

# Some Recent Tax Decisions of the European Court of Human Rights

## The *Yukos* Case – Decision Issued on the Merits

**In this note, the author examines the recent decision of the European Court of Human Rights on the merits in the *Yukos* case.**

### 1. Introduction

On 20 September 2011, the First Section Chamber of the European Court of Human Rights (ECtHR) published its decision on the merits in the *OAO Neftyanaya Kompaniya Yukos* case.<sup>1</sup> This decision on the merits of the claim (brought, effectively, by the former owners of the Yukos company) has been long awaited: the decision of admissibility was issued on 29 January 2009<sup>2</sup> and the public hearing was held on 4 March 2010.<sup>3</sup> This issue of “Some recent tax decisions...” is devoted entirely to this judgment.

The judgment is 163 pages long and contains 671 paragraphs plus two partly dissenting opinions of certain of the judges. This must be something of a record for the ECtHR, whose judgments seldom exceed more than 20 pages. Potential readers may wish to know that Paras. 6-306 (pages 2-49) relate, in detail, the facts of the dispute and Paras. 307-515 (pages 50-84) set out the Russian domestic law relevant to the dispute. After discussing an admissibility issue arising from the fact that related proceedings had been brought before the Permanent Court of Arbitration under the Energy Charter Treaty,<sup>4</sup> the discussion of alleged violations of the European Convention begins at Para. 527.

Previous readers will know that the issue arose from a tax investigation of the Yukos group of companies in Russia between November 2002 and March 2003, which resulted in additional assessment to various taxes, interest and penalties for the years 2000 to 2003. The additional assessment for the year 2000, for example, was for EUR 1.395 billion in taxes, EUR 0.935 billion in interest, plus a 40% penalty. The companies challenged these assessments through the Russian court system with virtually no success. Enforcement measures were taken by bailiffs, which led to the auction of shares in OAO Yuganskneftegaz, the principal production company of the group, on 19 December 2004. The shares were acquired by a previously unknown group, 000 Baykalfinansgrup, which, according to reports on 31 December 2004, was then acquired by OAO Rosneft, a Russian, state-owned oil company. The auction of the shares led effectively to the collapse of the Yukos group of companies. The basis of the additional assessments to tax and penalties was the

sale of oil products to a number of allegedly sham companies established in various regions of Russia where those companies enjoyed privileged tax regimes.

The Yukos company brought complaints under various articles of the European Convention, primarily Art. 6 (right to a fair trial) and Art. 1 of the First Protocol (right to enjoyment of possessions). There were also complaints brought under certain other articles, including arguments that the Yukos group had been the subject of discriminatory treatment contrary to Art. 14 (combined with Art. 1 of the First Protocol) and a general allegation that the treatment of the Yukos group (owned previously by Mr Khodorkovskiy, who had publicly clashed with Mr Yeltsin over political issues) was politically motivated.

The judgment of the ECtHR turns very much on the particular facts of the case. To a certain extent, it is of relatively limited general impact on issues concerning taxation and the European Convention. However, there are some useful summaries of the application of provisions of the European Convention in tax matters, which are very helpful. The case can also be seen as a test case for the ECtHR's ability to investigate and protect taxpayers against oppressive actions by revenue authorities.

This article discusses some of the complaints and the ECtHR's analysis.

### 2. Breach of Art. 6 (Right to a Fair Trial)

The Yukos company made several complaints regarding the proceedings before the Russian Courts.<sup>5</sup>

Art. 6 had already been held, in the admissibility decision, to apply under its criminal head to the 2000 tax assessment. By a majority of 6-1, the Court held that there had been a breach of this article in two respects. First, the time given to the Yukos group to prepare for the trial of the

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1. Application No. 14902/04.
2. And is discussed in P. Baker QC, “Some Recent Cases from the European Court of Human Rights”, 49 *European Taxation* 6 (2009), p. 327.
3. The webcast of that hearing is discussed in P. Baker QC, “Some Recent Cases from the European Court of Human Rights”, 50 *European Taxation* 6 (2010), p. 261.
4. See Paras. 516-526 of the judgment – because the parties to the arbitration were different from this case, and the issues somewhat different, there was no problem regarding the admissibility of the claim.
5. These are discussed at Paras. 527-551.

issues had been too short. The details are set out in the judgment, but broadly the lawyers acting for the Yukos group had been given four working days to examine at least 43,000 pages of evidence prior to the trial. In the view of the Court, this had infringed the principle of equality of arms since the time allowed was insufficient for the company to prepare properly for the trial, no matter the number of lawyers in its defence team.

