



IFA 2016

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MADRID • SPAIN



Judges Panel

Seminar F



The Right to Property The Right to Equal Tax Treatment

Seminar F – Judges Panel

Agenda



1. Introduction: personnel; overview of issues
2. Talkshow part 1
3. Case retroactive anti-abuse legislation
4. Case on retroactive, selective budget repair
5. Talkshow part 2
6. Case on unequal tax treatment
7. Case on unrebuttable notional taxation
8. Conclusion

Overview of issues (1)

The power of courts to disapply or declare unconstitutional Statute tax law which:

- Violates the right of property;
- Makes arbitrary distinctions

Especially:

- Retro-active taxation
- Unrebuttable notional taxation
- Discrimination or Privileges
- Excessive taxation



Overview of issues (2)



Is there a constitutional limit to taxation?

- Germany: *Halbteilungsgrundsatz* (split in half principle)
- Hungary: ECtHR Cases *R.Sz v Hungary*, *Gáll v Hungary* and *N.K.M. v Hungary* – 98% marginal rate
- Should taxpayers be able to pay both income and wealth tax from income?



Overview of Issues (3)



Budgetary consequences:

- Finding that tax legislation violates fundamental rights may be costly to the State budget
- Prospective overruling? (poor taxpayer who made the effort and the cost to litigate)



Overview of Issues (4)



Distinguishing Distinctions? (strictness of judicial review)

- Suspect distinctions: religion, race, sex, ethnic background, age, sexual orientation, etc.,
- Less suspect distinctions: legal/natural persons, self-employed taxpayers/employees, residents/nonresidents



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Talkshow Part 1



Talkshow part 1



- Can the court disapply or declare invalid Statute tax law for want of constitutionality or for violating Human Rights Conventions?
- For Judge Spano: ECtHR backlog 60,000 cases; ECtHR also deals with torture, stifling of freedom of expression, etc. Is it pointless to file a complaint in tax matters after exhaustion of national remedies in vain? High chance of inadmissibility?

Case 1

Retroactive Anti-abuse Tax Measures

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Case 1 - The Facts



- Bank sells artificial tax avoidance scheme to self-employed persons using a trust and the tax treaty with State B, reducing their effective tax rate from 45% to 4%, involving over € 100 million in tax revenue.
- Tax administration announces it will oppose the scheme; advises taxpayers to pay to prevent interest from accruing.
- Before test cases reach the courts, Parliament adopts five-year retroactive legislation.
- The courts resolve the cases in favour of the tax administration on the basis of the retroactive legislation.

Case 1 - Art 1 of Protocol 1 ECHR



1. Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
2. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

Taxation falls, in general, under Article 1(2) (control of the use of property: “to secure the payment of taxes”).

Case 1 - Methodology of Assessment



1. Does the applicant have a 'possession' within the meaning of Art. 1 Protocol No. 1? (compatibility *ratione materiae*) – “Possessions” can be “existing possessions” or assets, including, in certain well defined situations, claims (legitimate expectations).
2. Is there an interference with the peaceful enjoyment of a possession?
3. Is the interference 'lawful'?
4. Does it pursue a legitimate aim?
5. Proportionality: Has a fair balance been struck between the demands of the public interest and individual's fundamental rights?

Case 1 - Applicability and Interference

Huitson v the UK (dec.) 13 January 2015, no. 50131/12.

- Step 1: Applicability: the issue was whether the “applicant’s claim for income tax relief ... constituted an asset”.
- The ECtHR did not address the issue as the complaint was considered “manifestly ill-founded” on other grounds.
- Step 2: The ECtHR proceeded on “the assumption” that the retroactive amendments interfered with the enjoyment of possessions as the taxpayer was liable to pay tax on income received in past years.

Case 1 - Legitimate Aim



- In tax matters, the States enjoy a wide margin of appreciation. National legislature's assessment respected unless it is devoid of reasonable foundation.
- **Huitson v. UK, § 30:** “(...) it is a legitimate and important aim of public policy in fiscal affairs that a DTA should ... not be permitted to become an instrument by which [residents of the UK] avoid, or substantially reduce, the income tax that they would ordinarily pay on their income. Moreover, it is in the general interest of the community to prevent taxpayers [...] from exploiting the DTA in a way which would enable them to substantially reduce their income tax and secure a competitive advantage over those who chose not to use such a scheme.”

Case 1 - Proportionality (1)



- Retroactive taxation does not constitute *per se* a violation of Article 1 of Protocol No. 1.
- It has to be determined whether the retrospective application of the law fails to strike a fair balance between competing interests.
- The test: There must be a reasonable relationship of proportionality between the means employed and the aim pursued. The taxpayer must not bear an individual and excessive burden.

