

Unduly-paid taxes and the protection of the taxpayer's property right pursuant to Article 1, First Protocol ECHR¹

Junping Zheng²

1. Introduction

Taxation is one of the essential elements of sovereignty in every State, and is one of the essential instruments to generate public funds. In a theoretical terms the reason why a State should raise taxes is that they need to pay for the welfare and other public services provided by governments. This may be compared to a contract that is crucial both for the smooth functioning of the State and for people's lives. Tax collection, however, must comply with respect for the taxpayer's fundamental rights. The prohibition of confiscatory taxation laid down in domestic law³ is a manifestation of this respect. The "no confiscatory taxation" principle serves to strike a balance between public and the private interests. However, this might not be sufficient for the protection of private property rights, since it only regulates basic tax matters. In order to strike the right balance, more work is needed both at the domestic and international level.

This article provides an overview of the protection of taxpayers' property rights when taxes are unduly paid. The right to property is laid down in Article 1 of the First Protocol to European Convention on Human Rights (hereafter, the ECHR):

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.

¹ How to quote this article: J. Zheng, Unduly-paid taxes and the protection of the taxpayer's property right pursuant to Article 1, First Protocol ECHR, in *European Tax Studies*, 2014, No. 2, (www.seast.it/magazine), pp. 27-33.

² Junping Zheng, PhD candidate in European Tax Law at European School of Advanced Tax Studies – Alma Mater Studiorum, University of Bologna, Italy.

³ For example, Article 31 of the Spanish Constitution, paragraph 1, provides that the tax system cannot take on a confiscatory character.

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.

Many of the States in the world have related provisions in their constitutions to safeguard property rights, regardless of whether they have signed the ECHR⁴ or not⁵.

With regard to the characteristics of taxation – the obligatory contribution to public funds – the mainstream understanding is that taxation is, *per se*, an encroachment on possession within the meaning of Article 1, yet justified according to the public interest. However, the public interest cannot and should not be a universal and unconditional ground in all situations related to taxation. It needs to be subject to certain tests which are implied in Article 1, First Protocol ECHR.

2. Proportionality test: an essential element to determine whether there is a violation of Article 1 of the First Protocol

On the basis of Article 1, three distinct rules may be distinguished: the first and the fundamental rule is the peaceful enjoyment of property, which is enshrined in the first sentence of paragraph 1. From this basic assumption derives the second one, stating that individuals may be deprived of their property on certain conditions⁶. The third rule, embodied in the second paragraph, allows States to regulate the use of property in accordance with the general interest by enforcing such laws as they deem necessary for that purpose⁷.

⁴ The ECHR is one of the international conventions relating to the protection of property right. Mention should also be made of the International Covenant on Economic, Social and Cultural Rights (ICESCR).

⁵ China, that has not signed or ratified the ECHR, lays down in Article 13 of the Constitution: The state protects the right of citizens to own lawfully earned income, savings, houses and other lawful property. The state protects according to law the right of citizens to inherit private property.

⁶ In substantial terms, the deprivation should be based on the public interest; in formal terms, the law or the general principles of international law provide the conditions.

⁷ Rusen Ergec, 'Taxation and Property Rights under the European Convention on Human Rights', *Intertax* Volume 39, Issue 1, p.3. See further *Sporrong and Lönnroth v. Sweden*,

In relation to these rules and to the well-established Strasbourg case law, in the case of interference with the peaceful enjoyment of property, to establish whether the interference is in compliance with Article 1 of the First Protocol, three tests should be applied: this is crucial to determine whether an interference constitutes a violation of Article 1 of the First Protocol.

The first two are the lawfulness test⁸ and the legitimate aim test⁹. Considering the wide margin of appreciation of national authorities in the field of taxation, it may be useful to focus on the third requirement, that is, that the interference must strike a 'fair balance' between the public interest and the protection of the individual's fundamental rights. In other words, it is the proportionality test that is applied to establish whether the requirement is met, States are entitled a wide margin of appreciation to choose the means of enforcement and to evaluate whether the consequences of enforcement are justified. However, the Court can usually do much more work on this test than on the other two. From the perspective of the taxpayer, the Court can make an assessment on the enforced measures made by the authorities to establish whether the interference imposes a disproportionate or excessive burden on the applicant. In the case of unduly-paid taxation, the test can be essential to determine whether interference is reasonable. These cases can be complicated, as they concern not just the measures taken to raise taxes, but the authorities' refusal to refund unduly-paid amounts.

