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Retroactivity of tax legislation

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tary justification, such as the legitimacy of expectations as well as the good faith of both the authorities and the taxpayers. The legislator, when intervening in pending legal proceedings, should also act as a prudent lawmaker, following a scrupulous legislative process based on sound facts and figures which illustrate the risks and financial consequences were the act to not be validated.

2.4.
Legislation 'by' press release: the role of announcements in the debate about retroactive tax legislation

Johanna Hey

2.4.1. What is meant by the term 'legislation by press release'?

Legal restrictions on retroactive tax legislation are based on the rule of law[1] and the principle of legal certainty and predictability of the tax burden. From a normative perspective the tax burden is predictable if the underlying tax statutes are published in the official law gazette. However, this is only the last step in the law-making process. The change of the tax legislation starts to be visible during the first discussions and resolutions in cabinet or even earlier during a public debate about the need of a reform of the law. From that moment an alert taxpayer can sense that the law may change. Is it then 'fair' to insist that the new law may be applied only to transactions which take place after the law-making process is formally completed by the promulgation of the new law?

Enactment of tax increases from the date of their prior announcement is a very common practice of retroactive tax legislation. It is noted in all national reports. However, the concrete way in which 'legislation by press release' is carried out and the (scientific) appraisal of this practice differ significantly[2].

The question discussed below is whether announcements of forthcoming amendments are able to destroy the taxpayer's confidence in the prevailing legal situation, and whether the tax legislator is justified in going back to the date of the announcement the application of new tax laws.

Hence, the problem addressed by the term 'legislation by press release' is *not* a replacement of the formal legislative procedure. There is no doubt that the law needs to be promulgated in the required means of publication in order to come into force. However, if the tax legislator is allowed to apply a new tax statute from the date of its (first) announcement the announcement has the *effect* of replacing the existing law.

I will deal only with announcements in the case of an aggravation of the tax burden, excluding the practice of announcements of changes in favour of the taxpayer, as is used for example in France[3]. Announcements can be utilized in the implementation of new tax incentives to induce the intended behaviour even before the legislative procedure is concluded and the new law is promulgated. One might object to such a procedure in respect of the principle of equal treatment, because only a well-informed taxpayer is able to make use

1. See F. Vanistendael, in: V. Thuronyi, ed., *Tax Law Design and Drafting*, Vol. 1 (Washington: IMF, 1996), Chapter 2, at p. 25; and at length C. Sampford, *Retrospectivity and the Rule of Law* (Oxford: Oxford University Press, 2006).
2. See general report, section 3.1.
3. See national report of France, section 3.1.

of the incentive in advance of the legislative procedure. However, with regard to legal certainty and the protection of the taxpayer's confidence in the existing legal situation this category of 'legislation by press release' does not raise significant concerns[4].

2.4.2. Interdependency between the distinction between retroactivity and retrospectivity and the announcement

I will not deal with the concept and the distinction between retroactivity and retrospectivity and with the controversy between the 'tax-period related' and the 'taxable-event related' distinction between the two categories of retroactive legislation either[5]. This issue has to be discussed apart from the question whether an announcement can lessen the confidence of the taxpayer and gives the legislator legitimate reasons for making statutes retroactive to the date of their announcement.

However, there is an interdependency between the kind (intensity) of retroactivity and the question whether the tax legislator can lower the taxpayer's confidence by announcement. Announcements cause visible insecurity. If the line between retroactivity and retrospectivity is drawn mainly at the point whether the taxable event is already fully realized before the change takes place, it implies that in cases of retroactivity the taxpayer has no chance to react to the change of the law, whilst in cases of restrospectivity he might be able to at least partially adjust his behaviour.

For example, a taxpayer who only concluded a contract under the former law might be able to either insert right from the beginning a clause protecting himself from changes of the law or at least he can try to renegotiate the contract as soon as a change of the tax conditions is announced. In contrast, once the transaction is executed there is no longer any chance to deal with the insecurity and to react to an announcement.

Furthermore, the taxpayer might be tempted to secure advantages which are announced as going to be abolished just by signing contracts in the expectation that the tax legislator will issue a grandfathering rule for all contracts concluded and transactions started, but not finished, before a certain date. Often it will not be possible to carry out the whole transaction before the expected change. In this situation the legislator might be justified setting as cut-off date not the date of the promulgation but the date of an earlier announcement. This explains why announcement and grandfathering are closely related.

However, regarding both categories of retroactivity the concerns are based on the protection of the taxpayer's confidence. The only difference is that such confidence might deserve a higher protection from retroactive than from retrospective changes. Therefore, the relevance of the category of retroactivity for the assessment of the effect of announcements is only gradual but not categorical.

