Judgment of 11th May 2004, K 4/03

COUNTERACTING TAX LAW EVASION (I). OFFICIAL INTERPRETATION OF TAX REGULATIONS

Type of proceedings: Abstract review **Initiators:** Commissioner for Citizens' Rights, President of the Supreme Administrative Court	**Composition of Tribunal:** Plenary session	**Dissenting opinions:** 4

Legal provisions under review	**Basis of review**
Duty of fiscal authorities to comply with binding tax law interpretations issued by the Minister of Finance [Tax Ordinance Act 1997: Article 14 § 2 *in fine*]	Principle of the two-instance system of proceedings Limited binding nature of internal law acts [Constitution: Articles 78 and 93(2)]
Competence of fiscal authorities to disregard the tax effects of legal transactions concluded exclusively for the purpose of acquiring tax benefits [*Ibidem*: Article 24b § 1]	Rule of law Legal reservation (exclusivity of statutes) in relation to tax law [Constitution: Articles 2 and 217]

In considering a joint application of the President of the Supreme Administrative Court and the Commissioner for Citizens' Rights, the Constitutional Tribunal reviewed two regulations contained in the Tax Ordinance Act 1997, which lays down the foundations for the entire tax system.

Article 14 of the Tax Ordinance Act regulates the competences of the Minister responsible for public finance affairs (Minister of Finance) and aims to ensure uniformity in the interpretation and application of tax law. According to § 1 point 2 of this Article, the Minister is authorised to issue interpretations of tax law "taking into account the jurisprudence of the courts and the Constitutional Tribunal". Article 14 § 2 – in accordance with the wording in force prior to the entry into force of the Tribunal's judgment – stated that interpretations concerning "tax law problems", issued by the Minister to subordinate tax authorities and fiscal control authorities (the latter being a sort of tax police), shall be promulgated in the Official Journal of the Minister of Finance and – as was challenged in this case – shall be binding on all such authorities. Any explanations or interpretations adopted pursuant to Article 14 § 2 are abstract in nature, since § 4 expressly prohibits the Minister from issuing interpretations in relation to individual cases. Whilst the Minister's interpretations of law are binding on subordinate authorities, they do not bind taxpayers and, in particular, may not constitute a source of taxpayers' obligations. Article 14 § 3 acts as a significant guarantee in this respect, stating that taxpayers shall not suffer adverse consequences as a result of their compliance with interpretations of law promulgated in the Official Journal although, as a rule, this would not release them from the obligation to pay the tax; exception-

ally it may justify the remission of tax arrears.

The applicants challenged the binding nature of ministerial interpretations as regards all tax and fiscal control authorities (Article 14 § 2 *in fine*). They alleged that this regulation renders the two-instance system of tax proceedings illusive, since the organ of second instance is bound by the same official interpretation to an equal degree as the organ of first instance; this violates the principle of the two-instance system of proceedings, as expressed in Article 78 of the Constitution. Concurrently, the applicants claimed that the binding nature of ministerial interpretations, vis-à-vis all fiscal authorities, means that such interpretations *de facto* regulate not merely the actions undertaken by authorities subordinate to the Minister but also determine the rights of entities that are not organisationally subordinate to the Minister (i.e. taxpayers), thereby infringing the constitutional prohibition against internal acts serving as the bases of decisions concerning such entities (the second sentence of Article 93(2) of the Constitution).

Article 24b of the Tax Ordinance Act regulates the competences of fiscal authorities charged with counteracting the acquisition of tax benefits by taxpayers who have entered into civil-legal transactions principally (and as a rule exclusively) with the aim of acquiring such benefits. The relevant benefit consists either in a reduction of the tax liability or in an increase in the taxpayer's loss (thereby decreasing the amount of taxable income) or in increasing the amount treated by tax provisions as overpayment or due tax return. According to Article 24b § 1, which was challenged in this case, where a tax or fiscal control authority demonstrates that, when concluding a particular transaction, "one should not have expected other significant benefits" (i.e. benefits other than the aforementioned tax benefits), the authority should "disregard the tax effects" of such a transaction. Article 24b § 2, which was not challenged in this case, remained linked with § 1 by setting forth that where the parties have, in concluding a transaction, achieved an "intended economic result" for which a transaction other than that indicated by the parties is appropriate, the tax effects are to be deduced on the basis of that alternative ("appropriate") transaction.

