Should Tax Courts Stabilize the Economy?

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Should tax courts think about the economy when reaching a judicial decision? Economic crises are a given and inevitable part of the economy. The world has been living through such a crisis due to the COVID-19 global pandemic. As part of their efforts to stabilize the economy during crises, or even during "regular" business cycles, governments implement fiscal policy through the tax and transfer systems. Although the traditional fiscal stabilizers can promote economic stabilization more accurately, their design and application are costly, complicated, and not flawless.

Potentially, other tax institutions—such as tax courts and tax judges—can also contribute to fiscal stabilization during economic crises. This is because judicial decisions in tax disputes have fiscal implications. But scholars have paid little attention to the macroeconomic implications of courts and their fiscal stabilization potential. This Article fills this lacuna, offering a novel cost-benefit framework for analyzing whether tax courts should consider the macroeconomic environment when making judicial decisions. If not, then what should they do? If so, how?

This framework relies on previous empirical findings from courts in the United States and Israel, according to which business cycles have influenced judicial decisions. The analysis comprises three incremental steps:

> 1. *The benefit: can courts serve as fiscal stabilizers when making judicial decisions, particularly in tax cases?*

2. *The cost: should they act as fiscal stabilizers?*

3. *Only if the benefit outweighs the cost, how would the judicial fiscal stabilization mechanism be shaped? And what if the cost outweighs the benefit?*

INTRODUCTION

Courts and judges *can* potentially serve as fiscal stabilizers during economic crises. This is because many judicial decisions involve the redistribution of wealth between the government and ordinary people, or between parties in general. In addition, there is empirical evidence that judicial decisions in certain fields are affected by, or at least correlated with, the macroeconomic environment.[1]

This Article discusses whether judges *should* consider the nonlegal objective of economic stabilization when making judicial decisions in tax disputes between the taxpayer and the government. Financial crises are a given and inevitable part of any economy. Indeed, the world has been experiencing such a crisis due to the COVID-19 global pandemic,[2] which led to economic recessions worldwide.[3]

The macroeconomic theory started developing as an independent economic strand almost a century ago, building on John Maynard Keynes's 1936 book, which considered the Great Depression between 1929 and World War II.[4] Before this, the dominant model was the classical economic theory, in which the "invisible hand" would bring the market to full employment and efficient resource allocation without central government intervention.[5] The macroeconomic

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[1] *See* discussion *infra* Part III.A.3.

[2] *See generally Coronavirus Disease (COVID-19)*, WORLD HEALTH ORG., https://www.who.int/health-topics/coronavirus#tab=tab_1 (last visited Oct. 11, 2023) (providing information about the pandemic).

[3] *See, e.g.*, LAUREN BAUER ET AL., BROOKINGS INST., THE HAMILTON PROJECT, TEN FACTS ABOUT COVID-19 AND THE U.S. ECONOMY 1 (2020) (discussing the effect of the pandemic on the U.S. economy); STATE COMPTROLLER, SPECIAL REPORT: THE STATE OF ISRAEL'S COPING WITH THE COVID-19 PANDEMIC 15 (2021) (Isr.), https://www.mevaker.gov.il/sites/DigitalLibrary/Documents/2021/COVID-19/COVID-19-Abstracts-EN.pdf (examining the effect of the pandemic on the Israeli economy, with Chapter two reviewing economic and budget topics, and Chapter three reviewing welfare, education, health, and employment topics).

[4] JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 100–04 (1936).

[5] *See, e.g.*, 2 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 35 (1776); *see also* discussion *infra* Part I (discussing this topic further).

theory deals with aggregate processes and market-level issues.[6] One example is the economic phenomenon of the business cycle. This phenomenon is characterized by market instability in the product and growth levels, recessions and expansions, and repeated changes in various macroeconomic indicators, including inflation, product levels, and employment.

Economic literature has two main views regarding the desired response to the business cycle. On the one hand, Keynesian economists argue that the government must apply countercyclical policy to stabilize the fluctuations at the product level by affecting the aggregate demand.[7] On the other hand, classical economists claim that no intervention is necessary because the market will fix itself.[8] In practice, however, policymakers have a strong consensus regarding the desirability of using fiscal policy to stimulate the economy as a form of governmental intervention.[9] A recent example is the current COVID-19 crisis in which most countries have resorted to Keynesian economic stimulus.

Assuming arguendo that governmental intervention is normatively desired to reach a stabilizing outcome, there are two main tools of intervention: monetary and fiscal policy. Monetary policy refers to the central bank's actions to affect the market's interest rate and money supply.[10] Fiscal policy differs, focusing on how the government can influence aggregate demand through tax policy and governmental expenditures,[11] including transfer payments.[12] This Article focuses on the use of tax policy as a fiscal stabilizer.

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[6] *See* N. GREGORY MANKIW, MACROECONOMICS 287–88 (7th ed. 2010) (discussing the meaning of aggregate processes related to the market).

[7] *See* Jeff Strnad, *Some Macroeconomic Interactions with Tax Base Choice*, 56 SMU L. REV. 171, 173 (2003); RICHARD G. LIPSEY & K. ALEC CHRYSTAL, ECONOMICS 418 (12th ed. 2011).

[8] *See* Strnad, *supra* note 7, at 172.

[9] *See* Greg Mankiw, *News Flash: Economists Agree*, GREG MANKIW'S BLOG (Feb. 14, 2009), http://gregmankiw.blogspot.com/2009/02/news-flash-economists-agree.html.

[10] *See* MANKIW, *supra* note 6, at 83–84.

[11] *See* Strnad, *supra* note 7, at 173.

[12] Transfer payments are directly transferred from the government to individuals. Central institutions, such as the tax authority and the social security authority, collect and then redistribute them to eligible individuals without an exchange of goods or services. *See* JOSEPH E. STIGLITZ & JAY K. ROSENGARD, ECONOMICS OF THE PUBLIC SECTOR 29, 36–38 (4th ed. 2015).

The tax system can function as a countercyclical stabilizer. Its stabilizing potential is measured by (1) the time lag between identifying the problem and the actual influence of the policy, and (2) the degree of discretion in operating stabilizing means.[13] The tax system can stabilize the economy in two main ways: ad hoc legislation and automatic stabilizers.[14] The main advantage of ad hoc legislation is that it designs a tailored response, which involves discretion.[15] But this method is often too time consuming to accomplish the desired fiscal result.[16] In addition, the tax system can respond automatically.[17] When the tax base, commonly in the form of profits, shrinks during a recession, the tax burden decreases automatically.[18] Even so, automatic responses might be less accurate because changes in profits do not have to align with the business cycle. While the quicker, automatic response to macroeconomic instability may be more effective, the slower discretionary response might result in the design of more accurate policies. These issues concern the trade-off between accuracy and simplicity.[19]

Scholars have applied macroeconomic analysis to understand and design legal rules and institutions, including in the context of tax law.[20]

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[13] This timeframe covers the time it takes to identify the current stage in the business cycle, to design the policy, and for it to come into effect. *See* MANKIW, *supra* note 6, at 447; Yair Listokin, *Stabilizing the Economy Through the Income Tax Code*, 123 TAX NOTES 1, 4–5 (2009) [hereinafter Listokin, *Stabilizing the Economy*].

[14] *See* Listokin, *Stabilizing the Economy*, *supra* note 13, at 2; Yair Listokin, *Equity, Efficiency, and Stability: The Importance of Macroeconomics for Evaluating Income Tax Policy*, 29 YALE J. ON REGUL. 45, 55 (2012) [hereinafter Listokin, *Equity, Efficiency, and Stability*].

[15] *See* Listokin, *Stabilizing the Economy*, *supra* note 13, at 4.

[16] *See* MANKIW, *supra* note 6, at 447; Listokin, *Stabilizing the Economy*, *supra* note 13, at 4–5.

[17] *See* Listokin, *Stabilizing the Economy*, *supra* note 13, at 2.

[18] *See* MANKIW, *supra* note 6, at 448.

[19] *See* David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 981, 995 (2004), https://doi.org/10.2307/4135709.

[20] *See generally* Jonathan S. Masur & Eric A. Posner, *Should Regulation Be Countercyclical?*, 34 YALE J. ON REGUL. 857, 859–60 (2017) (evaluating the possibility of weakening regulations during economic downturns and strengthening them during upturns, to mitigate regulations' effect on employment); Andrew Hayashi & Daniel P. Murphy, *Savings Policy and the Paradox of Thrift*, 34 YALE J. ON REGUL. 743 (2017) (offering to reform legal interventions designed to increase savings in a way that account for macroeconomic considerations); Daniel K. Tarullo, *Time-Varying Measures in Financial Regulation*, 83 LAW & CONTEMP. PROBS. 1 (2020), https://doi.org/10.2139/ssrn.3464668 (arguing that incorporating a macroprudential component into financial

More specifically, empiricists have focused on tax legislation, tax reforms, and the effect of automatic and discretionary stabilizers.[21] But they need to consider judicial decisions and their ability to implement tax legislation effectively. The potential macroeconomic role of the courts has not been discussed—at least not sufficiently—in the long-term public and academic debate regarding macroeconomic policy.[22]

Judges can react faster than the legislature while still exercising discretion through individualized court decisions, which frequently have fiscal implications. Furthermore, because judges regularly make determinations regarding the outcomes of cases, these decisions can potentially exert an immediate stabilizing effect. Even if it takes the legislature and the judges the same amount of time to identify the stage in the business cycle, a judicial decision is often reached more quickly and efficiently than the typical legislative process. Moreover, judicial decisions frequently result in the immediate implementation of the decision, in contrast to the ordinary legislative process, which may delay the implementation of such policies.

This Article offers a normative framework for conducting a cost-benefit analysis of the judiciary's fiscal potential. This framework comprises three incremental steps. *Step 1*, the benefit: *can* courts contribute to fiscal stabilization when making judicial decisions, particularly in tax cases? The analysis in this part is informed by empirical findings from courts in the United States and Israel,

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regulation is central to achieving financial stability goals); Erik F. Gerding, *Against Regulatory Stimulus*, 83 LAW & CONTEMP. PROBS. 49 (2020) (providing a macroeconomic and legal framework for assessing the effectiveness of regulatory stimulus, in the form of financial deregulation, in providing a macroeconomic boost in a deep recession or liquidity trap).

[21] *See, e.g.*, Alan J. Auerbach & Daniel Feenberg, *The Significance of Federal Taxes as Automatic Stabilizers*, 14 J. ECON. PERSPS. 37, 37 (2000), https://doi.org/10.1257/jep.14.3.37 (arguing that a progressive income tax and a high marginal tax rate can reduce changes in after-tax income); Brian Galle & Jonathan Klick, *Recessions and the Social Safety Net: The Alternative Minimum Tax as a Countercyclical Fiscal Stabilizer*, 63 STAN. L. REV. 187, 191 (2010); Yilin Hou, *Fiscal Reserves and State Own-Source Expenditure in Downturn Years*, 33 PUB. FIN. REV. 117, 123 (2005), https://doi.org/10.1177/1091142104271139 (discussing the procyclicality of state budgeting); Mathias Dolls et al., *Automatic Stabilizers and Economic Crisis: US vs. Europe*, 96 J. PUB. ECON. 279, 281 (2012), https://doi.org/10.1016/j.jpubeco.2011.11.001; Alisdair McKay & Ricardo Reis, *The Role of Automatic Stabilizers in the U.S. Business Cycle*, 84 ECONOMETRICA 141, 141 (2016), https://doi.org/10.3982/ECTA11574.