A tax may be unduly-paid for different reasons: it may have been paid according to a national law later found to be in conflict with EU law,¹⁰ it may

case 7151/75; 7152/75, Judgment of 23 Sep. 1982, § 61; *The Holy Monasteries v. Greece*, case 13092/87; 13984/88, Judgment of 9 Dec. 1994, § 56.

⁸ This means the interference should be lawful, in particular, the taxation should have a legal foundation. The Court applies an extensive concept of law, furthermore, the applicable provisions of domestic law need to be accessible, precise and foreseeable. Usually this rule is satisfied in the specific cases, while, in some cases the Court rules that there is a violation of Article 1 to Protocol No.1 on the basis of the failure to satisfy the requirement of the "quality of law". See *Serkov v. Ukraine*, Judgment of 7 July 2011.

⁹ This means that the interference should pursue a legitimate aim in the public interest. In this respect, the national authorities are granted a wide margin of appreciation, especially in the tax field. The State's decision has been overturned only in a very few cases. See *S.S. Dangeville v. France*, Judgment of 16 April 2002, § 56.

¹⁰ See *S.A. Dangeville v. France*, judgment of 16 April 2002.

be the result of the failure of a third party to fulfill their obligations,¹¹ or it may be a withholding taxation that has been overpaid¹². Whatever the reason, in these cases, the authorities do not usually deny that the tax has been unduly-paid, but they refuse to allow it on the grounds of the public interest based on their wide margin of appreciation. As a result, the Court does not always identify a feasible way to ensure the refund of the unduly-paid taxation. In the case of *Bulves AD v. Bulgaria*, “*the government stated that the applicant company could have initiated an action against its supplier under the general rules of tort in order to seek compensation for the VAT it had not been allowed to deduct because of the supplier’s failure to comply with its VAT reporting obligations*”¹³.

It may be argued that the Court should shine more light on the respect of the general interest of the State in the field of taxation. At least, some affirmative signs could be given,¹⁴ such as counteracting tax evasion or preventing the taxpayers enjoying the benefit of a windfall, thus providing some objective materials in the balance of the proportionality test.

3. Possible remedies to a violation of Article 1 of the First Protocol, ECHR

According to the well-established case law of the Court, the remedies available to applicants usually consist of two kinds, namely, pecuniary damages and non-pecuniary damages. The attitude of the Court can be different in relation to the two kinds of damages in accordance with the merits of each case. However, some basic approaches can be identified in the case of an alleged violation of Article 1 of the First Protocol of the ECHR.

¹¹ See *Bulves AD v. Bulgaria*, judgment of 22 January 2009. In this case, the authorities rejected the applicant’s request for the refund of the tax as the applicant’s supplier failed to fulfill its account registration.

¹² See *EKO-ELDA AVEE v. Greece*, Judgment of 9 March 2006.

¹³ *Bulves AD v. Bulgaria*, Judgment of 22 January 2009, §34.

¹⁴ Some kinds of ‘general interest’ that could usually be confirmed without extensive testing.

3.1 Pecuniary damage

On the basis of the cases requesting a refund of unduly-paid taxes, the claimed pecuniary damages can include: the amount of the unduly-paid taxation,¹⁵ interest on the arrears (default interest), the inflation rate,¹⁶ and costs and expenses¹⁷.

According to the literature and case law, there are no competing positions with regard to the calculation of the interest; however the same unanimity is not found with regard to the day from which the interest should be calculated¹⁸.

According to the case law, the starting date for the calculation of interest is when the applicant makes an application for the refund of the unduly-paid taxes. In the view of the present author, the time required to prepare the application should be considered. When a certain amount of tax is confirmed as unduly-paid, the taxpayer's right to receive that amount is established, while there must be an interval between when the taxpayer becomes aware of the unduly-paid taxes and the submission of application for reimbursement. If the interval is long (within the period of validity) and the unduly-paid tax is completely out of the authorities' responsibility, it is not clear whether it is reasonable for the taxpayer to bear that loss of interest. As a result, it should be borne in mind that the first time the applicant makes an application should not be the sole criterion in calculating the default interest.

