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Finance Act notes: mutual assistance - section 134 and Schedule 39

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Council Directive 2001/44 amending Directive 76/308 on mutual assistance for the recovery of claims

SECTION 134 and Schedule 39 give effect to the Mutual Assistance Recovery Directive ("MARD") as that Directive was amended in June 2001: Member States of the European Union were to enact legislation bringing the amendments into force not later than June 30 this year. The background to the MARD and its 2001 amendment is instructive in understanding the section and the Schedule.

Most, if not all, Member States of the European Union recognise the general principle of public international law that one state will not assist in the enforcement of a tax debt due to another state: in the United Kingdom, this is sometimes referred to as the rule in *Government of India v. Taylor*[1] In the absence of agreement by treaty, or action at the level of the European Community, tax debts owed to one Member State would not be enforceable in another Member State.[2]

In federal states or confederations, however, it is usual to make provision for cross-border assistance in the collection of taxes between different states of the federation or confederation. In the United States, for example, judgments of one state of the Union for unpaid taxes are entitled to the full faith and credit clause of the Constitution[3] ; and in the Swiss Confederation a concordat was agreed on February 18, 1911 concerning the granting of reciprocal assistance in the execution of public law claims.[4]

It is not surprising, therefore, that there have been measures for the cross-border enforcement of tax claims within the European Union since 1976. The original Council Directive 76/308 applied only to refunds and interventions under the system of the European Agricultural Guidance and Guarantee Fund, to agricultural levies and to customs duties. This was extended to VAT by Directive 79/1071 of December 6, 1979. For these levies and duties there was some justification for legislation at the Community level since they all involved to an extent the Community's own resources.

In recent years, there has been discussion of proposals to extend the system created by Directive 76/308 to other taxes where there is no such Community interest.[5] The result of these discussions was the adoption at the Göteborg Council meeting on June 15, 2001 of Council Directive 2001/44, which amended Directive 76/308.

The amendments to the 1976 Directive were extensive. Perhaps the most important amendment was the extension of the system of mutual assistance to taxes on income and capital and taxes on insurance premiums. "Taxes on income and capital" are defined as those falling within Directive 77/799--in the UK these are: income tax, corporation tax, capital gains tax, petroleum revenue tax and development land tax (which is still listed in the 1977 Directive). The 2001 amendments also simplified and streamlined the system for cross-border assistance in recovery.

The MARD (as amended) now provides for three types of assistance between the revenue authorities of Member States. Article 4 provides for the exchange of information which may be useful to authorities of other Member States in the recovery of claims; section 134(3) of the Finance Act 2002 makes provision for this by removing the obligation of secrecy and allowing the exchange of such information. Article 5 provides for assistance in the service of documents relating to the recovery of duties. Undoubtedly the most extensive form of assistance is assistance in the recovery of tax debts (provided for by Articles 6-15 of the MARD).

There are at least three controversial issues about the MARD and the Finance Act provisions.[6] These are: the inability to challenge the foreign tax in the recovery proceedings; the potentially retrospective application of the legislation; and the recovery of taxes while the liability is being contested.

Perhaps the least controversial of these three points is Article 12(1) of the MARD which states that the liability to tax should be contested only in the country where that liability arose: only in that country will the tax laws be known, and any dispute should be heard there. This is reflected in the UK legislation in Schedule 39, paragraph 6(b) which states: "except as mentioned in paragraph 5 [which relates to debts where the overseas Court has struck down

the claim], no question may be raised as to the person's liability on the foreign claim". Thus, in proceedings in the UK for the enforcement of a foreign tax claim, the liability to tax cannot itself be challenged.

The potentially retrospective application of the MARD is more controversial. Neither the MARD nor the UK legislation is limited to the recovery of taxes becoming due after the date of the Directive or the date the legislation came into force. The only limit in terms of time is found in Article 14(b) of the MARD which states that there is no obligation to collect any tax "if the initial request applies to claims more than five years old, dating from the moment the instrument permitting the recovery is established in accordance with the laws, regulations or administrative practices enforced in the Member State in which the applicant authority is situated, to the date of the request". In other words, the only limit is that the initial request for assistance in recovery must be made within five years of the tax becoming due in the requesting state. The paragraph goes on to add, however, that where the claim is contested, the five-year time limit begins only when the claim can no longer be contested, *i.e.* when no further appeal can be made against any decision on liability.