[22] Yair Listokin is one of the few scholars who have discussed the stabilizing potential of the courts. *See generally* YAIR LISTOKIN, LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS (2019) [hereinafter LISTOKIN, LAW AND MACROECONOMICS], https://doi.org/10.4159/9780674239838.

according to which the business cycle has affected judicial decisions. Given the response patterns and the explanations that scholars have offered, it is nevertheless possible that judges respond to economic fluctuations subconsciously but also in an anti-stabilizing way. The analysis takes this point into account.

Step 2, the cost: *should* courts stabilize the economy via judicial decision-making in tax disputes? This Article reviews three groups of normative arguments. The first group includes arguments about the relationship between the judiciary and other governing authorities. The second group comprises arguments concerning the relationship within the judiciary, i.e., between judicial decisions relating to taxes and judicial decisions in other areas. The third group includes arguments concerning the relationship between the disputing parties and the judiciary.

Step 3, and only if the benefit outweighs the cost, meaning we reached the conclusion that judges should consider the macroeconomic environment: *how* should the judicial stabilizing mechanism be designed? This Article considers two tools. One is a "business cycle multiplier" that will increase or decrease the taxpayer's liability depending on the stage of the business cycle. The other is a Keynesian default rule that will favor the taxpayer during a recession and the tax authority during an expansion.

This Article proceeds as follows. Part I discusses the business cycle phenomenon and potential stabilizing mechanisms. Part II focuses on stabilizing tax policy and the trade-off between accuracy and simplicity. It subsequently identifies the problem: scholars have overlooked courts' stabilizing potential. Part III then analyzes the stabilizing potential of courts and judicial decisions vis-à-vis taxes, offering an empirical perspective and a judicial fiscal stabilizing mechanism. Subsequently, the Article concludes by offering future directions for studying judicial decision-making (as part of law) and macroeconomics.

I. THE BUSINESS CYCLE AND STABILIZING POLICY: A PRIMER

The phenomenon of the business cycle is one of the main issues in macroeconomic theory. It refers to economic instability resulting from fluctuations in macroeconomic metrics, mainly expansions and contractions in aggregate demand and employment levels.[23] These fluctuations occur in the short term over several months or years. To

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[23] *See* Listokin, *Equity, Efficiency, and Stability, supra* note 14, at 50.

identify fluctuations, macroeconomists measure changes in the gross domestic product (GDP) levels over time or the deviation of macroeconomic parameters from their trend.[24]

There are four stages in the business cycle: (1) a recession, during which economic activity in the market slows down; (2) a trough, which represents the lowest level of economic activity during a respective cycle; (3) an expansion, during which the market recovers and economic activity picks up; and (4) a peak, the highest level of economic activity during the cycle. Once the economy reaches a peak, a recession will follow, and so forth.[25] Figure 1 provides a visual representation of the business cycle, where the horizontal line represents the increasing GDP levels over time.

Figure 1: Business Cycle Stages as Identified by Judges[26]
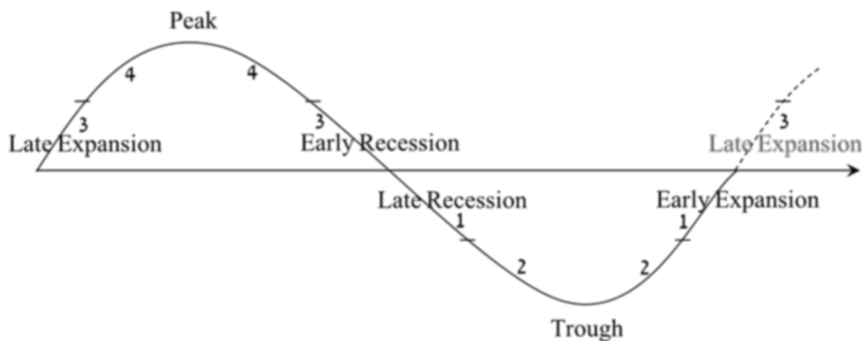
Business cycles differ in intensity and duration. Accordingly, identifying the stage of the business cycle or predicting when the economy will move to the next stage constitute significant challenges. Indeed, economists make such identifications retrospectively. For example, the National Bureau of Economic Research (NBER) has determined the peak and trough dates of business cycles

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[24] *See* MANKIW, *supra* note 6, at 257; Yosi Djivre & Yossi Yakhin, *Business Cycles in Israel, 1987–2010: The Facts* 2 (Maurice Falk Inst. for Econ. Rsch., Working Paper No. 11.02, 2011) (Isr.).

[25] *See* MANKIW, *supra* note 6, at 258.

[26] Gary Gorton & K. Geert Rouwenhorst, *Facts and Fantasies About Commodity Futures*, 62 FIN. ANALYSTS J. 47, 56 fig.5 (2006), https://doi.org/10.2469/faj.v62.n2.4083 (adapting Figure 5 to the analysis offered in this Article); Orli Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, 52 LOY. U. CHI. L.J. 437, 458 fig.1 (2021) [hereinafter Oren-Kolbinger, *Do Tax Judges Think About the Economy?*] (same).

approximately six to twenty-one months following the respective dates on which these occurred.[27]

Economists agree that business cycles result from disruptions or shocks to the economy's regular activity.[28] These shocks can derive, for example, from a monetary shock (the amount of money in the market), a technological shock (emerging new technologies), and even political shocks (legislation).[29] There is currently a consensus among policymakers that governmental intervention is desired to mitigate economic fluctuations.[30] But, there has been a long debate in economic theory over whether intervention in the business cycle is required and, if so, what type of intervention. The answer to the question of whether a central governmental institution should intervene in response to business cycles depends on the theory used to explain the phenomenon. The business cycle describes an optimal outcome, and any countercyclical or procyclical intervention may cause the situation to deteriorate.[31] For example, according to classical economists, business cycles are the market's optimal response to shocks that occur in the economy, similar to the "invisible hand." Therefore, no further action is needed.[32]

In contrast, according to Keynesian theorists, business cycles represent a failure of the economic system resulting from the same shock or problems in the market. It may be appropriate for the government to intervene to correct the problem. Accordingly, proponents of Keynesian models recommend interventions that run

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[27] *See Business Cycle Dating*, NAT'L BUREAU OF ECON. RSCH., http://www.nber.org/cycles/recessions.html (last visited Oct. 10, 2023); *Business Cycle Dating Procedure: Frequently Asked Questions*, NAT'L BUREAU OF ECON. RSCH., http://www.nber.org/cycles/recessions_faq.html (last visited Oct. 10, 2023) [hereinafter *Business Cycle Procedure*]; *US Business Cycle Expansions and Contractions*, NAT'L BUREAU OF ECON. RSCH., http://www.nber.org/cycles/cyclesmain.html (last visited Oct. 10, 2023).

[28] *See* MANKIW, *supra* note 6, at 257.

[29] *See id.* at 252–53, 278–79; Listokin, *Equity, Efficiency, and Stability*, *supra* note 14, at 51–52; Strnad, *supra* note 7, at 173–74.

[30] *See* Mankiw, *supra* note 9.

[31] Procyclical intervention is the opposite of countercyclical intervention. Procyclical fiscal policy lowers aggregate demand during recessions by raising taxes and lowering transfer payments and increases aggregate demand during expansions by taking the opposite actions. In so doing, the market deviates even further from steady state output levels. *See generally* Graciela L. Kaminsky et al., *When It Rains, It Pours: Procyclical Capital Flows and Macroeconomic Policies*, 19 NBER MACROECON. ANN. 11 (2004), https://doi.org/10.1086/ma.19.3585327.

[32] *See* Strnad, *supra* note 7, 171–72.

counter to the business cycle trend—countercyclical policies. Expansionary fiscal policy is thus desirable when product levels are below the equilibrium levels, and a narrowing fiscal policy is desirable when product levels are higher than equilibrium levels.[33]

Assuming arguendo that intervention is normatively required, there are two main types of intervention.[34] One is monetary policy, which focuses on affecting interest rates and money supply. The other is fiscal policy, which centers on influencing aggregated demand through tax and expenditure policies.[35]

Perhaps implementing countercyclical policy, such as stabilizing monetary or fiscal policy, is possible to respond to business cycles. For example, during a recession, the central bank will implement an expansionary monetary policy and purchase bonds from the public to increase the amount of money in the economy and lower interest rates. During expansion, it will sell bonds to reduce the amount of money in the economy. Monetary policy will affect, among other things, aggregate demand in the short term and, therefore, the level of GDP and employment.[36]

Alternatively, to affect market demand, the government can implement an expansionary fiscal policy (increase expenditures or reduce the tax burden) during a recession and apply a narrowing tax policy (reduce expenditures or increase the tax burden) during the

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[33] Expansionary fiscal policy entails increasing government spending or lowering the tax burden during a recession. By contrast, contractionary fiscal policy means taking the opposite action during an economic expansion—lowering government spending or increasing taxation. Both reflect the countercyclical fiscal policy that can stabilize the business cycle and its effect on the market. *See, e.g.*, Jonathan A. Parker, *On Measuring the Effects of Fiscal Policy in Recessions*, 49 J. ECON. LITERATURE 703, 704 (2011), https://doi.org/10.1257/jel.49.3.703.

[34] *See* WILLIAM J. BAUMOL & ALAN S. BLINDER, MACROECONOMICS: PRINCIPLES AND POLICY 88–89 (5th ed. 1991).

[35] In practice, different governments apply both fiscal and monetary policy tools, sometimes simultaneously. *See* RUDIGER DORNBUSCH ET AL., MACROECONOMICS 276 (11th ed. 2010); John B. Taylor, *Reassessing Discretionary Fiscal Policy*, 14 J. ECON. PERSPS. 21, 27–28 (2000), https://doi.org/10.1257/jep.14.3.21. For example, the United States, like other countries, responded to the Great Recession of 2007–2008 by implementing both fiscal and monetary policy. *See* John B. Taylor, *The Lack of an Empirical Rationale for a Revival of Discretionary Fiscal Policy*, 99 AM. ECON. REV. 550, 550, 554–55 (2009) [hereinafter Taylor, *The Lack of an Empirical Rationale*], https://doi.org/10.1257/aer.99.2.550; Listokin, *Equity, Efficiency, and Stability*, *supra* note 14, at 47–48, 60.

[36] *See* DORNBUSCH ET AL., *supra* note 35, at 248–62; LIPSEY & CHRYSTAL, *supra* note 7, at 418. *But see* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 7 (noting when interest rates are low, their stabilizing power is limited).

expansion phase. Fiscal policy can stabilize the aggregate demand and negate the business cycle and its effects on the economy.

The government can intervene in the market in response to the business cycle via revenue policies, such as taxes and loans, and spending policies. It can also apply a discretionary fiscal stabilization policy, making deliberate changes to tax rates, tax base, and tax expenditures.[37] When the government intervenes in the opposite direction to the business cycle trend, these actions are considered countercyclical and can serve as economic stabilizers.

In the short term, increasing government expenditure increases aggregate demand (the government participates in the market as a consumer), while increasing the tax burden decreases it (individuals have less disposable income).[38] Accordingly, the direction of the government's actions depends on the desired effect on the domestic product in the short term. But the scope and timing of the actions are not obvious.   Thus, in practice, fiscal tools are limited and complicated.[39]

Beyond economists' theoretical disagreement regarding the role of fiscal policy as a stabilizing mechanism, there is a practical difference in how governments have implemented fiscal policy over the years (sometimes in tandem with monetary policy and sometimes unsuccessfully). For example, various countries, including the United States, responded to the Great Recession via fiscal and monetary policy.[40]

Law and legal rules have an effect—sometimes minor and sometimes significant—on aggregate demand and supply, and thus on output. But although discourse regarding the relationship between law and macroeconomic theory accelerated after the Great Recession,[41] it remains in its infancy.[42]

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[37] Tax expenditures act in the same way as direct government spending. These two fiscal tools are economically equivalent. *See* STIGLITZ & ROSENGARD, *supra* note 12, at 33–34.

