International

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Some Recent Decisions of the European Court of Human Rights on Tax Matters

In this note, the author examines recent decisions of the ECtHR relating to human rights and taxation including a case on the imposition of an excessively high tax rate on a severance payment, a case on the right to privacy in respect of an audit on a shared server and a case on the extension of tax exemptions to non-mainstream religious organizations.

1. An Excessively High Tax (Finally!)

There have been many statements in the past from the European Court of Human Rights (ECtHR) that an excessively high tax, which undermines the economic viability of the taxpayer, would be regarded as expropriation and not taxation, and would infringe the right to enjoyment of possessions in article 1 of the First Protocol to the European Convention on Human Rights (ECHR or "the Convention").[1] However, so far as the author is aware, no previous reported case has ever found that a tax reached such a level.[2] Now we have such a case.

In the case of *NKM v. Hungary* (2013),[3] a tax at the rate of 98% on the top slice of a severance payment (resulting in an average tax rate of 52%) was found to violate the right to enjoyment of possessions.

Ms NKM was a Hungarian civil servant, and her employment was terminated in July 2011 as part of a wave of redundancies through the entire civil service. Under Hungarian law, she was entitled to two months' salary during her notice period and to severance pay amounting to eight months' salary. The total package appears to have equalled approximately HUF 5.9 million (approximately EUR 20,300). On this payment, she was subject to tax at 98% on the amount in excess of HUF 3.5 million. The result was that she suffered an overall tax burden of approximately 52% on the entirety of her severance pay, at a time when the general personal income tax rate in Hungary was 16%.

The legislation under which the 98% tax on the top slice was imposed had been enacted in 2010 and had then suffered several challenges before the Hungarian Constitutional Court, which had struck down provisions in the legislation on more than one occasion. Each time this happened, the Hungarian parliament had re-enacted the 98% tax (with some changes). The explanation for the high tax rate was based upon the generally unfavourable budgetary situation, and public concern at high remuneration packages. The history of the various constitutional challenges is set out in some detail in the decision of the ECtHR.

The Court first held that Ms NKM had a "possession" protected by article 1 of the First Protocol to the Convention. She had a legitimate expectation that, after having worked in the civil service for many years, she would receive the statutory severance payment. The decision records that the parties agreed that the high tax rate constituted an interference with her right to the peaceful enjoyment of her possession.

The focus of the decision was on the lawfulness of the interference and, in particular, whether the high tax rate on the top slice of the payment fell within the state's margin of appreciation in tax matters. The ECtHR noted that there was an element of retroactivity in the taxation of a severance payment, the right to which had been acquired over a number of years. The Court accepted that the taxation of the severance payment was intended to protect the public purse, and reflected the sense of social justice of the population, but doubted if these were served by the high level of tax. The element of proportionality required a fair balance between the general interests of the community and the protection of the individual's rights. The effect of the taxation on the severance payment was an average burden of 52%, which was more than three times the personal income tax rate of 16%. In the view of the Court, this was an excessive and disproportionate burden that applied only to a small group of individuals and, consequently, had a discriminatory element. The conclusion of the Court was that the taxation of the severance pay was not reasonably proportionate to the government's aim.

There are certain unique features in this case. The legislation was only enacted some ten weeks before Ms NKM's employment was terminated, and it deprived her of more than half of the severance pay she had earned over more than 20 years of service. The Court expressly found that she needed this pay as she was unemployed for a time after the termination of her civil service employment. The legislation itself had a retroactive element to it, and aspects of the legislation had been struck down by the Hungarian Constitutional Court on more than one occasion. There was also a discriminatory element in that it applied to only a small number of individuals.

Despite its special features, this is a clear example of an excessive tax being struck down as contrary to article 1

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1. *See*, for example, SE: ECtHR, 14 Dec. 1998, Application No. 13013/87, *Wasa Liv v. Sweden*.
2. In fact, in one very early case, DE: ECtHR, 31 May 1959, Application No. 551/59, *X v. Germany*, even a 100% tax was found not to be excessive.
3. HU: ECtHR, 14 May, 2013, Application No. 66529/11, *NKM v. Hungary*.

of the First Protocol to the Convention. It is interesting to note that the ECtHR referred[4] to the fact that tax rates exceeding 50% had been found unconstitutional in some Member States of the Council of Europe, such as Germany and France. What seems to have motivated the Court was not so much the 98% top tax rate, but the fact that the entire severance package was subject to tax at 52%, and that this was more than three times the normal tax rate.

One might add a small footnote about the outcome for Ms NKM. She claimed a little over HUF 2 million (approximately EUR 8,000)[5] as compensation for the amount of tax deducted from her severance pay, plus EUR 20,000 in respect of non-pecuniary damage. Having regard to the fact that she would have normally paid the 16% income tax, the ECtHR awarded her EUR 11,000 in total as compensation. She also claimed EUR 17,272 (68 hours at EUR 200 plus VAT per hour) as costs for legal work involved in bringing the case before the Court. The Court awarded her only EUR 6,000 in costs. Assuming that the EUR 17,272 was the actual amount of work charged by her lawyer, the result was that she was out of pocket by EUR 11,272 to bring a case in respect of which she received EUR 11,000 in damages. So, overall she was worse off as a result of bringing the case it would seem (unless her lawyer remitted some of the fees, or she was sponsored in bringing the litigation by a trade union or some similar body).