On its face, therefore, the MARD is retrospective. Take this example. Suppose that an assessment was issued in 1990 in a Member State in respect of taxes due for the year 1985. The assessment was contested and a final judgment was issued on January 1, 1998.[7] The Member State to whom the tax liability is due would have until January 1, 2003 to request other Member States to recover the tax. Article 15 of the MARD states that it is only the limitation periods of the State in which the liability arose which govern the claim.

Does this retrospective recognition of a claim--which would not previously have been enforceable in other Member States--contravene the right to enjoyment of property contained in Article 1 of the First Protocol to the European Convention on Human Rights ("ECHR")? Arguably not because of the second paragraph to Article 1 which states that the protection of property does not "impair the right of a State to enforce such laws as it deems necessary to secure the payment of taxes". This proviso is subject, however, to scrutiny on Convention grounds: an interesting question would be whether the non-recognition of foreign tax debts is such a well established principle of international law that a retrospective overriding of that principle conflicts with the rule of law which flows through the Convention.

The last of the controversial issues concerns the recovery of tax in one Member State while the liability is still being contested in the other Member State where the liability arose.

The second paragraph of Article 12(2) of the MARD provides that a contested tax claim may nevertheless be recovered in another Member State in so far as the laws in force in the State where recovery is made allows such action. This is reflected in Schedule 39, paragraph 4(1) which states that regulations may permit the recovery of a foreign tax debt while that debt is being contested in the other Member State.

Consider this scenario: a UK resident individual receives notice of an assessment to income tax in another Member State. He may only contest that liability in the other Member State--Article 12(1) and Schedule 39, paragraph 6(b). However, while he is contesting that liability, the other Member State may request the Inland Revenue to collect the income tax from him here. Recovery proceedings could, therefore, take place in the UK while the taxpayer is actively contesting the liability in the other Member State.

Interestingly, the whole question of the recovery of tax debts while the liability is being contested has recently been the subject of two parallel judgments of the European Court of Human Rights in *Janosevic v. Sweden*[8] and *Västberga Taxi AB & Vulic v.Sweden*[9] in which judgments were given on July 23, 2002. Both cases concerned the Swedish procedures under which taxes can be recovered not only while the tax liability is being contested but while the tax authorities are actually reconsidering their decision to issue an assessment (which is a step prior to the taxpayer appealing to the courts). In both these cases bankruptcy proceedings were commenced against the individual taxpayer, and the corporate taxpayer was dissolved for non-payment of taxes, while the liability was being contested. In both cases the Strasbourg Court held against the Swedish Government, though largely on grounds of the delay in the proceedings and not on grounds of enforcing the tax while the liability was being contested. On the latter point, the Court said as follows:

"The Court notes that neither Article 6 nor, indeed, any other provision of the Convention can be seen as excluding, in principle, enforcement measures being taken before decisions on tax surcharges have become final.[10] However, considering that the early enforcement of tax surcharges may have serious implications for the person concerned and may adversely affect his or her defence in the subsequent court proceedings, the States are required to confine such

enforcement within reasonable limits that strike a fair balance between the interests involved".[11]

In looking at the fair balance, the Court in these two cases emphasised the importance of the provisions of Swedish law that, if the tax liability was subsequently found not to be due, the debtor had a right to be fully compensated for all injury he had suffered as a result of the premature recovery of the tax. The implication of the judgments is that, if it were not possible for the debtor to be completely compensated for the premature and incorrect recovery of the taxes, then the fair balance would not have been struck.

On this point, the last sentence of the second paragraph of Article 12(2) of the MARD provides as follows:

"If the result of contestation is subsequently favourable to the debtor, the applicant authority shall be liable for the reimbursement of any sums recovered, together with any compensation due, *in accordance with the laws in force in the Member State in which the requested authority is situated.* " (emphasis added).

