# ENFORCEMENT OF FOREIGN TAXES IN THE EC

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## 1 The Mansfield Principle

The traditional rule is that one jurisdiction will not enforce tax debts owed to another. Such rule is sometimes referred to as "The Mansfield Principle", after the eighteenth Century English Lord Chief Justice who enunciated it. It applies even as between different parts of Her Britannic Majesty's possessions. The classic statement in modern English law is to be found in *Government of India v Taylor* [1955] AC 491. As Lord Keith stated, at page 511:

> "enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes, and that an assertion of sovereign authority by one State within the territory of another, as distinct from a patrimonial claim by a foreign sovereign, is (treaty or convention apart) contrary to all concepts of independent sovereignties."

The same applies to indirect claims where the foreign State, or its organ, in form seeks a remedy which is not based on revenue law, but which is in substance designed to achieve the same effect. For example, the rule applies to a claim brought by the liquidator of a foreign company, if the only creditor is a foreign revenue authority (*Peter Buchanan Ltd and Macharg v McVey* noted at [1955] AC 516).

In *QRS 1 Aps and others v Frandsen* [1999] STC 616, the English Court of Appeal decided that the rule survives the United Kingdom's implementation of the Brussels Convention of 27 September 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters.

## 2 The Mutual Assistance ("Recovery") Directive

EC Council Directive 76/308/EEC "on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European agricultural guidance and guarantee fund, and of agricultural levies and customs

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duties, and in respect of value added tax and certain excise duties" ("The Recovery Directive") for many years applied only to the indirect taxes and clawbacks of subsidies mentioned. It appears that it was little used.

The Recovery Directive is to be distinguished from EC Council Directive 77/799/EEC) of 19 December 1977 "concerning mutual assistance by the competent authorities of the Member States in the field of direct and indirect taxation" ("the Assistance Directive") which merely provides for exchange of information.

The Recovery Directive was amended by Council Directive 2001/44/EC ("the Recovery Directive") so as to apply to *direct* taxes.[2] It is now the duty of each Member State of the EC to implement into its municipal law. Unless and until it is so implemented, it is difficult to see how it can have any direct effect in favour of claimant Member States as against the tax debtor.

The Recovery Directive has been transposed into United Kingdom law by Finance Act 2002, section 134 and Schedule 39.

Broadly speaking, the Recovery Directive now requires each Member State to enforce tax debts owed to any other Member State. Hence, a tax debt anywhere in the EC will be of concern to a company if it has assets anywhere else in the EC. Such assets could include *choses in action* and other intangible property, such as bank accounts or securities.

An important – and disturbing feature – of the Recovery Directive is that the *validity* of the tax debt can be challenged only in the Creditor State. This is alarming enough given the present composition of the EC. It will become more alarming still as EC membership is extended to the East. Until recently, if, say, a company with assets in the United Kingdom is served with a spurious tax assessment in an EC State in which it has no assets, it may simply decide not to defend it. The assessment would in time become conclusive under the law of the taxing state but the resulting tax debt would not be enforceable in the United Kingdom. Now, the position is very different. The foreign state can in principle require the United Kingdom Inland Revenue to enforce the debt on its behalf and it is no defence that the assessment was for tax not due.

Given that the effect of the Directive will be limited to assets of the Company which are "in" the EU, one must consider the question of situs of assets, which is a very tricky one. The rules of private international law in this respect are not entirely settled. They are not necessarily the same in every EC State. Moreover, a further complication is that situs rules may vary depending on the legal issue in question. The crucial point may often be whether the "requested authority"can effectively seize assets belonging to the taxpayer.

Both the Directive and the United Kingdom Finance Act 2002 give rise to several difficult points of interpretation. The purpose of this article is merely to point out the

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2 Regrettably, the Books on Screen service has not (as of the October 2002 edition) got round to updating the Directive in line with the 2001 amendments. Similarly, the Directive is misleadingly included in its unamended form in Butterworths Orange Tax Handbook for 2002/03. This error is avoided in the Yellow Book by omitting to include the Directive at all!

structure of each and the major implications for taxpayers.

