipment to the partnership from the trusts for one dollar when taxpayer quit the partnership compel our conclusion that the trusts were not grounded in economic reality, but were instead simply the unavailing products of imaginative minds. The trusts, therefore, are to be treated as nullities for the purpose of determining taxpayer's tax liability, with the payments made to the trusts being properly treated as income taxable to taxpayer."); Van Zandt v. Comm'r, 341 F.2d 440, 443–44 (5th Cir. 1965) ("The only thing accomplished was to funnel family income to children in a way that allowed a deduction to the payor and taxation to the recipients at reduced rates."); Furman v. Comm'r, 381 F.2d 22, 22 (5th Cir. 1967) ("[T]he Trust lacked 'economic reality', and should not be recognized for tax purposes.").

37. *See* 309 U.S. 331 (1940).

asset investment portfolio.[38] Yes, title ownership to the assets had been changed to the trust, but nothing else of a substantive nature had occurred; nevertheless, for tax-reporting purposes, the taxpayer averred that the income that the trust generated was subject to the lower trust income tax rates.[39] The IRS challenged the taxpayer's position, and litigation ensued. After analyzing the facts of *Clifford*, the U.S. Supreme Court ruled in favor of the IRS. The Court held that the indicia of taxpayer control over the trust assets resulted in their de facto ownership by the taxpayer, and the trust as a separate legal entity accordingly should be ignored.[40]

Years later, Congress subsequently endorsed this outcome, providing a detailed regimen of strict rules, embodied in Subpart E of Subchapter J of the Code, which details the attributes of those trusts that, like the one in *Clifford*, should be ignored for tax purposes (so-called grantor trusts).[41] When grantor trust status applies, the income that the trust generates is taxed to the grantor, not to the trust.[42] At the time, grantor trust status thus subverted taxpayers' ability to capitalize upon the then lower

38. *Id.* at 332 ("In 1934 respondent declared himself trustee of certain securities which he owned. All net income from the trust was to be held for the 'exclusive benefit' of respondent's wife. The trust was for a term of five years, except that it would terminate earlier on the death of either respondent or his wife. On termination of the trust the entire corpus was to go to respondent, while all 'accrued or undistributed net income' and 'any proceeds from the investment of such net income' was to be treated as property owned absolutely by the wife.").

39. *Id.* at 333 ("It was stipulated that . . . the 'tax effects' of this trust were considered by [the taxpayer] . . . .").

40. *See id.* at 335 ("In this case we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. Rather, the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of § 22(a).").

41. For an excellent overview of this history, see Sherwin Kamin, Stanley S. Surrey & William C. Warren, *The Internal Revenue Code of 1954: Trusts, Estates and Beneficiaries*, 54 COLUM. L. REV. 1237, 1259–64 (1954).

42. *See* I.R.C. §§ 671–79.

trust tax rates.

But as the Code has evolved, tax professionals' attitudes toward grantor trust status have radically changed. In yesteryear, grantor trust status was generally to be avoided because it thwarted taxpayers' abilities to achieve their sought-after tax minimization. However, Congress has subsequently compressed trust tax rate brackets, making virtually all trust income generated subject to the highest marginal income tax rate.[43] Grantor trust status (whereby the taxpayer, rather than the trust, is taxed on trust income generated) is therefore no longer an anathema. To the contrary, depending upon the circumstances, some taxpayers now strategically pursue grantor trust status for the following two reasons: (1) it can produce a smaller overall income tax burden; and (2) by the grantor being burdened with income tax responsibilities rather than the trust, the fair market value of the trust assets may grow more rapidly, enhancing the amount of wealth inuring to the designated trust beneficiaries free of gift, estate, and generation-skipping transfer taxes.[44]

In light of the fact that grantor trusts now embody tax-favorable attributes, how can taxpayers change the status of a traditional nongrantor irrevocable trust into a grantor trust? One simple way is by the addition of an asset-substitution provision in the trust instrument.[45] Vis-à-vis

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43. *See id.* § 1(e).

44. *See, e.g.*, Brandon A.S. Ross, *Drafting Grantor Trust Powers with an Exit Strategy*, PROB. & PROP., Mar./Apr. 2013, at 34, 35 ("Grantor trust status for irrevocable trusts has been sought for decades to take advantage of three primary benefits of grantor trust status, other than the favorable income tax rates: (1) the grantor effectively could make a gift in the amount of the income tax liability of the trust assets to the beneficiaries of the trust by paying the income tax related to the trust assets without being deemed to make a gift to the trust beneficiaries that would be subject to gift tax; (2) the grantor could sell assets to the trust for fair market value without recognition of gain or imposition of gift tax; and (3) the grantor, shortly before death, could purchase or exchange low basis assets for high basis assets without imposition of income tax.").

45. *See generally* Michael D. Mulligan, *Power to Substitute in Grantor Does Not Cause Inclusion, with a Significant Caveat*, 109 J. TAX'N 32 (2008) (explaining

this provision, a grantor may switch the ownership of assets that he owns in his individual name to the ownership of the trust. Whether or not the substitution power is exercised, the provision's mere existence transforms the entire nature of the trust from nongrantor to grantor status.[46] Thus, with the addition of a simple provision in a governing instrument, taxpayers may unilaterally manipulate trust status and achieve tax outcomes never intended by Congress.[47]

The subversion of congressional and Treasury Department goals associated with unauthorized tax elections thus often comes at the steep price tag of forgone tax revenue. In the case of taxpayers utilizing grantor trust status to minimize their income and transfer tax obligations, for example, billions of dollars of tax revenue could be at risk of being forfeited. Admittedly, estimating this dollar amount is an imprecise exercise: the Code explicitly permits taxpayers to avail themselves of this technique (i.e., conferring grantor trust status on irrevocable trusts);[48] therefore, the revenue loss associated with this unauthorized tax election will not appear as part of the IRS's tax gap measurement computations.[49] Only educated speculation leads to the revenue loss conclusion: due to the utilization of

how a power of substitution may be employed to create grantor trust status).

46. *See* I.R.C. § 675(4)(C).

47. *See generally* Daniel L. Ricks, *I Dig It, But Congress Shouldn't Let Me: Closing the IDGT Loophole*, 36 ACTEC L.J. 641 (2010) (discussing how taxpayers manipulate grantor trust status in order to circumvent their transfer tax obligations).

48. *See id.* at 643 ("[Affording grantor trust status to irrevocable trusts] is antithetical to a transfer tax system and Congress never intended that the tax law would sanction [transactions involving them]. In fact, many estate planners believe that the unintended tax benefits created by the Internal Revenue Code in favor of society's wealthiest individuals provide low-hanging fruit for federal revenue generation.").

49. Instead, tax gap studies routinely explore the problems of nonfilers and those who underreport. *See, e.g.*, BARRY W. JOHNSON & PETER J. ROSE, INTERNAL REVENUE SERV., FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, §§ 4.1–4.2 (2019), https://www.irs.gov/pub/irs-pdf/p1415 .pdf [https://perma.cc/L8GW-HVL7].

this technique by a multitude of taxpayers, significant tax savings must be at stake, and substantial revenue hemorrhaging is unfolding.[50]

Beyond the tangible of revenue forfeiture is the intangible of how unauthorized tax elections spur derision directed toward the Code. This is a two-sided coin: on the one hand, those taxpayers who make unauthorized tax elections anecdotally smirk when following the advice of their tax professionals, often incredulous that the insertion of a few words in a governing document can have such a dramatic tax effect; on the other hand, those taxpayers who are bystanders to those making unauthorized tax elections often feel that they are chumps for not taking advantage of the system themselves.[51] From either vantage point, the picture presented is not pretty and is likely to erode taxpayer confidence in and compliance with the nation's tax system.

