UNREASONABLE AVOIDANCE OF LEGAL RULES IN NORWEGIAN TAX LAW

BY

MAGNUS AARBAKKE

Professor of Law,
University of Oslo

I. THE PROBLEM

We occasionally read or hear that a certain set of facts represents an avoidance of a legal rule. This expression is perhaps most often used in connection with tax statutes; though it is also used in other contexts.

Roughly speaking, two different opinions are discernible:

(1) The first is that there is no specific problem of avoidance of legal rules. The term therefore serves no useful purpose, and we should be better off without it. In Norway, the authors of our standard works on contract law are advocates of this concept. Fredrik Stang, who discusses avoidance of statutes prohibiting certain contracts, states:[1]

> You often speak about avoidance of legal rules, meaning that contracts that avoid the law are void. This is, however, quite illogical. If the contracting party has succeeded in "avoiding" the rule, he has not been in conflict with it; the contract is consequently valid. It is the unsuccessful attempts to avoid the rule that fail. They fail because they *do* collide with the rule, that is to say, because they do not avoid it. What you have tried to express with this confused phrase is this: even though an action does not collide with the expressed command of the law, it may be in conflict with its implied intent or with what an extended application of it demands.

A similar view is held by Professor Arnholm:[2]

> It is sometimes said that a prohibition of some sort of transaction must also apply to attempts at avoidance of the rule. In fact this is rather confused; the whole question is how much the prohibitive act really includes.

(2) The other view is that avoidance offers a specific problem which is difficult to solve in practice. There is a need for a specific term. This opinion seems to be held by Norwegian courts and administrative authorities, as well as by several authors.

[1] Stang, *Innledning til formueretten*, 3rd ed., Oslo 1935, p. 582.
[2] Arnholm, *Privatrett*, vol. 2, Oslo 1964, p. 257.

The term avoidance is used to denote a relation between a rule and a set of facts, although not necessarily a strictly homogeneous relation. Some of those who deny a specific problem of avoidance use the term in the following way. A conclusion is arrived at regarding the meaning of the rule, including its applicability or non-applicability to the set of facts. Then the term is used to express a definite view on the relation between the rule and its assumed coverage. It is clear that in these cases the term "avoidance" does not denote a specific legal problem (though perhaps a legislative one); the choice of words may seem erratic. It was probably in this sense that Stang used the term in the quotation above.

More frequently, however, the term "avoidance" is used to denote preliminary views on the relation between a rule of law and a set of facts. The term occurs as an argument for a certain interpretation of a legal rule. In these situations the term expresses the evaluations of the adjudicator.

Let us assume that there is a specific problem of avoidance. Then two questions may be asked: on which basis is one to decide what the purpose of a legal rule is; how extensively shall it be applied? A reference to general principles of interpretation of legal rules does not give a satisfactory answer to these questions. For what are the general principles of interpretation? Does not the term "avoidance" refer to such a principle?

Of course, there is no reason to dispute the postulate that a problem which is provisionally classified as a question of avoidance may be solved on the basis of a study of legislative history or of precedents laid down by the courts. But this does not exclude the possibility of a specific requirement for the application of a norm, a requirement that some people refer to by using the term "avoidance".

It therefore seems reasonable to assume that there is a real and specific problem of avoidance of law which sometimes has to be solved on the basis of a specific norm.[3] Hereafter avoidance will be discussed as a matter of principle. I do not intend to give a formula which can be applied to practical cases.[4] Only income tax law will be considered.

[3] See Kvisli, *Innføring i skatteretten*, Oslo 1962, pp. 96 ff., Woldseth in *Dommer og uttalelser i skattesaker og skattespørsmål m.v.*, 1968, pp. 763 ff.

[4] See Vik in *Dommer og uttalelser i skattesaker og skattespørsmål m.v.*, 1958, pp. 864 ff., Torgersen, *Lov og rett*, 1964, pp. 193 ff.

II. IS THERE A SPECIFIC NORM OF AVOIDANCE?

Is there in Norway a specific norm of avoidance? There is no authoritative expression of such a norm on the statute books. But this is not conclusive evidence, since exactly the same could be said about most of the norms which we consider to be incorporated in our sources of law.

From a practical as well as from a theoretical point of view, it seems sensible to use the following two criteria for the recognition of a specific norm of decision. First, the norm must in fact have been applied by at least a representative selection of those who make legal decisions in the system concerned. Second, there must be a conviction that it is correct to apply the norm.

When using these criteria to decide whether a specific norm of avoidance exists, there is one thing that should be remembered: the situations that may be examined are practical deliberations about legal problems. In making legal decisions, the court attaches importance to several norms and factors. There is an interplay of elements, and it can hardly be expected that it will be possible to point out every single element that was considered. Nor can an exact description of the impact of each element be expected. Even if the judge in a case actually attached weight to the norm that is referred to by the term avoidance, a reader of his decision may find that it was based on other elements, because—taking everything into consideration—those elements give the most acceptable explanation of the court's decision. The existence of such decisions does not, of course, necessarily imply that the norm which is referred to by the term avoidance is not valid, nor that it is generally speaking of little importance.