Another matter that should not be ignored is the potential economic impact on the applicant resulting from the unduly-paid tax. Although this is not often noted by the taxpayers, it could be claimed in most cases. The impact could be significant: if the taxpayer is not in possession of the amount of the unduly-paid taxes, this means they could not make use of it, resulting

¹⁵ This item is always recognized by the Court on condition that there is a violation of Article 1, but the calculation of the amount will be subject to domestic law.

¹⁶ This is a optional term for the applicant, when it is claimed that the applicant should submit a detailed application to the Court in order to obtain a favourable ruling. See *Serkov v. Ukraine*, judgment of 7 July 2011 §51.

¹⁷ Including the cost of domestic remedies (defence before the Court, the Administrative Court) and the ECtHR. The costs will be judged on the basis of the principle of reasonableness (as well as authenticity and necessity), especially the cost legal advice and representation. See *Eko-Elda AVEE v. Greece*, judgment of 9 Mar 2006, § 42.

¹⁸ It is customary to add three percentage points to the marginal lending rate of the European Central Bank.

in lost investment opportunities. The losses could be significant. The problem is clearly how to calculate them and how to make sure this would not be abused. However, it may be argued that this is one aspect that calls for closer attention.

3.2 Non-pecuniary damage

Together with the claim for pecuniary damages, there is usually a claim for non-pecuniary damages. In recent years, the Court's attitude seems to be more unambiguous as a result of case-law rulings. In the early years, non-pecuniary damage was recognized by the Court but with no specific compensation¹⁹. It is gratifying that in the case of *Serkov v. Ukraine* the Court awarded EUR 4,000 to the applicant for non-pecuniary damage.²⁰ This is a positive sign for the protection of taxpayers' rights.

4. Suggestions for domestic taxation legislation

With regard to unduly-paid taxation cases, time plays an important role both for taxpayers and the tax authorities. However, due to the importance of taxation for a State, there is an obligatory administrative appeals procedure prior to the judicial appeals procedure in most EU countries. In other words, the judicial appeals procedure can be initiated only on condition that the administrative appeal channels have been exhausted²¹. This gives rise to two problems: the objectivity of the administrative appeal, and the time required to complete the administrative appeal that may at times be complicated. There are reasonable grounds for the existence of administrative appeals channels: however these two aspects should be borne in mind in the design of improved procedures. In the case of unduly-paid taxes, it should be possible to introduce a streamlined process.

¹⁹ The judgment is usually stated as follows: the applicant may have sustained non-pecuniary damage, and the present judgment provides sufficient compensation for it.

²⁰ Judgment of 7 July 2011, § 52.

²¹ This is not the case in Italy, as there is prior administrative procedure. For further details of the appeals procedure, see Nico Kleemans, 'The relationship between the national systems of legal protection of the taxpayer and the European Convention on Human Rights', *EC TAX REVIEW*, 2000-1, p.46.

Naturally, with regard to compensation for the taxpayer in the case of unduly-paid taxes, there is room for improvement in domestic procedures, and this calls for more in-depth research.

5. Conclusion

Taxation, as an encroachment on or at least an interference in the enjoyment of property rights, is justified by the general interest, but only if certain conditions are met. As a result, the "fair balance" test between the general interest objectives pursued and the measures applied in the cases that involve unduly-paid taxation could be essential for determining the existence of a violation of the Article 1 to the First Protocol of the ECHR. The ECtHR does not shine much light on the elements that could be considered in the proportionality test, especially on the general interest side due to consideration for the State's wide margin of appreciation. However, with the increasing attention to the protection of the human rights, the Court could do more²². In addition, in terms of the protection of taxpayers' rights, there is much work to be done in the domestic law system both in procedural and substantial terms.

²² As may be seen in the remedies in the unduly-paid cases, the Court has been favourably disposed to the interests of the taxpayer in recent years and that must be seen in a positive light.