Secondly, the Court upheld a similar complaint that the company had been given only 21 days after the first instance judgment had become available before the beginning of the appeal hearings. This was also held to have impeded the company's ability to prepare and present properly its case on appeal.

Other complaints about arbitrariness in bringing the action, the poor quality of the first instance judgment and delay in producing the appeal judgment were all rejected.

### 3. Violation of Art. 1 of the First Protocol (Right to Enjoyment of Possessions)

One of the more interesting aspects of the judgment is the discussion of the requirements to be met by tax legislation if there is no breach of the right to enjoyment of possessions.<sup>6</sup>

The principal challenge here was the imposition of an administrative penalty beyond the three-year time limit stipulated in Art. 113 of the Tax Code. The penalty assessment for 2000 had been issued several months beyond the expiry of that time limit. This was challenged before the Russian Constitutional Court, which decided to create a new exception to the time limit in regard to cases involving avoidance schemes. The ECtHR considered that this change in interpretation of the rules on time limits in respect of taxpayers who acted abusively was not a change that could have been reasonably foreseen. As such, it went beyond judicial interpretation and deprived the rules of their accessibility and their foreseeability, which are elements of the qualitative requirements for a rule to be regarded as a rule of law. On the specific issue of the judicial extension of the time limit, the Court found by a majority of four-three that there was a breach of the right to enjoyment of possessions.

Other challenges to the tax assessments for the years 2000 to 2003, on the grounds that they were not based on a reasonable and foreseeable interpretation of domestic law, were rejected by the Court.<sup>7</sup>

One interesting point here is that the Court stated on more than one occasion that, because the company was a large business (as opposed to an individual) it would be expected to have recourse to professional auditors and consultants who could advise it on the correct interpretation and application of the tax law.

Turning from challenges to the assessment of the taxes to the enforcement of the taxes, the Yukos company complained that the measures taken to enforce the tax debt – particularly the auction of shares – infringed its right to enjoyment of possessions. By a majority of five-two

the Court upheld this challenge. It noted, in particular, the ways in which the bailiffs might have enforced the tax liability, some of which could have kept the company afloat, as opposed to the auction, which unquestionably would lead to its demise.

The Court was also critical of a 7% enforcement fee (amounting in total to approximately EUR 1.16 billion) which was a flat fee imposed as part of the enforcement procedure.

The interesting element of the judgment here is the discussion of the considerations that need to be taken into account in enforcing tax debts where there are various alternative mechanisms available to the bailiffs and the need to strike a fair balance between the general interest of the public and the protection of the fundamental rights of the taxpayer.<sup>8</sup>

### 4. Other Complaints

As explained in section 1., a complaint based upon discrimination was made, but was rejected, and also an unusual complaint based on Art. 18 of the ECHR that the steps taken against the Yukos company were politically motivated.

The Courts also found no need to separately examine complaints under Arts. 7 and 13 of the Convention.

### 5. Concluding Comments

Overall, the Court found in favour of the Yukos company in respect of Art. 6, on the limited grounds that it was given insufficient time to prepare for the trial and for the appeal, and in respect of Art. 1 of the First Protocol, on the narrow issue of the extension to the three-year time limit for imposing penalties. However, it also decided for the company on the much broader issue of the enforcement steps taken in regard to auctioning the shares in the principal production company. Thus, complaints by the company were upheld, but not the more far-reaching complaints of discrimination and political motivation.

The question of compensation to the company – referred to “as just satisfaction” under Art. 41 of the ECHR – was left open. The Court considered that this issue was not yet ready for decision and that it should be reserved, “having regard to any agreement which might be reached between the applicant company and the respondent Government”. Assuming no agreement is reached, it will be difficult to anticipate what will be the award of “just satisfaction”. The company had claimed a lump sum in excess of EUR 81 billion, plus a daily interest payment of slightly over EUR 29.5 million in respect of pecuniary damages.

6. See, particularly, Paras. 559 and 560 of the judgment, and Paras. 567-575.

7. See Paras. 576-605.

8. See Paras. 635-658 in particular.

Arguably, the lack of sufficient time to prepare its case and its appeal damaged the ability of the company to present its defence, although the Court accepted that the sales of petroleum products to allegedly sham companies gave rise to a tax liability under Russian law. The extension to the three-year time limit for penalties impacted only on a small part of the total liability. On the other hand, the enforcement measures, especially the auction of the shares, effectively destroyed the business of the group.

When assessing “just satisfaction”, the Court does not apply an approach that is strictly aimed at *restitutio in integrum*. In fact, in many cases the Court has taken the view that a simple declaration that a complainant’s rights have been violated is just satisfaction. That is unlikely to be the case here, but how much of the

pecuniary damage claim is awarded would be quite difficult to estimate at this point.