[38] *See* Strnad, *supra* note 7, at 173.

[39] *See* LIPSEY & CHRYSTAL, *supra* note 7, at 418.

[40] *See* MANKIW, *supra* note 6, at 333; STIGLITZ & ROSENGARD, *supra* note 12, at 23.

[41] *See* Morgan Ricks, *Money, Private Law, and Macroeconomic Disasters*, 83 LAW & CONTEMP. PROBS. 65, 65 (2020).

[42] *See, e.g.*, Yair Listokin, *Law and Macro: What Took So Long?*, 83 LAW & CONTEMP. PROBS. 141, 141 (2020) (defining law and macroeconomics, discussing several hypotheses regarding the underdevelopment of law and macroeconomics, and setting forth the necessary conditions for the future of law and macroeconomics); *6th Conference on Law & Macroeconomics*, LAW & MACROECONOMICS,

II. THE STABILIZING POWER OF THE TAX SYSTEM AND ITS LIMITS

This Part focuses on the role of the tax system as a fiscal stabilizer and the use of two types of stabilizers: discretionary tax stabilizers and automatic tax stabilizers. It discusses the substitution between complexity and accuracy in shaping legal rules in this context, concentrating on the problem at the heart of this Article—the inherent difficulty that using tax stabilizers entails in light of this substitutability—as a basis for Part III of this Article that discusses the proposed solution.

Fiscal policy consists of tax policy and government expenditure.[43] This Article focuses on tax policy. The tax system is a critical fiscal tool that is used, among other things, to stabilize the economy during business cycles. According to Keynesian macroeconomic theory, increasing the tax burden reduces individuals' disposable income, leading to a decline in their consumption and likewise in the level of GDP, while reducing the tax burden achieves the opposite result.[44] The tax system defines the tax burden using the tax base and tax rates.[45] In addition, the tax system also includes tax expenditures, which reduce the total tax collected and are a substitute for government expenditure.[46]

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https://lawandmacroeconomics.com (last visited Oct. 10, 2023) (listing prior and upcoming Law and Macroeconomics conference meetings and links to law and macroeconomics articles published in edited volumes).

[43] *See* discussion *supra* Part I.

[44] Changes in the tax policy that the government applies can generate a larger stabilizing effect compared with the size of the original change. This relates to the concept of the "Keynesian Multiplier Effect." The Keynesian multiplier measures the change in the gross domestic product (GDP) level due to changes in taxes and government spending. For example, government spending can result in an even larger increase in the GDP compared with the size of spending because it increases spending, thus leading to an increase in income, which in turn results in more consumption and so on. *See* MANKIW, *supra* note 6, at 292–95; Listokin, *Equity, Efficiency, and Stability, supra* note 14, at 51–53.

[45] Designing a tax system requires the determination of the tax base, on the one hand, and the tax rates applicable to the tax base, on the other. The tax base multiplied by the tax rates is the total tax collected. A common tax base is income, although consumption is also frequently taxed. The wider the tax base, the lower the tax rates the government must impose to collect the tax revenue that it needs to function. *See* JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES 85–95 (5th ed. 2017).

[46] Tax expenditures include deductions, credits, tax exemptions, preferential tax rates, and allowances for tax deferral. Several examples of tax expenditures are the deduction of health insurance costs incurred by the employer, earned income tax credit (EITC), and the deduction of charitable contributions. *See, e.g., Credits and*

There are two critical parameters for characterizing stabilizing tax policy. The first is the speed at which the response results in an effect, i.e., whether the tax rule achieves the stabilizing goal quickly or whether there was a time lag between the identification of a need for stabilization, the activation of the tax rule, and the achievement of the stabilizing result. The second is whether the stabilizer is an automatic stabilizing tool or a discretionary one. Usually, an automatic response is simpler (cheaper) and faster but may be inaccurate, whereas a discretionary response is more complex (expensive) and takes longer but is more accurate.[47]

The tax system can serve as a stabilizing tool in two main ways: as a discretionary response or as an automatic response.[48] The discretionary response is new tax legislation in response to business cycles.[49] The automatic response is reflected in the predesign of mechanisms in the tax system, e.g., through legislation.[50] When needed, these mechanisms will automatically respond to business cycles without the need for further intervention by policymakers.[51] Thus, the tax base constitutes an automatic fiscal stabilization mechanism. Suppose the economy's GDP level decreases due to a recession, leading to a reduction in individuals' income. Consequently, the average tax rates imposed on income decrease, as does the tax burden, in a countercyclical manner.[52]

First, it is necessary to clarify the nature of a discretionary fiscal response. The governing body, e.g., the legislature, must adopt and implement a new law. New legislation can change tax rates and the tax base to stabilize the economy—for example, by increasing or decreasing tax rates.[53] Furthermore, the tax base can be expanded or reduced to increase or decrease the aggregate demand in the market according to the stage in the business cycle, thus achieving the desired

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Deductions for Individuals, IRS, https://www.irs.gov/credits-deductions-for-individuals (last visited Oct. 10, 2023).

[47] *See* Listokin, *Stabilizing the Economy, supra* note 13, at 4–5.

[48] *See id.* at 2; Listokin, *Equity, Efficiency, and Stability, supra* note 14, at 55.

[49] *See* Listokin, *Stabilizing the Economy, supra* note 13, at 4.

[50] *See* Robert M. Solow, *Rethinking Fiscal Policy,* 21 OXFORD REV. ECON. POL'Y 509, 509–14 (2005).

[51] *See* Listokin, *Stabilizing the Economy, supra* note 13, at 2.

[52] *See* MANKIW, *supra* note 6, at 448.

[53] *See* Listokin, *Stabilizing the Economy, supra* note 13, at 2, 4 (providing as an example the Obama stimulus package from 2009, which changed tax rates and increased spending through statute to increase government deficits in response to a negative shock to the economy caused by the financial crisis).

stabilizing result. Changing tax rates or the tax base through legislation—for example, exempting certain income or allowing deductions of certain expenses for tax purposes—constitutes a discretionary fiscal response.[54]

The legislative process may have an advantage over automatic decisions. This is because exercising discretion when designing fiscal stabilizers can achieve a more accurate result that is tailored to the economic situation. Exercising discretion allows utilizing experts' knowledge to characterize the business cycle accurately, including identifying the current stage in the cycle, its expected duration, its degree, and the optimal response to it, whether fiscal or otherwise. Therefore, implementing discretionary stabilizers in response to business cycles can fine-tune the stabilizing mechanism and, consequently, achieve the desired result of product-level stabilization.

The difficulties associated with the legislative process support the claim that although discretionary fiscal stabilizers can be more accurate, it is not always possible to implement them in time to achieve stabilization. The legislative process is time-consuming.[55] Decision makers need to consider how long it takes to identify the stage in the business cycle,[56] to design the appropriate stabilization tool and draft a bill, to complete the legislative process,[57] and, finally, to affect aggregate demand and the level of GDP through the new legislation. This time frame may be too lengthy, meaning that the stabilizing response suited to the original economic need will be activated too late and, consequently, even in an anti-stabilizing manner, contrary to the legislature's intention.[58] Nevertheless, even if the legislative process is completed on time, political considerations may cause the actual fiscal stabilizer to differ from the original one and make it inaccurate.[59]

The following paragraphs illustrate how the mismatch described above between the fiscal instrument and the time of its application can

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[54] *See id.* at 4.

[55] *See* MANKIW, *supra* note 6, at 447; Listokin, *Stabilizing the Economy, supra* note 13, at 4–5.

[56] If economic indicators are utilized to identify the business cycle, the common measuring time of these indicators is at least two quarters. *See Business Cycle Procedure, supra* note 27.

[57] *See* Listokin, *Stabilizing the Economy, supra* note 13, at 4–5.

[58] *See id.* at 5; Listokin, *Equity, Efficiency, and Stability, supra* note 14, at 72–73; STIGLITZ & ROSENGARD, *supra* note 12, at 521; Taylor, *The Lack of an Empirical Rationale, supra* note 35, at 550; Strnad, *supra* note 8, at 180.

[59] *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 9–10.

unfold. In the case of the business cycles identified in Israel between 1993 and 2012, the average period from peaks to troughs was slightly over two years. The average length of time that elapsed between troughs and peaks was almost three years.[60] Accordingly, the steps described in the previous paragraph must occur during the period between any given peak and trough and vice versa to achieve a stabilizing outcome.

An examination of the first decade of the 2000s demonstrates that the Israeli economy entered a recession during the final quarter of the year 2000, subsequently reaching a trough in the second quarter of 2003. The recession lasted forty-four months. Accordingly, the period of subsequent expansion began in the third quarter of 2003, reaching a peak in the first quarter of 2008. In this case, the expansion lasted seventy-six months.[61]

In February 2002, during the second half of the recession, the Israeli government appointed a committee to recommend ways to reform the direct taxation system within ninety days.[62] The committee submitted its recommendations in June 2002: these centered on reducing the direct tax burden on "personal income" along with expanding the tax base on capital income and taxing income sourced outside of Israel.[63] The committee recommended a gradual reduction, from 2003 to 2008,[64] in the marginal tax rates applicable to the middle class, which were higher than the rates in other countries.[65] The committee expected the projected GDP growth and the expansion of the capital income tax base to fund the tax reduction.[66] The government immediately submitted the bill to amend the Income Tax

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[60] *See* Djivre & Yakhin, *supra* note 24, at 13.

[61] *See id.*

[62] *See* Reforma B'Mas Hakhnasa, Hamlatzot H'Vaada L'Reforma B'Mas, Mugash L'Sgan Rosh H'Memshala V'Sar H'Otzar Sylvan Shalom, רפורמה במס הכנסה, המלצות הוועדה לרפורמה במס, מוגש לסגן ראש הממשלה ושר האוצר סילבן שלום 4–5 (2022) (Isr.), https://www.gov.il/BlobFolder/unit/tax-reforma-committee/he/Vaadot_achchud_TaxReformaCommittee_Report_Full.PDF.

[63] *Id.* at 6, 9.

[64] *See id.* at 23–30.

[65] *Id.* at 18.

[66] *See id.* at 31.

Ordinance—Amendment 132.[67] About two weeks later, the law was passed by the Israeli parliament, the Knesset.[68]

This response is akin to stabilizing fiscal policy in a recession but not in a time of expansion. Tax rates continued to decline, however, even though the economy moved into the expansion phase and overcame the recession in the third quarter of 2003. In general, the direct tax burden declined until 2009 and then began to rise. But in 2009, the economy had already moved into a new cycle and recession. These changes did not correlate with the business cycle.[69]

Second, fiscal stabilization tools can also be designed to operate automatically alongside discretionary fiscal stabilizers. Scholars commonly claim that automatic fiscal stabilizers have an advantage over discretionary stabilizers due to their immediate response to macroeconomic instability.[70] Thus, the government can formulate tax rules that respond automatically and immediately to macroeconomic variables related to business cycles. Transfer payments, such as unemployment benefits, can also be used as automatic stabilizers because they automatically increase with decreasing GDP, employment, and income levels.[71]

Various tax bases, such as the income tax and consumption tax, e.g., sales tax or value-added tax, essentially respond automatically to macroeconomic variables related to business cycles. Thus, the tax base acts as an independent automatic fiscal stabilizer. It responds immediately to income changes caused by economic fluctuations without the need to identify the stage in the business cycle or any additional legislative procedure.[72] Therefore, if the level of GDP falls due to a recession, individuals' incomes will also decline.[73] But average tax rates will also decrease due to the decline in revenue, and

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[67] *See* Draft Bill Israeli Income Tax Ordinance, 5762–2002, HH 3156 770 (Isr.), https://fs.knesset.gov.il//15/law/15_ls1_516785.PDF.