There can be no doubt that the Norwegian courts and administrative authorities—certainly the tax authorities—assume the validity of a specific norm when the term avoidance is used. The most important Supreme Court decisions on which this assertion is based will be mentioned below. Norwegian courts are not inclined expressly to refer to a norm of such a vague and arbitrary character as the norm behind the term avoidance. There are therefore good reasons for believing that the norm of avoidance has been considered, without being mentioned in the decision, in several other cases.

It must, however, be noted that legal usage is not strict. As

synonyms for the expression "avoidance of tax statutes", the courts and the authorities use such expressions as "The motive of the transaction was fiscal", "The Court must consider the substance of the transaction, not the form" or "The transaction is a simulation or *pro forma*". It could be said that the rule of seeking the true intention of the party, so well established within Norwegian contract law, has served as a formula by means of which the norm referred to by the term avoidance could be introduced. This sometimes makes interpretation of the decisions difficult. On the other hand, it has facilitated the introduction of a new norm which was needed.

III. THE SUBSTANCE OF THE NORM

In the absence of an authoritative formulation of the norm of avoidance, the substance of the norm is not easily defined.

It would seem that the norm of avoidance has a scope of application that is delimited in a comparatively distinct fashion: it applies to the relation between legal rules and legal rights and duties. On the other hand, it does not apply to the relation between legal rules and mere facts. Thus if a man and a woman cohabit without being married, this is not—from a legal point of view—an avoidance of the Marriage Code or other pieces of legislation that attach legal consequences to marriage. Usually the norm of avoidance applies to legal relations based on contracts, such as sales, leases or mandates. But presumably the norm also applies to legal relations based on other factual circumstances.

There are two legal aspects of the norm of avoidance. If an act places a burden on the subjects, e.g. to pay a tax, our norm may imply that a certain set of facts is covered by the act, although somebody has attempted to withhold its application. Conversely, if the act grants benefit to the subjects, e.g. certain subsidies, the norm may require that the act shall not be applied to a set of facts that someone has attempted to bring within its scope.

The effect of the norm of avoidance will depend on the statute concerned in each case. It may imply that a contract is void, that a person is burdened with a tax, or that he will not obtain an advantage.

As usual with ordinary norms of statutory interpretation, the

norm of avoidance is not used directly for the purpose of applying a statutory rule to a set of facts. The norm is used indirectly by indicating that a certain set of facts shall be judged in a certain way, or that a statutory rule shall be construed in a certain way. This feature of the norm will be examined more closely below.

However, the aspect of the norm of avoidance that has attracted the greatest attention is not its implications, but the conditions of its application. What characterizes situations with regard to which it properly can be stated that the rule of avoidance was applied?

As pointed out before, the term avoidance occurs when the adjudicator takes a preliminary view of the relation between a legal rule and a set of facts. If an act is onerous for the subject, the adjudicator starts with the assumption that the act does not apply to the set of facts which is under consideration. If the act is beneficial for the subject, the assumption is the opposite, namely that the act does apply to the set of facts which is under consideration. But the use of the term avoidance is not sufficiently explained by this. There must be some additional condition. The nature of this condition is the crux of the matter.

In some court decisions it is held that it is a necessary—and probably also a sufficient—condition that the parties shall have formed the contract for the purpose of avoiding an onerous act, or to come within the scope of a beneficial act. It is not sufficient that such an intention shall have been a motive. It must have been a *conditio sine qua non*. It is true that older conrt decisions do not support this view. Thus, in 1912 the Supreme Court of Norway made the statement that the Court supported the following opinion by the Court of Appeals:[5]

> The fact that the sale has taken place in order to avoid heavy taxation, a fact which has been freely admitted, cannot make the sale less effective.

But in more recent court decisions statements can be found expressing the doctrine of intention.[6] Particularly interesting is the minority opinion of Judge Schjelderup in a case 1933 N.Rt. 1050:

> I consider Norwegian law to be such that a contract properly formed cannot be declared void because of its fictitious character unless the avoidance of a legal rule was intended. In other words, intention to avoid the rule must be present in relation to the statutory provision concerned.

[5] 1912 N.Rt. 1006.
[6] E.g. 1925 N.Rt. 472 (below).

There are also statements in majority opinions that express the same view, as in the decision 1937 N.Rt. 196:

> The facts of the case at bar do not indicate that fiscal grounds in any way motivated the brothers when they found it best suited their purposes to form a limited company when they decided to form a joint venture.

