

## The exchange of information between tax authorities and the taxpayer's right to be heard<sup>1</sup>

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### 1. Introduction

On 22 October 2013 the Court of Justice of the European Union (CJEU) handed down its judgment on an application for a preliminary ruling in *Sabou*,<sup>3</sup> essentially concerning the interaction between mutual assistance procedures in tax matters and respect for fundamental rights, with particular reference to the right to a defence (and, particularly, the taxpayer's right to be heard by the tax administration).

In the past, the CJEU did not focus on the question of mutual administrative assistance with specific regard to the impact that this could have on taxpayers' rights: on the contrary, the Court always focused more on the technical aspects of the exchange of information procedures and was more concerned with possible ways for that process to become more efficient and swift<sup>4</sup>. Simply put, the purpose of safeguarding the tax revenue of Member States took primacy over the protection of fundamental rights as far as administrative cooperation was concerned<sup>5</sup>.

As a result, scant attention – or none at all – was paid to the possibility that such procedures might affect the fundamental rights of European taxpayers. This is the case even in the current context, in which not only the EU but

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<sup>3</sup> Court of Justice of the European Union, judgment 22 October 2013, C-276/12.

<sup>4</sup> See, for instance, Court of Justice of the European Union, judgment 13 April 2000, C-420/98, *W.N.* and judgment 1 July 2004, joined cases C-361/02 - C-362/02, *Tsapalos*. On several other occasions, the Court referred to the Mutual Assistance Directives exclusively in order to dismiss possible justifications put forward by Member States for the purpose of justifying restrictions of the fundamental freedoms by referring to preventing tax avoidance and tax evasion. This reasoning was adopted by the Court for the first time in judgment 28 January 1992, C-204/90, *Bachmann*.

<sup>5</sup> A clear example of this attitude is provided by the 2002 OECD Model Agreement on Exchange of Information on Tax Matters, Article 1 of which states that: "The rights and safeguards secured to persons by the laws or administrative practice of the requested Party remain applicable to the extent that they do not unduly prevent or delay effective exchange of information".

also the OECD is reconsidering the measures that need to be taken (or improved) to enhance cooperation between States on tax matters<sup>6</sup>.

However, the question of how to reconcile the two objectives (i.e. an efficient exchange of information between tax authorities on the one hand, and the protection of the fundamental rights of the taxpayer on the other) continues to be one of the most neglected aspects in the debate on mutual international assistance and tax avoidance<sup>7</sup>.

This is even more significant if we consider that the activities that are part of the exchange of information procedures fall within the scope of the most problematic and authoritative area of administrative action, i.e. the preliminary inquiry by the tax authority. This helps to explain why the CJEU judgment in *Sabou* deserves particular attention. Furthermore, the decision makes some interesting points on the (sometimes ambiguous) interaction and integration, within the EU context, between different sources of protection of fundamental rights (the European Charter of Human Rights, the Charter of Fundamental Rights of the European Union, and the general principles of the EU legal order)<sup>8</sup>.

## 2. Facts of the case and questions referred to the CJEU

The facts of the case are relatively straightforward: a professional Czech football player claimed in his tax returns to have incurred certain expenses during the previous fiscal year, in different Member States. He maintained that those expenditure were inherent to his professional activity (and hence deductible from his taxable income) because, according to his statement, he

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<sup>6</sup> A prime example of this current attitude is the fact that at least five out of 15 of the "actions" enshrined in the OECD Action Plan on Base Erosion and Profit Shifting revolve around mutual assistance and exchange of information between States. On the evolution of the instruments for administrative cooperation in tax matters, see BUCCISANO A., *Cooperazione amministrativa internazionale in materia fiscale*, in Riv. Dir. Trib., 2012, 7-8, 669.

<sup>7</sup> MASTELLONE P., *Tutela del contribuente nei confronti delle prove illecitamente acquisite all'estero*, in Dir. Prat. Trib., 2013, 4, 791.