In challenging Article 24b § 1 in its entirety, the applicants argued that this provision allows tax authorities to allege "tax law evasion" in respect of any transaction intended to lawfully decrease an individual's tax burden (i.e. which is the essence of tax optimisation for each taxpayer). It is unclear whether the tax authorities will deem valid legal transactions undertaken by taxpayers to be tax law evasion. The applicants argued that this conflicts with the principle of legal certainty, as stemming from the constitutional principle of the rule of law (Article 2), requiring the decisions of public authority organs to be foreseeable and predictable. The applicants also cited Article 22 of the Constitution as a basis of review, linking this with the principle of "the freedom of economic activity, as expressed in an individual's freedom to structure their economic relations", but the Tribunal declined to rule on this aspect of the claim (cf. paragraph 11 of the principal reasons for the ruling).

The application of the President of the Supreme Administrative Court and the Commissioner for Citizens' Rights also referred to two provisions of the Supreme Administrative Court Act 1995, which had already ceased to have binding force. The Tribunal, however, declared it inadmissible to rule on these provisions since

they were no longer in force (cf. the final part of the ruling).

The Tribunal's reasoning for the ruling follows the same structure as the application, beginning with the issue of the constitutionality of Article 24b § 1 of the Tax Ordinance Act and only thereafter considering Article 14 § 2. The structure of the principal reasons for the ruling presented below corresponds to this sequence.

Judges Marian Grzybowski, Adam Jamróz, Marek Mazurkiewicz and ***Bohdan Zdziennicki*** disagreed with the Tribunal's finding that Article 24b § 1 of the Tax Ordinance Act did not conform to the Constitution and, accordingly, submitted a joint dissenting opinion regarding this part of the judgment (point 2 of the ruling).

RULING

1. Article 14 § 2 of the Tax Ordinance Act, insofar as it states that interpretations of the Minister responsible for public finance affairs shall be binding on tax and fiscal control authorities, does not conform to Article 78 and the second sentence of Article 93(2) of the Constitution.

2. Article 24b § 1 of the Tax Ordinance Act does not conform to Article 2, read in conjunction with Article 217, of the Constitution.

The Tribunal discontinued proceedings in relation to the review of Articles 18(2) and 59 of the Supreme Administrative Court Act 1995 – by reason of loss of binding force of these provisions, pursuant to Article 39(1) point 3 of the Constitutional Tribunal Act.

PRINCIPAL REASONS FOR THE RULING

1. One of the elements of the principle of trust in the State and its laws, as derived from the principle of the rule of law (Article 2 of the Constitution), is the prohibition of sanctioning – in the sense of attributing negative consequences to, or refusing to recognise positive consequences of – the lawful behaviour of legal norms' addressees. Thus, where the addressee of a legal norm concludes a lawful transaction and thereby achieves a goal which is not prohibited by law, the objective (including the tax objective) accomplished in this manner should not be regarded as tantamount to prohibited objectives.

2. The constitutional obligation to pay taxes specified by statute (Article 84) does not constitute an obligation for taxpayers to pay the maximum amount of tax, nor a prohibition on taxpayers seeking to take advantage of various lawful methods of tax optimisation. There is a fundamental difference between unlawful tax evasion, constituting an infringement of law, and the avoidance of tax as a result of lawful transactions concluded for this purpose.

3. As a rule, no constitutional difficulties arise as a result of the legislator's response to economic phenomena harmful to the State's fiscal interests, including where this concerns

the sphere of taxpayers' contractual relationships, even where the legislator's response takes the form of a "general norm of tax law evasion". Each such response should, however, observe the necessary constitutional requirements concerning respect for the rights and freedoms of taxpayers.

4. From the principle of the rule of law, as expressed in Article 2 of the Constitution, stems the requirement for the legislator to comply with the principles of correct legislation. This requirement is functionally tied with the principles of legal certainty, legal security and protection of trust in the State and its laws. These principles have particular significance in the sphere of human and civil rights and freedoms.