C. *Benefits Associated with Unauthorized Tax Elections*

In reading the last Section of this analysis, one might reasonably think that unauthorized tax elections are nothing short of public policy debacles. However, this could not be

50. There are numerous articles written about such trusts; and judging by their titles alone, one can gather that they produce sizable tax savings. *See, e.g.*, Rachna D. Balakrishna, *Defective Grantor Trusts: Greater Flexibility and Income Tax Leverage*, 32 EST. PLAN., Dec. 2005, at 30; Kuno S. Bell, *Use Defective Grantor Trusts for an Effective Triple Play*, 75 PRAC. TAX STRATEGIES 12 (2005); Howard M. Larsen, *Defective Grantor Trusts Can Be Boon in Asset Protection and Estate Planning*, ORANGE CNTY. LAW., Apr. 1999, at 18.

51. *See, e.g.*, Ernst Fehr & Urs Fischbacher, *The Economics of Strong Reciprocity*, *in* MORAL SENTIMENTS & MATERIAL INTERESTS: THE FOUNDATIONS OF COOPERATION IN ECONOMIC LIFE 151, 167 (Herbert Gintis et al. eds., 2005) ("[I]f people believe that cheating on taxes, corruption, or abuses of the welfare state are widespread, they themselves are more likely to cheat on taxes, take bribes, or abuse welfare state institutions."); Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane*, 16 VA. TAX REV. 155, 199 (1996) (theorizing that "when we hear about Leona Helmsley evading taxes and going to jail, some of us say to ourselves 'we had better pay our taxes,' but many others tend to engage in an internal dialogue that sounds more like 'this rich woman evaded her taxes; from what I hear, most other rich people do, and probably I should or I'll be losing out'").

further from the truth. Instead, they constitute important signals to Congress and the Treasury Department that something is askew, warranting attention.[52] If the legislative branch and the agency charged with overseeing taxpayer compliance are attuned to the existence of these elections, their very presence may prove constructive.

An example illustrates this point.

The Code defines *corporate entities* to include "associations."[53] For decades, the governing regulations identified a set of six criteria linked with being an association (i.e., associates, business objective, continuity of life, centralized management, limited liability, and free transferability of interests).[54] Business enterprises that had a majority of these attributes (i.e., at least four) were deemed associations, taxable as corporations; and those with fewer were not, taxable instead as partnerships, proprietorships, or trusts.[55] To avoid corporate status and its concomitant tax burdens, many taxpayers, with the assistance of their tax advisers, inserted provisions in their operating documents to safeguard against this.[56] This legal footwork often was

52. This is the exact converse of those situations when the government nudges taxpayers to engage in particular behaviors that society deems optimal. *See generally* Kathleen DeLaney Thomas, *Taxing Nudges*, 107 VA. L. REV. 571 (2021) (describing how Congress should tax governmental nudges).

53. I.R.C. § 7701(a)(3).

54. *See* Treas. Reg. § 301.7701-2(a)(1) (1996) (pre-amendment in 1997).

55. *See id.*

56. *See, e.g.*, Littriello v. United States, 484 F.3d 372, 376 (6th Cir. 2007) ("These unincorporated business entities had the characteristics of both corporations and partnerships, combining ease of management with limited liability, and were increasingly structured with the Kintner regulations in mind, in order to take advantage of whatever classification was thought to be the most advantageous."); *see also* Field, *Checking In on "Check-the-Box," supra* note 1, at 463 ("[G]iven the bright line rules set forth in the Kintner regulations and the flexibility afforded under the applicable state business statutes, practitioners were often able to create LLCs and other business entities with a carefully tailored set of rights and responsibilities so as to achieve tax classification as either a corporation or a partnership, as desired by the client, while retaining significant features of the other classification.").

expensive, resource-intensive, and time-consuming—and a simple verbiage mishap could prove to be a tax detriment.[57]

After decades unfolded, during which there were multiple court challenges and the issuance of thousands of pages of private letter rulings authenticating the tax status of various business enterprises (constituting de facto unauthorized elections),[58] the Treasury Department came to the belated, but enlightened, conclusion not only that these drafting exercises were a waste of time and resources for taxpayers but also that government oversight was an exercise in futility. That being the case, the Treasury Department, on its own initiative, devised what are known as check-the-box regulations, which permit taxpayers to essentially decide the tax status of the business enterprises they establish without the omnipresent threat of being second-guessed by the IRS.[59] In lieu of spending countless hours and enduring hefty professional fees to secure a desired tax outcome, going forward, taxpayers may instead rely on a set of pro-taxpayer default rules or, alternatively, complete a simple one-page election form that grants almost complete discretion to them to choose the tax status of the business enterprises that they form.[60]

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57. *See, e.g.*, Rod Garcia, *Treasury Officials Address Check-the-Box Entities*, 67 TAX NOTES 1009, 1009 (1995) (According to a Treasury official, "[i]t's a resource allocation question. . . . Too many resources have been wasted both by the IRS and the private sector in resolving classification issues, even though in the end the taxpayer gets the desired status. . . . Classification becomes a very intricate game that if you have counsel[,] you get out of the maze and you're home free." (internal quotation marks omitted)).

58. *See* Field, *Checking In on "Check-the-Box," supra* note 1, at 464 ("Presumably, taxpayers also incurred significant legal fees in obtaining advice on these classification issues. Further, the Service noted that small businesses could be particularly hard hit by the considerable costs of obtaining advice regarding how to structure business entities to obtain the most favorable combination of state law and tax treatment.").

59. *See* Simplification of Entity Classification Rules, 61 Fed. Reg. 21,989, 21,990 (proposed May 13, 1996) (to be codified at 26 C.F.R. pt. 301).

60. *See* JOINT COMM. ON TAX'N, 105TH CONG., REVIEW OF SELECTED ENTITY CLASSIFICATION AND PARTNERSHIP TAX ISSUES 17 (Comm. Print 1997) (noting that "[t]he principal impact is that taxpayers may now choose with greater simplicity

The check-the-box regulations are emblematic of the trifold signaling value of unauthorized tax elections.

Fulfilling public policy goals. For starters, by calling attention to legislative or administrative shortcomings associated with statutory or administrative prose, unauthorized tax elections can direct Congress toward the fulfillment of public policy goals. As a general axiom, Congress seeks to make economic growth as robust as possible. Therefore, whenever the nation's legislative body perceives an impediment to such growth, it seeks to eradicate it. In line with this orientation, the Treasury Department follows the same script. When the Treasury Department thus analyzed how the choice-of-entity issues might be retarding economic growth, it took a bold measure—the issuance of the check-the-box regulations—to foster the long-standing congressional goal of facilitating business formations.

Safeguarding the nation's coffers and reducing deadweight economic losses. Another signaling value of unauthorized tax elections is safeguarding the nation's coffers and reducing the deadweight economic losses associated with tax planning.[61] Once an unauthorized tax

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and lower compliance costs whether they will pay two levels of tax on business income under the corporate tax rules, or whether they will pay only one level of tax under the partnership tax rules"); Susan Pace Hamill, *The Taxation of Domestic Limited Liability Companies and Limited Partnerships: A Case for Eliminating the Partnership Classification Regulations*, 73 WASH. U. L.Q. 565, 600 (1995) (The new check-the-box regulations "save both taxpayers and the Service an enormous, if largely unmeasurable, amount of transaction costs. Without having to seek expensive advice or use the Service's resources, persons deciding among the major domestic entities—the corporation, the partnership, and the LLC—can be absolutely certain of the tax treatment of their entity." (footnote omitted)); Victor E. Fleischer, Note, *"If It Looks like a Duck": Corporate Resemblance and Check-the-Box Elective Tax Classification*, 96 COLUM. L. REV. 518, 531–32 (1996) (commenting that the check-in-the-box regulations "reduce[] the transaction costs of closely examining local law when organizing a business venture").

