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Recent Tax Cases of the European Court of Human Rights

This article discusses recent cases concerning the right to silence/freedom from self-incrimination in tax matters, and the need for full disclosure of evidence by revenue authorities in penalty cases. It also discusses cases on penalties fixed as a percentage of the tax underpaid, the removal of the suspension of limitation periods, and compensation to taxpayers for the breach of their Convention rights.

1. The Right of Silence

The right of silence (also known as the freedom from self-incrimination) in tax matters, where a substantial penalty may be at stake, is a difficult issue. A recent decision from the European Court of Human Rights (ECtHR) has clarified, and in some respects widened, the circumstances where a taxpayer can rely upon the right of silence.[1]

The European Convention on Human Rights (ECHR or "the Convention") does not expressly contain a right of silence, or a freedom from self-incrimination. However, the ECtHR has long implied such a right and freedom, deriving it from the presumption of innocence in article 6(2) of the Convention. In the tax context, the line of case law that began with *Bendenoun v. France* (1994)[2] and which reached its conclusion in *Jussila v. Finland* (2006)[3] establishes that a substantial penalty (particularly a tax-geared penalty) imposed to punish or to encourage compliance falls within the scope of a criminal charge for Convention purposes. The consequence is that the right of silence will be applicable in any tax investigation where there is a likelihood of a significant penalty if there is found to be default on the taxpayer's part. This is potentially highly problematic, as much of the information and documentation that the tax investigators will be seeking will be in the possession of the taxpayer. If a taxpayer can rely upon the right of silence not to answer questions or supply documentation, this will make the role of tax investigators significantly more difficult. That may be the consequence of this recent judgment.

In 1991, M. Chambaz was subject to a tax investigation in Switzerland in connection with his returns for the 1989-90 tax year. In the course of the investigation, he was asked to supply various documentation, which he refused to provide. As a consequence, he was subject to two fines totalling CFH 5,000. He appealed against those fines to the Administrative Court of Vaud.

While the appeal was pending, a new investigation was opened into the possibility of tax evasion and this led ultimately to a substantial charge for undeclared tax, together with a penalty for tax evasion in excess of CHF 1 million. M. Chambaz brought various claims under the Convention but the two that are most significant are an infringement of the right of silence/freedom against self-incrimination by seeking to force the disclosure of documents, and a failure to observe the equality of arms in the litigation in the sense that he was refused access to certain documents that the Swiss tax authorities had obtained from third parties (unless, according to the Swiss authorities, he obtained consent from those third parties) (*see* section 2.).

There was an initial issue as to whether article 6 of the Convention was applicable because there was no question of the penalty for tax evasion at the time he was asked to produce the documentation. On this point, the ECtHR noted that it was necessary to examine the various different tax proceedings globally in order to determine whether or not there might be a criminal charge arising in those proceedings. Here, there was ultimately an issue raised of tax evasion, so article 6 was applicable even at the early stages. This is potentially a further step towards recognizing that article 6 will apply to most tax cases. It takes a realistic approach to the fact that a tax investigation might lead, whether in respect of the year in question or other years, to a criminal penalty and hence article 6 is engaged.

On the issue of self-incrimination, the case had similarities to two previous cases: *Funke v. France* (1993)[4] and more specifically the case of *JB v. Switzerland* (2001).[5] The Court held by a majority of five to two that the imposition of penalties for the refusal to hand over documents infringed the right of silence and was a contravention of article 6(1).

What is particularly significant here is the Court made no distinction between the answering of questions (either at a meeting or in writing) and the handing over of documents. The freedom from self-incrimination applied, in the view of the majority of the Court members, in both cases. This is a point that was previously not entirely clear. It was clear that forcing a taxpayer to answer questions or create new documents giving information interfered with the right of silence. However, handing over existing doc-

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1. CH: ECtHR, 5 Apr. 2012, Application No. 11663/04), *Chambaz v. Switzerland* (unfortunately the decision is only available in French). The author would like to thank his good friends Rui Palma and Robert Attard for drawing his attention to the cases discussed in this article.
2. FR: ECtHR, 24 Feb. 1994, Application No. 12547/86, *Bendenoun v. France*.
3. FI: ECtHR, 23 Nov. 2006, Application No. 73053/01, *Jussila v. Finland*.
4. FR: ECtHR, 25 Feb. 1993, Application No. 10828/84, *Funke v. France*.
5. CH: ECtHR, 3 May 2001, Application No. 31827/96, *JB v. Switzerland*.

umentation seemed to be in a different category. Assuming that the documentation was physically present in the country concerned (or in another country with which there were arrangements for exchange of information), then the documentation was potentially accessible to the tax authorities by, for example, a search warrant. To require the taxpayer to hand over the document (as opposed to the tax authorities obtaining a warrant and taking possession themselves) hardly seemed sufficiently serious to be regarded as an infringement of the freedom from self-incrimination. However, the majority of the Court in this case has confirmed that the freedom from self-incrimination is engaged even with regard to existing documentation.