[68] DK, 15th Knesset, Session No. 335 (2002) (Isr.).

[69] *See* Sophia Igdalov et al., *The Wage Response to a Reduction in Income Tax Rates: The 2003–2009 Tax Reform in Israel* 29 (Bank of Isr. Rsch. Dep't, Discussion Paper Series No. 2017.14, 2017).

[70] *See* Milton Friedman, *A Monetary and Fiscal Framework for Economic Stability*, 38 AM. ECON. REV. 245, 250–57 (1948); Solow, *supra* note 50, at 509–14.

[71] STIGLITZ & ROSENGARD, *supra* note 12, at 857.

[72] *See* Listokin, *Equity, Efficiency, and Stability*, *supra* note 14, at 53, 56.

[73] This assertion assumes a progressive tax system, meaning that marginal tax rates rise with income. *See* I.R.C. § 1; ARYEH GREENFIELD, INCOME TAX ORDINANCE § 121, at 175 (18th ed. 2013).

accordingly, the tax burden will subside in a stabilizing and countercyclical manner.[74]

The potential advantage presented lies in the simplicity of automatic stabilizers: low implementation costs stemming from their speedy response to economic instability. But a possible disadvantage is that they need to be more accurate. Predicting the transition between the various stages of the business cycle and identifying the current stage is critical if, according to the normative recommendation, the government should apply a stabilizing countercyclical response. But such predictions and identifications are nontrivial. Although economists offer various macroeconomic metrics for predicting, identifying, and characterizing business cycles, these are only sometimes accurate. Therefore, we can expect that automated fiscal tools based on one or more of these metrics will not sufficiently and accurately stabilize the business cycles.

Automatic responses are based on monitoring macroeconomic variables, which does not provide a sufficiently accurate measure to predict or identify business cycles. In addition, legislative automatic stabilizers are often based on a single economic index, while economists rely primarily on a combination of economic indices. Therefore, although the income tax system may automatically respond to a decrease in wages, its actual response may not be stabilizing because it will not fit the business cycle in terms of timing, type, and size. Thus, automatic stabilizers will act faster than discretionary ones but achieve a less accurate outcome.

Therefore, this Article shifts the focus to judicial institutions and examines whether they can contribute to fiscal stabilization during economic crises and increase social welfare where classical stabilizers—discretionary or automatic—miss the mark. To be clear, this Article does not claim that judicial institutions can or should replace the other branches of government in designing economic policy. Instead, it argues that, under certain circumstances, courts should complement the efforts of the legislative and administrative branches to improve aggregate social welfare by implementing economic policy.

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[74] *See* Strnad, *supra* note 7, at 183–84; Mankiw, *supra* note 6, at 448; Stiglitz & Rosengard, *supra* note 12, at 520.

III. ANALYSIS: TAX COURTS AND FISCAL STABILIZATION

This Article focuses on legal institutions' roles—and, in this context, the judiciary's role—in affecting aggregate demand and promoting economic stabilization while resolving tax disputes between the taxpayer and the tax authority.[75] The proposed analysis consists of three incremental steps and uses cost-benefit analysis as a normative criterion.[76]

The first step is examining the fiscal stabilization potential of the judiciary from a positive point of view. One must ask whether the judiciary can promote fiscal stabilization when resolving financial disputes between the taxpayer and the tax authority. The analysis in this Part is informed by empirical findings from courts in the United States and Israel, according to which the business cycle affects judicial decisions.

Assuming that the answer to the first positive question is affirmative, meaning that judicial decisions in tax disputes have fiscal stabilization potential and can increase social welfare, the analysis proceeds to the second step. This step focuses on the normative question of whether tax judges should serve as fiscal stabilizers. In this context, this Article reviews three groups of normative arguments that reflect the social welfare costs associated with the consideration of the macroeconomic environment in judicial decision-making. The first group includes arguments about the relationship between the judiciary and the other branches of government. The second group focuses on considerations related to the relationships within the judiciary. The third group involves arguments concerning the relationship between the disputing parties and the judiciary.

Note that the analysis proceeds to the third and final step only if the answer to the second question is also affirmative, meaning that the social benefit outweighs the cost.[77] This step concerns the design of two possible judicial stabilizing mechanisms. One is a "business cycle multiplier" that will increase or decrease the taxpayer's liability

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[75] Listokin explains how judicial decisions in bankruptcy disputes can affect the aggregate demand and product levels without disrupting the credit market. *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 19–20.

[76] The following analysis builds on my previous body of work on tax courts and macroeconomics. *See generally* Oren-Kolbinger, *Do Tax Judges Think About the Economy?, supra* note 26; Orli Oren-Kolbinger, *Courts Responses to Economic Crises: Descriptive and Normative Analyses*, 5 LAW SOC'Y & CULTURE 519 (2022) (Isr.).

[77] Listokin raises a similar argument in his book. *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 16.

depending on the stage in the business cycle. The other is a Keynesian default rule—à la Listokin—that will favor the taxpayer during a recession and the tax authority during an expansion, or more generally, the party that has a higher propensity to consume during a recession and vice versa.

Nevertheless, even if the answer to the second question is negative, meaning that judges considering the business cycle leads to a social welfare loss, this is not the end of the discussion. Considering the empirical finding that judges' decisions are consciously or subconsciously influenced by the business cycle, if this decision-making pattern has an adverse effect on social welfare, judges should not consider the economy when making decisions. In the case that judges' decisions are procyclical, as in the Israeli case described below, it means that they exacerbate the current recession or expansion. This is not the desired outcome. If so, finding out about such decision-making patterns, revealing the data to the judges, and instructing judges to refrain from doing so should improve social welfare. Going neutral will make things better by definition because the procyclical, decision-making pattern will no longer exist. There is social value in revealing the patterns and notifying judges so they will refrain from considering the macroeconomic environment.

A.   *Step 1: Can Judicial Decisions in Tax Disputes Between the Taxpayer and the Tax Authority Contribute to Fiscal Stabilization?*

This Part first describes the legal process in tax disputes between the taxpayer and the tax authority in the United States and Israel, contextualizing the courts' role in this process. Subsequently, it explains why judicial decisions in tax disputes can potentially exert a stabilizing effect and what is needed to bring this potential to fruition. Finally, it presents empirical findings from previous studies that examined the effect of macroeconomic variables on judges' decisions in Israel and the United States.[78]

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[78] The studies in Part III.A.3 of this Article demonstrate that nonlegal economic variables are already present in the judicial decision-making process, whether judges consider them consciously or subconsciously. It is worth noting that identifying any type of connection (whether correlation or even a causal relationship) is not a necessary condition for the argument in this Article about the stabilizing potential of judicial decisions. This potential stems from the characteristics of the judicial decision itself, which is a discretionary decision that can be implemented immediately. The implementation of this potential depends on the amounts of money in dispute between the taxpayer and the tax authority, alongside the indirect effect of judicial decisions concerning the behavior of the tax authority "in the shadow of the law." *See*

1. The Legal Process

i. Israel

In Israel, unlike in the United States, not all taxpayers are required to file an annual tax return.[79] The Israeli Income Tax Ordinance determines which taxpayers are required to do so. In their tax return, taxpayers report income for the preceding tax year and other tax information.[80] A tax assessor from the tax authority confirms or denies the tax return.[81] The tax assessor has the authority to prepare a tax report on the tax authority's behalf in certain circumstances.[82] The taxpayer has the right to challenge the assessor's report. In such cases, another assessor examines the case.[83] If the taxpayer disagrees with the second assessor's decision, they can appeal the decision to an Israeli district court, a court of first instance in such disputes.[84] Unless the Chief District Court Judge orders otherwise, these "tax appeals" are

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infra note 104. The purpose of presenting the empirical findings is to show that economic variables are not foreign to judicial decisions. Therefore, it does not matter if judges consciously consider the macroeconomy to promote economic stabilization or if they are subconsciously affected by other nonlegal factors and judicial biases. In addition, these findings will be relevant again in Part III of this Article, which introduces the judicial stabilizing mechanism.

[79] *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 451–52.

[80] *See* GREENFIELD, *supra* note 73, § 131, at 185–88. It should be noted that this Section deals with self-employed taxpayers and not wage earners, who are subject to a different tax-reporting regime. Israeli employers withhold the required tax from their employees' salaries and pass it directly to the tax authority, for reasons of administrative simplicity. The interaction between wage earners and the tax authority in Israel is limited, and hence simpler and less costly, because the reporting mechanism of their income involves a third party, and it is accurate enough to serve as an internal enforcement mechanism. For rules dictating tax reporting by wage earners, see *id.* § 164, at 203. Although US employers withhold taxes from their employees' salaries as well, the existing mechanism does not satisfy the filing requirement, and US employees must file an annual tax return at any rate. The fact that in the Israeli context only the self-employed interact with the tax authority does not affect the stabilizing potential of judicial decisions. Indeed, the amount of tax payments in dispute can be substantial enough compared with the product level, which is the relevant parameter when discussing the stabilizing potential of the decisions. For further discussion, see Part III.A.2 of this Article.

[81] *See* GREENFIELD, *supra* note 73, § 145, at 192–95.

[82] *See id.* § 145, at 192–95 (discussing the power to assess and the assessment procedure).

[83] *See id.* §§ 150–150A, at 197 (illustrating the right of objection before the assessing officer).

[84] *See id.* § 153, at 198 (discussing the right of appeal to the district court).

heard and decided by one judge.[85] The taxpayer and the tax authority can appeal the district court's decision in the Israeli Supreme Court as a matter of right.[86]

ii. United States

In the United States, all taxpayers file an annual tax return.[87] If the tax assessor at the IRS does not approve the return—for example, on the basis of underreporting or underpayment—they issue a notice of deficiency.[88] If the taxpayer and the tax assessor cannot reach an agreement, the taxpayer can petition the US Tax Court,[89] which has jurisdiction over a broad array of tax issues.[90] Most taxpayers file their petitions to the US Tax Court, which does not require payment of disputed tax prior to litigation.[91] Tax litigation can also take place in the US district courts and the US Court of Federal Claims. But, to litigate, the taxpayer must first pay the amount in dispute and then request a refund.[92] Taxpayers can appeal decisions made by the Tax Court or a US district court to the US court of appeals.[93] Decisions

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[85] *See id.* § 154, at 198 (explaining the court of appeal).

[86] *See id.* § 157, at 198 (describing the appeal to the Supreme Court).

[87] *See* I.R.C. § 6012 ("Persons required to make returns of income[.]"). See *About Form 1040, U.S. Individual Income Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-1040 (last visited Oct. 12, 2023), for an overview of the Form 1040 that individual taxpayers usually use to file their annual tax return.

[88] See I.R.C. § 6212, for the notice of deficiency.

[89] See I.R.C. § 6213, for overviews of the petition to Tax Court, and § 7441, establishment of the United States Tax Court as an Article I court.

[90] *See* TAXPAYER ADVOC. SERV., NAT'L TAXPAYER ADVOC. ANNUAL REPORT TO CONGRESS 174 & n.8 (2022), https://www.taxpayeradvocate.irs.gov/reports/2022-annual-report-to-congress (listing deficiencies as one example and referencing I.R.C. §§ 6214, 7476–7479, 6330(d), 6015(e), and 7436).

[91] *See* I.R.C. § 6213(a); *see also* TAXPAYER ADVOC. SERV., *supra* note 90, at 174 ("The Tax Court is a 'prepayment' forum, which is one major advantage for taxpayers as their case can be adjudicated on the merits without paying the disputed tax in advance. In fiscal year (FY) 2022, about 98 percent of all tax-related litigation was adjudicated in the Tax Court." (footnote omitted)).