Thus the taxpayer against whom premature recovery has been wrongly made is entitled to be compensated in accordance with the laws of the state in which the recovery was made: compliance with the ECHR is thus a question of whether the *requested state* provides for full restitution in the circumstances of wrongful recovery. Only if the requested state provides for full restitution would the balance be struck and the ECHR not be infringed. Taking the UK as an example, if a taxpayer has wrongly paid over tax to the Inland Revenue or Customs & Excise, there may well be circumstances where the taxpayer is not entitled to be fully compensated for injury suffered as a result of the incorrect collection of tax. Where penalties are involved, so that Article 6 is engaged, there may be a potential breach of the European Convention.

Aside from the three contentious points on the MARD and the implementing legislation, there is a more general issue raised by the MARD. The general principle of non-enforcement of foreign tax debts has probably had a greater influence on the development of international tax law--and the claims to jurisdiction of different countries--than is sometimes appreciated. Countries are only likely to claim jurisdiction to tax where they can enforce that jurisdiction: if the taxpayer is present in their country, or the source of the income or situs of the property is in their country. Once the general principle of non-enforcement of tax debts is abandoned, this restraint on claims to tax jurisdiction also goes out the window. This is not to suggest that Member States of the European Union will begin to tax residents of other Member States on income from sources outside the first state. However, there may be situations in the future where Member States will seek to extend their tax jurisdiction over persons or property where they could not previously have hoped to enforce the claim but may now do so under the MARD. An example would be claiming a degree of tax jurisdiction over former residents of a Member State. Where, for example, a former resident has taken out pension arrangements and claimed a tax deduction for premiums, the former Member State might wish to seek to recover those deductions against the former resident in the Member State in which he now resides.[12] There are potentially much wider ramifications to the MARD than have been envisaged so far.[13]

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1.[1955] AC 491--on this see Rule 3 of *Dicey & Morris, The Conflict of Laws* (13th ed., Sweet & Maxwell, 2000). Other Member States for which there is authority for the non-enforcement of foreign tax debts include: Austria (Supreme Court, February 16, 1892, (1893) Clunet 930); Belgium (Cass., February 18, 1929, Pas. 1929, I, 96); Denmark (*City of Bergen v. Olsen,* October 23, 1924, AD (1923-24) No. 147); France (*Bemberg C. Buenos Aires,* February 24, 1949, S. 1949 2.101); Ireland (*Peter Buchanan v. McVey* [1954] IR 89); Italy (Court of Appeal of Genoa, January 5, 1932, [1932] *Giurisprudenza Italiana* 1, 2, 128); and Sweden (Supreme Court, December 31, 1924, AD (1923-24) No. 148).

2.A recent example of this in the UK was the case of *QRS v. Frandsen* [1999] STC 616 which involved an attempt to enforce taxes allegedly due to Denmark in the United Kingdom.

3.See *Milwaukee County v. M E White Co.* 296 US 268 (1935, Supreme Court).

4.SR 281.21.

5.See the documents COM (1998) 364 final and COM (1999) 183 final.

6.These points were raised in the short debate in the Committee of the Whole House during the passage of the Finance Bill--see *Hansard,* Commons May 9, 2002, cols 386 *et seq.*

7.Unfortunately, in many, if not all, Member States delays in hearing tax cases are substantial, and it is by no means unusual for a case concerning a tax liability to take 10 years or more: unfortunately, this position may not improve following the European Court of Human Rights' decision in *Ferrazzini v. Italy* (Application No. 44759/98), reported in [2001] STC 1314.

8.Application No. 34619/97.

9.Application No. 36985/97.

10.Article 6 applied in this case because there were 20% and 40% tax surcharges involved, hence the reference to tax surcharges in the quotation from the judgment.

11.Paragraph 106 of the *Janosevic* judgment.
12.For an example of the collection of "negative personal liabilities"--the repayment of premiums paid on a policy--against a former resident, see the decision of the Hoge Raad of the Netherlands of December 7, 2001, Case No. 35, 231, reported in (2001) 4 ITLR 558.
13.Some of these issues were discussed in my short article "Changing the Norm on Cross-Border Enforcement of Tax Debts" (2002) 30 Intertax 216-218.
14.Q.C., Gray's Inn Tax Chambers.
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