In practice, this may make advisers more inclined to tell any client who is subject to an investigation (where a penalty may be the outcome) not voluntarily to hand over documentation. If the documentation is in the country, this may lead to more searches by revenue authorities. The interesting issue is if the documentation is in a third country with which there is no arrangement for exchange of information: in those circumstances, a taxpayer who relies upon his right of silence and refuses to hand over the documents may effectively block the investigation (and clearly cannot be penalized for relying upon the right of silence).

2. Breach of the Principle of Equality of Arms

The second allegation in *Chambaz v. Switzerland* (2012) was that there was a breach of the principle of equality of arms in that the taxpayer was not entitled to see all documentation assembled by the tax authority. In particular, on the grounds of his non-cooperation, the Swiss revenue authorities refused to disclose to him certain documents obtained from third parties unless he obtained consent from those third parties. The majority of the Court followed a strict approach in this respect: the only grounds on which a prosecution authority may refuse to supply documentation (whether helpful to the tax authorities or helpful to the taxpayer) are on grounds of protection of vital national interests or to protect the fundamental rights of third parties. As the refusal to supply the documentation in this case came within neither of these exceptions, there was therefore a breach of article 6(1) by the Swiss tax authorities in refusing to supply documentation to the taxpayer.

Again, this is likely to have a significant impact. Where the tax authorities seek to impose a substantial penalty against a taxpayer (and possibly, even in circumstances where there is the potential for the imposition of such a penalty), the taxpayer is entitled to *full disclosure* of all documentation in the possession of the revenue authority, whether that documentation is favourable to the taxpayer or to the tax authority. In effect, if a substantial penalty is a prospect, the taxpayer has full rights to complete disclosure by the revenue authority, and arguments based upon preservation of the confidentiality of third-party information are unlikely to be accepted. Take, for example, a transfer pricing dispute where, if incorrect pricing is proved, the taxpayer may face a substantial penalty. If the revenue authority relies on third-party comparables, it seems extremely unlikely that the tax authority could refuse to supply that information to the taxpayer even if it potentially breached third-party confidentiality.

This is a very significant case[6] and displays some of the difficulties that arise from treating substantial, tax-geared penalty matters as criminal for Convention purposes.

3. Fixed Penalties and the Right to a Fair Trial

The case of *Segame SA v. France* (2012)[7] confirms that the mere imposition of a penalty as a *fixed percentage* of the tax due is not a breach of the right to a fair trial in article 6.

The taxpayer company operated an art gallery in Paris and, following an audit, was subject to an additional charge to the French tax on objects of art. The additional charge to tax entailed an automatic penalty fixed at 100% of the tax due (though, while the matter was under litigation, this fixed penalty was reduced by statute with retroactive effect to a 25% fixed penalty). The taxpayer company challenged the tax liability and the penalty before the Administrative Tribunal, Court of Appeal and Supreme Administrative Court (*Conseil d'Etat*) but was unsuccessful. The taxpayer company then took the matter on to Strasburg, arguing it had been denied the right to a fair trial, as there was no court with full competence to adjudicate on the amount of the penalty. It was accepted by the French Revenue (as one would have expected) that the penalty fell within the criminal head of article 6.

Curiously, the ECtHR rejected the taxpayer's allegation that there was a breach of article 6. The ECtHR noted that the taxpayer had, in practice, been given a full opportunity to challenge the amount of the tax, and that the French courts could have determined that there was no tax due in which case there would have been no penalty.

With all respect, the ECtHR seems to have missed the point here. Once liability to the tax was determined, the penalty seems to have been automatic as a matter of French law, with no possibility of the French court determining, for example, that the taxpayer lacked culpability or merited only a lower penalty. The answer by the ECtHR[8] is that the law itself fixed the penalty in proportion to the gravity of the offence by fixing a percentage of the tax unpaid. In saying this, the Court noted specifically that tax matters involved the interests of the state, and that tax does not fall within the "hard core" of the criminal law.[9] This seems to be an acceptance that, perhaps as a matter of the effective administration of tax law, states should be permitted to have a penalty fixed as a percentage of the tax underpaid, without the taxpayer always having an opportunity to challenge the level of the fixed percentage. The ECtHR stated expressly that the 25% penalty did not appear to

6. And it is a bit of a pity that it has not been translated into English yet, as it is clearly of relevance and not everyone will be able to read the original.
7. FR: ECtHR, 7 June 2012, Application No. 4837/06, *Segame SA v. France* – again this judgment is only available in French.
8. *Segame SA v. France* (2012), at para. 59.
9. Quoting, in this respect, *Jussila v. Finland* (2012), at para. 43.

be disproportionate.[10] In principle, it is a little hard to see how this judgment can be justified: where tax is under-declared, there may be a wide range of possible culpability of the taxpayer concerned. A fixed percentage can hardly be said to be proportionate where different levels of culpability are involved.

