



**Principles vs. Rules:  
Toward a More Fundamental  
Formulation of Tax Law**

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# Viewpoints



## Principles vs. Rules: Toward a More Fundamental Formulation of Tax Law

by *Martin B. Tittle*

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Last December, Eric Solomon, then-deputy assistant secretary for regulatory affairs in the U.S. Treasury's Office of Tax Policy, suggested to Tax Analysts following the GWU/IRS conference that the rules in Circular 230 might be better framed as broad/general principles, rather than as tailored rules. Then, in March, Steve Musher, IRS acting associate chief counsel (international), discussed the general principles incorporated in the latest cost-sharing regulations at the Georgetown conference in Washington. A week later, Buchanan Ingersoll partner Herman Bouma and Scott Taub, the Securities and Exchange Commission's acting chief accountant, both proposed that the United States move more toward "principles-based" accounting. Those references to "principles" make me wonder whether the U.S. tax world might be considering a shift away from elaborative rulemaking toward what John Miller has called the "social context" approach to tax law.<sup>1</sup>

<sup>1</sup>See John A. Miller, "Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation," 68 *Wash. L. Rev.* 1, 16 (1993).

Elaborative rulemaking has been in full flower at least since the 1960s, when Stanley Surrey was assistant secretary for tax policy, and its central tenet is that tax law should be managed through extensive regulations that are authoritative, detailed, and inevitably complex.<sup>2</sup> Elaborative rules provide fairness through certainty, at least for the situations that are directly addressed in them. They also provide opportunities for planning because it is almost always possible to construct transactions that lie outside the stricture of the rules and yet achieve the same economic result that the rules are intended to regulate.

In Miller's social context approach, broad principles, instead of elaborate rules, are used to ensure fairness by resolving economically similar situations in a particular manner. The problem is that the lack of specificity inherent in general principles always leads to a need for interpretation. If that interpretation is performed by judges who are not tax specialists, the result can be characterized either as

<sup>2</sup>See Hugh J. Ault, "Tax Simplification From a Comparative Point of View," in *International Studies in Taxation: Law and Economics* 29, 32, 44 (1999) ("The phenomena of a narrow rule, tax-payer [sic] conduct at the border of the rule, another rule in response, etc. has been a characteristic of many of the [world's tax] systems, especially the United States. Rather than going back to first principles and working out solutions in a fashion which can generate new answers to new questions, the approach taken necessarily leads to complexity and confusion.").

“judicial meddling” or as the healthy and welcome injection of “common sense.” In either case, the taxing authority gives up some of the control it had with the elaborative approach in exchange for a broader net that, at least nominally, is harder for taxpayers and their advisers to plan around.

One problem I see with a shift toward general principles is that it would come with no “guidebook” for their application beyond the system of common law. A source that might be adapted to fill this need is article 31 of the Vienna Convention on the Law of Treaties (VCLT). Article 31(1) says “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” The four standards set forth in this sentence — plain meaning, with recourse to context and/or object and purpose if necessary, all under the

umbrella of good faith — could give structure to the interpretation of tax laws stated as broad principles, and they would also make it very difficult for planners to defeat or argue around those principles. Although article 31 is itself stated in general principles, its meaning has been interpreted and applied over the past 26 years by international judicial authorities, including (since 1995) the panels and Appellate Body of the World Trade Organization.

Naturally, U.S. courts could not be compelled to apply the VCLT directly. Nevertheless, I wonder if there isn’t some way to embed the four article 31 factors in legislation and regulations so as to allow, suggest, or mandate their application, at least as an initial approach to interpretation. Maybe it can’t be done, but the potential benefit of a shift away from narrow rules and toward broad principles would make it worth trying. ♦