Case 1 - Proportionality (2)



Huitson v. UK, §§ 32-35: Fair balance was not considered upset, taking into account that:

1. It was within the “discretionary judgment of Parliament to legislate with retrospective effect”: the number of taxpayers relying on the scheme and the potential financial loss for the Government;
2. Due to the highly artificial nature of the tax scheme no need for impact assessment or bring legal proceedings before enacting the legislation;
3. At no stage the tax administration indicated the tax scheme could safely be relied on;
4. The taxpayer could reasonably have expected that Parliament would respond in a way which ensured fairness generally between all taxpayers.

Case 1 – Comments by Judge Davis



- Tackled under abuse doctrine
- If that does not work:
- Acceptance of retro-activity depends on proportionality



Case 2

Retro-Active Budget Repair

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Case 2 - The Facts



- Announcement of a “special employer’s levy”
September 2013
- Budget measure to reduce budget deficit
- Applies from January 2014
- Imposed on salaries paid by employers in excess of € 150,000 per employee
- Calculated on salaries paid in 2013
- Tax cannot be passed on to the employees

Case 2 - The Issues



- Tax announced in September 2013, operative from 2014, but calculated on wages paid for the entire year 2013.
- 2013 wages would include bonuses paid at the beginning of that year in respect of previous year.
- High income self-employed persons not affected by the tax.
- Is the tax compatible with constitutional or treaty based principles of legal certainty, protection of property and non-discrimination?

Case 2 - Australia's Position (1)



- Australia does not have a general bill of rights and no constitutional right to protection against interference with property
- Human Rights (Parliamentary Scrutiny) Act 2011
 - proposed legislation must include an assessment of whether the law is compatible with human rights (s 8(3))
 - failure to comply with s 8(3) does not affect validity, operation or enforcement of the legislation (s 8(5))

Case 2 - Australia's Position (2)



- Assessment: “the levy’s design is reasonable, necessary and proportionate to the task of repairing the nation’s finances, being payable by those with a greater ability to pay”
- Tax is compatible with human rights and freedoms recognised or declared by human rights instruments, as they apply to Australia

Case 2 – Comments Judge Mellinshoff (1)



The requirement of equal treatment

- On the basis of the aim of the tax law, employers with high-salary employees are discriminated against
- Employment of high-salary employees does not necessarily indicate a higher ability to pay
- No justification in the aim of budget repair



Case 2 – Comments Judge Mellinshoff (2)



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The right of property

- The right of property guarantees that the use of the property benefits the owner
- Therefore excessive taxation is unconstitutional
- Whether a taxation is disproportionate has to be judged not only by the tax scale but also by the design of the tax base
- Not every taxation of more than 50% is unconstitutional



Case 2 – Comments Judge Mellinshoff (3)

Retroactive Taxation

- Different kinds of retroactivity
- The levy entered into force in 2014 but the tax base is the wages sum paid in 2013
- The raising of a general tax rate for all taxpayers in the course of a year would not be judged to be a forbidden retroactive taxation
- Therefore I would not judge the retroactivity to be unconstitutional



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Talkshow Part 2



Talkshow part 2



- Absolute or relative limit to income taxation above which it is a violation of the right of property?
 - German *Halbteilungsgrundsatz*
 - ECtHR *N.K.M., Gáll and R.Sz. v. Hungary* (98% rate)
- Budgetary consequences of striking down Statute tax law
- Remedies in case of a finding of a violation? Immediate effect? Prospective overruling?
- Distinguishing distinctions?
 - ECtHR *P.M. v. UK* (Application No. 6638/03).
 - ECtHR *Burden & Burden v. UK* (Appl. No. 13378/05)

Case 3

Gift and Inheritance Tax exemption only for 'business property'

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Case 3 - The Facts



- General gift and inheritance tax at a flat rate of 40% for individuals
- Liquidity facility for business property
 - debt repayment scheme: 10 yearly installments
 - only for business property
 - requirement to continue the business for 3 years
- Debt repayment scheme is replaced by a debt cancellation scheme, exempting 90% of the first € 3 million of (shares in) business property

Case 3 - The Issues



1. The admissibility of a complaint by taxpayers who do not benefit from an exemption
2. Establishing object and purpose of the tax law for identifying the correct comparator to assess possible discrimination
3. The constitutionality test for a fiscal privilege/discrimination
4. Consequences of a finding of discrimination: what should the court decide?