61. *See, e.g.*, Brant J. Hellwig, *Questioning the Wisdom of Patent Protection for Tax Planning*, 26 VA. TAX REV. 1005, 1007 (2007) ("[T]ax planning creates deadweight loss to society through distortions in taxpayer behavior and transaction costs that do not contribute to the public fisc."); Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. CHI. L. REV. 601,

election has entered the ambit of public awareness, politicians and tax administrators have the opportunity to change the governing law or administrative regulations in one of two ways: eradicating pernicious elections or embracing salutary ones. Either action yields positive outcomes insofar as fisc drainage is plugged and taxpayers do not spend countless sums of money on legal and accounting fees developing work-arounds.

Preserving the Code's stature. A third and final by-product of addressing unauthorized tax elections is that doing so helps keep the Code's stature intact. There are numerous empirical studies indicating that tax compliance is infectious: taxpayers are more prone to be compliant if they believe that fellow taxpayers are compliant; and the exact opposite is also true, that is, if taxpayers perceive a lack of fellow taxpayer compliance, they are more prone to be noncompliant as well.[62] The fact that unauthorized tax elections are just that—namely, unauthorized—means that their existence is likely to breed contempt toward the tax system by both participants and nonparticipants. Remedial action will allay such contempt.

II. TWO COMPARATIVE CASE STUDIES

Unauthorized tax elections serve a useful signaling purpose to nudge politicians and tax administrators alike that something is amiss that requires reform. In some instances, reform will be necessary to purge unauthorized tax elections that are pernicious and subversive in nature; in

643 (2007) ("In general, tax planning is inefficient because tax-motivated changes in behavior produce deadweight losses."); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222 (2002) ("Tax planning is . . . almost always positively bad for society . . . .").

62. *See* Robert H. Frank, *Without More Enforcement, Tax Evasion Will Spread Like a Virus*, N.Y. TIMES (Oct. 30, 2020), https://www.nytimes.com/2020/10/30/business/tax-evasion-virus-IRS.html [https://perma.cc/4TZB-3LLX] (explaining how tax noncompliance can prove infectious between and among taxpayers, causing even those inclined to be tax compliant to lose their grounding).

other instances, reform will be necessary to formally institutionalize those unauthorized tax elections that enhance and strengthen the nation's tax system.

Below, this analysis presents a comparative case study depicting two unauthorized tax elections: Section II.A overviews an unauthorized tax election involving so-called Crummey trust formation, and Section II.B details an unauthorized tax election regarding so-called bypass trust utilization. Some commentators might be inclined to label the former a "bad" election insofar as it provides a direct bridge that enables taxpayers to circumvent their gift tax obligations,[63] and to label the latter a "good" election insofar as it enables each spouse of a married couple to make use of his/her estate tax exemption amount.[64] However, what this analysis reveals in Section II.C is that such dichotomous labeling is misplaced and an exercise in dangerous oversimplification.

63. *See, e.g.*, Bradley E.S. Fogel, *The Emperor Does Not Need Clothes—The Expanding Use of "Naked"* Crummey *Withdrawal Powers to Obtain Federal Gift Tax Annual Exclusions*, 73 TUL. L. REV. 555, 555 (1998) ("The federal gift tax annual exclusion allows a donor to give $10,000 per calendar year [(currently, $15,000 per calendar year)] to an unlimited number of individuals free of gift tax. The exclusion is unavailable for gifts of 'future interests.' Most gifts in trust are at least partially future interests, therefore the exclusion is unavailable for these gifts. In order to make a gift trust that qualifies for the federal gift tax annual exclusion to withdraw the gift from the trust, the donee may be given a temporary power called a *Crummey* power.").

64. *See, e.g.*, Stewart J. Beyerle, *Bypass Trusts Can Maximize Unified Credit*, 18 EST. PLAN. 212, 213 (1991) ("[W]hen the first spouse dies, his or her portion of the assets is first allocated to an irrevocable bypass trust up to the $600,000 exemption amount of the unified credit, and any excess is allocated to the marital deduction trust. As a result, there will be no estate tax on the death of the first spouse. The value of the bypass trust, including any appreciation thereon, will also escape estate taxation on the death of the surviving spouse.").

A. *Case Study One: Crummey Trust Provisions*

By way of background, in 1924, in order to safeguard the integrity of the estate tax, Congress enacted a gift tax.[65] Taxpayers could no longer circumvent their estate tax burdens simply by making significant lifetime transfers.[66] For reasons of administrative convenience, however, Congress introduced the gift tax annual exclusion.[67] This exclusion enables taxpayers to make present-interest transfers, such as birthday and graduation gifts, free from gift tax, thereby negating the need for any record-keeping and filing submissions.[68] In contrast, all future-interest gifts—that is, those that do not immediately vest in the name of a designated beneficiary—are included in the gift tax base.[69]

When making gifts, trust usage is commonplace. The reasons for trust popularity are multifaceted. Trusts are excellent vehicles by which grantors can preserve and safeguard contributed trust assets, which are managed and invested by investment-savvy trustees and, in many instances, distributed at a later point in time to one or more

65. Revenue Act of 1924, ch. 234, §§ 319–24, 43 Stat. 253, 313–16.

66. *See* Estate of Sanford v. Comm'r, 308 U.S. 39, 44 (1939) ("An important, if not the main, purpose of the gift tax was to prevent or compensate for avoidance of death taxes . . . .").

67. *See* H.R. REP. NO. 72-708, at 29 (1932) ("[The annual exclusion] on the one hand, is to obviate the necessity of keeping an account of and reporting numerous small gifts, and, on the other, to fix the amount sufficiently large to cover in most cases wedding and Christmas gifts and occasional gifts of relatively small amounts."); *see also* S. REP. NO. 72-665, at 41 (1932) ("Such exemption, on the one hand, is to obviate the necessity of keeping an account of and reporting numerous small gifts, and, on the other, to fix the amount sufficiently large to cover in most cases wedding and Christmas gifts and occasional gifts of relatively small amounts.").

68. *See* I.R.C. § 2503(b)(1).

69. *Id.* ("In the case of gifts (*other than gifts of future interests in property*) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not, for purposes of [the gift tax] be included in the total amount of gifts made during such year." (emphasis added)).

designated trust beneficiaries.[70] Indeed, trusts are designed to protect trust beneficiaries from themselves (in terms of overspending), as well as from evil and conniving spouses and overly rambunctious creditors.[71]

By their very nature, virtually all trust contributions theoretically constitute future interests and, as such, endure gift tax exposure. However, to safeguard against gift tax imposition, tax professionals devised a clever transfer tax-minimization scheme. With respect to trusts that they were tasked to draft, they engrafted provisions that permitted trust beneficiaries a limited window period to immediately withdraw contributed trust funds.[72] The agenda associated with adding such withdrawal window periods was simple: to transform what otherwise would be a future interest—and thus subject to gift tax exposure—into a present interest that qualified for the annual gift tax exclusion.[73]

Over a half century ago, in *Crummey v. Commissioner*,[74] the IRS challenged an important element related to the viability of this technique. The agency claimed that, notwithstanding the existence of withdrawal provisions, in those situations in which minors were the designated trust beneficiaries and no guardians had been appointed on their behalf, trust contributions were future interests; as such, these trust contributions could not qualify for the gift tax

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70. *See generally* AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER & MARK L. ASCHER, SCOTT AND ASCHER ON TRUSTS § 2.1 (5th ed. 2006).

71. *See* Allison Tait, *Trusting Marriage*, 10 U.C. IRVINE L. REV. 199, 215 (2019) ("Trusts have traditionally played a key role in this planning, prized for their ability to protect assets from creditors, including spouses.").

72. For an excellent discussion of the origins and use of so-called Crummey withdrawal powers, which form the basis of this window period, see generally Bradley E.S. Fogel, *Back to the Future Interest: The Origin and Questionable Legal Basis of the Use of Crummey Withdrawal Powers to Obtain the Federal Gift Tax Annual Exclusion*, 6 FLA. TAX REV. 189 (2003).

73. *See id.* at 194 n.20 ("Based on Crummey withdrawal powers held by the beneficiaries, gifts to the trust are considered gifts of present interests that may be offset by the federal gift tax annual exclusion.").