However, later the doctrine of intention has been rejected at least to the point that an intention to reduce a tax burden is irrelevant. A Supreme Court decision 1963 N.Rt. 478 leaves little doubt:

> The Town Court and the Court of Appeal discuss whether the merger was motivated in whole or in part by fiscal considerations. I cannot see any reason to do this. I agree with the plaintiffs that this factor is irrelevant, and that the decision must depend on an objective evaluation of the transaction on the basis of the facts of the case.[7]

So-called tax planning has long been accepted, even by the legislature, as a legitimate activity. Since 1945 several tax acts have been passed whose purpose has been to motivate people to enter into certain types of transactions. Without tax planning such statutes could not fulfil their purpose.

A criterion for applying the norm of avoidance must be found elsewhere. The Supreme Court decision of 1963, mentioned above, indicates that "an objective evaluation" of the relation between a set of facts and a legal rule constitutes such a criterion. Technically, "avoidance of law" implies that the judge or others who make decisions have come to the preliminary conclusion that the relation between a set of facts and a legal rule must be evaluated in a certain way. This evaluation, which is a subjective reaction, has been made the relevant fact.

I will try to make an attempt to describe what kind of subjective reaction is involved. Possibly the following will give an indication. Avoidance of law means that an adjudicator who is confronted with a certain rule of law and a certain set of facts feels that in case of a strict application the interested party would benefit in a manner that would represent an unconscionable application of the law.[8] In other words: avoidance of law means that

[7] See, also 1966 N.Rt. 1189 and Kvisli, *Innføring i skatteretten*, Oslo 1962, pp. 96 ff.

[8] Woldseth, *Dommer og uttalelser i skattesaker og skattespørsmål m.v.*, 1968, pp. 767 ff.

a negative evaluation is being ascribed to the relation between a set of facts and a legal rule; the term is used to express a disapproval. Since this is a preliminary opinion, the disapproval will be an argument in favour of a decision following another line than the one originally indicated by the language of the statute.

It would, of course, be preferable if the norm of avoidance could be expressed in more precise terms. But this is very difficult, if possible at all. Usually, when one wishes to express the conception of a value premise, it is necessary to express it in an indirect way. One may, for instance, make a list of different sets of facts and classify the cases as, respectively, avoidance or non-avoidance of the law. By studying cases that others have adjudicated, a reader may gain some impression of their opinions as to the substance of the norm. What Professor Knoph called "rationalization of legal standards"[9] could more correctly be termed a method of expressing one's own and others' conceptions of basic values.

From a practical point of view such norms as the norm of avoidance, as this has been described above, have obvious weaknesses. The attachment of legal importance to purely subjective conceptions of a value involves great insecurity, since such conceptions will differ from one judge or authority to another. And the taxpayer's own conception of values may differ from those of the authorities. Therefore objections are sometimes raised against the doctrine of avoidance because it makes precalculation of tax implications difficult. The answer to this is that the wish to precalculate is also founded on a basic value, namely the want of security with subjective elements similar to those of the norm of avoidance. Should the claim for security be taken seriously, it would probably prohibit all application of law as we know it. If one considers the decision making of judges and administrative authorities, it must be admitted that conceptions of values play a dominant part. Besides, the characteristic feature is not the difference, but the conformity in conceptions of value.

It is another matter that some time may elapse before conformity can be established. An illuminating example is the attitude towards dependent companies. In a decision from 1912 the Supreme Court found that a Swedish company's subsidiary in Norway could not be considered to be a branch of a foreign company

[9] Knoph, *Rettslige standarder,* Oslo 1939, pp. 29 ff.

set up in avoidance of the Tax Act of 1882.[1] In the opinion of the Supreme Court it was irrelevant

> ... that the Swedish company can by means of its business connection with the Norwegian company pursue the same economic ends as if it had established a branch in Christiania (Oslo). The company purposely avoided establishing a branch office; it established a subsidiary company. As long as a method of establishment is used which is not in itself of an unlawful nature, the company must be permitted to choose as it pleases the method best suited to serve its interests.

But this decision did not make the situation clear; the tax authorities refused to abide by it. The assessment submitted to the Supreme Court in the case 1919 N.Rt. 754 is characteristic:

> A businessman in Bergen established a company at Fana and transferred his business to the company. The tax authorities in Bergen assessed him as owner of the business, instead of the company; they held that the establishment of the company was an avoidance of the tax statute. The assessment was declared void. The Supreme Court agreed with the Court of Appeal that "the law does not entitle the authorities to disregard the existence of the company in question, even if the company in fact had been established in order to convey the property and income concerned to Fana with regard to taxation".

This decision no more put the question of avoidance at rest than had the decision of 1912; seemingly, it was necessary to wait till 1937, when the Supreme Court maintained (1937 N.Rt. 196):

> A limited company may be completely real and valid even though all power is placed in the hands of one or two shareholders.

Eventually the tax authorities seem to have accepted the Supreme Court's opinion.