<sup>8</sup> On the point of the relationship between fundamental rights and tax law in the EU, see, *ex multis*, BAKER P., *Taxation and European Convention on Human Rights*, in British Tax Review, 2000, 211; MARCHESE S., *Diritti fondamentali europei e diritto tributario dopo il Trattato di Lisbona*, in Dir. Prat. Trib., 2012, 1, 289; GREGGI M., *La rilevanza fiscale della Convenzione Europea dei Diritti dell'Uomo: dall'interesse fiscale al principio di non discriminazione*, in Riv. Dir. Fin., 2000, 1, 412; DEL FEDERICO L., *I principi della Convenzione Europea dei Diritti dell'Uomo in materia tributaria*, in Riv. Dir. Fin., 2010, 2, 206.

visited those countries for interviews with a number of football clubs for transfer purposes. After raising doubts over the truthfulness of these statements, the Czech tax authorities carried out an investigation, involving requests for information from the tax authorities of the Member States to which the taxpayer had travelled. In order to do so, the tax administration resorted to the mechanisms of mutual assistance provided for by Directive 77/799/EEC<sup>9</sup>. In light of the results of the investigation, the Czech tax authorities concluded that the expenses claimed were not work-related and should be disallowed as deductions.

As a result, the taxpayer brought an action essentially claiming that the Czech tax authorities had obtained information about him illegally, since he had not been notified of their request for assistance to other authorities and had not been given the chance to comment on the results of the request before the tax administration issued its final assessment. On this point, the Czech Supreme Administrative Court was unsure whether a taxpayer had the right to take part in the exchange of information between the authorities involved.

### **3. Protection of taxpayers' rights in an integrated multi-level scenario**

In its judgment, the Court considered four possible levels of protection that could theoretically be applied to the case at issue: the provisions of Council Directive 77/779/EEC, the Charter of Fundamental Rights of the European Union, the general principles of the EU legal order, and national law. This cross-reference gives us the exact measure of the current level of juridical integration within the European context, as far as fundamental rights are concerned: the scenario appears to be complex and multi-faced, with the intertwining of various provisions of different types, from various sources and with different objectives. The ECHR is notably absent from the list of sources, which could be interpreted as proof of how its integration into the

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<sup>9</sup> Council Directive 77/799/EEC of 9 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums. The Directive was repealed by Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation.

EU – and consequent applicability by the Court of Justice of the European Union – is still far from settled.

First of all, the Court ruled out the possibility of applying the Charter of Fundamental Rights of the European Union<sup>10</sup> to the case at issue because of its temporal validity: the Charter came into force on 1 December 2009, that is to say, after the facts referred by the Czech Court had taken place<sup>11</sup>.

In addition, the Court ruled out the prospect of Directive 77/799/EEC being of assistance to the taxpayer in the case at issue, as the aim of the Directive was to counter international tax evasion and avoidance by way of a more efficient level of coordination and cooperation amongst tax authorities in order to reach an exact determination of the amount of tax to levy<sup>12</sup>. In other words, it was found that the Directive merely imposes certain obligations on the Member States concerned and, as a result, is not concerned with granting specific rights to the taxpayer, nor laying down an obligation for the relevant authorities to consult the taxpayer<sup>13</sup>.

The Court then observed that, despite all of the above, the rights of the defence (which most certainly include the right to be heard) are among the fundamental rights constituting the “general principles of the EU”, according to Article 6 TEU, thus forming an integral part of the EU legal order<sup>14</sup>. Consequently, the Judges found that the general principles of European

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<sup>10</sup> Article 41 of the Charter makes provision for a specific right of the individual to be heard before any individual measure which would affect him adversely is taken (Article 41.2), under the heading “Right to good administration”. On the point, the Court has previously stated that “the right to be heard guarantees every person the opportunity to make known his views effectively during an administrative procedure and before the adoption of any decision liable to affect his interest adversely” (see Court of Justice of the European Union, judgement 22 November 2012, C-277/11, *M*).

<sup>11</sup> If this had not been the case, the Charter would have been applicable to the issue, since Article 51 expressly provides that “the provision of this Charter are addressed to the institutions and bodies of the Union with due regard for the principle of subsidiarity and to the Member States only when they are implementing Union law” (since Directive 77/799/EEC has to be considered as an act of Union law). Nevertheless, the Court expressly stated on one occasion that, according to its wording, Article 41.2 of the Charter is addressed only to the EU institutions and bodies, and not to the member States (Court of Justice of the European Union, judgement 21 December 2011, C-482/10, *Cicala*).