## 3 Survey of Recovery Directive

### 3.1 Which Taxes are Covered?

Article 2 provides that it applies to, *inter alia*:

> "(g) taxes on capital and income"

Article 3 provides that the phrase "taxes on capital and income" means "those enumerated in Article 1(3) of Directive 77/779/EEC, read in conjunction with Article 1(4) of that Directive". Article 1(2) and (3) of this Directive, i.e. the Assistance Directive, provides:

> "(2) There shall be regarded as taxes on income and on capital, irrespective of the manner in which they are levied, all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the disposal of movable or immovable property, taxes on the amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
>
> "(3) The taxes referred to in paragraph 2 are at present, in particular:
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> ...
>
> in Ireland[3]
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> Income tax
> Corporation tax
> Capital gains tax
> Wealth tax
>
> ...
>
> "(4) Paragraph 1 shall also apply to any identical or similar taxes imposed subsequently, whether in addition to or in place of the taxes listed in paragraph 3. The competent authorities of the Member States shall inform one another and the Commission of the date of entry into force of such taxes."

The Directive would thus apply to Irish income tax or corporation tax on its profits to which a person was held in the Republic to be liable. It would also apply to, say, withholding tax on interest if that could be characterised as "income tax".

### 3.2 Which other debts?

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3 Ireland is taken as an illustration.

The Recovery Directive also applies to "interest, administrative penalties and fines, and costs incidental to the claims referred to in points (a) to (h), with the exclusion of any sanction of a criminal nature as determined by the laws in force in the Member State in which the requested [i.e. the enforcing] authority is situated": Article 2(i).

### 3.3 Notification Procedure

Article 5 provides:

> "The requested authority shall, at the request of the applicant authority, and in accordance with the rules of law in force for the notification of similar instruments or decisions in the Member State in which the requested authority is situated, notify to the addressee all instruments and decisions, including those of a judicial nature, which emanate from the Member State in which the applicant authority is situated and which relate to a claim and/or to its recovery."

### 3.4 Core Provision

The core provision is Article 6, which provides:

> "At the request of the applicant authority, the requested authority shall, in accordance with the laws, regulations or administrative provisions applying to the recovery of similar claims arising in the Member State in which the requested authority is situated, recover claims which are the subject of an instrument permitting their enforcement."

### 3.5 Contested Debts

Article 7(2) contains an important limitation:

> "The applicant authority may not make a request for recovery unless:
>
> > (a) the claim and/or the instrument permitting its enforcement are not contested in the Member State in which it is situated, except in cases where the second subparagraph of Article 12(2) is applied ..."

See also 3.7.

### 3.6 No Contest in Member State of Recovery

Article 8 provides that "the instrument permitting enforcement of the claim shall be directly recognised and automatically treated as an instrument permitting enforcement of a claim of the Member State in which the requested authority is situated".

Alternatively, it can be supplemented or replaced with an instrument authorising enforcement in the territory of the requested authority. This would in the United Kingdom typically be a court judgment.

### 3.7 Contest During Recovery Procedure

Article 12 provides that, should liability be contested once the recovery procedure is under way, that must be in the applicant state. That normally results in suspension of the recovery. However, Article 12.2 provides an exception:

> " ... unless the applicant authority requests otherwise in accordance with the second subparagraph. Should the requested authority deem it necessary, and without prejudice to Article 13, that authority may take precautionary measures to guarantee recovery in so far as the laws of regulations in force in the Member State in which it is situated allow such action for similar claims."

3.8 Freezing Orders and Interlocutory Measures

Article 13 ominously provides:

> "On a reasoned request by the applicant authority, the requested authority shall take precautionary measures to ensure recovery of a claim in so far as the laws and regulations in force in the Member State in which it is situated so permit."

3.9 Limitation

Article 14(b) provides a limitation period of five years – but that is dating from the time tax becomes recoverable in the requesting state. Hence, the law is *prima facie* retrospective in that it applies to enforcing any tax debt in existence, provided the debt itself is not more than five years old: see Article 14(b). Depending on the tax system of the country, the debt could not arise until many years after the relevant income or gains were realised.