4. Limitation of Tax Debts Not a Right to Property

In a rather complex case, *Optim and Industerre v. Belgium* (2012),[11] the Court had to decide whether a limitation period that prevented the collection of taxes was a right to a possession within the scope of article 1 of the First Protocol. The two companies involved were subject to provisional tax assessments that, under Belgium law, prevented the limitation period from running. However, a judgment of the Belgium Court of Cassation of 10 October 2002 held that the issue of a provisional tax assessment did not prevent the limitation period from operating. The impact of this judgment caused the Belgium legislature to enact a law in 2004 that confirmed that a provisional assessment of tax did suspend the operation of the limitation period. The two taxpayers in this case challenged that law on grounds that it interfered with their right to a fair trial under article 6 and their right to enjoyment of their possessions under article 1 of the First Protocol.

So far as article 6 was concerned, this was met with the finding that ordinary tax matters (not involving a penalty) do not fall within the scope of that article.[12] So far as the right to the enjoyment of possessions was concerned, the question was whether the expectation that the limitation period would operate to bar recovery of tax was or was not a "possession" within the scope of the article. The conclusion of the ECtHR was that it was not a possession. The Court concluded that, whilst the taxpayers might have had a legitimate expectation that their tax debts would be subject to the operation of the limitation rules, the introduction of the change in the law did not deprive them of a "possession" in the sense of Article 1 of the First Protocol.

5. Just Satisfaction as the Repayment of a Tax Debt

In a previous article in this series,[13] the case of *The Association of Jehovah's Witnesses v. France* (2011)[14] was discussed. In that case, the ECtHR found that the effect of the imposition of tax in France was to interfere with the freedom of religion guaranteed by article 9. However, the question of the remedy was left for further discussion. The Court has now issued a further judgment[15] dealing with the question of "just satisfaction" under article 41 of the Convention.

The Association claimed that it had already paid to the French Treasury a sum in excess of EUR 4.5 million, and it claimed repayment of this sum together with interest (a total sum just short of EUR 6.5 million). The Court discussed the principles applicable in these circumstances, and noted that the finding of a breach of article 9 required the French government to remedy the breach in full. It was a matter for the French government to decide how it should provide a complete remedy. However, the only way in which the violation of the taxpayer's rights could be fully compensated was by way of the reimbursement of the entire sum of tax unlawfully imposed. Consequently, the Court ordered the reimbursement of the sum of just over EUR 4.5 million together with interest.

This is a significant outcome. In rather too many cases previously, the Court has been willing to find that a declaration that the Convention rights of the taxpayer have been breached is an adequate remedy of itself, and possibly added to that a nominal figure for moral damage. That, of course, is not the outcome that the taxpayer is usually seeking: the taxpayer is usually seeking the reimbursement of tax due or the discharge of the tax assessment. In this case, the Court was very clear that the reimbursement of the full amount of tax was the only way in which the breach of the taxpayer's rights could be fully remedied. It is interesting that the French government estimated that the judgment against it would total a cost of almost EUR 60 million, once one took into account the taxes that could not now be collected, together with penalties and interest on them. The breach of article 9 had a not-insignificant impact on French tax revenues.

10. Contrasting this with the case of GR: ECtHR, Application No. 35533/04, *Mamidakis v. Greece*.
11. BE: ECtHR, 11 Sept. 2012, Application No. 23819/06, *Optim and Industerre v. Belgium* – once again this judgment is only available in French.
12. IT: ECtHR, 12 June 2011, Application No. 44759/98, *Ferrazzini v. Italy*.
13. *See* P. Baker, *Some Recent Decisions of the European Court of Human Rights on Tax Matters*, 52 Eur. Taxn. 6, pp. 308-310 (2012), Journals IBFD.
14. FR: ECtHR, 30 June 2011, Application No. 8196/05, *The Association of Jehovah's Witnesses v. France*.
15. FR: ECtHR, 5 July 2012, Application No. 8196/05, *The Association of Jehovah's Witnesses v. France* – again available only in French at present.