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ing advantage in the ability to identify loopholes in the legislation which have led to tax shelters at an earlier stage, and legislate against those loopholes early. However, this is only a timing advantage: if one assumes that the loophole would eventually have been identified, and that legislation to close the loophole could have been introduced retrospectively, then early legislation has no long-term impact.

The second advantage is that, because taxpayers are required to highlight any tax shelters in which they are engaged, it is more likely that the shelters will be picked up in an audit. The corollary is that less resources need to be allocated to the audit function since the taxpayer already does part of the work of the audit agent. Two comments to this: does the potential saving in resources for the revenue authority justify interfering with fundamental legal rights? Secondly, is there a danger that, if audit agents focus only on disclosed tax shelters, non-disclosable matters may pass under the radar?

At the end of the day, one has to be aware of the possible long-term impact that tax shelter disclosure may have. If, as Professor Shaviro suggests, there should be a strict liability penalty for even good faith understatement of a tax position where substantial tax is at stake, then one has to see what will be the impact on taxpayer behavior. One possibility is that taxpayers will never take a position where there is even the slightest possibility that this differs from the view taken by the revenue authority or the slightest possibility that the position may be found to be incorrect. Given the uncertainties over tax law and findings of fact, this effectively pushes us into a near-totalitarian society where taxpayers do exactly and only what the revenue authorities tell them to. This assumes that there is (perhaps with hindsight) only one possible view a taxpayer might take of his liability.

By showing us the logical extension of tax shelter disclosure, I consider that Professor Shaviro is doing us a great service. He implicitly warns us where the introduction of tax shelter disclosure may ultimately lead.

Tax Shelter Disclosure and Civil Penalty Rules – Comment on the paper by Daniel Shaviro

Roman Seer

1. Self-Assessment System versus State Assessment System

The U.S. income and corporate tax system is procedurally based on self-assessment – as far as I can see: from its beginning in 1913. The taxpayers are obliged to compute and assess the owed tax against themselves. Their responsibility covers not only the tax-relevant facts, but also the application of law. Tax procedure including tax collection seems to be extensively socialized, like an act of self-regulation by society.

The continental Europe approaches this public affair traditionally from a different point of view. Taxation is still a state act. The state tax authorities are fully responsible for tax assessments by using an inquisitorial system. However, the taxpayers have to comply by delivering some evidence. Of course, they have to file tax returns in which the tax-relevant items are to be declared. But they are not responsible for the assessment of the concrete tax amount they have to pay. Only the state tax administration will assess the tax in a tax notice which is qualified as a formal administrative act. The tax authorities are responsible for applying the law to the reported and inspected or, moreover, examined facts.

At first sight, we recognize a fundamental difference between both systems. On closer inspection, however, the gap appears to be less big. For the tax return decision, as to which tax base items have to be recognized, a continental European taxpayer must apply the tax law to the facts, too. Tax relevance of facts always carries an issue of applying law. From this point of view a continental European taxpayer is also responsible for both, the diligent recording of facts *and* the correct application of law.

On the other hand, no self-assessment system will be sufficient without state act means. A voluntarily complying taxpayer is still a rare animal that could be listed as an endangered species by the World Wide Fund. No tax declaration system can exist without a – structural – verification system. Therefore, modern tax authorities use different risk management systems to check tax returns. Auditing is one very important classic instrument. In the U.S., levy surcharges on tax in cases of non-compliance – especially by civil penalties – constitute another important sanction measure, less common in continental Europe.

However, if the likelihood to be drawn in the so-called audit lottery is declining, the lack of verification can not be compensated by higher civil penalties. Firstly, drastic penalties may somehow deter taxpayers from cheating on tax authorities, but not proportionally to the decreasing number of audits. Secondly, the likelihood to be charged by civil penalties is in the same way declining as the auditing rate. Thirdly,

the unlucky person whose odd is drawn in the auditing lottery will be treated harshly while many other non-compliant taxpayers remain undiscovered and uncharged. Civil penalties which levy a multiple of the true tax amount are not acceptable from the point of legal protection in the single case. Despite its character as civil penalty the addition to tax will fall under Art. 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms. Art. 6 § 2 of this convention will be violated by heavy penalties which are assessed automatically without any effective possibility of exculpation.