[92] *See* 28 U.S.C. § 1346(a)(1); I.R.C. § 7422(a); TAXPAYER ADVOC. SERV., *supra* note 90, at 174 ("The U.S. [d]istrict [c]ourts and the U.S. Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full3 and (2) the taxpayer has filed an administrative claim for refund." (footnote omitted)).

[93] *See* I.R.C. § 7482 (a)(1) ("The United States [c]ourts of [a]ppeals (other than the United States Court of Appeals for the Federal Circuit) shall have exclusive jurisdiction to review the decisions of the Tax Court . . . ."); *see also* 28 U.S.C. § 1294

made by the US Court of Federal Claims are appealed to the US Court of Appeals for the Federal Circuit.[94] The US Supreme Court reviews very few tax appeals from the US courts of appeals.[95]

> 2. The Stabilizing Potential of Judicial Decisions in Tax Proceedings—A Combination of Exercising Discretion and Rapid Implementation

As stated, this Article argues that judicial decision-making in general, and decision-making in tax disputes in particular, have fiscal stabilizing potential that scholars have previously overlooked.[96] This stabilizing potential stems from two main characteristics of the judicial decision: (1) it is discretionary and therefore more accurate, and (2) it can be implemented quickly and, therefore, more simply (cheaply). Unlike other fiscal stabilization tools, in the case of judicial decisions, these two characteristics coexist and do not come at each other's expense. Therefore, judicial decisions have a significant advantage.

Nevertheless, this Article argues that two noncumulative conditions must be met for this potential to be realized. The tax amounts in dispute, which are redistributed between taxpayers and the tax authority in legal disputes, must be significant enough to push the aggregate demand in the direction required to achieve a stabilizing result. Likewise, the indirect effect of court rulings on decisions made by the tax authority "in the shadow of the law" must be similarly significant.[97] If these criteria are met, adding judicial decision-making to the array of fiscal stabilization tools could improve social welfare.

In essence, the judicial decision is a ruling in a specific civil dispute between the taxpayer and the tax authority that is made after exercising judicial discretion.[98] As part of the decision, the court decides whether to allocate tax money to this taxpayer or the government. When the court continuously exercises discretion across

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(stating that appeals from a US district court are filed to the appropriate US court of appeals).

[94] *See* 28 U.S.C. § 1295(a)(3).

[95] *See id.* § 1254 (stating the jurisdiction of the US Supreme Court). Between the years 2000 and 2021, the US Supreme Court decided only twenty-six cases involving federal taxation issues. *See* THE SUPREME COURT DATABASE, http://scdb.wustl.edu/analysis.php (last visited Oct. 28, 2023) (choose "2000-2021" for range of terms; then choose "Federal Taxation"; and then click "analyze").

[96] *See* discussion *supra* Part II.

[97] For an explanation of the term, see *infra* note 104.

[98] And with regard to tax judges, it is reasonable to assume that they have accumulated some fiscal or economic specialization during their term.

many decisions, the combination of decision results can exert an accurate stabilizing result if exercised according to the relevant stage of the business cycle.

Along with accuracy, judicial decisions may be reached and implemented faster than legislation and therefore are a simpler (cheaper) stabilizing tool. Judicial decisions can and should be implemented immediately, while legislation involves a sequence of decisions made by several decision makers. Although there may be a time lag from the moment the legal dispute arises until a court decision is made, the court should consider the economic situation at the time of the decision as its macroeconomic reference point. If the court relies on the macroeconomic environment at a different point, the judicial decision may not have a stabilizing effect.

It is expected that judicial decisions will be implemented immediately. Thus, it will be possible to exhaust the stabilizing potential of judicial decisions and avoid the inherent difficulty involved in the lengthy legislative process. To this end, judges must identify the relevant stage in the business cycle and respond accordingly. Although this task is not trivial for economists, let alone jurists, it is possible. This Article addresses this point in the second and third stages of the analysis.

It can also be argued that the judge should consider only the case at hand while disregarding any external considerations so that similar taxpayers receive similar treatment. If not, similar cases will have different results, depending solely on the stage in the business cycle at the time of the decisions. This Article responds in two ways: First, it considers this potential gap to be part of the cost of having courts function as fiscal stabilizers in the second step of the analysis. Second, this Article's argument reflects, to some extent, the current reality in the courts. Taxpayers can already raise a financial hardship argument to support their request for lenient tax treatment. It proposes extending this kind of argument to capture the macroeconomic environment at the time of the decision in addition to particular economic considerations.

Furthermore, the counterargument regarding moral luck can be raised in any case of a taxpayer seeking relief due to his or her economic circumstances. This is because a taxpayer who does not suffer from financial difficulties will not be given relief due to personal circumstances. By contrast, a taxpayer suffering from financial difficulties will receive relief. Therefore, this counterargument is not unique to this context.

According to Yair Listokin, the practical significance of the judicial decision is that it may lead to an increase in aggregate demand if the winning party spends the funds allocated to them by the court on consumption.[99] This increased consumption will increase aggregate demand, which is the stabilizing activity required during an economic crisis.[100] Therefore, Listokin argues that the party with the higher marginal propensity to consume[101] should be preferred in marginal cases during a recession.[102]

By contrast, during an economic expansion, stabilization is achieved by reducing aggregate demand so that the market returns to the product level of equilibrium. Thus, the aggregate demand will decrease, and the market will converge on the GDP levels of equilibrium. Therefore, this Article deduces from Listokin's recommendation that during an expansion, the court should prefer the party that is more likely to avoid consumption.

To summarize this part of the discussion, it is important to note that alongside the theoretical debate concerning the courts' ability to serve as fiscal stabilizers when deciding tax disputes, a complementary empirical examination is needed to explore whether this potential can be realized. The actual impact of these decisions on economic stabilization depends on the number of disputes brought before the courts and their financial scope. Therefore, the empirical analysis should focus on the specific economy under discussion. Accordingly, the normative recommendation will also depend on time and place. Thus, when the litigation volume is large enough, it would be justified to proceed to the second stage of the analysis: an examination of the costs this entails.[103]

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[99] *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 189 (using bankruptcy litigation as an example of a legal area where judges can contribute to raising aggregate demand by forgiving more debt).

[100] *See id.* (using bankruptcy litigation as an example of a legal area that "could have an empirically important stimulus effect" because of the dollar amount of student loans outstanding).

[101] Marginal propensity to consume represents the increase in consumption due to receiving an additional unit of income. For example, if the taxpayer received an additional one dollar and spent eighty cents, their marginal propensity to consume is 80 percent. *See* DORNBUSCH ET AL., *supra* note 35, at 196–97; LIPSEY & CHRYSTAL, *supra* note 7, at 369.

[102] *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 186, 189.

[103] The author of this Article is planning to perform this analysis as part of a future empirical study. For this study, the author of this Article will collect Tax Court decisions and decisions from Israeli district courts in tax disputes, as well as complementary decisions from the US courts of appeals and the Israeli Supreme

Even if the empirical examination shows that the scope of tax litigation is insignificant and that taxpayers try to avoid litigation to resolve disputes with the tax authority, it is worth noting that the tax authority decides taxpayers' cases "in the shadow of the law."[104] Both parties internalize court decisions and act according to how they expect a court will rule in their future case.[105] Therefore, court decisions also impact both parties' future choices, and accordingly, it

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Court, during a typical business cycle and during the Great Recession of 2007-2008 and the COVID-19 crisis. The author of this Article will identify the tax amounts involved in disputes and redistributed between the taxpayer and the tax authority and calculate their weight in the domestic product levels. Additional necessary data for a complete analysis includes information about the proceedings at the earlier administrative level, meaning between the taxpayer and the tax authority. But this information is supposed to remain confidential. *See* I.R.C. § 6103; GREENFIELD, *supra* note 73, § 231(a), at 228. It is important to note that the scope of litigation in the different instances is not constant and can change every year. This also means that there can be several cases in which the tax liability is so significant that it may exert a direct effect on the product level in the market. For example, in November 2020, the US Tax Court reached a decision in a dispute between the Coca-Cola Company and the IRS on the matter of transfer pricing. *See* Coca-Cola Co. v. Comm'r, 155 T.C. 145, 287–88 (2020). The Tax Court decided in favor of the IRS and ruled that Coca-Cola must pay $3.3 billion in income tax. *See id.*; Reuven S. Avi-Yonah & Gianluca Mazzoni, *Coca-Cola: A Decisive IRS Transfer Pricing Victory, at Last*, 169 TAX NOTES FED. 1739, 1739 (2020). Rueven Avi-Yonah and Gianluca Mazzoni flagged this case as "the first decisive IRS victory in a major transfer pricing case since 1979." Avi-Yonah & Mazzoni, *supra*, at 1740. They explained in their analysis of the case that the last time the IRS had a decisive victory in a transfer pricing dispute was in 1979. *Id.* at 1739. Since then, the IRS has lost all major cases, although starting in 2018, there were signs of a possible change. *Id.* They argued in the summary of their analysis of the Coca-Cola case that the Tax Court may have ruled in favor of the IRS due to the extreme effect of the COVID-19 crisis on the US budget and the urgent need to finance the deficit. *See id.* at 1745.

[104] Robert Mnookin & Lewis Kornhauser coined this term in their article. *See* Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 968 (1979), https://doi.org/10.2307/795824. Scholars have used it in the context of plea bargaining. *See* Stephanos Bibas, *Plea Bargaining Outside the Shadow of Trial*, 117 HARV. L. REV. 2463, 2466 (2004), https://doi.org/10.2307/4093404; Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 225 (1982), https://doi.org/10.1086/467699.

[105] *See* Oren Bar Gill & Oren Gazal Ayal, *Plea Bargains Only for the Guilty*, 49 J.L. & ECON. 353, 354 (2006), https://doi.org/10.1086/501084; George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 1–2 (1984), https://doi.org/10.1086/467732; Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55, 56 (1982), https://doi.org/10.1086/467692.

is worth assessing the scope of litigation to quantify the benefits for stabilization.

    3.   Judges' Responses to Business Cycles—Empirical
           Findings from Israel and the United States

     This Part discusses the empirical studies that have found that judges' decisions in tax disputes are influenced by, or at least correlated with, the macroeconomic environment. These findings and their explanations are inconsistent and vary depending on the jurisdiction and time. But the findings can shed some light on the stabilization potential of the courts, demonstrating that the business cycle is already present in the judicial decision-making process, whether consciously or not.

     In a previous empirical study, the author of this Article examined whether judicial decisions that the district courts made in Israel in income tax appeal cases were affected by the stage in the business cycle at the time of the decision.[106] Nine specialized tax judges in the district courts made these decisions between the beginning of the second quarter of 1993 and the end of the third quarter of 2010.[107] The author

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[106] *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 437. Several characteristics of the legal process in Israel made it an ideal setting for the empirical analysis. First, one judge sits in each case, "similar to the procedures of the US Tax Court." *Id.* at 452. Therefore, there is no need to control for any panel effects. Second, only the taxpayer can petition the district court, again, similar to the procedure in the US Tax Court. *Id.* Therefore, the dataset has a practical and methodological advantage over studies focusing on courts of appeals that include appeals filed by both taxpayers and the tax authority. Third, political considerations play a much smaller role in the nomination of judges to the Israeli court system compared with the nomination process to US courts. *Id.* Fourth, the Great Recession had a mild effect on the Israeli economy "compared with [its] effect on the US economy." *Id.* This can mitigate any methodological concerns about a significant external shock that affected case outcomes. For this final point, see Dylan Matthews, *Stanley Fischer Saved Israel from the Great Recession. Now Janet Yellen Wants Him to Help Save the U.S.*, THE WASH. POST (Jan. 13, 2014, 9:58 AM), https://www.washingtonpost.com/news/wonk/wp/2014/01/13/stanley-fischer-saved-israel-from-the-great-recession-now-janet-yellen-wants-him-to-help-save-the-u-s. For an explanation regarding the data collection and coding processes the author of this Article used in the empirical study, see Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 453–54.