In the next two sections an attempt will be made to clarify how the norm of avoidance should be applied within Norwegian tax law. The point of departure has been mentioned above. It is that according to a preliminary view there is a certain relation between a given set of facts and a given statutory provision. By classifying a certain action by a party as an avoidance of the law the adjudicator expresses his disapproval, which is an argument for another conclusion than that which his preliminary view would indicate. Technically there are alternative ways. Either the

[1] 1912 N.Rt. 486.

set of facts can be described differently, or the statutory provision concerned can be construed differently. In what follows we shall examine these alternatives.

IV. AVOIDANCE AS AN ARGUMENT IN FAVOUR OF CHANGING DESCRIPTIONS OF SETS OF FACTS

Application of law is said to be application of legal rules to sets of facts. This is not quite correct. Application of law is application of rules to *descriptions* of facts. These descriptions are *termed* "sets of facts". The sets of facts that are relevant are not given, they are construed by the judge or by others who have to apply the rules.

Most sets of facts must be determined through the application of certain rules on the collecting of evidence, on examining it, and on establishing the burden of proof. These rules are inadequate when determining a set of facts where a contract enters into the picture. The existence of a contractual right or duty cannot be proved or refuted, nor can its contents. The legal matter of a contract must be determined by application of other norms. These are mainly contract-law principles about whether a contract has been entered into, about its contents, and about its validity. But these rules must be adapted to the specific interests involved in tax law.

In the field of income tax the relevant facts are construed in a specific manner. To a great extent this influences the application of law. According to the Norwegian Taxation Act, the taxpayer should state the set of facts upon which the assessment is to be based. The task of the tax authorities is to decide whether the taxpayer's representation should be accepted. They have to explain what they consider to be the most correct set of facts. When the relevant facts are to be laid down in this way, the task is not only constructive, it is also destructive or critical. This gives rise to the need of a specific terminology to express the reasons for not accepting the taxpayer's suggestion as to how the set of facts should be construed.

A reasonable interpretation of decisions by tax authorities seems to be that the disapproval which the term avoidance implies is often used as an argument for not accepting the taxpayer's re-

presentation of the set of facts. The disapproval of the authority is not directed at the contract as such. Nor is it directed at the actions that have been undertaken according to the contract. People may form their contracts and act as they wish without interference from the tax authorities. But in their income tax return they must produce descriptions which are reasonable in the view of the tax creditors. If this has not been done, it is the task of the tax authority to give a description which the authority thinks is reasonable. The extent to which such revised descriptions are necessary depends on the circumstances. A few examples may illustrate this problem.

The taxpayer's representation will often be that a contract should be construed in accordance with its wording. The wording is of course an important factor, which must be taken into consideration by the tax authorities also. Even the legal category under which the parties have classified their contract—e.g. as a sale or a lease—is relevant, but only if it has been used for the purpose of giving an idea of the substance of the contract without mentioning all the details; this is often the case with standard forms. Whether a legal term has been used in this way or for some other purpose is, of course, a matter that has to be decided in each particular case.

But the wording of the contract is not the only relevant factor.[2] We may have to deal with a case of avoidance when the taxpayer claims that the wording represents the true meaning of the contract in spite of other factors calling for a different description. The role of the norm of avoidance is then to balance the wording of the contract and the other relevant factors. A few examples may serve to illustrate this.

The acts of performance that have been undertaken or have to be undertaken according to the contract are of importance. A decision 1963 N.Rt. 478 shows that more weight may, on the basis of the norm of avoidance, be attached to such actions than to the wording of the contract:

> The question was whether a legal transaction should be classified as a merger or not in relation to a tax rule which gave an absorbing company the right to deduct the absorbed company's previous losses. The contract contained the usual provisions, including one clause to the effect that the company to be absorbed should "convey in a lump its assets and liabilities". The absorbing company

[2] 1934 N.Rt. 1103, 1957. N.Rt. 187.

> claimed that the legal matter should be described, according to the wording of the contract, as a merger. On examining the acts that had been undertaken, it was found that the absorbing company had taken over liabilities of 60,000 Norwegian kroner but—to use the expression of the Supreme Court—"nothing else of importance".

The set of facts was described according to the acts, not the wording of the contract. Therefore it could not be classified as a merger. The decision is considered to be one of the leading authorities in the doctrine of avoidance. In this case the disapproval implied in the term avoidance referred to the taxpayer's representation of a legal transaction with a revised description as effect.

The decision of 1963 is also interesting from another angle, concerning individual acts as data of interpretation. The company drew attention to the fact that rights under contracts, goodwill, etc., were conveyed by the transaction. This claim did not seem unreasonable and under normal conditions there would have been no objection to it. The Supreme Court, however, reasoned that these assets could have been acquired without a merger, and in consequence the conveyance was disregarded for tax purposes. A reasonable interpretation of this is that the norm of avoidance was of importance in deciding what should be considered as the effect of a legal transaction.