74. 397 F.2d 82 (9th Cir. 1968).

annual exclusion.[75] The Tax Court agreed with the IRS's analysis, ruling in the agency's favor,[76] and the taxpayer appealed.

Years earlier, in *Fondren v. Commissioner*,[77] the Supreme Court held that gifts made to an irrevocable trust for the grantor's minor grandchildren, where the terms of the trust required that income and corpus be accumulated and were not to be distributed until such time as each grandchild reached age twenty-five, constituted future-interest gifts and hence were taxable.[78] To avoid the fate of the taxpayers in *Fondren* and the disqualification of their trust contributions from the gift tax annual exclusion, tax professionals opted to add window periods coupled with beneficiary withdrawal rights to trust documents. Courts routinely upheld the validity of these devices as being bona fide mechanisms to make trust contributions into present interests that qualified for the gift tax annual exclusion.[79]

Still, on appeal in *Crummey*, the U.S. Court of Appeals for the Ninth Circuit wrestled with the fact that the taxpayer's minor children were not likely to exercise this

75. *Id.* at 83 ("This determination was based upon the Commissioner's belief that the portion of the gifts in trust for the children under the age of 21 were 'future interests' which are disallowed under § 2503(b).").

76. *See* Crummey v. Comm'r, 25 T.C.M. (CCH) 772 (1966), *aff'd*, 397 F.2d 82 (9th Cir. 1968).

77. 324 U.S. 18 (1945).

78. *Id.* at 28–29 ("The graduated scale of payments, beginning at age twenty-five and ending at thirty-five, together with the prohibition of payment earlier except in case of necessity, shows principal concern for a period of adult life. And, from the fact that this would be the period when the grandchildren normally would be assuming family responsibilities of their own, the inference well might be drawn that the chief purpose was to give aid and some security in that time. The contingent provision, in case of earlier need, cannot be taken therefore to represent the donors' primary concern as expressed in the instruments. *Cf.* Fisher v. [Comm'r], 132 F.2d 383, 386 [(9th Cir. 1942)]. But, whether so or not, in the particular circumstances that need was but a contingency to be realized, if at all, in the future. And, until realized, the contingency stood squarely in the way of any child's receiving a single dollar from the fund.").

79. For an excellent analysis of these cases, see generally Fogel, *supra* note 63.

withdrawal right.[80] Nevertheless, as expressed by the Ninth Circuit, "as a technical matter, we think a minor could make the demand."[81] This legal technicality sufficed to convince the court to rule in the taxpayer's favor.[82]

The court's imprimatur of approval launched a stampede of eager taxpayers anxious to utilize this technique, which, decades later, shows no signs of abating. Now, almost without exception, the terms of virtually every irrevocable trust contain these provisions, permitting the wholesale use of these de facto unauthorized tax elections in which taxpayers opt to make their otherwise future-interest trust contributions into present-interest ones.

Like many other unauthorized tax elections, Crummey trust provisions may wreak havoc. They subvert the legislative intent of providing a mechanism for relatively small annual gifts to be made absent the need to file transfer tax returns; their use shrinks the transfer tax base; and, to the general public, their presence makes the Code appear absurd because of the transformative nature of the addition of a few seemingly meaningless words.[83] And Crummey trust provisions do not exist on the dark web; unlike clandestine tax shelters of the past, both the public and Congress are well aware of the existence of this technique.[84] Such toleration

80. *See Crummey*, 397 F.2d at 86–87.

81. *Id.* at 87.

82. *Id.* at 88.

83. John L. Peschel, *Major Recent Tax Developments in Estate Planning*, *in* 33 U. S. CAL. L. CTR. TAX INST. ch. 14, ¶ 1401.02 (1981) ("[T]he *Crummey* power, in theory, has a strong legal basis but, in practice, emits an equally strong odor of sham."); *see* Willard H. Pedrick, *Crummey Is Really Crummy!*, 20 ARIZ. ST. L.J. 943, 948 ("[T]he [Crummey] withdrawal right is transparently a flim flam."); Benjamin N. Henszey, Crummey *Power Revisited*, 59 TAXES 76, 77 (1981) ("[T]he IRS is aware that the [Crummey] power is a sham in most cases . . . ."); DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S REVENUE PROPOSALS 130 (1998), https://home.treasury.gov/system/files/131/General-Explanations-FY1999.pdf [https://perma.cc/CS5J-TZ49] (stating that "the Crummey power is essentially a legal fiction").

84. A Google search of the phrase "Crummey trust" yields about 95,600 results. GOOGLE, https://www.google.com/search?q=Crummey+trust [https://

suggests that, at least in the minds of those in power, the proposed fix of disqualifying all trust contributions from exclusion from the gift tax base may prove worse than the problem itself, which excludes the majority of trust contributions from the gift tax base.

B. *Case Study Two: Bypass Trust Provisions*

From inception, the nation's estate tax always included a fairly significant exemption that insulated the vast majority of taxpayers' estates from its imposition.[85] This exemption, however, was granted on a taxpayer-by-taxpayer basis (i.e., married couples were not treated as a single economic unit). That being the case, a common estate planning strategy quickly emerged. In order to secure the use of both spouses' exemption amounts, on the death of the first spouse, the decedent spouse would establish a so-called bypass trust that was designed to absorb the decedent spouse's unused estate tax exemption amount; and upon the surviving spouse's demise, the bypass trust assets would not be included in the surviving spouse's estate (hence, the moniker *bypass*).[86]

An example illustrates how taxpayers use bypass trust assets to capitalize upon the use of each spouse's estate tax exemption amount.

Consider the plight of married couple Spouse A and Spouse B. Assume that each has $10 million of assets in his/her respective name, the prevailing estate tax exemption is $10 million, and the estate tax rate is forty percent. Suppose further that Spouse A dies and bequeaths his entire estate to Spouse B. Due to the unlimited estate tax marital

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perma.cc/S84K-PYYB] (last visited May 28, 2022) (search "Crummey trust").

85. *See generally* Jay A. Soled, *The Federal Estate Tax Exemption and the Need for Its Reduction*, 47 FLA. ST. U. L. REV. 649, 652–59 (2020) (exploring the history of the federal estate tax exemption).

86. *See generally* Beyerle, *supra* note 64 (explaining the virtues of bypass trust use to capitalize upon each spouse's unified credit exemption amount).

deduction,[87] at his demise, no estate tax would apply (i.e., $10 million gross estate minus $10 million of assets passing to the decedent's surviving spouse). However, at Spouse B's demise, she would have a $20 million gross estate ($10 million from her husband's estate plus $10 million of her own), generating a $4 million estate tax (i.e., [$20 million (gross estate) – $10 million (exemption)] x 0.4).

Compare the foregoing outcome with the following set of facts: Spouse A "elects" to insert certain provisions in his will that would result in the establishment of a bypass trust at his demise. He subsequently dies, and, under the terms of his will, his $10 million of assets flow into a bypass trust; furthermore, Spouse A designates Spouse B as the trustee of the bypass trust; trust income is distributed annually to her; and corpus distributions are made to her and/or her children in accordance with an ascertainable standard (for their health, education, maintenance, and support). Notwithstanding the vast amount of latitude that Spouse B has with regard to the trust assets, their value is not included in her gross estate upon her demise, because she has no direct control over them. That being the case, due to the assumed estate tax exemption amount, her gross estate would escape estate tax entirely because it would equal $10 million: her original assets would not be augmented by the assets held by the bypass trust, so the family unit would be able to save $4 million of estate tax.