5. The constitutional requirements of correct legislation are infringed, in particular, when the wording of a legal provision is so vague and imprecise that it creates uncertainty amongst its addressees as regards their rights and duties, by creating an exceedingly broad framework within which authorities charged with applying the provision are required, *de facto*, to assume the role of law-maker in respect of these vaguely and imprecisely regulated issues. Where legal provisions exceed a certain degree of ambiguity this may in itself constitute grounds for declaring such provisions to be unconstitutional, both in respect of constitutional provisions requiring statutory regulation in a certain field (so-called legal reservation), such as the placing of limitations on the exercise of constitutional rights and freedoms (the first sentence of Article 31(3)), and also in respect of the rule of law principle as expressed in Article 2.

6. The principle of the specificity of legal provisions, as a constituent component of the principle of trust in the State and its laws, requires particular emphasis in certain fields of legal regulation. In addition to criminal law, one such field is the law relating to public levies. The principle of the specificity of legal provisions is made concrete in this field by the requirement that the constitutive elements of taxes and other public levies be defined by statute (Article 217 of the Constitution). The legislator's correct stipulation of all taxpayers' duties, together with the consequences of their actions from the perspective of instituted public-legal obligations, also represents an expression of compliance with the principle of legality (Article 7 of the Constitution), according to which all organs of public authority may only act within the limits of, and on the basis of, the law.

7. The constitutional acceptability of the legislator's use of ambiguous phrases (including general clauses) depends on the fulfilment of conditions seeking to ensure the maximum foreseeability of decisions taken on the basis of provisions containing such phrases. Firstly, the requirements of comprehensibility of a particular ambiguous phrase may not allow the existence of an exceedingly broad field of individualised interpretation. Secondly, it is necessary to provide ambiguous phrases with content guaranteeing the uniformity of jurisprudence (decisions applying the law). Thirdly, the interpretation of unclear terms may not permit organs applying such terms to engage in illegitimate law-making. The aforementioned restrictions on the legislator's use of ambiguous phrases, formulated in constitutional jurisprudence in relation to regulations applied by courts, must be treated in an even stricter manner when the legislator delegates the interpretation of ambiguous phrases to administrative organs.

8. Article 24b § 1 of the Tax Ordinance Act contains a particular norm empowering tax and fiscal control authorities to assess factual circumstances from the perspective of their consequences on tax liability. This approach differs from the civil law concept of evading tax law (Article 58 § 1 of the Civil Code) primarily because, *de lege lata*, no existing legal norm treats as unlawful a taxpayer's attempts to lower or avoid their tax burden. Since the actions envisaged by Article 24b § 1 of the Tax Ordinance Act remain lawful, it is not possible to allege that those engaging in them have infringed any norm of a *iuris cogentis* nature.

9. Pursuant to Article 24b § 1 of the Tax Ordinance Act, the conclusion of a lawful transaction entered into solely for the purpose of obtaining tax benefits amounts to tax law evasion, with the consequence that its effects on an individual's tax liability are disregarded by tax and fiscal control authorities. Despite the existence of an erroneous interpretation suggesting an inseparable link between § 1 and § 2 of the reviewed Article, it is unnecessary for tax authorities to demonstrate that a transaction other than that entered into by the parties was "appropriate" for achieving the economic result intended by the parties, thereby requiring the tax implications to be assessed, according to § 2, on the basis of such an alternative transaction.

10. Article 24b § 1 of the Tax Ordinance Act, understood as above, does not fulfil the aforementioned standards stemming from Article 2, read in conjunction with Article 217, of the Constitution. In particular, use of the following ambiguous phrases therein raises objections which do not permit one to assume that the interpretation of such phrases within jurisprudential practice will actually be uniform and rigorous, or that their wording will prevent organs applying the law from deducing that they may engage in law-making: "one could not have expected"; "other significant benefits"; "benefits stemming from the reduction of tax liability". The legislator's assumption that the taxpayer's transaction should bring not only tax benefits (i.e. reducing tax liability, increasing tax reimbursement, increasing the taxpayer's loss) but also other unspecified significant benefits unrelated to tax liability, is vague in itself.