We may conclude from this and other decisions that it is insufficient for the taxpayer to confine himself to describing the legal transaction according to the wording of a contract. In order to be accepted as "reasonable" the description must also take into consideration acts and other circumstances connected with the legal transaction concerned. This was emphasized in the decision 1966 N.Rt. 1189 when the Supreme Court held that "the real matter (the substance) must be the basis".[3]

Another important factor in deciding the effect of a legal transaction for tax purposes are the interests of the parties to the transaction. Such interests may follow from another contract, but may also follow from other sources. The question is whether it may be considered unreasonable to the tax creditors to describe a set of facts according to the wording of the transaction without taking the parties' interests into consideration and, if so, whether the true character of the transaction must be disclosed when assessment takes place.

The answer to both these questions must be in the affirmative.

[3] See below.

The Taxation Act expressly provides so in some cases, and the courts have applied the same principles to other situations as well.

In particular, courts have freely revised contractual determination of the value of goods and services. Two cases may serve as illustrations. The following is an excerpt from the decision of the Supreme Court in 1966 N.Rt. 46:

> The condition for Reksten's right to deduct the 148,000 kroner concerned must be that the selling price to his children—which, in this connection, I fix at 240,000 kroner—is equivalent to the property's real value in the open market.

The other example is also taken from a decision of 1966. It dealt with a person's right to deduct loss materialized by sale to a company of whose 350 shares he owned 330. The Supreme Court in 1966 N.Rt. 1470 did not accept the contract price. The judge who delivered the opinion of the Court expressed himself as follows:

> I agree with the respondent that the cut-price transfer to the company cannot be accepted as a loss of trade, because it was not a commercial one, but a fictitious price fixed for tax purposes, and it does not represent a real loss for the seller.

Contractual provisions of payment for goods or services are dealt with correspondingly. The remuneration given by a company to its shareholding manager is assessed as follows. First, the services that the shareholding manager really has given to the company are estimated. Then a "normal" salary for this kind of service is fixed. The difference between this amount and the company's payment is then considered to be something other than a salary, i.e. a dividend.

An evaluation of the unreasonableness of a taxpayer's description of a legal transaction has also been used as a basis for deviating from the wording of other contractual provisions. Loans from a company to its shareholders have sometimes been taxed as dividends. This means that it has been regarded as unreasonable to describe the matter according to the wording of the contract. It is, however, a matter of doubt whether an accompanying interest is a sufficient reason to deviate from the wording of a contract where provisions concerning future acts of performance are concerned, such as clauses about the repayment of a loan.

The foregoing discussion has dealt with cases where the norm of avoidance was taken into consideration when the court had to

evaluate different types of data. It may now be asked whether the norm of avoidance also may be considered an independent part in the process of adjudication. It is difficult to give an answer to this question. When searching for examples, one soon discovers that this is a field where insistent attempts have been made to rely upon the doctrine of the law of contract that the true meaning of the parties shall prevail. This may cause confusion both with regard to terminology and reasoning. In principle, however, it may be correct to revise the description of legal transactions on the grounds that the description produced by a party cannot be accepted as reasonable. The decision 1937 N.Rt. 443 is pertinent in this connection:

> A company had been established by seven Norwegian shipping companies. According to its articles, the company's head office was to be in Panama. The company was established in accordance with the laws of that country; it was registered there, and it had a registered agent there. The company owned two ships. They sailed under a charterparty to which the company and an American company were parties. The American company equipped the ships. The accounting was done in Oslo, but the accounts were signed by the company's resident agent in Panama, who also on the company's behalf dealt with the authorities there. It was admitted that at least one purpose of establishing the company was to save taxes and fees. A majority of the Supreme Court held that the company was "a form without substance". The minority held that the company must be accepted as real, but it should be considered to have its head office in Norway. It could not be taxed separately from the other companies because it was not founded in accordance with the Norwegian Limited Companies Act.

The reasoning of the majority went a little further than its conclusion. The legal transaction concerned was not totally disregarded by the majority, but it was considered to constitute a partnership instead of a limited company. Apart from this an acceptable interpretation of the decision seems to be that the majority found unreasonable the claim that the company as a foreign subject was non-taxable in Norway.

Even though the norm of avoidance might theoretically be dealt with as an independent factor, in the great majority of cases legal rights and duties must be accepted in accordance with the wording of the legal transaction concerned. They may not have been redefined just because the parties to the transaction could have

attained the same ends, apart from taxation, by choosing another language. The decisions on closely related companies that were quoted above illustrate this point.

V. AVOIDANCE AS AN ARGUMENT IN FAVOUR OF AN INFORMAL INTERPRETATION OF STATUTES

A proposition that adjudication merely concerns application of statutory rules would not be quite correct. What is applied is not a rule in the statute book but an *interpretation* of such a rule. The interpretation is often determined by other factors than the wording of the statute. In this context we have to deal with the question whether the norm of avoidance is relevant as such a factor.