<sup>12</sup> On the same point, see also Court of Justice of the European Union, judgment 27 September 2007, C-184/05, *Twoh International*.

<sup>13</sup> Council Directive 77/799/EEC, as well as the so-called “Collection Directive” (Council Directive 76/308/EEC), did not provide for any direct protection of taxpayers’ rights, merely referring to the instruments offered by national laws. The same can be said for the “new” Council Directive 2011/16/EU, which does not enshrine a specific set of rights conferred on the taxpayer but which, however, makes an express reference to the Charter of Fundamental Rights of the European Union.

<sup>14</sup> See also Court of Justice of the European Union, judgement 18 December 2008, C-349/07, *Sopropé*.

Union law applied to the case at issue, since the Czech Republic was implementing EU law (i.e. the Directive), and as a result these principles had to be taken into account. In other words, there was a need to consider whether the taxpayer could derive his right to participate in the exchange of information not from the Directive, but from the generally recognized rights of the defence.

#### **4. Effectiveness of taxpayer protection: is there a general right to be heard during the exchange of information procedure?**

Finally, the Court stated that a request for information by one Member State to the tax authorities of another Member State does not constitute an act giving rise to such an obligation to consult the taxpayer who is under investigation, as far as EU law is concerned.

This reasoning revolves around a distinction between the investigative stage and the contentious state. The investigative stage, which merely consists of the collection of information, takes place only between the tax authorities. It is therefore different from the contentious stage, which takes place between the tax authority and the taxpayer, beginning when the taxpayer is sent the proposed adjustment. The taxpayer is required to be put in the position of being able to participate in the contentious stage, but no similar right exists, in the Court's opinion, with regard to the investigative stage (even when it includes the examination of witnesses)<sup>15</sup>. Although the Court did not state it explicitly, the distinction between the investigative stage and contentious stage finds its justification in the nature of the administrative proceedings.

Simply put, the information provided through the exchange mechanism does not count as decisive evidence. The receiving authority is not inextricably bound to accept the information, since they may be in possession of other data which could lead to opposite conclusions. It follows

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<sup>15</sup> Even though, as highlighted by AG Kokott in her Opinion, it is not possible, generally speaking, to "rule out the existence of investigative measures which are so onerous in themselves that the protection of the person concerned requires a right to be heard". Nevertheless, AG Kokott also pointed out that "the constitutional traditions common to the member States also have included a right to be heard in the context of administrative proceedings only in isolated cases and only recently".

that it is up to the administration to examine the facts and draw conclusions, by way of an evaluation which is not part of the mechanism regulated by the Directive<sup>16</sup>.

As a result, the information exchanged has only an indirect effect on the taxpayer, as opposed to the official assessment by way of which the tax authority concludes the administrative stage (which, on the contrary, has a direct effect on the taxpayer). On this basis, there is nothing to prevent a Member State from granting the right to be heard to taxpayers during the investigative stage, in accordance with the rules and procedures applicable in the country in question.

It is significant that the Court made no explicit mention of proportionality, which still needs to be considered in this connection, especially since it entails the need to strike a sometimes difficult balance between the relevance of the taxpayer's rights and setting aside those rights in light of the efficacy of the procedure at issue<sup>17</sup>.

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<sup>16</sup> At a later stage, it will be up to the national courts to evaluate whether the information upon which the tax authority based its assessment had an effective probative value and was correctly obtained (as, for example, in *Falciani*). On this point, see MARCHESI S., *Attività istruttorie dell'amministrazione finanziaria e diritti fondamentali europei dei contribuenti*, in *Dir. Prat. Trib.*, 2013, 3, 493.

<sup>17</sup> In his Opinion on *National Panasonic v Commission* (C-136/79), AG Warner accepted the existence of an exception to the right to be heard where the purpose of the decision would or might be defeated if the right were granted.