The judgment turns, to a large extent, on the facts of this particular, somewhat egregious and exceptional case. There are some interesting general statements buried in the judgment about taxation and the European Convention. The Court has found Russia to have infringed the Yukos company’s rights in certain (in some cases, quite narrow) respects. On the other hand, on the major issues of discriminatory application of tax investigations and politically motivated actions, the Court found that the claims were not made out. Perhaps the jury has to remain out for the present on the question of whether or not the ECtHR has shown itself capable of protecting taxpayers under the European Convention against oppressive actions on the part of revenue authorities.

## Cumulative Index

[continued from page 532]

*Henriette Fuchs-Grootscholten:*  
Redesigned Individual Income Tax  
Benefits of a “Start-Up Nation” on the  
Move 367

**Italy**

*Giuseppe Campolo:*  
New Regulation Provides Clarification  
regarding the Tightened CFC and  
Anti-Tax Haven Rules 42

*Pietro Mastellone, LL.M.:*  
The Shift in the Burden of Proof in  
regard to Transfer Pricing 211

*Paolo F. Tripoli (LLM):*  
Turin Tax Court Denies Treaty  
Residence State Dividend Exemption  
Absent Source Taxation 260

**Luxembourg**

*Pierre-Jean Estagerie:*  
Introduction of an Expatriate Regime  
for Highly Skilled Employees 319

*Anja Taferner and Marc Schmitz:*  
New Tax Rules for Intra-Group  
Financing in Luxembourg 421

**Netherlands/Japan**

*Dick A. Hofland and  
Prof. Dr Frank P.G. Pötgens:*  
The LOB Provision in the New Japan–  
Netherlands Tax Treaty Ambiguities  
and Incompatibilities with EU Law  
Prompted the Netherlands to  
Reconsider the LOB Provision 215

**Netherlands/United Kingdom**

*Hein Vermeulen:*  
REITS under the New Netherlands–  
United Kingdom Tax Treaty 159

**Norway**

*Thor Leegaard:*  
Commissionaire Structure as an Agency  
Permanent Establishment – Uncertain  
Profit Allocation 263

**Portugal**

*Tània de Almeida Ferreira:*  
The New Participation Exemption  
Regime 105

**Slovak Republic**

*Tomáš Círan and Zuzana Blažejová:*  
2011 Amendments to the Slovak Income  
Tax Act 166

**United Kingdom**

*Douglas Roxburgh:*  
– Budget 2011 and Finance (No. 3)  
Bill 2011 – available online at [http://online.  
ibfd.org/kbase](http://online.ibfd.org/kbase)  
– Finance (No. 3) Act 2010 and Finance  
Bill 2011 – available online at [http://online.  
ibfd.org/kbase](http://online.<br/>ibfd.org/kbase)  
– Finance Act 2011 556

**United Kingdom/European Union**

*Fraser Dickinson:*  
Are the UK Thin Capitalization Rules  
Compliant with EU Law? – An Update  
in the Light of Recent ECJ Decisions 487

**EU Update** EU 1-40

**Human Rights Issues and Developments**

*Philip Baker QC:*  
– Some Recent Tax Decisions of the  
European Court of Human Rights 253  
– Some Recent Tax Decisions of the  
European Court of Human Rights –  
*The Yukos Case – Decision Issued  
on the Merits* 545

**CFE News**

*Dr Tigran Mkrtchyan:*  
CFE Forum 2011: Permanent  
Establishment in Direct and Indirect  
Tax – *Summary Report* 256

*Rudolf Reibel:*  
A Developing Relationship: Tax  
Authority – Taxpayer – Tax Adviser –  
*Report from the 3rd CFE Professional  
Affairs Conference in Düsseldorf* 98

CFE Response to the Green Paper  
on the Future of VAT – available online at  
<http://online.ibfd.org/kbase>

Opinion Statement of the CFE on Persons  
Liable for Payment of VAT to the Tax  
Authorities regarding Operations Taking  
Place in One Member State 309

Opinion Statement of the CFE on the  
Consequences of Involvement in  
Missing Trader Fraud 302

Opinion Statement of the CFE on the  
Decision of the European Court of  
Justice of 10 February 2011 in Joined  
Cases C-436/08 and C-437/08, *Haribo  
and Österreichische Salinen*, and the Tax  
Treatment of Inbound Dividends in the  
European Union and in Relations with  
EEA and Third Countries 472

Opinion Statement of the CFE on the  
Right to an Effective Recovery of Taxes  
Levied in Violation of EU Law 304

Opinion Statement of the CFE on  
*X Holding (C-337/08)* 150