## 4 Implementation of Recovery Directive in United Kingdom Law

4.1 Finance Act 2002, Section 134

The Recovery Directive has now been implemented in the United Kingdom. Finance Act 2002, section 134 (Recovery of taxes etc due in other Member States) provides:

> "(1) Schedule 39 to this Act has effect with respect to the recovery in the United Kingdom of amounts in respect of which a request for enforcement has been made in accordance with the Mutual Assistance Recovery Directive by an authority in another Member State.
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> (2) The "Mutual Assistance Recovery Directive" means Council Directive 76/308/EEC, as amended by Council Directive 2001/44/EC.
>
> (3) No obligation of secrecy imposed by statute or otherwise precludes a tax authority in the United Kingdom –
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>> (a) from disclosing information to another tax authority in the United Kingdom in connection with a request for enforcement made by the competent authority of another Member State;

(b) from disclosing information that is required to be disclosed to the competent authority of another Member State by virtue of the Mutual Assistance Recovery Directive;

(c) from disclosing information for the purposes of a request made by the tax authority under that Directive for the enforcement in another Member State of an amount claimed by the authority in the United Kingdom.

(4) In subsection (3) "tax authority in the United Kingdom" means –

(a) ...
(b) the Commissioners of Inland Revenue, or
(c) ...

..."

4.2 Finance Act 2002, Schedule 39

Schedule 39 provides:

"RECOVERY OF TAXES ETC DUE IN OTHER MEMBER STATES

Introduction

1-(1) This Schedule applies where in accordance with the Mutual Assistance Recovery Directive an authority in another Member State makes a request for the recovery in the United Kingdom of a sum claimed by that authority in that State.

(2) In this Schedule –

(a) the "Mutual Assistance Recovery Directive" has the meaning given by section 134; and

(b) the "foreign claim" means the claim in relation to which a request under that Directive is made as mentioned in subparagraph (1).

Enforcement of claims in the United Kingdom

2-(1) Subject to the following provisions of this Schedule –

(a) such proceedings may be taken by or on behalf of the relevant UK authority to enforce the foreign claim, by way of legal proceedings, distress, diligence or otherwise, as might be taken to enforce a corresponding UK claim, and

(b) any enactment or rule of law relating to a corresponding UK claim shall apply, with any necessary adaptations, in relation to the foreign claim.

(2) "The relevant UK authority" means ...

(3) A "corresponding UK claim" means a claim in the United Kingdom corresponding to the foreign claim.

(4) The enactments referred to in subparagraph (1)(b) include, in particular, those relating to the recovery of penalties and of interest on unpaid amounts.

Power to make supplementary provision by regulations

3...

4-(1) Except where permitted by virtue of regulations under paragraph 3(4) applying an enactment that permit such proceedings in the case of a corresponding UK claim, no proceedings under this Schedule shall be taken against a person if he shows that proceedings relevant to his liability on the foreign claim are pending, or are about to be instituted, before a court, tribunal or other competent body in the Member State in question.

(2) For this purpose proceedings are pending so long as an appeal may be brought against any decision in the proceedings.

(3) Proceedings under this Schedule may be taken if the proceedings in the Member State are not prosecuted or instituted with reasonable expedition.

..."

4.3 Comment

It will be appreciated that the United Kingdom has arguably not totally implemented the Directive, especially so far as concerns enforcement of contested claims.

## 5 Forestalling

How to forestall the application of the Recovery Directive to the taxpayer, particularly a company, is a very delicate question, on which input from insolvency, company and criminal, as well as tax, barristers, would be helpful. *Prima facie,* the Company should ensure that it has no assets in any relevant EC jurisdiction which can be seized. There is always the possibility of a "freezing order" being made against the taxpayer, preventing it withdrawing such assets as are currently situate in the State of enforcement or intended enforcement.

Care would have to be taken lest it were alleged that those involved in removing the assets of the Company from, say, the United Kingdom jurisdiction were guilty of some crime.

