

The Proportionality Principle in EU Tax law, WTO, Investment law

Dr. Ricardo García / Dr. Toni Marzal

Introduction

- Work in progress: comparative analysis of judicial review of tax measures in supranational/international adjudication (EU law, WTO and international investment arbitration)
- Starting hypothesis --> there is something special about taxation:
 1. models of judicial review developed elsewhere are ill-suited to tax cases
 2. taxation as a test case for the accuracy of models of judicial review

Proportionality today - starting assumptions

- Proportionality is understood as synonymous with balancing
- Proportionality is irresistible -->
 - ✓ Intuitive appeal: to judge is to balance
 - ✓ Present internationally and domestically, and in all branches of the law
- Proportionality in taxation involves weighing tax fairness against legal certainty

Distinctiveness of proportionality as a type of legal reasoning

1. Functionalism/instrumentalism

- A measure is viewed and judged as a tool to achieve a certain result
- Non-utilitarian arguments are excluded (e.g. arguments based on authority or principle)

2. Universality

- Cases are seen as conflicts between universal (and generally uncontroversial) values
- Exclusion of individual or group interests

The distinctiveness of taxation cases

1. No universality:
 - ✓ The objective of raising taxes is not a universal value, but the interest of a particular State
 - ✓ That interest is almost never subject to balancing
2. No functionalism: cases are most often about the proper extent of the State's fiscal authority. Typically:
 - ✓ Reallocation of profits through formal legal engineering to minimise tax bill
 - ✓ State nevertheless taxes as if reallocation had not happened, justifying its taxation measure as seeking to combat tax avoidance
 - ✓ Challenge brought to adjudicator: can the State treat the profits as located within its area of fiscal authority?

Proportionality and tax abusive behaviours

- Cases on abuse/tax avoidance – common thread in cases adjudicated by CJEU, Investment arbitration tribunals, WTO system
 - Proportionality is traditionally defined as a tool to solve conflict between legal certainty (taxpayer's predictability) and tax fairness/raise revenue against abusive behavior of taxpayer)
 - Is it really a proportionality analysis? (i) A substantive dimension: issue of competence (territoriality) – right of the State to collect taxes (ii) A procedural dimension – to tax, you need to prove that the transactions are abusive

CJEU (1)

- *SIAT* (C-318/10) - Belgian tax authority denied deductibility of business expenses (the income was not taxed in Luxembourg)
 - Justification of the restriction on the freedom to provide services - prevention of tax avoidance and evasion (balanced allocation of taxing power)
 - Proportionality test – “*whether that legislation goes beyond what is necessary in order to attain those objectives*”
- The tax literature – proportionality as “balancing of interests” - present the case as victory of legal certainty over tax fairness (collection of taxes and prevention of tax avoidance)
- In our view – (i) Belgium has the right to tax (territoriality); (ii) if it proves that the arrangement is not genuine or “wholly artificial arrangements” (*Cadbury Schweppes*) – genuine economic activities enjoy the EU freedoms of circulation

Arbitration tribunals – BITs (2)

- *Cairn Energy (indirect transfer of participations)*. In 2006, Sale of shares of an offshore company (Jersey) by UK resident (the Jersey Company owns operative Indian companies - USD 1.56 billion)
 - No taxation either in India or in UK in indirect transfer of shares
 - Jersey company does not have economic activity – holding company (pure shell)
 - India (2012) – retroactive amendment 9 (1) of the Income Tax Act (ITA) to allow India to tax indirect transfer of shares. Is it a clarification or retroactive legislation?
 - Retroactive legislation – breach of FET?

Arbitration tribunals – BITs (2)

- Traditional narrative on proportionality – *para. 1789: “balancing exercise between India’s public policy objectives (tax fairness/raise revenue/prevention of abusive behaviors) and the Claimant’ interest in benefiting from values of legal certainty and predictability”*
- In our view – NO proportionality – (i) India has the right to tax capital gain from indirect transfer of shares, BUT (ii) India has to prove that the taxpayer’s transactions are abusive:
 - Award – India does not prove that the 2006 transactions were abusive (para. 1260-1591)
 - Double non-taxation is not always abusive – problem with India’s argumentation
 - In our view – India should have proven better that the arrangement was abusive (principal purpose was to obtain a tax advantage, last minute tax planning + economic activity of the Jersey company, etc.)

WTO – Appellate Body (3)

- Article XX of the GATT and XIV of the GATS – general exceptions to allow the States to introduce discrimination between imported and domestic goods and services (National Treatment Principle)
- Two-tier analysis: i) general exceptions apply (i.e. para. (d) of Art. XX: “*Necessary to the prevention of deceptive practices*”; ii) “*whether the measure cannot be deemed as arbitrary or unjustifiable discrimination, and second, it cannot be applied in a manner that would constitute a disguised restriction on international trade*”)

WTO – Appellate Body (3)

- Does the principle of proportionality play a role in assessing Art. XX GATT and XIV GATS? Again, it is not an issue of proportionality
- *Argentina – Measures relating to trade in goods and services*
 - Tax measures introduced by Argentina against service providers located in non-cooperative jurisdictions like Panama (WHTs, non-deductibility of payments, etc.)
 - Non-cooperative jurisdiction – No Bilateral treaty/no Agreement on exchange of information
 - Art. XIV(c) GATS – defensive measures against tax evasion and avoidance practices by MNEs operating in non-cooperative jurisdictions (harmful tax competition)
 - General interest – (i) See paragraph 7.681-7.682. Panama presented the case as a balancing dichotomy between tax certainty and fairness (equality in tax matters). The Panel rejected this idea!! There is no such a breach in legal certainty in the fight of Argentina against abusive tax practices!; (ii) Panama has **not proven** alternative measures and less-trade restrictive to ensure this objective (fair tax collection)
 - Argentina has the right to tax (tax measures) to prevent abuse

Conclusions

- Traditional narrative – “proportionality is a tool for balancing divergent interests”.
- In abuse – such narrative is frequently presented. Proportionality solves conflict between legal certainty/predictability versus tax fairness (tax collection)
- Based on cases adjudicated by CJEU/Arbitration tribunal/WTO – proportionality is ill-suited. *Don't call it proportionality when...*
 - States has the right to ensure tax collection and prevent abuse (WTO) – substantive dimension
 - But States have to prove that there is abuse (CJEU and Cairn Energy) – procedural dimension