For decades, bypass trust utilization was standard fare in the estate planning world.[88] But this unauthorized tax

87. I.R.C. § 2056(a).

88. *See* Glen T. Eichelberger & Brian P. Teaff, *Bypass Trusts: Obsolete Bygones or Too Good to Pass Up*, 40 EST. PLAN. 2, 3 (2013) ("[Prior to portability of the estate tax exemption amount], it was generally impossible for a married couple's estate plan to avoid some degree of complexity to ensure tax efficiency because a spouse's estate tax exemption amount was a 'use it or lose it' proposition."); Jay A. Soled, *A Proposal to Make Credit Shelter Trusts Obsolete*, 51 TAX LAW. 83, 83 (1997) ("Since the introduction of the unified credit in 1976, married couples who attempt to minimize transfer taxes and maximize the wealth passing to their heirs have generally been plagued by an expensive and

election carried a steep price tag. Year after year, trustees had to complete and file annual trust income tax returns (Form 1041s); the IRS had to process and monitor such returns for their accuracy; and surviving spouses sometimes had to deal with not-so-accommodating trustees who could demand steep fiduciary commissions.[89] And what did this entire exercise have to show for itself? A lot of paper shuffling to achieve an objective that was already commonplace under the Code—namely, treating married spouses as a single economic unit.[90]

Approximately a decade ago, Congress finally responded to the insidious avalanche of bypass trust formation. It chose to make the estate tax exemption portable between spouses so that upon one spouse's demise, the surviving spouse could automatically receive the decedent spouse's exemption amount.[91] This reform eradicated the need for thousands and thousands of trusts to be formed—and eliminated the silliness that this entire exercise engendered.

burdensome exercise. In order for each spouse to optimize the use of his or her unified credit under the Code and to promote the economic well-being of the surviving spouse, the last will and testament of each spouse, using technical formulas and special terms of art, must establish a testamentary trust for the benefit of the surviving spouse. Known in tax parlance as credit shelter or bypass trusts, these trusts, if properly structured, are intended to shield the assets of the first decedent spouse from inclusion in the gross estate of the surviving spouse." (footnote omitted)).

89. *See* Soled, *supra* note 88, at 92–94 (discussing the administrative costs to the government and taxpayers regarding bypass trust utilization).

90. *See* Angela V. Langlotz, *Tying the Knot: The Tax Consequences of Marriage*, 54 TAX LAW. 329, 332 (2001) ("Following the 1948 codification of filing joint returns, married couples with a given income paid exactly the same tax, regardless of which spouse earned the income or what proportion of household income was attributable to each.").

91. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 303(a), 124 Stat. 3296, 3302–03 (enacting Code § 2010(c), which permits portability of decedent spouse's unused estate tax exemption).

C. *The Uselessness of a Binary Analysis*

Notwithstanding the foregoing analysis, framing unauthorized tax elections in a binary fashion as being either good or bad is overly simplistic and inherently flawed. On the surface, some unauthorized tax elections (e.g., bypass trust utilization) appear to offer a method to achieve administrative goals and have an aura of wholesomeness about them;[92] conversely, those unauthorized tax elections (e.g., Crummey withdrawal powers) that are specifically designed to achieve tax minimization have a suspect quality about them.[93]

But categorizing unauthorized tax elections in this good/bad manner smacks of superficiality. The so-called bad unauthorized tax elections are not necessarily corrupt insofar as they inform Congress and the Treasury Department that the tax system is possibly burdened with meaningless metrics (distinguishing between present and future interests) or saddled with anachronistic structural features of years past (retaining grantor trust status predicated on an erstwhile trust tax bracket rate structure that no longer exists). By the same token, conceptualizing so-called good unauthorized tax elections as being purely virtuous in nature is misplaced; it misses the mark in that their utilization enables tax professionals to prey on taxpayers' ignorance and to make huge fees along the way.

What this comparative study thus informs and reinforces is the notion that an unauthorized tax election is neither an unadulterated positive nor an unadulterated negative. The one thing that can be said with any confidence

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92. For example, so-called good unauthorized elections might include those provisions designed to fulfill choice of business entity requirements or, alternatively, bypass trust utilization.

93. For example, so-called bad unauthorized elections might include the insertion of a power of substitution to achieve grantor trust status or, alternatively, Crummey withdrawal provisions that enable trust contributions to qualify for the gift tax annual exclusion.

is that the existence of an unauthorized tax election warrants immediate attention: left unattended, such elections can gradually corrode the integrity of the tax system; by contrast, if timely addressed, their existence can guide meaningful guidance and reform.

III. NEED TO ADDRESS UNAUTHORIZED TAX ELECTIONS

Because Congress does not know the economic and personal plights of each taxpayer, it often permits them to make important tax decisions via a myriad of approved tax elections.[94] In this manner, Congress enables the Code to shed its otherwise monolithic aura, making it far less likely to be perceived by the general public as being Procrustean in nature.

Below, Section III.A explores the nature of the Code's authorized elections and their utility. Based upon this template, Section III.B next details how Congress and the Treasury Department need to address and respond to unauthorized tax elections.

A. *The Code's Authorized Tax Elections*

Tax elections punctuate the Code and serve a multitude of purposes: sometimes they alleviate the need for burdensome record keeping;[95] other times they can reduce the costs that taxpayers incur to be tax compliant;[96] still other times their utilization facilitates business

94. *See supra* note 1 and accompanying text.

95. For example, taxpayers may elect to use a standard mileage deduction instead of having to keep exhaustive records of how much they spend on items such as gasoline, tolls, and insurance to maintain their automobiles for business use. Rev. Proc. 2019-46, § 4, 2019-49 I.R.B. 1301. When it comes to home office expenses, the IRS permits taxpayers to elect a simplified safe harbor method for determining a taxpayer's deductible home office expenses. Rev. Proc. 2013-13, § 1, 2013-6 I.R.B. 478; I.R.S. News Release IR-2013-5 (Jan. 15, 2013).

96. For example, to alleviate the costs associated with tax compliance, Congress permits taxpayers to elect a tax year other than the required tax year in order to exact lower fees from their tax professionals. I.R.C. § 444(a).

transactions;[97] and, finally, tax elections provide plain-vanilla opportunities for taxpayers to save taxes.[98] And tax elections are not some new phenomenon: soon after the introduction of the modern income tax in 1913, Congress began to make tax elections part and parcel of the Code's fabric.[99]

Gauged at least by their pervasiveness, tax elections have many virtues. For example, their features add elements of flexibility to the Code, enabling taxpayers to carry on their daily affairs with as little tax-related intrusiveness as possible.[100] Furthermore, other tax elections have the capacity to make the Code more equitable in nature.[101] While politicians from both sides of the political aisle often find themselves at odds regarding policy issues, when it comes to tax elections, Democrats and Republicans generally come together, as evidenced by the fact there exists no legislative history of a proposed tax election spawning legislative controversy.

But not all share this Pollyannaish view of tax elections. There are several commentators who harbor misgivings regarding the existence of these elections.[102] Chief among

97. For example, taxpayers may purchase a partnership interest (rather than the assets of the partnership) and still secure a tax basis in the partnership's assets equal to fair market value. *See id.* § 754. A similar election can be made regarding the purchase of a corporate equity interest. *See id.* § 338(a).

98. The executor of a decedent's estate may elect to value all of the property in the gross estate as of the date six months after the decedent's death. *Id.* § 2032(a).

99. For example, the Internal Revenue Code of 1939 permitted taxpayers to elect an extension of time to file their income tax returns. I.R.C. § 53(a)(2) (1939) (53 Stat. 28); *see also* Revenue Act of 1921, ch. 136, § 240, 42 Stat. 227, 260 (current version at I.R.C. § 1501 (2006)) (filing of consolidated returns was electable); Revenue Act of 1918, ch. 18, § 223, 40 Stat. 1057, 1074 (1919) (allowing certain married couples to file jointly).

100. *See supra* note 95.

101. *See supra* note 98 (enabling the executor of a decedent's estate to avoid bearing an estate tax on wealth that no longer exists).