[107] For an explanation of how the author of this Article defined specialized judges versus generalist judges, see Orli Oren-Kolbinger, *Measuring the Effect of Social Background on Judicial Decision-Making in Tax Cases*, 22 FLA. TAX REV. 579, 589–96 (2019).

of this Article identified four complete business cycles and another half cycle of the Israeli economy during the period in question.[108]

As part of the study, the author of this Article tested two alternative hypotheses. The first is based on classical economic theory.[109] The decisions will be noncyclical and will not be affected by the economic situation. The second is based on Keynesian theory, according to which the business cycle will have a stabilizing countercyclical effect: the court will be more inclined to favor the tax authority during an extension period and the taxpayer during a recession period.[110]

For the analysis, the author of this Article collected and coded data regarding the business cycle,[111] professional and personal background of the judges whose decisions formed the sample,[112] characteristics of the parties and characteristics of the underreporting or underpayment as reflected in the decision, and data about the procedure and decision.[113] The primary independent variable was the business cycle.[114] The dependent variable was the case outcome, i.e., whether the court accepted the taxpayer's appeal and overruled the

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[108] The timeframe of the empirical study overlapped with reliable data on the business cycle in Israel. *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 453 n.55. For data on the business cycle, see Djivre & Yakhin, *supra* note 24, at 13.

[109] *See* discussion *supra* Part I (discussing classical economics).

[110] *See* discussion *supra* Part I (discussing Keynesian economics).

[111] *See* Djivre & Yakhin, *supra* note 24, at 13 (providing the data). For an explanation regarding the use of the data, see Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 456–57.

[112] *See The Israeli Judicial Authority—Israeli Judges*, GOV.IL, https://judgescv.court.gov.il (last visited Oct. 12, 2023) (providing a search engine and information about current and former judges in Hebrew).

[113] For an explanation of the collected data, see Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 453–60.

[114] *Id.* at 455–59. Defining and coding the business cycle variable for the empirical article was complicated because it needed to represent the way judges identify the transition between the stages of the cycle as they decide cases. This contrasts with the way economists identify the changes in the business cycle, meaning retroactively and after a certain amount of data has accumulated. The theoretical assumption was that judges can identify the macroeconomic trend and respond to it, even if there is a certain delay in their identification of the trend. Therefore, when the author of this Article coded the business cycle variable as identified by judges, the author of this Article allowed for a one-quarter (three month) shift in the business cycle coding and matched the court cases accordingly. For example, decisions that were made during the first quarter of a certain year were matched with the stage in the business cycle during the second quarter of that year.

tax authority's decision or whether it dismissed the appeal.[115]   The other explanatory variables, which served as the control variables, included the gender of the judge, previous occupation prior to the appointment to the trial, judicial seniority, type of assessee, and district of jurisdiction.[116]

The study's statistically significant findings were surprising because it did not confirm either of the two hypotheses regarding the direction of the relationship (or lack thereof) between the business cycle and the case outcome. The empirical analysis revealed that the business cycles influenced judicial decisions in tax disputes in Israeli district courts. Therefore, the hypothesis based on classical theory must be rejected. But the pattern of influence was rather anti-stabilizing and procyclical and not in line with the stabilizing Keynesian macroeconomics. Contrary to the theoretical prediction, the judges were more inclined to decide in favor of the tax authority in times of recession and favor taxpayers in times of expansion.[117] Such a pattern may exacerbate economic instability if the volume of tax cases in court is high and "the shadow of the law" is extensive.[118]

The explanation this Article proposes for the findings is positive and relies on a historical examination of the Israeli economy and the economic policy implemented by decision-makers in times of economic instability.[119] Developed countries generally deal with the business cycle using a stabilizing, countercyclical fiscal policy. By contrast, fiscal policy in developing countries can be characterized as anti-stabilizing.[120] Although Israel is a developed country, economic studies conclude that its fiscal policy is procyclical, contrary to

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[115]   *Id.* at 454–55.

[116]   *Id.* at 460.

[117]   *Id.* at 464–65, 469. As the article explains, almost 17 percent of the variance in case outcomes can be explained by the independent variables. The meaning of this value is that there are other potential variables that can explain the dependent variable. In the context of judicial decisions, it is plausible that these are "legal" variables relating to the facts of the cases and the implementation of the legal rules in each case. This value also fits the general judicial decision-making discussion because the claim was not that judges solely follow macroeconomic considerations but rather that these considerations guide judges' decisions, alongside the rule of law.

[118]   *Id.* at 465–66.

[119]   Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 466–68.

[120]   *See* Michel Strawczynski & Joseph Zeira, *Cyclicality of Fiscal Policy in Israel*, 5 Isr. Econ. Rev. 47, 50 (2007).

economic predictions.[121]   Thus, during periods of recession, a contractionary, anti-stabilizing fiscal policy is implemented, mainly expressed in reduced government expenditures, even though this may exacerbate the recession.[122]

Michael Strawczynski and Joseph Zeira explained that the Israeli economy experienced trauma stemming from a fiscal policy that spiraled out of hand between 1973 and 1985.[123] The policies adopted in this period led to very high government spending and deficits, creating a significant national debt,[124] which the Israeli government then sought to reduce over the years.[125] Thus, in times of recession, when tax collection decreases, the government reduces the amount of government spending to reduce the national debt further. But this policy constitutes a procyclical fiscal policy. Strawczynski and Zeira found that the degree of procyclicality decreased from the start of the stabilization program in 1985, which improved the deficit.[126]

This Article proposes adopting a similar explanation for the procyclical judicial response it identified in tax cases. According to this explanation, Israeli judges adopted a restrictive policy similar to what was pursued by decision-makers due to the economic trauma described in previous paragraphs. Indeed, this may explain their procyclical response to business cycles when reaching judicial decisions in tax cases. Six of the nine judges in the database began "their judicial careers in the 1970s and 1980s[,]"[127] and presumably, they absorbed knowledge about government policy during periods of recession or growth in their adult lives. In addition, six of the nine judges acquired professional experience, to a limited or extensive extent, in public

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[121]   *Id.* at 55; *see also* Arie Marom et al., *The State-of-the-Economy Index and the Probability of Recession: The Markov Regime-Switching Model* 2 (Bank of Isr. Rsch. Dep't, Discussion Paper Series No. 2003.05, 2003), https://www.boi.org.il/media/omnox3jy/dp0305e.pdf; Djivre & Yakhin, *supra* note 24,108 at 1, 2.

[122]   Strawczynski & Zeira, *supra* note 120, at 60. Michel Strawczynski and Joseph Zeira conclude their article by wondering when the effect of the economic trauma will disappear. *See id.* at 65. They claim that minimizing procyclical fiscal policy is the Israeli economy's first step toward the implementation of a countercyclical fiscal policy, as is expected of a developed country. *See id.*

[123]   *Id.* at 53.

[124]   *Id.* at 59–60.

[125]   *Id.* at 64–65.

[126]   *Id.* at 56.

[127]   *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 467.

service—a factor that possibly intensified the degree of their exposure to government policy on economic issues.[128]

In their empirical work, Thomas Brennan et al. explored how macroeconomic variables affected judicial decision-making in the US Supreme Court during the 1920s and 1930s.[129] They based their first hypothesis on a cooperation theory of judging.[130] According to this hypothesis, judges will give deference to the government during recessions by siding with it because they do not specialize in economics.[131] In this way, the judiciary will promote the government's economic policy.[132]

Brennan et al. based their second hypothesis on an informational theory of crisis jurisprudence.[133] Judges prefer a growing economy to an economy suffering from recession.[134]   Judges cannot apply economic policy directly in the courtroom, thus their decisions signal dissatisfaction with the government's economic policy.[135] Therefore, during recessions, judges will decide in favor of the taxpayer, signaling to the government that they disapprove of the flawed economic policy that led to the recession.[136] The prediction would be different during extreme economic circumstances, e.g., the Great Depression, which occur due to an exogenous shock and not because of government malfunction.[137] During extreme economic conditions, judges will be inclined to decide in favor of the government, thus supporting its efforts to mitigate the crisis.[138] During economic upturns, judges will signal their approval of the government's economic policy by siding with the government.[139] These scholars found that economic variables

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[128]   *See id.* at 467.

[129]   *See* Thomas Brennan et al., *The Political Economy of Judging*, 93 MINN. L. REV. 1503, 1505 (2009) [hereinafter Brennan et al., *Political Economy*]; Thomas Brennan et al., *Economic Trends and Judicial Outcomes: A Macrotheory of the Court*, 58 DUKE L.J. 1191, 1192 (2009) [hereinafter Brennan et al., *Economic Trends*].

[130]   *See* Brennan et al., *Political Economy, supra* note 129, at 1514–17.

[131]   *See id.* at 1517.

[132]   *See id.* at 1516–17.

[133]   *See* Brennan et al., *Economic Trends, supra* note 129, at 1194, 1198.

[134]   *See id.* at 1197–98.

[135]   *See id.*

[136]   *See id.* at 1200–01.

[137]   *See id.* at 1201.

[138]   *See id.* at 1200.

[139]   *See* Brennan et al., *Economic Trends, supra* note 129, at 1200. Two other articles have already discussed the theory posed by Brennan et al., as part of a symposium on

are apparent in the judicial decision-making process. But this mechanism is different from the one the author of this Article identified concerning the district courts in Israel.[140]

Three additional empirical studies analyzed the relationship between judicial decisions and the business cycle in other legal fields. John Donohue and Peter Siegelman focused on employment discrimination cases and how unemployment rates affect the volume of litigation.[141] They found that judges awarded higher compensation amounts to employees subjected to discrimination during recessions.[142] This represents a countercyclical response. But they found that the high expected value of litigation during recessions led to the filing of more cases, including weaker cases, which, in turn, leads to a lower win rate in times of recession.[143]

In order to identify systemic distinctions between specialized and generalist courts, Robert Howard and Shenita Brazelton performed a field study comparing decisions that the Bankruptcy Court and federal district courts made.[144] Although they did not find evidence of capture

judicial decision-making held at Duke University School of Law in 2009. *See* Scott Baker et al., *Justices as Economic Fixers: A Response to a Macrotheory of the Court*, 58 DUKE L.J. 1627, 1627 (2009); Ernest A. Young & Erin C. Blondel, *Does the Supreme Court Follow the Economic Returns? A Response to a Macrotheory of the Court*, 58 DUKE L.J. 1759, 1760 (2009). They raised several concerns regarding the authors' argument and analysis. First, the theory underlying the judges-acting-as-voters decision-making mechanism is unclear. *See* Baker et al., *supra*, at 1634 n.17; Young & Blondel, *supra*, at 1774. Second, they measured judges' responses to the macroeconomic environment at the time of oral arguments and not at the time of the decision. *See* Baker et al., *supra*, at 1637–38. The final decision in the case, however, can take place long after the oral arguments, meaning that judges' responses might miss the stabilization point. *See id.* Finally, they do not consider the normative implications of the behavioral pattern they identified, including regarding separation of powers and judges' actions as ultra vires. *See id.* at 1640–43; Young & Blondel, *supra*, at 1773–77.

[140] *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 448–51.

[141] *See* John J. Donohue III & Peter Siegelman, *Law and Macroeconomics: Employment Discrimination Litigation over the Business Cycle*, 66 S. CAL. L. REV. 709, 709 (1993) [hereinafter *Employment Discrimination Litigation*]; Peter Siegelman & John J. Donohue III, *The Selection of Employment Discrimination Disputes for Litigation: Using Business Cycle Effects to Test the Priest-Klein Hypothesis*, 24 J. LEGAL STUD. 427, 427 (1995) [hereinafter *Discrimination Disputes*], https://doi.org/10.1086/467964.