Case 3 - Admissibility of the Complaint



- The possible unconstitutionality of the rule must be decisive for the decision of the specific case
- Normally a non-exempted taxpayer cannot claim the same tax exemption as the preferred group of taxpayers
- The only exception is an overall discriminatory tax law, e.g. if the exempted group is so wide or irrelevantly defined that the structure of the tax law itself is affected which may lead to unconstitutionality of the complete tax law

Case 3 - Criteria for judicial review



1. Object and purpose of the tax law
2. A distinction between groups of taxpayers referring to that object and purpose
3. The aim of the distinction must be constitutional
4. The margin of discretion for the legislator
 - wide as regards the definition of the tax base and as regards tax rates
 - narrow as regards any derogations from this definition and rate, which need to be justified

Case 3 - Decision German Constitutional Court (1)

BVerfG v. 17.12.2014 – 1 BvL 21/12



- Tax exemptions are generally justified by public welfare considerations
- The tax exemptions for business assets are unconstitutional in so far as they are too wide and leave too much room for creative tax structuring
- The unconstitutionality of the exemptions affect the entire tax law

Case 3 - Decision German Constitutional Court (2)

BVerfG v. 17.12.2014 – 1 BvL 21/12



- A general relief for business assets falls within the margin of discretion of the legislator, even up to full exemption from inheritance and gift tax
- However, the generous acceptance of non-business-bound assets in a company disproportionately privileges donees and heirs of company shares, which cannot be justified by object and purpose of the exemption
- As regards the inheritance of large companies, the court requires evidence of concrete economic needs for exemption

Case 3 - What should the court do?



- Prospective overruling: the provisions held unconstitutional remain in force until Parliament passes a replacing law
- The Court required the legislator to replace the rejected provisions by constitutionally acceptable provisions before 30 June 2016
- The legislator missed the deadline. Consequences?
 - The judgment is unclear on the issue
 - some writers maintain there is no inheritance tax at all now
 - more likely is that the provisions are still applicable

Case 3 – Comments Judge Davies



- Valid tax
- Does not cease to be a valid tax because of the consequences of the operation of the law
- If a law *would* be found unconstitutional, there would be no prospective overruling

Case 4

Unrebuttable Taxation of Presumed Income

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Case 4 - Facts and Issue



- Income tax based upon a presumed 4% return on net wealth save for the first € 20 000
- Rate 30% - effective taxation 1.2% of net wealth
- Because of decline in interest rates, for savings accounts holders and State bonds holders the real after tax income is minus 0.2% (effective tax rate 130 %)
- Income tax or wealth tax?

Case 4 – South Africa's position (1)



- If it is an income tax then can it be imposed on amounts either in cash or otherwise which have not been received nor have accrued to a taxpayer? Is there a 'monetary value'?
- Assume that for income tax purposes there is a monetary value, can the tax be attacked as a deprivation of property?

Case 4 – South Africa’s position (2)



SA Reserve Bank v Shuttleworth 2015 (5) SA 146 (CC) at para 42:

“A blissful starting point would be to affirm that the power to tax residents is an incident of and subservient to representative democracy.”

- The authority to impose a tax burden or appropriate public money is solely within the remit of the legislature.
Shuttleworth at para 42
- If a dominant purpose of a statute is to raise revenue as opposed to regulate conduct, the charge would be treated as a tax

Case 4 – South Africa's position (3)



- *Taxation is not regarded as amounting to deprivation or expropriation which would trigger protection under the constitutional right to property.* (First National Bank of SA Ltd t/a Wesbank v Commissioner of South African Revenue Services and another 2001 (3) SA 310 (CC))
- But what if the deprivation is arbitrary, and insufficient reasons are provided for the particular deprivation?
- Is a rate of return which is imposed by government and which is higher than the rate earned by a risk-adverse investor an arbitrary rate?

Case 4 – South Africa's position (4)



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“If substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable.”

Tennant v Smith (Surveyor of Taxes) [1892] AC 150 (HL) per Lord Halsbury LC

- But is it not a requirement that an accrual of a right must be capable of being turned into money to be regarded as income subject to tax?
- Without being turned into money, can an amount imputed not be considered to be an arbitrary act?
- Could it be argued that a taxpayer can claim on the basis of so arbitrary a rate that there is an infringement of a right to private property that the taxpayers rights have been subjected to an unjust attack which fails any form of proportionality test?
- *Daly v the Revenue of Commissioners* [1995] 3 IR 1
- If it is a wealth tax, and it is argued that the rate of return is imputed to wealth then why would this be considered to be an arbitrary provision?

Case 4 - Comments Judge Spano



- Legislative assumption in principle national sovereignty
- Proportionality test
- Different margin depending on whether wealth tax or income tax?



Conclusion



- Common Law: elephant test
- Civil Law: fair balance
- If I were a taxpayer ...
- If I were a politician ...