102. *See, e.g.*, Cauble, *supra* note 1, at 489 ("Tax elections are harmful."); Field, *Choosing Tax*, *supra* note 1, at 26 ("Many tax academics seem to have an

their concerns is that tax elections add an unwelcome dimension of complexity to the Code,[103] often requiring sophisticated tax counsel to help guide the decision-making process.[104] Because many taxpayers lack the resources to secure such advice, they cannot make tax-savvy decisions, putting them at a distinct disadvantage relative to those with greater financial resources.[105] In addition, tax elections can sap the nation's fisc of much-needed revenue.[106]

Notwithstanding the just-articulated virtues and misgivings associated with tax elections, a key reason why they are so important to the tax system is that they supply Congress and the Treasury Department with vital information. Instead of taxpayers trying to make these elections on their own (via the unauthorized tax election route), a qualification for Code-authorized tax elections is that taxpayers must disclose their choices by submitting designated election forms.[107] These election forms enable the IRS to better police compliance and enable Congress and the Treasury Department to garner critical information about tax trends and compliance concerns, which empowers both the legislative and administrative branches of government to execute constructive responses.

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instinctive distaste for explicit elections in the tax system."); Yin, *supra* note 1, at 130 ("If the taxpayer is well-advised, [every tax] election, which has ramifications for tax purposes only, will always be to the detriment of the fisc.").

103. *See* Cauble, *supra* note 1, at 447 ("[T]ax elections generate complexity.").

104. *See id.* at 423 ("[A]n unsophisticated couple who is unaware of the election may fail to obtain beneficial tax treatment.").

105. *See* Field, *Choosing Tax*, *supra* note 1, at 31 ("[A]n election, while technically available to all eligible taxpayers, may be functionally available only to the wealthiest, most sophisticated group of taxpayers, who can best navigate the complexity of the election process.").

106. *Id.* at 30 ("[I]t is virtually axiomatic to say that explicit elections reduce tax revenue.").

107. *See id.* at 28 ("Once the technical requirements for making an election are determined, the taxpayer must prepare and file the election accordingly.").

B. *Addressing the Code's Unauthorized Tax Elections*

Ideally, the life cycle of an unauthorized tax election should be as follows: Congress enacts a new law or the Treasury Department promulgates a new Treasury regulation; tax professionals develop an unauthorized tax election, bring it into the public domain, and empower taxpayers to achieve tax outcomes that neither the legislative nor administrative branch of government anticipated or intended; and then the governing law or the Treasury regulation in question is amended in a manner that eradicates the unauthorized tax election or, alternatively, incorporates it into the Code.

Notwithstanding this supposed ideal, Section III.B.1 explores why this imaginary life cycle does not ordinarily exist, and Section III.B.2 then prescribes an enlightened methodology to address unauthorized tax elections.

1. Unauthorized Tax Elections and Their Resiliency

Both the public and academic commentators often express surprise and dismay at the elongated shelf life of many unauthorized tax elections. Many times, it is years, and in some cases decades, before Congress addresses the problem of specific unauthorized tax elections.[108] And the

108. *See* Field, *Checking In on "Check-the-Box," supra* note 1, at 464–65 ("Since the issuance of Revenue Ruling 88-76 [Rev. Rul. 88-76, 1988-2 C.B. 360 (dealing with entity classification issues)], the Service issued seventeen revenue rulings, several revenue procedures, and numerous letter rulings on entity classification issues. Presumably, taxpayers also incurred significant legal fees in obtaining advice on these classification issues. Further, the Service noted that small businesses could be particularly hard hit by the considerable costs of obtaining advice regarding how to structure business entities to obtain the most favorable combination of state law and tax treatment. These additional cost, resource allocation, and distributive considerations contributed to the Service's decision to move to a simplified elective entity classification regime [approximately a decade later], where taxpayers could 'elect to treat certain domestic unincorporated business organizations as partnerships or as associations for federal tax purposes,' while still availing themselves of the local laws' flexibility for structuring unincorporated businesses."(footnotes omitted) (quoting I.R.S. Notice 95-14, 1995-14 I.R.B. 7)).

reason for such inaction cannot be attributed to a lack of awareness. The vast majority of unauthorized tax elections are not shrouded in deep secrecy; to the contrary, the mass media routinely writes articles about them (albeit not directly referring to them as "unauthorized elections").[109]

There are at least four reasons why unauthorized tax elections have often proven so long-lasting and resilient.

First, the financial and administrative benefits associated with unauthorized tax elections typically inure to those politicians in power.[110] Consider the fact that most congressional members come from the upper echelons of wealth.[111] Maintaining unauthorized tax elections allows them to preserve and, in some cases, augment their wealth. Because it may be against their financial self-interest to address unauthorized tax elections, turning a select blind eye toward them, at least from their perspective, is a logical response.

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109. *See, e.g.*, Leonard Sloane, *Your Money: Clifford Trusts Facing Threats*, N.Y. TIMES, May 5, 1984, at 32 (describing how taxpayers could "elect" to use trusts to mitigate their tax burdens); Arden Dale, *Revising Grantor-Retained Annuity Trusts*, WALL ST. J. (May 4, 2009, 12:01 AM), https://www.wsj.com/articles/SB124147213290384703 [https://perma.cc/7CYQ-3QD8] (explaining how taxpayers can "elect" not to pay gift tax).

110. For example, many taxpayers utilize S corporations and "elect" to pay themselves as little salary as possible to avoid employment taxes. *See* I.R.C. § 1402; *see, e.g.*, David R. Sicular, *Subchapter S at 55—Has Time Passed This Passthrough By? Maybe Not*, 68 TAX LAW. 185, 211–12 (2014) ("Such well-known individuals as Newt Gingrich and John Edwards famously used S corporations to take advantage of this fact."); Paul Sullivan, *The Advantages and Risks of Gingrich's Tax Strategy*, N.Y. TIMES (Feb, 3, 2012), https://www.nytimes.com/2012/02/04/your-money/advantages-and-risks-of-gingrichs-s-corporation.html [https://perma.cc/K3HU-Q7HN] (explaining how Newt Gingrich and John Edwards avoided paying a lot of taxes by categorizing their labor income as S corporation earnings).

111. *See generally* Jonathan Klick, *The Wealth of Congress*, 40 HARV. J.L. & POL'Y 603 (2017) (describing the vast amount of wealth that most congressional members have accumulated); Karl Evers-Hillstrom, *Majority of Lawmakers in 116th Congress Are Millionaires*, OPEN SECRETS (April 23, 2020), https://www.opensecrets.org/news/2020/04/majority-of-lawmakers-millionaires/ [https://perma.cc/XVS7-Q445].

Second, the tax and estate planning legal bars also have a financial self-interest in preserving unauthorized tax elections. In most instances, the utilization of unauthorized tax elections requires sophisticated planning.[112] That being the case, tax professionals, commanding steep price tags, are often called into duty to help clients orchestrate their unauthorized tax elections.[113] Certainly, from the standpoint of the tax and estate planning legal bar, maintaining the status quo is an exercise in commercial self-preservation.

Third, there is no natural lobbying group focused on opposing unauthorized tax elections. By their nature, having been developed by sophisticated tax counsel, many unauthorized tax elections are complex and hard to understand.[114] As such, they do not attract the public's ire that other tax gimmicks generate, for example, the utilization of offshore accounts to hide earnings, which are immediately discernible and smack of fraudulent behavior.

Finally, due to political divisiveness, motivating Congress to take action, even to defeat destructive tax ploys, is not easy.[115] Indeed, there are those political action groups that aver that closing these tax dodges is a cloaked attempt to surreptitiously raise taxes.[116] Furthermore, the Treasury

112. Each unauthorized tax election described in this Article (e.g., Crummey and bypass trusts) requires the advice of skilled professionals to navigate.

113. *See, e.g.*, Field, *Tax Elections*, *supra* note 1, at 25 (noting that "where taxpayers tend to be relatively sophisticated and well-advised, as in the context of large corporate acquisitions where a regular section 338 election or a section 338(h)(10) election might be made, taxpayers are likely to be able to obtain the necessary information about the tax law from their tax advisors, albeit at a high hourly billing rate").

114. *See supra* Part II.