[142] Recessions correlate with longer unemployment periods.

[143] *See Employment Discrimination Litigation*, *supra* note 141, at 719; *Discrimination Disputes*, *supra* note 141, at 428–30.

[144] Robert M. Howard & Shenita Brazelton, *Specialization in Judicial Decision Making: Comparing Bankruptcy Panels and Federal District Court Judges*, 22 AM. BANKR. INST. L. REV. 407, 407 (2010).

in the bankruptcy context, their findings were as follows: First, when making decisions, both district court judges and specialized Bankruptcy Court judges were influenced by their political ideology.[145] Second, in the district courts, specialized judges were more attuned to the political and economic climate than generalist judges.[146] Third, a few specialist judges who received lower pay and limited tenure followed the legislative preferences of Congress.[147]   Fourth, the decisions that specialist judges made were more sensitive to the state of the economy because they showed a correlation with the unemployment rate.[148]

Lance Bachmeier et al. studied the effect of various macroeconomic indicators, e.g., GDP, consumption levels, inflation rates, unemployment rates, and interest rates, on antitrust, bankruptcy, contracts, body injuries, and products liability litigation.[149] They reached similar findings to those of Donohue and Siegelman about increased litigation during economic shocks.[150] They found that GDP, consumption levels, and inflation rates had a countercyclical effect on litigation.[151] This means that in the presence of an economic shock connected to one of the variables mentioned above, more cases were litigated.[152]

The empirical evidence discussed so far indicates that judges respond to the business cycle. Therefore, it is not a hypothetical matter. Another interesting empirical matter, which is outside the scope of this Article, concerns identifying the mechanism that drives judges' responses. Is the response conscious or subconscious, and what is its source? Does it seek to stabilize the economy, cooperate with other government authorities, or perhaps express sympathy for taxpayers in times of recession?

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[145]   *Id.* at 425.

[146]   *Id.* at 418, 426.

[147]   *Id.* at 419.

[148]   *Id.* at 426, 428.

[149]   Lance Bachmeier et al., *The Volume of Federal Litigation and the Macroeconomy*, 24 INT'L REV. L. & ECON. 191, 193 (2004), https://doi.org/10.1016/j.irle.2004.08.004.

[150]   *Id.* at 193–94; *see* sources cited *supra* note 143.

[151]   Bachmeier et al, *supra* note 149, at 206.

[152]   *Id.* at 193–94.

B.   *Step 2: Should Courts Serve as Fiscal Stabilizers?*

The previous step of the analysis focused on the positive question of whether the business cycle affects judicial decision-making. It also asserted that it is possible to quantify the social benefit of using the courts as a fiscal stabilizer. This social benefit depends on the number of disputes brought before the courts and their financial scope.

The current section focuses on the costs of doing so, reviewing the relevant normative arguments, which are organized into three main groups. These arguments relate to the relationships between the judiciary and the other branches of government, within the judiciary, and between the disputing parties and the judiciary. Just as the examination of the benefit in the previous step depends on time and place, so does the examination of the cost in the current step.

1.   First Dimension: The Relationship Between the
      Judiciary and the Legislative and Executive Branches

When considering the relationship between the three branches of government, the main concern relates to the fundamental principle of separation of powers. Judges are nominated to make decisions based on legal rules and interpretation, not on nonjudicial considerations like judges' personal and professional background characteristics or economic policy. But extensive empirical literature has confirmed hypotheses based on legal realism and critical perspectives, according to which judges consider nonlegal variables—including the macroeconomic environment—when making judicial decisions.[153] In addition, the separation of powers entails maintaining a system of checks and balances rather than erecting barriers between the various authorities. Therefore, we should consider two types of social costs: (1) the social cost of having the judiciary complement the efforts of

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[153] *See* FRANK B. CROSS, DECISION MAKING IN THE U.S. COURTS OF APPEALS 6 (2007); FORREST MALTZMAN ET AL., CRAFTING LAW ON THE SUPREME COURT: THE COLLEGIAL GAME 10 (2000); RICHARD A. POSNER, HOW JUDGES THINK 19 (2008) (providing general resources on judicial decision-making); JEFFREY A. SEGAL & HAROLD J. SPAETH, THE SUPREME COURT AND THE ATTITUDINAL MODEL 86–96 (2002) (outlining the attitudinal model of judging and giving several examples through the mid 19th to early 20th century); Tracey E. George & Taylor Grace Weaver, *The Role of Personal Attributes and Social Backgrounds on Judging, in* THE OXFORD HANDBOOK OF U.S. JUDICIAL BEHAVIOR 286, 286 (Lee Epstein & Stefanie A. Lindquist eds., 2017) (describing the social background model of judging); LEE EPSTEIN & JACK KNIGHT, THE CHOICES JUSTICES MAKE 10 (1998); Lee Epstein & Tonja Jacobi, *The Strategic Analysis of Judicial Decisions*, 6 ANN. REV. L. & SOC. SCI. 341, 343 (2010) (outlining the strategic model of judging), https://doi.org/10.1146/annurev-lawsocsci-102209-152921.

other government branches to stabilize the economy, thus limiting the judiciary's ability to criticize the actions of the other branches; and (2) the social cost of lower levels of public trust in the judiciary.

Another argument is the degree of coordination and cooperation between the different authorities within the branches of government. This Article proposes asking two questions as yardsticks to assess the cost in this context: First, is it possible to coordinate the stabilizing actions of the authorities so that the actions they take will be accurate and in accordance with the stage of the business cycle? Second, is it possible to promote cooperation between them in addition to coordination?   If so, this means that the authorities will have knowledge of each other's actions and may act in a complementary or, if needed, substitutionary manner.

2.   Second Dimension: Policy Considerations Within the Judiciary

In this context, several concerns can be raised. First, should judges specialize in economics and the analysis of financial information?   Must these judges be economic experts to make decisions that implement economic policy and have fiscal implications?   This Article argues that judges should gain judicial specialization in deciding these cases, but this does not mean they must be experts in economics. Judges frequently decide cases concerning matters outside their expertise, including economic orientation. For example, they appraise companies, calculate compensation for the loss of future income, and determine the admissibility and weight of scientific evidence. Indeed, judicial decision-making is not limited to the technical implementation of legal rules, and accordingly, there is no justification for precluding judges from considering relevant economic policy. Suppose there is a basis for concern that judges lacking economic knowledge will reach erroneous decisions. In that case, the answer is providing judges with relevant training or ensuring that they rely on experts in the field, as they do in other areas of law.

Second, when judges consider the macroeconomic environment, what point in time during the business cycle should constitute the relevant reference point? Four potential time points can be relevant: (1) the time at which the taxpayer made a tax violation; (2) the time at which the taxpayer appealed the tax authority's decision in court; (3) the time of oral arguments; or (4) the time at which the judge reached a decision. As mentioned above, the advantage of judicial decisions over legislation is the potential for their immediate implementation. Therefore, if the goal is to achieve a stabilizing fiscal

result, the economic situation at the time of the decision must be considered rather than that at any other point in time.

The issue of the appropriate reference point in time leads to the third concern: will this result in a slippery slope of gaming the system, enabling parties to benefit from timing the deliberations and decision dates? As previously explained, business cycles are not fixed.[154] Identifying the stages of the business cycle or the transitions between them is not straightforward. Thus, even if a party requests to change the hearing date, this does not guarantee the stage in the business cycle at which the decision will be made. Moreover, the court sets the hearing dates and can deny unreasonable requests.

Fourth, how much coordination should be established between different courts or judges within the same court who decide cases in different areas? Coordination is, of course, desirable to effectively implement a stabilization policy. Coordination can be achieved by employing an organized and accessible information system to transfer information about the business cycle and the decisions made inside the legal system.

Fifth, what are the implications for the precedent and legal certainty principles? In the United States, the Tax Court handles most disputes between taxpayers and the IRS,[155] and in Israel, the disputes with the tax authority are filed in district courts.[156] Therefore, other courts are not bound by their decisions. Even if a higher court decides the case and it becomes a precedent, the stage in the business cycle is only one parameter that the court considers. Thus, the judge will be able to deviate from an earlier precedent if the economic situation is significantly different in the future. Legal certainty may be impaired considering the difficulty involved in identifying the stage in the business cycle in real time. But, as demonstrated through the empirical findings from Israel, tax judges did distinguish between the various stages in the business cycle; yet their decisions were procyclical and anti-stabilizing. A related concern is that it is hard to predict the length of the legal process and during which stage of the cycle it will end. That said, because the court controls its schedule and the case's progress, the parties will be discouraged from delaying the case.

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[154] *See* discussion *supra* Part I.

[155] *See* TAXPAYER ADVOC. SERV., *supra* note 90, at 174 ("In fiscal year (FY) 2022, about 98 percent of all tax-related litigation was adjudicated in the Tax Court.").

[156] *See* GREENFIELD, *supra* note 73, § 153, at 198 (discussing the right of appeal to the district court).

3.   Third Dimension: The Relationship Between Litigating
     Parties and the Judiciary

In this context, this Part addresses two concerns. The first is
giving sophisticated taxpayers an advantage over unsophisticated
taxpayers because the former can use their resources to strategically
time the legal proceedings. This may lead to lower levels of trust in the
court system, causing unsophisticated taxpayers to refrain from
appealing the tax authority's decisions and to believe that the system is
biased against them.

But this is not concerning both vis-à-vis the technical aspect of the
timing of the procedure and from the substantive perspective of
reaching the decision. Technically, the taxpayer must file an appeal
within a specified timeframe of the tax authority's decision regarding
their assessment.[157] As explained above, once the appeal procedure
has commenced, the court can reject attempts to stall the process.[158]
Moreover, economic theory and empirical data demonstrate that
unsophisticated taxpayers have a higher marginal propensity to
consume than sophisticated taxpayers: they spend a higher percentage
of their income on consumption.[159] Therefore, if the stabilization
mechanism follows the normative guideline that Listokin proposed to
favor the party with a higher marginal propensity to consume,[160] the
court may favor the unsophisticated taxpayers in times of recession
more than it favors sophisticated taxpayers. During expansions, the
court will favor the authority.

The tax amounts in disputes between the tax authority and
sophisticated taxpayers are more significant than those involved in
disputes with unsophisticated taxpayers. Thus, the tax authority's
relative advantage over them is more significant than its advantage over
weak taxpayers. Of course, this Article does not ignore the built-in

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[157]   In Israel, taxpayers have thirty days after receiving a tax assessment to submit an
appeal to the district court. *See id.* (discussing the right of appeal to the district court);
see also Regulation 2, Court Regulations (Appeals in Income Tax Matters), 5738–1978,
KT 3914 193 (Isr.), https://www.nevo.co.il/law_html/law00/72550.htm ("An appeal
of a tax assessment shall be submitted by written notice within thirty days from the day
the assessment was delivered to the appellant."). In the United States, taxpayers have
ninety days after the notice of deficiency authorization was mailed to them to file a
petition with the Tax Court (or 150 days if the notice is addressed to a person outside
the United States). I.R.C. § 6213(a).

[158]   *See* discussion *supra* Part III.B.2.

[159]   Christopher Carroll et al., *The Distribution of Wealth and the Marginal Propensity to
Consume*, 8 QUANTITATIVE ECON. 977, 982–85 (2017).

[160]   *See* discussion *supra* Part III.A.2.

power gaps between sophisticated and unsophisticated taxpayers that the legal process might exacerbate. But there is no reason to assume that the situation is more difficult in tax matters than in other areas of law.

