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ENFORCEMENT OF FOREIGN REVENUE LAW

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One of the interesting features of European (i.e EC/EU) law is that there are virtually no issues in the cross-border context that are not considered in the light of it. The rule that the Courts of one country will not enforce the penal and revenue laws of another country has been described by Dicey[2] as well-established and almost universal. Despite this, the question of enforcement of the revenue laws of one member state in another and its implications under European law has, however, come before the Court of Appeal in England recently. *QRS1 Aps and Others* v *Frandsen*[3] involved an attempt by the Danish tax authorities to collect unpaid taxes in England.

The case involved asset stripping activities in Denmark. Until 1992, Mr Frandsen, the respondent, owned several Danish companies directly or indirectly. In November 1992, all of the assets of the companies were disposed of for cash. This cash was then used by the companies to purchase the respondent's shares. In 1994, the companies were put into liquidation on the ground that they had been engaged in asset stripping. In March 1995, the Danish tax authorities claimed corporation taxes of DKr 30 million plus DKr 10 million in interest against the companies. At that stage, the companies had no assets and their only creditor was the Danish tax authorities. The Danish tax authorities appointed a liquidator and agreed to fund an action by the companies against the respondent based on Danish law prohibiting companies from providing financial assistance for the acquisition of their own shares.

The respondent, Mr Frandsen, was resident in the UK. He was also domiciled in England within the meaning of the Brussels Convention on Jurisdiction and the

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2 Dicey and Morris: The Conflict of Laws - 12th Edition page 97.

3 [1999] STC 616.

Enforcement of Judgments in Civil and Commercial Matters. He was therefore within the jurisdiction of the English courts.

Claims were commenced both in England and Denmark for restitution of the value of the assets which were disposed of to finance the purchase of Mr Frandsen's shares. The companies also claimed, as an alternative, damages arising out of the respondent's negligence or reckless default in allowing the companies to suffer loss as a result of the asset stripping in which he had been involved.

Mr Frandsen applied to strike out the action in the English courts on the basis that it was for the enforcement of a foreign revenue law.

In the High Court, Sullivan J noted that English case law on the indirect enforcement of foreign revenue laws still applied. In particular, the principle in *Peter Buchanan Limited* v *McVey*[4] is authoritative. This principle provides that indirect enforcement of a tax claim occurs where the liquidator of a foreign company, appointed by a foreign tax authority, seeks to recover from one of the company's directors assets under the director's control for the purpose of satisfying the foreign state's unsatisfied claim for taxes due from the company.

Although the Danish companies accepted the proposition as a matter of law, they argued that the issue should be approached from the point of view of the Brussels Convention. In particular, Article 1 provides:

> "This Convention shall apply in civil and commercial matters whatever the nature of the Court or tribunal. It shall not extend, in particular, to revenue, customs or administrative matters".

It was argued that proceedings by a liquidator to realise a company's assets are "civil and commercial matters" for the purposes of Article 1. Furthermore, indirect enforcement of a claim at the behest of a revenue authority is not a revenue matter. It was argued that the derogations from the general principle should be construed strictly and in such a way as not to conflict with the underlying objective of the article. It was held, however, that even accepting that the proceedings by a liquidator for the benefit of creditors or shareholders may well fall within "civil and commercial matters", this is not a bar to an English court striking out a claim made in England if it is satisfied that the claim is bound to fail under English law. Mr Justice Sullivan concluded that the Convention confers jurisdiction upon the Courts of the contracting parties to entertain proceedings falling within its scope. Having done so, it does not seek to regulate the details of procedures to be followed in the

4 [1955] AC 516.

Courts of those parties.

There is no definition of "revenue matters" in the Convention and no decision of the European Court of Justice as to what the words mean. The learned Judge saw no reason to restrict "revenue matters" in the context of the Convention to direct as opposed to indirect enforcement of revenue claims. Although decisions of the ECJ were cited by the companies in relation to Article 1, none of them was directly on point. Mr Justice Sullivan did, however, note an underlying theme in the judgments, namely that the Court of Justice has looked at the substance and not merely the form of the claim. This, he regarded, as being in line with the approach in English law as found in the *Buchanan* decision.

In the Court of Appeal, Simon Brown LJ noted that the facts were in all material respects indistinguishable from those in the *Buchanan* case. Three issues were, however, considered:

(1) What are revenue matters?

The test in the absence of a definition or any ECJ decisions on the meaning of the term was to ask what the original member states would have regarded as revenue matters for the purposes of the Convention.