The Taxation Act does not only require that the taxpayer in his income tax return shall submit a description of his rights or duties. The taxpayer must also submit a representation of what he considers to be the actual set of facts in the case.

If the statute in question prescribes what is to be regarded as income, the norm of avoidance will be an argument in favour of an extensive interpretation. Sometimes legal writers presume that interpretation of a statutory text is an operation involving a comparison between the wording of the act and the facts at issue. Interpretation therefore cannot be extended beyond the possible scope of the language. In the opinion of the present writer no sharp line can be drawn between what might be called interpretation inside and interpretation outside the wording of an act. But there is a tradition of using the term of extensive interpretation. And the concept seems to serve a purpose when classifying different methods of interpretation.

However, it is not easy to illustrate that the *courts* have been inclined to use an extensive interpretation, arguing that otherwise there would be an avoidance of law. But when the Supreme Court in a decision of 1925 held that the term "alienation" included exchange of real property, at least one of the judges stated that he concurred because the exchange was a part of a transaction whose tax consequences would otherwise be unreasonable. Nor is it easy to find court decisions on *assessments* based upon

extensive interpretations which have onerous results for the taxpayer. But a decision 1965 N.Rt. 1094 may be mentioned.

> The disputed matter concerned a partnership. The partners had agreed that one of them should redeem the other's share, and that the definite settlement was to be decided by arbitration. The Board of Assessment held that this agreement should be regarded as an alienation of the share. The taxpayer argued that alienation took place at the moment of the arbitrational decision and not at the moment of agreement to seek arbitration. The reason for the dispute was the fact that the share had been inherited in the period between these two points of time, and if alienation were held to have taken place at the time of the arbitration award, there would be no taxable gain. The previous owner would be non-taxable because alienation took place after the hereditary succession. The inheritor would be non-taxable because the partnership had not increased in value during his period of ownership. The Supreme Court upheld the contention of the taxpayer. The judge who delivered the opinion of the court stated: "I wish to remark that when judging whether the solution is reasonable or not, one should not leave out of account that the only import of the transfer to the heirs is that they had passed on to them their share in the inheritance from their father who died in 1958, and nothing more."

An acceptable interpretation of this quotation is that, since the transfer was regarded as reasonable, this was an argument against choosing an extensive interpretation. If the transaction had been regarded as unreasonable, the solution might have been a different one.

The reason why the norm of avoidance so rarely leads to extensive interpretations is probably that the courts and the tax authorities take into consideration other norms as arguments against such interpretations, and find these decisive. It suffices to mention the fundamental ideas of the rule of law in public administration.

If the rule in question excepts a certain method for calculating gross income; if it allows the deduction of certain expenses; or if it in some other way permits a reduction of taxable income, then the problem will be whether the norm of avoidance may be used as grounds for a restrictive interpretation.

It is easier to find instances of this than of extensive interpretations based on the same reasons. Certain decisions concerning so-called wash-sales of shares and bonds are illuminating. Such sales do not occur today as frequently as they once did; but from

the viewpoint of tax law the decisions in question remain important. The basic decision is 1925 N.Rt. 472.

> In the autumn of 1920 one Kallevig entered into the following two transactions. (1) On November 4 he bought 25 shares in The Foreign Forestry Industrial Company. On November 8 he sold the same number of shares in the same company at the same price. He even used the same broker. But the shares involved were not identical, nor were the contracting parties. Both contracts were fulfilled on November 13. The parties exchanged shares, and paid stamp duties and brokerage fees. (2) On December 4 Kallevig sold 40 shares of the Klavenæss Bank to Mr. Eger and 20 to Mrs. Eger. On December 10 he bought, at the same price, from the same persons the same number of shares in the same bank. This time, too, the shares were not identical. Kallevig maintained that the sales of November 8 and December 4 had resulted in tax-deductible losses. This view was rejected. The Supreme Court held that the respective sales and purchases had been coherent transactions. "The substance of the dual transactions was not to part with the share interests in question, but to keep these. At the same time the only assignable purpose of the transactions was to obtain tax relief according to the Urban Taxation Act, sec. 39, This purpose is not irrelevant to the tax authorities when deciding whether the transactions represent real alienations or not." The transactions were found not to be covered by the tax statute's term "alienation".