The second concern is the possible adverse impact on the court's ability to regulate parties' behavior. This is because decisions are inconsistent throughout the business cycle. But the cost associated with this concern is negligible. First, if the court consistently considers the parameter of economic stabilization, the results of its decisions will also be consistent. If the parties want to distinguish their case from a previous one because the economic situation has changed, they will still be able to do so.

Nevertheless, given the low rate of tax disputes that get to court, whether trial or appellate court,[161] the primary effect of courts' decisions on behavior happens "in the shadow of the law."[162] There is no reason that this will change if the court consciously considers the business cycle. Indeed, the tax authority decides the majority of tax disputes. Therefore, it will necessarily apply the stabilizing ruling in its ongoing work with taxpayers in a manner that is consistent with the ruling and its obligations as an administrative authority.

In conclusion, the costs of having courts consider the macroeconomic environment when making decisions in tax disputes depend on a series of normative and systemic considerations, as detailed above. It is an empirical question that depends on time and the specific economy, similar to evaluating the benefit that will result from such a move.

C. *Interim Summary: Before Moving to Step 3*

Step 3 of the analysis focuses on the design of potential judicial stabilizing mechanisms. But the underlying assumption of Step 3 is that Steps 1 and 2 of the analysis resulted in an increase in social welfare from judges considering the macroeconomic environment when deciding tax disputes. This increase is reflected by shorter recovery periods from recessions and expansions and curbed troughs and peaks.

But what if the potential social cost described in Step 2 of the analysis outweighs the potential benefit described in Step 1? This can happen in two scenarios; the first considers whether the court follows

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[161] *See* Oren-Kolbinger, *Do Tax Judges Think About the Economy?*, *supra* note 26, at 442.

[162] *See* Mnookin & Kornhauser, *supra* note 104, at 997.

the business cycle, meaning that judges decide in an anticyclical way. But, in this scenario, the magnitude of cases and the amount of tax money in dispute is such that it is not large enough to generate enough social benefit of stabilization. This means that there is some positive social benefit from their decision-making pattern. Still, it needs to be more significant to mitigate the social cost of instructing judges to consider the macroeconomic environment. The second is if the court decides in a procyclical way, meaning that not only is there no social benefit from their decision-making to economic stabilization, but their decisions lead to social harm. That certainly cannot mitigate the social cost, even if it is minimal. The sum of the two items is, by definition, negative.

Suppose the cost-benefit analysis leads to a negative outcome in the context of social welfare. It does not matter if this is because of the first or second scenario. In that case, the normative recommendation should be that the judges do not consider the business cycle at all. Once the outcome is negative social welfare, they should refrain from considering the business cycle.

In the first scenario, it is important to be mindful that if the magnitude of cases goes up, e.g., in the case of a surge of petitions to the court, the court should return to anticyclical decision-making. By doing that, the social harm can be avoided. In the second scenario, judges should just stop considering the business cycle. In both cases, going back to neutral would have business cycle benefits.

The second scenario reflects the case of the Israeli judiciary. As described in Step 1, in Israel, the decision-making pattern of tax judges has been procyclical. Therefore, they fall under scenario two, so there is no social benefit from being anticyclical to begin with. It would be beneficial to tell Israeli judges who decide tax disputes about their decision-making patterns and then instruct them to ignore the business cycle. In the Israeli case, just going back to neutral would have business cycle benefits. Of course, if it is possible to train judges to apply countercyclical policy *and* the magnitude of cases becomes significant, then it may work. But if that is not the case, then instructing the judges to ignore the business cycle should be advocated.

D. *Step 3: How Should the Judicial Stabilizing Mechanism Be Designed?*

After completing the first two steps of the analysis and only if the fiscal potential of the courts will increase aggregate welfare, the analysis moves to the third stage. Here, this Article proposes two discretionary mechanisms by which the judiciary may consider the macroeconomic environment when deciding tax disputes.

The first mechanism is a "business cycle multiplier" that will increase or decrease the taxpayer's liability depending on the stage of the business cycle. This means that any formulas used in calculating tax liability and fines will be updated to include an element of relief or aggravation, depending on the stage of the business cycle. Note that substantive law or its interpretation does not become dependent on the business cycle, and this mechanism applies only after deciding on the taxpayer's liability.

How will this multiplier be designed? The multiplier will be set similarly to the Consumer Price Index (CPI).[163] This means it will have a baseline, starting when the mechanism is implemented, and its values will relatively change over time. It will follow existing macroeconomic indicators like changes in the level of GDP or other indicators that are highly correlated with the business cycle for simplicity.

For example, suppose the dispute between the taxpayer and the Tax Authority ends in a decision against the taxpayer and the taxpayer must pay a tax debt to the Tax Authority, which was made during a recession. In that case, the amount will be adjusted downward. The amount will be adjusted upwards if the decision is made during the expansion stage. Similarly, if the taxpayer wins, meaning that the Tax Authority must repay them a tax refund, then during a recession, the amount will be adjusted upwards, meaning that the taxpayer will receive a larger refund. During an expansion, the tax refund will be adjusted downwards.

According to Keynesian theory, reductions in the tax liability of the taxpayer during the recession stage and increases in tax liability in the expansion stage can be justified.[164] The tax liability formula can be designed linearly, meaning that the relief component will increase as

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[163] The Consumer Price Index (CPI) is a measure of how prices for a market basket of consumer goods and services have changed on average over time for urban consumers. *See Consumer Price Index,* U.S. BUREAU OF LAB. STAT., https://www.bls.gov/cpi (last visited Oct. 12, 2023).

[164] *See* discussion *supra* Part I (discussing expansionary tax policy and narrowing tax policy).

the recession intensifies, while the aggravation component will increase as the expansion boosts. Under this mechanism, the courts would be responsible for locating the latest economic data. As described, this would not add complexity because the data for the selected macroeconomic measurement that the outcome will be adjusted according to, e.g., the unemployment rate or the GDP, is readily available. The courts can use an easy computational solution that will draw the data to the information technology system of the court. Once there is a court decision, the outcome can be adjusted automatically.

A similar tool already exists in the court system, as all sums owing to or by the tax authority or the taxpayer are modified by the interest rate and the CPI. This concept of adjusting the case outcome is familiar to the tax and court systems. Therefore, this Article suggests utilizing this technique in the tax dispute setting.

This measurement has the advantage of being straightforward, which supports simplicity as a tax policy principle. It can be added to the current system because it is an external and objective parameter and can be done without the aid of specialists or sophisticated technological tools. Similar to how court decisions regarding unpaid taxes are adjusted according to the interest rate, the current process can be automatic.

The second mechanism is a Keynesian default rule that, in close cases, will tip the scales during a recession in favor of the party with the higher propensity to consume.[165] This Article claims that it can be broadened so that during an expansion, the party with the higher propensity to consume would be disadvantaged. It is safe to assume that this means that the taxpayer will be favored during a recession and the tax authority during an expansion because the taxpayer is considered to have a higher propensity to consume.

Compared with the first one, the advantage of this mechanism is that it can be implemented even in nonmonetary cases, meaning cases that do not necessarily involve underpayment of taxes owed. It will, however, only be effective in cases where the odds of winning are equal to the odds of losing. Additionally, because it is a rule that tilts the odds in favor of the opposing party, its application would be restricted so it does not override the fundamental provisions of tax laws.

It will be possible to deviate from the default rule according to the normative guideline that Listokin proposed and prefer the tax

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[165] *See* LISTOKIN, LAW AND MACROECONOMICS, *supra* note 22, at 186, 189.

authority in a recession if the tax authority can show that it has a higher marginal propensity to consume.[166] Under this mechanism, in contrast to the previous one, the parties must bring evidence concerning their marginal propensity to consume. Thus, during a recession, the tax authority may present plans for government expenditure to convince the court that the government should be accorded an advantage when distributing the tax money between the parties.

But this technique has two main shortcomings. First off, it only works in close circumstances. This aspect will not affect the case outcome if it is not a close one. Therefore, it will have a low impact on stabilization because it might only influence a small number of cases. Second, it requires the parties to demonstrate to the court what their marginal propensity to consume is if they would like the court to differ from the default, making it a more complicated and costly option.

The second mechanism has additional drawbacks. First, instructing judges to consider economic considerations will require training to implement this mechanism consciously and consistently. This becomes even more necessary considering the empirical findings presented above. Although judges respond to the macroeconomic environment, the nature of the response depends on time and place. Second, because tax authority decisions are made "in the shadow of the law," and the financial scope of these decisions is significantly larger than the decisions courts make, it makes sense for the tax authority to adopt a similar decision-making mechanism to achieve a stabilizing result. But, given the complexity of the mechanism, requiring the tax authority to implement it would only exacerbate the complexity.

This is why the multiplier in the first mechanism has an advantage. It is simple, and therefore inexpensive, to implement because it only involves the multiplication of the result by a specific macroeconomic factor that is specified outside of court, and judges are not required to compute it themselves. It applies to all cases, not only close cases. As stated earlier in this Part, it is possible to do so computationally plainly by applying the factor to the result. But the first mechanism's disadvantage is that it cannot be used when there is a nonfinancial issue instead of a financial one. After examining the advantages and drawbacks of both mechanisms, this Article contends that the business cycle multiplier can be used for monetary disputes while a simpler

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[166]   *See id.*

default rule, which assumes that taxpayers should benefit during a recession, can be used for non-monetary conflicts.

These mechanisms are not flawless. First, instructing judges to consider economic considerations will require training to implement this mechanism consciously and consistently. This becomes even more necessary considering the empirical findings presented above. Although judges respond to the macroeconomic environment, the nature of the response depends on time and place. Second, because tax authority decisions are made "in the shadow of the law," and the financial scope of these decisions is significantly larger than the decisions courts make, it makes sense for the tax authority to adopt a similar decision-making mechanism to achieve a stabilizing result.

CONCLUSION

Economic crises are inevitable. Academic discussions concerning business cycles and fiscal stabilization policy focus mainly on stabilization actions taken by the legislature and the executive branch. Fiscal stabilization mechanisms are characterized by the degree of discretion involved in their operation and the time it takes to implement them and achieve the stabilizing result. In general, there is a trade-off between these two characteristics: the greater the degree of discretion exercised in the design of the stabilizers, the more accurate the outcome, although it takes longer to achieve the stabilizing result. Moreover, with regard to automatic stabilizers, the result is achieved more rapidly but is less accurate.

Considering this trade-off, this Article proposes examining the courts' stabilizing potential in resolving tax disputes between taxpayers and the tax authority. Academic literature has not yet adequately addressed this potential. Judicial decisions have an inherent advantage in that they are made with discretion and implemented immediately. Therefore, this Article presents a normative framework based on a cost-benefit analysis to examine the potential for stabilization through judicial decisions vis-à-vis tax. When the social benefit exceeds the cost, it would be appropriate to implement a legal stabilization mechanism to help stabilize the economy.

This line of research can be expanded in several directions. One is an empirical examination of the theoretical argument the author of this Article developed in cases of economic crises resulting from various causes. Specifically, the author of this Article will compare the global economic crisis of 2007–2008 with the global COVID-19 crisis we are currently experiencing. The author of this Article will examine

the decision-making patterns of courts during these periods to determine whether these patterns promote deficit reduction or sympathy for the economic situation of taxpayers.

In addition, the author of this Article will expand the theoretical argument to other areas of law, such as bankruptcy and social security, and specialized courts, such as the Tax Court and labor courts. Indeed, these cases result in the redistribution of significant sums between the parties and therefore have significant fiscal stabilizing potential. Accordingly, the author of this Article would argue that the normative framework proposed in this article can also be applied to other contexts to achieve a result that increases social welfare.