11. The conclusion that Article 24b § 1 of the Tax Ordinance Act does not conform to Article 2, read in conjunction with Article 217, of the Constitution renders it superfluous for the Constitutional Tribunal to rule on the issue of whether this provision also infringes the constitutional principle of economic freedom (Article 22). There exists no scale of the non-conformity of legal provisions with the Constitution, and the number of constitutional bases which a norm is found to infringe is not decisive as regards the range of legal consequences flowing from this finding. Conversely, if the Tribunal found that the reviewed provision conforms to other constitutional bases, this would exert no influence on the fundamental effect of the prior finding of non-conformity (i.e. the removal of the provision from the legal order).

12. The finding of non-conformity with the Constitution of Article 24b § 1 of the Tax Ordinance Act does not preclude the continuing operation of § 2 of this Article, despite the partial reference to § 1 in this latter provision. Such reference is clearly technical in nature and serves to abbreviate the wording of § 2 by referring to the hypothesis of § 1. It

does not, however, make the application of § 2 conditional upon the application of § 1. The norm expressed in § 2 may continue to be applied even after § 1 has been found to be unconstitutional. Furthermore, it is only after omitting the aforementioned reference, which seemingly narrowed the scope of application of the norm expressed in § 2, that this norm acquires the appropriate sense and significance. As a result of eliminating § 1, the norm decoded from § 2 takes on the scope of application stemming from its wording, which takes no account of the reference to the hypothesis of § 1.

13. Article 78 of the Constitution, governing the right of each party to appeal against judgments and decisions issued at first instance, refers both to judicial and administrative proceedings. The essence of this right is the possibility to have verified a decision that was taken at first instance. The legislator's obligation consists not only in granting the party a formal entitlement to lodge an appeal against a first instance judgment or decision, but also in creating legal guarantees securing the efficiency of this mechanism, in the sense that it should allow the second instance organ to review the correctness of the relevant decision on its merits. The interpretation of provisions constituting the basis for a decision belongs to the fundamental stages of applying the law, whilst reviewing the correctness of an interpretation issued by a first instance organ constitutes one of the most important elements of the appellate organ's review of the decision on its merits.

14. The possibility, mentioned in the second sentence of Article 78 of the Constitution, to create statutory exceptions to the principle expressed in the first sentence thereof, does not mean that it is possible, by means of statute, to shape a right to appeal against first instance decisions so as to essentially endow this right with a purely formal character.

15. On the basis of the guarantee expressed in Article 78 of the Constitution, the possibility to appeal to a court against a final decision of an administrative organ (in this case: the decision of a tax or fiscal control authority) may in no event be treated as equivalent to an appeal against a decision of an organ of first instance. There are fundamental differences concerning the scope and criteria of review, as well as the nature of the decisions taken, between appellate proceedings conducted by second instance administrative organs and proceedings involving the consideration by an administrative court of complaints against final decisions.

16. The aforementioned aspects of Article 78 of the Constitution are infringed by the regulation contained in Article 14 § 2 of the Tax Ordinance Act, according to which "interpretations concerning tax law problems" issued by the Minister of Finance to tax and fiscal control authorities and promulgated in the Minister's Official Journal are binding on their addressees. An individual's constitutional right to have their case reconsidered following the lodging of an appeal is rendered illusory by the existence of binding abstract interpretations of tax law issued by the Minister. The binding nature of the official interpretation on all tax and fiscal control authorities, in practice, reduces the two-instance review merely to a formal process for confirming that the first instance organ correctly complied with the instructions contained in the official interpretation. The fact that the binding official interpretation is abstract in nature (i.e. it does not apply only to the case of a particular taxpayer) does not alter the nature of its influence on the substance of decisions

taken by fiscal organs in the cases of individual taxpayers.

17. From the second sentence of Article 93(2) of the Constitution stems one of the fundamental assumptions regarding sources of "internal law", according to which they may not form the basis for decisions taken in relation to citizens, legal persons and other entities. Although this provision in located immediately following a regulation (the first sentence of Article 93(2)) which deals with only one of the various forms of internal law (i.e. orders), the stipulation expressed therein refers to all forms of internal legislation. Equally, the term "decision" used therein should be understood broadly, as encompassing within its scope each individual legal act affecting the situation of a citizen, legal person or other entity.