The companies accept that direct revenue claims would fall within the exception, but argued that indirect claims are not excluded and, in particular, this claim was not. This, they argued, was a private law claim, not merely in form but in substance. This was rejected by the Court on the basis that it would mean that the *Buchanan* case was wrongly decided. It also implied that the Courts of other member states would have come to a different conclusion from the House of Lords on this. After reviewing both foreign jurisprudence and commentary, no support for this view could be found. It was held, therefore, that a claim of this kind plainly fell within the compass of revenue matters as that expression would be understood by all member states for the purposes of Article 1 of the Convention.

(2) Can the claim be struck out even if the Convention applies?

The companies argued on the basis of the decision of the European Court of Justice in *Kongress Agentur Hagen GmbH* v *Zeehaghe BV*[5] the effectiveness of the

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5 From Case 365/88 [1990] ECR I-1845 that procedural rules of a member state may not be applied so as to impair.

Convention. In this respect, the Court agreed with the companies that if the claim was a civil matter within Article 1, the application of the rule against enforcing foreign revenue laws would not only impair the effectiveness of the Brussels Convention, but "indeed substantially derogate from it".

(3) Is the rule against enforcing foreign revenue judgments contrary to the EC Treaty?

The companies argued that the rule against indirect enforcement of revenue laws is incompatible with Community law. This argument was not raised in the High Court. It was based on the assumption that the Brussels Convention does not extend to the claim (because it is a revenue matter) and therefore national rules on jurisdiction and enforcement apply. Those rules are subject to the rules of the EC Treaty which is not altered or reduced by the Brussels Convention. The liquidator, it is argued, was seeking to provide a cross-border service protected by Article 59 of the Treaty. That service was the recovery in England of monies owed to Danish companies for which the liquidator is remunerated by the Danish tax authorities. The rule against enforcing foreign tax judgments has the effect of restricting the liquidator's rights under Article 59. Any restriction on these rights must be objectively justified.

For the purpose of this argument, the Court only addressed the question of objective justification, assuming for this purpose the correctness of the earlier aspects of the argument. The question of justification was to be determined by examining the reasoning underlying the rule against enforcing foreign tax claims. The two explanations for the rule as set out by Lord Keith in *Government of India, Ministry of Finance (Revenue Division)* v *Taylor*.[6] One is that enforcement of a claim for taxes is an extension of sovereign power. The second is that a court will not recognise liabilities running in a foreign state, if they run counter to the "settled public policy" of its own. A court should not pass upon the provisions for the public order of another state. It was argued by the companies that the first explanation is a justification for the exclusion of direct enforcement claims. However, in the case of indirect claims, it was agreed that there is no need to scrutinise the Danish tax law and therefore the second explanation does not apply. These arguments were rejected by the Court on the basis that once it is recognised that an indirect claim is caught by the rule, simply because in substance it is a claim brought by a nominee for a foreign state to give extra-territorial effect to that state's revenue law, both explanations apply equally to justify a bar on indirect claims as on direct claims. If the claim that this is a private law claim is rejected, there can be no better reason for allowing indirect claims than direct ones.

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6 [1955] AC 491.

The Court had no doubt on the interpretation of the relevant Community law and therefore felt it unnecessary to make a reference to the European Court of Justice.

The End of the Road

Although the Courts had no difficulty in dismissing the claim and, in particular, rejecting the suggestion that the longstanding rule was amended by the EC Treaty or by the Brussels Convention. Simon Brown LJ acknowledged that within the EU, there may be good arguments for disapplying the rule with regard to both direct and indirect claims, while rejecting the idea that the law currently permitted this. He noted the words of Lord Templeman in *Williams and Humbert Limited* v *W & H Trademarks (Jersey) Limited*[7] where he said: "this rule with regard to revenue laws may in the future be modified by international conventions or by the laws of the European Economic Community in order to prevent fraudulent practices which damage all states and benefit no state".

Within the EU, provision already exists for the collection of unpaid VAT and Customs duties by Council Directives 76/308 and 79/1071. There are proposals to extend this to direct taxation. In addition, more difficult issues arise in relation to indirect enforcement where liquidators act not only on behalf of revenue authorities, but also other creditors (*Ayres* v *Evans*[8]; and *Priestley* v *Clegg*.[9] Within the EU, three member states are parties to the Council of Europe and OECD Multilateral Convention on mutual administrative assistance in tax matters. Thus, even at present, the application of the rule is not quite as absolute as was said to be the case by Lord Templeman in *Williams and Humbert Limited*. Whatever direction is taken, it is unlikely to be broader than it is at present.

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7 [1986] AC 368.

8 (1981) 39 ALR 129 Federal Court of Australia.

9 (1985) (3) SA 950 Transvaal Provincial Division.