115. *See, e.g.*, Jake Johnson, *Republicans Renege on Deal with Democrats, Strip Funding for IRS in Gift to Rich Tax Cheats*, SALON (July 19, 2021, 3:58 PM), https://www.salon.com/2021/07/19/republicans-renege-on-deal-with-democrats-strip-funding-for-irs-in-gift-to-rich-tax-cheats_partner [https://perma.cc/AF9A-8KTW] (describing how Senate Republicans refuse to bolster IRS funding, equating it to a tax increase, notwithstanding that it would augment tax compliance).

116. *See, e.g.*, Grace Wyler, *There Is a Second Part of Grover Norquist's Tax*

Department is ordinarily reluctant to do anything unilaterally—even addressing unauthorized tax elections—at the risk of being criticized for overstepping its administrative role, producing a torrent of political and public opprobrium.[117]

In light of these logistical obstacles, unauthorized tax elections are likely to enjoy unwarranted and undeserved longevity. The only times that Congress or the Treasury Department usually opts to address them are when it becomes apparent that a significant amount of revenue is at risk of being lost or when the administrative burdens associated with their use become intolerable.

As previously pointed out, consider two illustrative examples that affirm this point.

i. Clifford Trusts

Years ago, taxpayers would routinely make unauthorized tax elections to establish so-called Clifford

Pledge . . . And Many Conservatives Are Infuriated By It, BUS. INSIDER (Nov. 29, 2012, 3:04 PM), https://www.businessinsider.com/conservatives-cheer-on-norquists-waning-power-2012-11 [https://perma.cc/E3NJ-4DBC] ("[A]ccording to the pledge, the elimination of any tax credit or deduction—including industry subsidies and tax loopholes—qualifies as an increase in taxes.").

117. *See, e.g.*, Claire Hinshaw, *Limitations on the Business Interest Deduction: The New I.R.C. § 163(j) Under the Tax Cuts and Jobs Act*, 38 REV. BANKING & FIN. L. 594, 607–08 (2019) (noting that "the AICPA criticizes the Treasury's adoption of a broad and detailed definition of interest and instead suggests interest include 'any amount generally treated as interest under other provisions of the Code or regulations'" (quoting Annette Nellen, Chair, Am. Inst. of Certified Pub. Accts., Re: Notice of Proposed Rulemaking Regarding the Limitation on Deduction for Business Interest Expense [REG-106089-18] (Feb. 21, 2019), https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20190221%20aicpa-comments-sec-163j-prop-regs.pdf [http://perma.cc/ZBG4-PNAF])); Christopher R. Egan, Casenote, *The Federal Circuit's Shallow Analysis of Consolidated Taxation Invalidates the Loss Disallowance Rule*—Rite Aid Corp. v. United States, 55 SMU L. REV. 1813, 1813 (2002) ("[T]he Federal Circuit invalidated the long-criticized loss disallowance rule in Treasury Regulation Section 1.1502-20. This rule limits the loss that consolidated corporate parents can recognize from the sale of their subsidiary stock. Critics argue that the loss disallowance rule is invalid because it creates a new tax without Congressional approval." (footnote omitted)).

trusts.[118] The term of a typical Clifford trust would extend ten years and one day, during which time the income generated would be subject to the then lower trust tax rates; and at the conclusion of the trust term, the accumulated income and principal would revert to the trust settlor.[119] This tax ruse, which jeopardized the integrity of the nation's income tax brackets, lasted several decades before Congress decided that too much revenue was being siphoned off annually.[120]

ii. Bypass Trusts

As previously pointed out,[121] under the terms of their wills, taxpayers would habitually establish testamentary bypass trusts designed to utilize the estate tax exemption of the first spouse to perish. Years later, when the

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118. These trusts were eponymously named after the *Helvering v. Clifford* decision. 309 U.S. 331 (1940).

119. *See* Frank T. Adams, *The Tax Reform Act of 1986—Moves to Eliminate Income Tax Shifting and Deferral of Payments*, 61 FLA. BAR J., Feb. 1987, at 59, 59 ("The Clifford trust was a widely accepted and utilized vehicle for providing funds for the child's education and to assist the child in early, relatively low, earning years. In later years when the grantor's income often began to wane, the assets would come back to the grantor."); John W. Bowman, *Tax Savings Through Income Splitting Still Available After Tax Reform Act*, 15 TAX'N FOR LAWS. 324, 326–27 (1987) ("An income-shifting device that has been used for many years is the *Clifford* trust, sometimes called a short-term or ten-year trust. These trusts were used where a person wished to shift income to a lower tax bracket family member but did not want to make an absolute transfer of the income-producing property."); *see also* Note, *Conclusiveness of Trust Terms in Tax Litigation: Circumvention of the Clifford Rule*, 60 YALE L.J. 1426, 1426 (1951) ("Trusts are frequently used to minimize income taxes. Since each autonomous trust is taxed as a separate entity under the Internal Revenue Code, taxpayers can finesse the upper tax brackets by distributing income-producing property among several trusts." (footnotes omitted)).

120. *See, e.g.*, James W. Colliton, *Standards, Rules and the Decline of the Courts in the Law of Taxation*, 99 DICK. L. REV. 265, 327 (1995) ("A sixth major force in tax law development is the need to generate revenue. . . . The need for revenue was apparent in the grantor trust tax changes made by the Tax Reform Act of 1986. This Act had the objective of lowering tax rates by eliminating tax preferences. Congress eliminated the benefits of the ten year trust to partially make up for the revenue lost to lower rates.").

121. *See supra* Section II.B.

administrative onus associated with bypass trust use was perceived to be a nightmare, Congress took action, making the estate tax exemption amount portable between spouses.[122]

In the cases of both Clifford and bypass trusts, it took several decades for Congress to take legislative action. And the reality is that had Congress been more proactive, far less tax revenue would have been lost, professional fees could have been minimized, taxpayers would have had to endure less administrative turmoil, and legislators might have simultaneously elevated the Code's public stature—all virtuous goals, worth endeavoring to achieve.

2. Methodology to Address Unauthorized Tax Elections

Despite the fact that taxpayers have largely had free rein to make unauthorized tax elections, this does not have to be the case. Although unauthorized tax elections are often unintended effects of congressional or Treasury actions, the unauthorized tax elections themselves function as signals to notify Congress and the Treasury of legislative or regulatory weaknesses. If Congress and the Treasury pay attention, they can eradicate or codify unauthorized tax elections—whichever is preferable for taxpayers, the Code, and the fisc.

When Congress enacts legislation or the Treasury Department promulgates regulations, neither is prescient. As is sometimes reflected in the legislative history, Congress commonly harbors expectations regarding the direction that statutory construction will take,[123] but these determinations are precatory in nature, untested by the creative minds of tax professionals. The same can be said about Treasury regulations and how the tax community will construe

122. *See supra* note 91.

123. *See, e.g.*, Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845, 848 (1992) ("Using legislative history to help interpret unclear statutory language seems natural.").

them.[124] Once these laws and regulations are in the public domain, tax professionals will do whatever is in their power to hash over and configure the statutory and regulatory verbiage in ways designed to alleviate the financial and administrative burdens associated with tax compliance—that is, develop unauthorized tax elections—and earn hefty fees from their clients for doing so.

Furthermore, Congress is often loath to make wholesale changes to the Code. Instead, piecemeal reform is routine: Congress tackles one issue at a time and rarely examines the Code as a whole.[125] As a result, structural incongruities punctuate the Code, paving possible paths to unauthorized tax election usage.[126] Grantor trust status use is emblematic of this phenomenon. In the 1940s, by expanding the definition of *grantor trust status*, Congress sought to address the problem of taxpayers exploiting lower trust income tax rates; fast-forward to 1986 when Congress compressed the

124. *See generally* Randolph E. Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 YALE L.J. 660 (1940) (describing how courts and taxpayers construe Treasury regulations).