18. Although the challenged regulation contained in Article 14 § 2 of the Tax Ordinance Act gives rise to doubts as regards the factual scope and nature of its normative influence on the addressees of tax law provisions, § 3 of the same Article (protecting taxpayers against adverse consequences as a result of their compliance with binding ministerial interpretations) demonstrates that such interpretations constitute elements of the normative basis for decisions taken in relation to taxpayers. Such normative status may also be confirmed by the statutory requirement that these ministerial interpretations be published, analogous to the requirements for sources of law. Such a statutory scheme does not withstand critique in the light of the second sentence of Article 93(2) of the Constitution. It leads, on the one hand, to the undesired erosion of the difference between law-making and law-interpretation and, on the other hand, it permits acts addressed, from a formal perspective, exclusively to the internal State structure to exert an influence in the sphere of taxpayers' rights and freedoms, a sphere whose regulation is permissible solely by legal instruments described in the closed list of sources of universally binding law. Thus, in addition to its non-conformity with the second sentence of Article 93(2) of the Constitution, the approach adopted in Article 14 § 2 of the Tax Ordinance Act may lead to the unbalancing of the whole concept of the sources of law, as adopted by the constitutional legislator.

19. The use, by tax and fiscal control authorities, of legal means intended to efficiently secure the uniform application of tax law does not, as a rule, give rise to objections and remains in the interest of taxpayers themselves, since it constitutes for them a guarantee of compliance with the values stemming from Article 2 of the Constitution such as the foreseeability of public administration organs' decisions. Nevertheless, it may not be thought that the optimum guarantee of achieving such uniformity is by ensuring that official ministerial interpretations are binding on tax and fiscal control authorities. In particular, the normative structuring of the legal institution contained in Article 14 § 2 of the Tax Ordinance Act fails to provide such a guarantee. One of the shortcomings of this regulation is its failure to precisely specify the desired relationship between the Minister's official interpretations and the judicial means for correcting erroneous decisions issued by tax and fiscal control authorities. This stems, firstly, from the ambiguous phraseology concerning the extent to which the Minister is obliged to take into account the jurisprudence of the courts and the Constitutional Tribunal when issuing official interpretations of tax law problems (cf. Article 14 § 1 point 2 of the Tax Ordinance Act). Secondly, when introducing the institution of binding official interpretations, the legislator failed to unambigu-

ously resolve issues relating to the binding nature of administrative court decisions on administrative organs, where the activities of such administrative organs formed the subject of the appeal (cf. Article 153 of the Proceedings before Administrative Courts Act 2002, equivalent to former Article 30 of the Supreme Administrative Court Act 1995). It is beyond any doubt that, in the event of conflict between the administrative court's legal assessment of a concrete case and the Minister's abstract interpretation, the court's legal assessment would have absolute priority. The problem remains, however, that the administrative court's interpretation would not directly affect the nature of the Minister's abstract interpretation, which would retain binding force in other future cases of this type.

20. The guarantees stemming from the principle of "protection from adverse consequences", as contained in Article 14 § 3 of the Tax Ordinance Act, should continue to encompass taxpayers complying with official interpretations of tax law, even when such interpretations are no longer binding on tax authorities.