Frankly, 68 hours of legal work by her lawyer to make submissions in a case where the judgment is 26 pages long does not seem excessive: the ECtHR perhaps needs to consider its own credibility in situations such as this where an individual establishes that their rights have been infringed, but nevertheless appears to be out of pocket at the end of the day.

2. Auditing an Electronic Archive on a Shared Server

The case of *Bernh Larsen Holding AS and Others v. Norway* (2013)[6] discusses an interesting issue of the right to privacy where revenue authorities are carrying out an audit and wish to see an electronic archive maintained on a shared server.

In the course of an audit of the taxpayer company (referred to as "BLH") the revenue authorities asked to make a copy of all the data on the server used by the company. The server belonged to another company at the same premises as the taxpayer: BLH only rented server capacity, and the server was used by other companies, as well as by employees and persons working for the companies for their private email correspondence. BLH allowed the tax authorities access to the server and provided passwords for access, but refused to copy the contents of the entire server. They subsequently provided a back-up tape of the contents, but then challenged the right of the tax authorities to this back-up tape.

Other companies that used the server and refused to provide a copy to the revenue authorities were notified that they would also be audited.

The challenge to the use of the back-up tape passed through the Norwegian courts with those courts upholding the right of the revenue authorities to a copy of the entire contents of the server. From the Norwegian Supreme Court the taxpayers took the case on to the ECtHR alleging a breach of the right to privacy in article 8 of the Convention.

In a long decision, the ECtHR discussed the application of the right of privacy to a company's correspondence. The Court examined the Norwegian legislation and concluded that it was sufficiently precise and foreseeable for requiring access to the server. The Court also concluded that access to the entire material held on the server was necessary in a democratic society, and was not disproportionate given the variety of safeguards in the legislation. The Court seemed to have been particularly struck by the fact that it was the companies' own choice to opt for a "mixed archive" on a shared server, which made it impossible to separate out the documents relating to one company only.

As a conclusion, the Court (by a majority of 5:2) found that there had been no breach of the right to privacy by the revenue authorities demanding a copy of the entire contents of the server.

Interestingly, two of the judges dissented on the grounds that the legislation authorizing the revenue authority to take a copy of the material on the server was insufficiently clear, and that the interference was disproportionate.

No doubt the issue of auditing documents held on an electronic archive on a shared server is something that is likely to arise in other countries. The Norwegian legislation seems to have been quite detailed, with significant safeguards, which was persuasive in this case. In other countries, similar legislation may not be so successfully defended.

3. Pyramids and Cults

The decision of the ECtHR in *The Association of Jehovah's Witnesses v. France*[7] was discussed previously in this journal.[8] That case concluded that a tax burden arising out of the audit of various religious cults, and the denial to those cults of the tax exemptions extended to mainstream religions, was so high that it would force them to cease their activities and prevent them from continuing their religious activities; this infringed the freedom of religion in article 9 of the Convention.

This case has now been followed by several subsequent cases, where taxes (imposed as a result of an audit of a cult or sect in France) were held to infringe article 9 of the Con-

4. *NKM v. Hungary* (66529/11), at para. 65.
5. It is difficult to tie this figure to the 52% rate on a severance package of slightly over HUF 5.9 million, or EUR 20,300.
6. NO: ECtHR, 14 Mar. 2013, Application No. 24117/08, *Bernh Larsen Holding AS and Others v. Norway*.
7. FR: ECtHR, 30 June 2011, Application No. 8196/05, *The Association of Jehovah's Witnesses v. France*.
8. *See* P. Baker, *Some Recent Decisions of the European Court of Human Rights on Tax Matters*, 52 Eur. Taxn. 6, pp. 309-310 (2012), Journals IBFD.

vention. This was on the basis that in each case the amount of the tax undermined the ability of the sect or cult in question to continue its religious activities.[9]

By way of contrast, however, in a further decision,[10] the ECtHR concluded that the tax in question, which amounted to between 24% and 26% of the resources of the particular association, was not so high as to undermine the ability of the Association to continue its religious activities. It would seem, therefore, that those cults with better resources to withstand the tax charge can pay the tax without a breach of their right to engage in religious activities under article 9 of the Convention.

9. See FR: ECtHR, 31 Jan. 2013, Application No. 50615/07, *Association des Chevaliers du Lotus d'Or v. France*; FR: ECtHR, 31 Jan. 2013, Application No. 50471/07, *Association Cultuelle du Temple Pyramide v. France*; and FR: ECtHR, 31 Jan. 2013, Application No. 25502/07, *Eglise Evangelique Missionnaire et Salaun v. France* (all available in French only). The author is particularly grateful to his former student Rui Palma of Freshfields, Portugal for drawing his attention to these decisions.
10. FR: ECtHR, 8 Jan. 2013, Application No. 41729/09, *Sukyo Mahikare France v. France.*

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