One would also have to consider general insolvency legislation.

A re-structuring of the taxpayer's business might be required to ensure that it was carried on as effectively as before without exposure to foreign tax claims.

## 6 Tax Indemnities

It is a moot point whether, before the 2001 amendments to the Recovery Directive, a right of indemnity given by a state to a person to recover from a third party taxes which he had been compelled to pay to it would be enforceable in a foreign jurisdiction. The question has arisen in particular with regard to the indemnity given by United Kingdom law to the settlor of a non-UK resident trust who has been compelled to pay capital gains tax in respect of capital gains realised by the trustees. While my own view is that such an indemnity would not in general be enforceable in a foreign state which had adopted the Mansfield Principle, that view is far from being universally accepted.

One only complication arises from the certain *dicta* of Lord Mackay in the House of Lords in *Williams & Humbert Ltd v W & H Trade Marks (Jersey) Ltd* [1986] AC 368. The case concerned an action for breach of fiduciary duty on the part of a company the shares in which had been seized by the Kingdom of Spain. The claim had existed before the seizure. The House of Lords held that this was not a claim for the enforcement of foreign taxes or to give effect to a penal confiscation. That was the *ratio* of the case and was, with respect, obviously right on the state of the authorities.

Lord Mackay stated, *obiter*, at 440H-441A:

> "Having regard to the questions before this House in *Government of India v Taylor* [1955] A.C. 491, I consider that it cannot be said that any approval was given by the House to the decision in the *Buchanan* case except to the extent that it held that there is a rule of law which precludes a state from suing in another state for taxes due under the law of the first state. No countenance was given in *Government of India v Taylor*, in *Rossano's* case [1963] 2 Q.B. 352 nor in *Brokaw v Seatrain U.K. Ltd* [1971] 2 Q.B. 476 to the suggestion that an action in this country could be properly described as the indirect enforcement of a penal or revenue law in another country when no claim under that law remained unsatisfied. The existence of such unsatisfied claim to the satisfaction of which the proceeds of the action will be applied appears to me to be an essential feature of the principle enunciated in the *Buchanan* case [1955] A.C. 516 for refusing to allow the action to succeed."

It has been suggested that these *dicta* may mean that where a foreign Revenue authority extracts tax from a person such as an agent of a non-resident (or the settlor of a non-resident trust) and gives the person who has been compelled to pay the tax a statutory right of indemnity against the principal (or the trustees), then there is no reason why a foreign court should not enforce it, as there is no "unsatisfied claim" by the Revenue. See, for example Leon Sartin's article *Tax Recovery Claims by the Settlor* in *The Personal Tax Planning Review* Volume 6 Issue 3. My own view is that this is a mis-reading and that Lord Mackay would be very surprised if his *dicta* were so interpreted. For the whole rule in *Government of India* would be subverted if governments could simply make a local person liable and then leave him to claim an indemnity abroad.

In *QRS 1 Aps and others v Frandsen* [1999] STC 616, the English Court of Appeal followed *Buchanan*, having taken into account Lord Mackay's dicta. Simon Brown LJ in the Court of Appeal said:

> "It is a fundamental principle of English law that our courts will not directly or indirectly enforce the penal, revenue or other public laws of another country (see r 3 of *Dicey and Morris on the Conflict of Laws* (12th edn, 1993) Vol 1 p 97 and the comment upon it in that work)."

In my view, the Recovery Directive does not assist a person who has been given a tax indemnity. It applies only to direct claims by Member States.

**Conclusion**

Honest taxpayers dealing with honest, reasonable, efficient and fair jurisdictions within the EC will have little to fear from the new provisions. They of course will, from time to time, experience in a magnified form the type of hassle currently identified with defending un unjust claim by their local Revenue authorities. Some wily persons established outside the EC will no doubt develop strategies which ensure that they hold assets in the EC only indirectly in such a way that they cannot be seized. Others may decide simply to remove their assets from the EC altogether. Once again, countries like the United Kingdom, which attract international investment because of the integrity of their institutions will suffer because of the dishonesty of some of the citizens of our EC partners.