MAIN ARGUMENTS OF THE DISSENTING OPINION OF FOUR JUDGES

- According to Article 84 of the Constitution, everyone shall comply with his responsibilities and public duties, including the payment of taxes, as specified by statute. Article 24b of the Tax Ordinance Act is one of the instruments for securing the proper fulfilment by taxpayers of such tax obligations.
- The so-called resistance against taxes encountered in economic practice may express itself in actions which are assessed differently from a legal perspective. On the one hand, such actions may be lawful and may constitute a realisation of the principle of freedom of economic activity, such as when taxpayers take advantage of tax reliefs. On the other hand, such actions may be unlawful and may consist in, for example, taxpayers misleading the tax authorities as to the existence or level of their tax liability. Alternatively, such actions may constitute an abuse of the freedom of economic activity; the challenged provision concerns precisely such actions. Taxpayers who abuse their economic freedom, as opposed to taxpayers who violate the law, do not directly avoid the payment of tax but merely seek to endow their economic behaviour with such features as to render it non-taxable, although the ultimate economic result is the same as in the event of taxable behaviour. The essence of such behaviour is the conclusion by taxpayers of transactions which, although permitted by law, have been entered into for purposes which may not be accepted by law. A specific feature of this behaviour – referred to as "inadequacy" – is the application of means that do not lead in the simplest way to achieving the intended economic goal.
- Article 24b § 1 of the Tax Ordinance Act may only be applied to following the exhaustion of all other instruments envisaged in the detailed provisions of substantive tax regulations, and only upon fulfilment of conditions specified by statute. The tax or fiscal control authority must demonstrate that the taxpayer's actions were deliberate, that the taxpayer thereby intended to evade tax law, and that the sole motive for concluding an atypical legal transaction was for the taxpayer to acquire a tax benefit. This must take place with due regard for all material-legal and procedural guarantees intended to protect the taxpayer's interests. Taxpayers have the right to present their arguments and tax authorities are obliged to acknowledge them. The decisions of tax authorities are subject to judicial review.
- In the jurisprudence of the Constitutional Tribunal, it is assumed that the vagueness of a provision may justify a finding of non-conformity with the Constitution only when it reaches a degree preventing the ambiguity arising thereby from being removed by the ordinary means available to eliminate inconsistency in the application of law. The decision to deprive a particular provision of binding force as a result of its ambiguity should be treated as a last resort, utilised only in the event that other methods of removing the consequences of such ambiguity, in particular by way of judicial interpretation by the courts, prove insufficient. In the present case, the content of financial law doctrine and the jurisprudence of the courts are uniform to such an extent that no doubts are raised as regards the proper understanding of the challenged Article 24b § 1 of the Tax Ordinance Act, despite its infelicitous drafting.

- The removal of the challenged provision from the legal order may have a dangerous impact on the functioning of public finance by upsetting – contrary to Article 2 of the Constitution – the coherence of its statutory legal regulation. This may be taken advantage of in order to effectively "legalise" certain forms of tax misappropriations within transactions involving dishonest taxpayers.

Provisions of the Constitution and the Constitutional Tribunal Act

Constitution

Art. 2. The Republic of Poland shall be a democratic state ruled by law and implementing the principles of social justice.

Art. 22. Limitations upon the freedom of economic activity may be imposed only by means of statute and only for important public reasons.

Art. 31. […] 3. Any limitation upon the exercise of constitutional freedoms and rights may by imposed only by statute, and only when necessary in a democratic state for the protection of its security or public order, or to protect the natural environment, health or public morals, or the freedoms and rights of other persons. Such limitations shall not violate the essence of freedoms and rights.

Art. 78. Each party shall have the right to appeal against judgments and decisions made at first stage. Exceptions to this principle and the procedure for such appeals shall be specified by statute.

Art. 84. 1. It shall be the duty of every Polish citizen to defend the Homeland.
2. The nature of substitute service shall be specified by statute.
3. Any citizen whose religious convictions or moral principles do not allow him to perform military service may be obliged to perform substitute service in accordance with principles specified by statute.

Art. 87. 1. The sources of universally binding law of the Republic of Poland shall be: the Constitution, statutes, ratified international agreements, and regulations.
2. Enactments of local law issued by the operation of organs shall be a source of universally binding law of the Republic of Poland in the territory of the organ issuing such enactments.

Art. 93. 1. Resolutions of the Council of Ministers and orders of the Prime Minister shall be of an internal character and shall bind only those organizational units subordinate to the organ which issues such act.
2. Orders shall only be issued on the basis of statute. They shall not serve as the basis for decisions taken in respect of citizens, legal persons and other subjects.
3. Resolutions and orders shall be subject to scrutiny regarding their compliance with universally binding law.

Art. 217. The imposition of taxes, as well as other public imposts, the specification of those subjects to the tax and the rates of taxation, as well as the principles for granting tax reliefs and remissions, along with categories of taxpayers exempt from taxation, shall be by means of statute.

CT Act

Art. 39. 1. The Tribunal shall, at a sitting in camera, discontinue the proceedings:
[…]
3) if the normative act has ceased to have effect to the extent challenged prior to the delivery of a judicial decision by the Tribunal.