125. For example, a corporation that distributes current earnings and profits is deemed to be making dividend payments, even though the corporation may have experienced prior losses. I.R.C. § 316(a); STEPHEN SCHWARZ & DANIEL J. LATHROPE, FUNDAMENTALS OF CORPORATE TAXATION 154–55 (10th ed. 2019) ("This seemingly harsh rule was enacted many years ago as a relief measure to permit corporations with deficits to pay dividends and thus avoid an undistributed profits tax then in effect. Although the tax was later repealed, the 'nimble dividend' rule survived without any Congressional explanation of why it was still necessary.").

126. *See, e.g.*, Matthew A. Melone, *The Patenting of Tax Strategies: A Patently Unnecessary Development*, 5 DEPAUL BUS. & COM. L.J. 437, 472–73 (2007) ("Patented tax strategies will not be designed for a single taxpayer but for a broad enough market to justify their development costs. . . . Strategies that meet the patentability standards of novelty and nonobviousness will likely have their genesis in the structural infirmities of the Internal Revenue Code."); Richard J. Kovach, *Technical and Policy Standards for Inflation Adjustments Under the Internal Revenue Code*, 33 OKLA. CITY U. L. REV. 603, 628 (2008) (noting that "federal taxation policy has been glaringly inconsistent and haphazard in its attempts to protect taxpayers against inflationary distortions"); Daze Swift Lee, *Tax Reform Proposals on a Gift Tax on the Transfer of Property by Nonresidents*, 10 U. MASS. L. REV. 194, 208 (2014) ("First, the current Internal Revenue Code creates inconsistency in the application of gift tax rules.").

trust tax bracket structure but failed to correspondingly narrow the rules applicable to grantor trust status, opening the door for taxpayer exploitation.[127]

Unauthorized tax elections, though, do serve a beneficial purpose: they spotlight vulnerabilities in statutory and regulatory language and structural flaws in the Code's design. And once unauthorized tax elections fulfill their signaling role, for the reasons already stated, their existence can—and must—be addressed. Taking a page from authorized tax elections,[128] Congress and the Treasury Department should independently examine the merits and flaws of each unauthorized tax election and either formally institute or eradicate the particular election in question. The one thing that Congress and the Treasury Department should never do is ignore unauthorized tax elections—whether their overall merits outweigh their shortcomings or vice versa.

Eradicating those unauthorized tax elections that yield more detriments than benefits speaks for itself. However, given the reluctance of either Congress or the Treasury Department to act, something must be done to incentivize the legislative and administrative branches to undertake purging initiatives. One recommendation immediately comes to mind: years ago, Stanley Surrey developed the tax expenditure budget, which pinpoints those Code provisions that depart from the ideal and the costs associated with their retention;[129] following this paradigm, the Joint Committee

127. *See generally* Burton W. Kanter & Michael J. Legamaro, *The Grantor Trust: Handmaiden to the IRS and Servant to the Taxpayer*, 75 TAXES 706 (1997) (explaining how taxpayers utilize grantor trust status to their advantage).

128. *See supra* Section III.A.

129. *See* Bernard Wolfman, *Statesman, Scholar, Mentor*, 98 HARV. L. REV. 343, 344 (1984) ("The 'tax expenditure' budget is Stanley Surrey's signal achievement in fiscal policy. Enacted over ten years ago, supported by his writing and that of others, that budget and its underlying theory require every thoughtful person to ask whether the tax law is the best vehicle—or even a sensible one—to effect nontax social policy, to provide economic incentives, or to reward or punish."); Harry L. Gutman, *Reflections on the Process of Enacting Tax Law*, 26 OHIO N.U.

on Taxation should develop a similar sort of cost expenditure budget with respect to unauthorized tax elections.[130] Doing so would bring heightened scrutiny to unauthorized tax elections and hasten calls for their elimination.

The exact opposite is true with respect to those unauthorized tax elections in which the associated benefits outweigh the associated burdens: heightened scrutiny would hasten calls for their codification, which would benefit not only taxpayers but also the Treasury. Codification enables Congress to mandate that certain conditions be met before election privileges are extended. In some instances, such conditions will be minor and entail simply checking a box; in other situations, condition fulfillment will prove more onerous. Importantly, part and parcel of making elections is completing designated election forms. Such forms typically elaborate when the election must be filed; where it must be submitted; a checklist of those preconditions that must be met before an election is permissible; and, in some instances, the rationale behind the election's availability.[131] As the recipient of such forms, the IRS would be in a better position to monitor taxpayer compliance, gauge the popularity of such elections, and better calibrate where to direct the agency's limited resources.[132]

Citizen lobbying and watchdog groups should call the virtues of these beneficial unauthorized elections to the

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L. REV. 183, 185 (2000) ("Stanley Surrey pioneered the effort to identify how and the extent to which the tax system was being used to achieve non-tax objectives through his introduction of the tax expenditure concept in 1967 and its quantification in the tax expenditure budget.").

130. *See generally* George K. Yin, *How Codification of the Tax Statutes and the Emergence of the Staff of the Joint Committee on Taxation Helped Change the Nature of the Legislative Process*, 71 TAX L. REV. 723 (2018) (describing the role of the Joint Committee on Taxation and its expertise in tax matters).

131. There is an elaborate treatise written exactly on the topic of federal tax elections. MICHAEL B. LANG & COLLEEN A. KHOURY, FEDERAL TAX ELECTIONS (1991).

132. *See* Field, *Choosing Tax*, *supra* note 1, at 29 ("The IRS must process explicit elections to ensure taxpayer eligibility and compliance with the technical requirements for the time and manner of making the election.").

public's attention.[133] Indeed, politicians generally crave having their names associated with an administrative cost-savings mechanism or a device that saves taxpayers time, money, and resources.[134] If these lobbying groups highlight the advantages associated with certain unauthorized tax elections, they are sure to generate political interest and cultivate an amenable environment for codification.

In a nutshell, transforming something that was once unauthorized into something that is authorized elevates its status, making the entire process far more transparent to both the IRS and the general public.

CONCLUSION

This analysis illustrates that the existence of unauthorized tax elections is neither an inherent evil nor an unalloyed blessing. Instead, unauthorized tax elections function as important signaling mechanisms that something in the governing or administrative law is askew, requiring a complete overhaul or a minor tweaking. Congress and the Treasury Department thus have a responsibility to monitor the existence of such elections and, on a case-by-case basis, respond by either eradicating or formally institutionalizing them.

Due to the manipulative nature of unauthorized tax elections, they admittedly do not instill taxpayer faith and confidence in the integrity of the Code. From a public policy perspective, once they serve their signaling purpose of

133. *See, e.g.*, Karl Evers-Hillstrom, *Left-Leaning Watchdog: Companies Avoiding Taxes Spent Millions on Lobbying*, THE HILL (June 9, 2021, 3:30 PM), https://thehill.com/business-a-lobbying/557588-left-leaning-watchdog-companies-avoiding-taxes-have-spent-millions-on [https://perma.cc/M927-CSWQ] ("Fifty-five companies that didn't pay any corporate income tax in 2020 shelled out $408 million on lobbying over the past six years, according to a new report from left-leaning watchdog group Public Citizen.").

134. *See* Gregory Koger, *Position Taking and Cosponsorship in the U.S. House*, 28 LEGIS. STUD. Q. 225, 225–26 (2003) (explaining why congressional members would want their names associated with particular legislative bills).

alerting the powers that be that reforms should be undertaken, their existence should ideally be short-term. Accordingly, Congress and the Treasury Department must identify unauthorized tax elections and swiftly respond to address them.

If Congress and the Treasury Department heed this advice and limit the longevity of unauthorized tax elections, the salutary effects would be enormous. Legislative and administrative goals would be more readily fulfilled, fiscal needs met, and public confidence in the nation's tax system strengthened. Just as authorized elections often serve critical roles in productively shaping the contours of the Code and facilitating tax administration, unauthorized elections, if appropriately and timely handled, can do so as well.