Spirit of the law

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Bill Dodwell considers the government's proposals that large businesses should publish their tax strategy

One of the interesting phrases used in the recent consultation, Improving Large Business Compliance, is 'the spirit of the law'. The context is that the government is proposing a requirement that large businesses should publish their tax strategies,

including their: ‘attitude to tax planning and appetite for risk in tax planning (eg whether they seek to work in accordance with the spirit – in addition to the letter – of the law)’.

This is a difficult concept. Lord Hoffmann, one of the leading judges of recent times, wrote in the British Tax Review (2005) ‘…tax avoidance in the sense of transactions successfully structured to avoid a tax which parliament intended to impose should be a contradiction in terms. The only way in which parliament can express an intention to impose a tax is by a statute, which means that such a tax is to be imposed. If that is what parliament means, the courts should be trusted to give effect to its intention. Any other approach will lead us into dangerous and unpredictable territory.’ For Lord Hoffman, the spirit of the law can only be discerned from the law itself and, as he puts it, we should then trust our judges to interpret fairly what parliament has written.

Purposive construction is the modern aid to interpretation of the law. Unless there is complete clarity on the meaning of the law, we are asked to construe the words in the context of the statute – and take a realistic view of transactions. This latter point is most important and may be traced back to Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35]: ‘The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.’ Judge Ribeiro’s words have been adopted by the British courts.

It seems clear that our judges do not see a difference in practice between ‘the law’ and ‘the spirit of the law’ – once they have enquired into the facts and tried to make sense of the words written by parliament.

There are situations, though, where the intention of the parliament is unclear. In some cases before the courts, judges have said they cannot apply purposive construction because they are unable to discern the purpose. In other cases, it is clear that subsequent commercial developments could not have been in the reasonable contemplation of the legislature. Falling back on trying to tax the economic profit isn’t necessarily helpful since tax law often provides instances where something other than the accounting profit is taxed (and accounting principles have changed too).

There are other scenarios in which the words of the law are clear but it seems highly unlikely that parliament could have envisaged their application. If the taxpayer claims that a tax advantage is arising, we now have to apply the GAAR.

The GAAR asks whether the taxpayer's contortions amount to a reasonable course of action in light of the statute and – most importantly – the policy intent behind the provisions. That policy intent must be discerned from almost anything released at the time by HMRC, the Treasury and parliament itself.

Surely we now have the tools in the form of purposive construction, a realistic assessment of the facts and the GAAR to ensure that it is almost impossible for the taxpayer to claim an unintended advantage through planning or tax avoidance.

The implication of the consultation on Large Business Compliance is that HMRC considers there is still a gap. Companies are being asked whether they seek advantages from applying in a reasonable way the clear words of the law enacted by parliament – but apparently in ways not intended by the legislature. Is that realistic?

Like taxpayers, our tax authority has to apply purposive construction if the meaning of the law is unclear. Yet the intention of parliament is not relevant. HMRC's legal duty is to collect the tax due under the law. HMRC have said many times that they are obliged to collect tax, even when apparently unfair or when it is being levied on something far in excess of the economic profit. We see an example of this in Lobler – the case involving an individual who invested in an insurance bond but who mistakenly cashed it in over two years, leading to a huge tax charge in the first year and an unusable loss in the second. Fortunately the Upper Tribunal decided that relief could be granted through rectification – but HMRC's position was that they had to collect the tax due under the law. How, then, should taxpayers consider 'the spirit of the law'?

One route chosen by some groups is to refrain from planning that does not support their commercial activities. This is a sensible objective and surely a better one than trying to find the 'spirit'. I do wonder whether the continued search for the spirit is out of date – after all, it ignores modern construction and the GAAR. That search starts to take us into Lord Hoffmann's 'dangerous and unpredictable territory'.