2. Criterion of Sphere Responsibility

In my opinion, we must differentiate using the criterion of sphere responsibility. As a state body the tax authorities are responsible for the statutory tax law, regulations, rulings, advice and precedents (leading cases) of state courts. A taxpayer can rely on these issues. If the taxpayer files a tax return confiding in these sources, no sanctions, especially no civil penalties, should be imposed *ex post*.

On the other hand, facts and transactions realized by the taxpayer, are located in his/her influence sphere. In general, the taxpayer has to provide the tax authorities with the facts which are relevant under the law, regulations, rulings and judicial precedents. If the taxpayer does not consider these facts when computing the taxable income, the consequence shall be sanctions like civil penalties.

The problematic grey area affects the extensive range of cases in which it is unclear if or how far the facts or transactions realized by the taxpayer are relevant for the concrete tax and where no substantial authority leads the tax treatment. On the one hand, the facts and transactions are rooted in the sphere which is under the influence of the taxpayer. Therefore, he or she is responsible to disclose the facts which are otherwise hidden in his books. On the other hand, the taxpayer should not be forced to file the tax return pro fiscus. The solution for this conflict is the disclosure statement which protects him/her against civil penalties and enables the tax authority to examine the taxpayer's opinion. This seems to be an adequate balance between the legal protection of the taxpayer on the one hand and the budgetary interests of the tax authority on the other hand. The taxpayer is able to argue for his position. The tax authority can attend to the public interests. If there is no way for a compromise the Tax Court has to decide as the neutral public instance.

I agree with Daniel Shaviro that the "reasonable cause and good faith"-exception clause is less appropriate. It encourages taxpayers to go shopping for opinions as "penalty shields". I think the taxpayer does not act "in good faith" if a tax advisor denies a request because he or she is seriously in doubt of supporting the taxpayer's position by writing an expertise. In the single case it is not easy to decide if there has been a reasonable cause *and* whether the taxpayer has acted in good faith. The alternative is still a disclosure statement as the prerequisite for hindering civil penalties.

Furthermore, Daniel Shaviro pointed out the dilemma between over- and under-disclosures. Indeed, disclosing everything may effectively become equivalent to disclosing nothing. However, the need of disclosures has its origin in the sphere of the tax authority. It is the task of the tax administration as a state body to examine the tax

obligations. If taxpayers disclose transactions and other facts, they provide the tax authorities with information. Only excessive strategies of overwhelming the Revenue Service with disclosures can be indicated for penalizing. Besides these abusive strategies you will find the mistakes not in the disclosure procedure but in the uncertainty and complexity of modern tax law, accompanied by a declining percentage of auditing which is caused by reduced staffs of tax agents.

3. Tax Shelter Category

The other important question is indeed to define the category of tax shelters. In contrast to Daniel Shaviro's appointment I can not say "I know it when I see it." For example, if a company uses a tax benefit which is granted and intended by the legislator to trigger economic growth, does this already constitute a tax shelter? Or: if a national income tax law, following consequently the realization principle, allows over generations increasing hidden reserves, does this represent a tax shelter?

Under German tax law we found also some diffuse categories like "Loss-Contribution-Companies" or "Tax-Deferral-Models". These new provisions bear a great deal of uncertainty. Thus, I am very reluctant to copy the U.S. tax shelter regime. On the other hand, the general anti-avoidance rules (GAARs) are also not very meaningful. For example, Art. 42 German Abgabenordnung tries to prevent the misuse of legal instruments contrary to the intention of the law. Due to the interpretation of this provision in a "substance over form"-sense, an economic substance test has paved its way into the jurisdiction. This can be a tool to deal with the phenomenon of Controlled Foreign Companies which Daniel Shaviro has mentioned using the example of the *Cadbury Schweppes* case. The European Court of Justice has unfortunately remained elusive as to when an arrangement may be considered only wholly artificial and intended to escape the national tax which is normally payable. What is the minimum level for controlled companies for carrying on genuine economic activities in the host Member State? This must be put in more concrete terms in order to be applicable.