A decision of 1961 and another of 1963 are sometimes referred to as striking examples of the justification of restrictive interpretations which are burdensome to the taxpayer. Both concern legal transactions that, according to their wording, should effect a merger of two companies by transfer of the assets and liabilities of one company to the other in exchange for shares in the latter company. Both decisions were to the effect that the absorbing company was not entitled to substitute the other company where its tax privileges were concerned. The absorbing company was therefore denied the right to deduct from its taxable income losses of the other company accruing before the merger. These decisions are hardly of much interest to the question of restrictive interpretations of tax rules benefiting the taxpayer. A condition for applying the above-mentioned general rule must be that the transactions concerned could reasonably have been classified as mergers, which here was hardly the case. Amongst other things a merger is characterized by the increase of the absorbing company's capital by the net capital of the absorbed company. Since the companies which were swallowed had negative net capitals, this

important feature was missing from the transactions. But the Supreme Court also gave another reason for its decision, as will be seen below.

On the other hand, it would not be correct to conclude that the norm of avoidance is irrelevant or superfluous in general.

Probably the norm of avoidance plays its most important part where interpretations within the wording of an act are concerned. For there are cases where arguments for extensive or restrictive interpretation are presented to the benefit of the taxpayer. Then the norm of avoidance may have a counterbalancing effect and lead to the choice of an interpretation based on the wording of the act. Arguments such as "One must put up with the fiscal consequences of the form one has chosen." may be taken as an illustration of this view.[4]

In what follows we shall only consider whether disapproval of the results of a suggested definition of a concept may lead to redefinition.

It is well known that tax law has borrowed several concepts from private law. In tax law these concepts are used to classify legal transactions, such as sales and leases, or terms such as a juridical person, e.g. a company. These concepts are characterized by not being rigidly defined. The definitions are open to revision. The concepts may thus be more or less comprehensive than they are commonly understood to be. It is an important part of the application of law to reexamine the definitions when classifying new phenomena.

Our question is whether disapproval of the anticipated tax consequences may form the basis of a redefinition. This question contains two subsidiary questions that should be distinguished from each other. In some cases the problem is whether a legal transaction shall be ascribed to one concept or to another, each with different fiscal consequences. A decision of 1966 N.Rt. 1189 may serve as an illustration.

> A company that had owned and run a power station sold it for 2,500,000 kroner. The taxable capital gain was about 1,260,000 kroner. As the shareholders did not wish to continue as members of the company, all the shares were transferred to one Bergesen at a price based on the assumption that the company's sales profit would not be subject to taxation, on condition that it was to be reserved and later used for reinvestment. After having bought the shares, Bergesen borrowed from the company a substantial part of

[4] 1927 N.Rt. 717.

> its capital, i.e. the amount brought in by the sale of the power station. The board of taxation, however, did not accept the company's claim for tax-free reservation. The decision was confirmed by the Supreme Court, which stated: "There is no doubt that tax considerations were motives for the selling shareholders as well as for Bergesen, both when the purchase was agreed upon and when choosing the form in which to execute the transaction. This cannot by itself decide the question of the right to claim tax-free reservation. But in this case I find it hard to consider the matter in any other light than that the alienation in fact was a transfer to Bergesen of the company's right of payment for the sale of the power station and of its tax benefit. The "empty" company had no value as such. It cannot therefore be decisive that the company still exists on paper. For tax purposes the classification of a transaction must be based on its substance, not on its form."

The section of the Supreme Court's reasoning quoted above has become ambiguous owing to the deliberations about the empty company. There was little reason to point this out after having classified the legal matter as a transfer of a claim, not as a transfer of shares. The term "empty" cannot be properly applied to a company with a net capital of 1,500,000 kroner. It is more suitable in a different context, as we shall see below.

In this connection, our main interest is in the Supreme Court's criterion for classifying the transaction concerned as a transfer of a claim, not as a transfer of shares. The Supreme Court said "that for tax purposes the classification of a transaction must be based on its substance, not on its form". What this expression means is not clear. One possible interpretation is the following. The Supreme Court started from customary conceptions of what should be classified as a transfer of shares and what should be classified as a transfer of a claim, but found them unsuitable. The final choice of classification was due to disapproval of the idea that a company should have the right to tax-free treatment of its gains.

A clearer manifestation of the fact that a classification may be based on value norms is found in a minority opinion of Judge Bonnevie in a decision 1927 N.Rt. 1078, which concerned the same question of classification as the decision of 1966 did, but in relation to a different legal rule.

> I wish to stress that in my opinion there is nothing illegitimate in employing the chosen method of alienation by transfer of shares instead of by transfer of the ship. And in my opinion the shareholders had reason to believe that there could be neither legal nor

> moral objections to their relieving themselves of their interests in this manner, relying on the transaction's not being subject to income taxation.

The other subsidiary question refers to the problem of what minimum requirements a legal transaction must fulfil in order to be considered as a legally binding transaction of a recognized type. This is the problem whether there are "empty" rights or duties. From our angle, the question is whether the minimum requirements should be increased if the taxpayer's representation is regarded as unreasonable.

It can scarcely be doubted that the answer must be in the affirmative. In a decision 1929 N.Rt. 211 we see that legal effect was assumed in a case where, although the transaction was rather empty, there were nevertheless legitimate fiscal interests:

> In 1917 a person had bought roubles for 37,625.00 kroner. In 1923 he sold them for 17,50 kroner. The assessment board refused deduction of the loss on the grounds that the person did not undertake a real sale in 1923. The Supreme Court reversed the decision: "According to the evidence there seems to be no reason to assume that it was anything but a real sale. It is another matter that the sale was probably undertaken with special regard to the assessment."

The most reasonable explanation of this decision is that the tax consequences of the transaction were found to be reasonable according to the tax law.

The importance of a norm of avoidance may also be illustrated by two decisions that concern more complicated matters. In both cases the courts had to decide whether a given transaction should be regarded as a recapitalization of a company—which does not change a company's identity for tax purposes—or as the establishment of a new company. The first decision, 1948 N.Rt. 133, is of great interest in spite of the fact that it concerns the application of a rule that was later repealed:

> A company got into financial difficulties. It was arranged that its main creditor—a bank—should take over all the company's assets, except some equipment worth 3,000 kroner, and all its liabilities. The company was to keep its books and files. Furthermore, a general meeting was held. At this meeting it was decided to write down the share capital to nil. A new issue of shares was also decided upon. It was assumed that the subscribers should be the company's previous shareholders and creditors. The subscription was put through accordingly. A new board was elected, mostly from among members of the old board. The assessment authority held that this

> was the establishment of a new company. The Supreme Court, on the other hand, held that the transaction should be regarded as a recapitalization.

The other case that is referred to above is an Appeal Court decision of 1959:[5]

> A company was bankrupt. After a period of receivership the situation was clarified sufficiently to calculate the creditors' dividends to approximately 6 per cent. A third party then bought the company's assets and liabilities for an amount equivalent to the sum of the dividends. He also bought the shares at a modest price. The company's estate was then released from the custody of the court. The company's name was changed, and partownership in a vessel was transferred to it. The court upheld the decision of the assessment authority, which refused deduction of previous losses from the income of the ship. The transaction was regarded as the establishment of a new company.

The distinction between these two decisions may be explained in different ways. One explanation is that in the first case the persons who attempted to deduct the loss were the same persons who had sustained it as owners of the company. Their interest in the company's maintaining its identity and consequent favourable tax treatment was considered as reasonable under the tax law. In the second case the interested parties had changed. Their claim for retrieving the company's loss on favourable tax conditions was considered as unreasonable under the tax law.

The view that the taxpayer's claim was an unreasonable application of the tax law was probably of decisive importance in defining the term "merger" in the decision 1961 N.Rt. 1195. The judge who delivered the opinion of the Supreme Court said:

> I agree with the Town Court that the rules of the Taxation Act ... cannot be understood to mean that *any* merger gives the absorbing company a right to deduct the other company's loss from its income. It must be—as the Town Court says—"a real amalgamation in the sense that the company which was swallowed up in whole or in part carries its business with it to the absorbing company, and that it might thus be said that the business that the last-mentioned company carries out after the amalgamation also incorporates in whole or in part the other company's business".

"Transfer of business" is here pointed to as being the decisive criterion of identity. The basic value that was decisive for this

[5] *Dommer og uttalelser i skattesaker og skattespørsmål m.v., 1959,* p. 444.

choice is not mentioned. But there can hardly be any doubt that the Supreme Court considered the claim of deduction as unreasonable under the tax law. Probably this decided the choice of criterion of a merger.

In the decision 1966 N.Rt. 1189, the Supreme Court discusses the matter of principle involved in the problem of "empty" legal matters. The court expressed its approval of a statement made by Mr. Kvisli, director-general of the section for tax legislation in the Ministry of Finance, in a textbook:[6]

> It will scarcely be sufficient in any case to show that a transaction is motivated by tax considerations. But the more pointless the transaction will be if the tax consequences are eliminated, the more it will have the character of a fictitious arrangement. If the transactions do not have certain values of their own as economic realities, they will be in the danger zone in relation to tax law even though they may be above criticism in relation to private law.

VI. SUMMARY

The present author submits that as a part of Norwegian law there is a norm that the tax authorities and the courts shall examine whether the taxpayer's classification of legal transactions is unreasonable under the tax law. If his classification is unreasonable, this should be taken into consideration, either when the relevant set of facts is described or when the legal rule is construed. What this may lead to cannot be deduced from any norm. As usual the decision will be reached on the basis of an overall consideration and the balancing of a number of factors. The specific effect of the norm of avoidance can rarely be discerned, since the tax authorities and the courts also consider other basic values as arguments in favour of an opposite result, specifically the ideas compreheuded in the rule of law. Often they attach greater weight to such arguments than to the norm of avoidance.

[6] Kvisli, *Innføring i skatteretten*, Oslo 1962, p. 109.