2.4.3. What is meant by 'press release'?

A change of the law can announce itself in many different ways. Early signs of a reform can be a change of a constant jurisprudence, a court demanding a reform[6] or a public debate on the need for a change in the law. However, from these signs it will be very difficult to judge, *if*, *when*, and *how* the law will change. More certainty is given by an official press release which can be published either by the parliament (the legislator itself) or by any

4. Similarly C. Sampford, *Retrospectivity and the Rule of Law* (Oxford: Oxford University Press, 2006) at p. 118.
5. See general report, section 1.2.
6. E.g. judgment of the Bundesfinanzhof (German Supreme Fiscal Court) of June 30, 2010, reference number II R 60/08, www.bundesfinanzhof.de, claiming the need of a reform of the German land tax which was held to be unconstitutional from years later than 2006.

other party involved in the law-making process, as, for example, the State Secretary of Finance in the Netherlands[7]. However, since not all legal systems know such an instrument of announcement by formal press releases, below I will look at the topic from a broader perspective and will deal with all kinds of announcements not only official press releases.

2.4.4. Role of Publication

The characteristic of retroactivity until the date of announcement is an enactment of the law prior to its publication, 'replacing' the publication as date of effectiveness by a date of announcement. Therefore it is necessary to deal with the role of the publication of laws.

Publication of laws is an indispensable element of legal systems governed by the rule of law. Legitimacy of the law and legal certainty can only be guaranteed if the law applied is published in a way accessible to everyone. Publication means the opposite of an arcane society where the citizen does not know in advance as to which event the state will threaten him.

Observing the – usually constitutionally provided – legislative procedure, including the promulgation as a final act, is also a question of the separation of powers[8]. An announcement of the tax authorities can never overrule the prevailing tax legislation enacted by the parliament. If an announcement of the tax authorities already has far-reaching legal consequences, the legislator is in the position of just confirming what the executive proposed without the option of deciding differently after the parliamentary debate[9].

Despite this normative concept of publication, one could argue that the taxpayer usually does not study the official law gazette, but gets his information about changes of the law from all kinds of other sources, namely from the press and media. It might be an overstated formalism to insist on the publication in the official law gazette.

Nevertheless, in my view there are quite a few important arguments why the promulgation in the relevant law gazette has to be the demarcation line for the protection against a worsening of the tax burden.

Insisting on the promulgation in the required way is not a mere formalism, because the official law gazette is the only reliable source for getting information about what the law at present asks of the citizen. No other source can claim the same reliability.

Moreover, every taxpayer has equal access to the official law gazette, whereas it is unclear in which way an announcement will be disseminated. There is no legal obligation to read a certain newspaper or to contact internet resources. Therefore, it is also a matter of equal treatment to refer only to the official law gazette. Otherwise there will always be some taxpayers who are better informed than others. The tax planning industry in particular is usually equipped with best contacts to the law-making institutions. They may be warned at an early stage of an upcoming abolishment of a tax incentive, which gives them the ability to adjust their strategies, whilst the 'normal' taxpayer will be caught off guard. This begs the question of whose capacity to take note is relevant. The German Constitutional Court pointed out that the taxpayer – at least in matters of substantial economic effect – normally would have recourse to professional advice anyhow, and that professionals also have to carefully follow upcoming legislative initiatives[10]. However, in my view one should take the

7. See general report, section 3.1 and national report of the Netherlands, section 2.2 and 3.1.
8. Sampford, supra note 1, at p. 158 and p. 160, furthermore see with regard to the importance of the separation of powers Vanistendael, supra note 1, Chapter 2, at p. 16.
9. Sampford, supra note 1, at p. 158 and at p. 161.
10. Judgment of the Federal Constitutional Court 7 July 2010, reference number 2 BvL 1/03, www.bverfg.de/entscheidungen/ls20100707_2bvl000103.html, at marginal no.74.

normal taxpayer's chances to get information into account. He is the addressee of the tax obligation, and there is no obligation for everyone to have a tax advisor.

Finally, until the promulgation the taxpayer has no guarantee that the change will actually take place in the way it is announced. Depending on the legislative procedure of the particular country, even at a late stage of the legislative proceedings the bill can fail to obtain the necessary consent. In case the change does not take place as announced the taxpayer is not protected, and he cannot claim damages. His confidence in the draft bill is not protected.

Consequently, from the constitutional role of the promulgation follows the *normative statement* that the taxpayer's expectations to be burdened only in accordance to the law and how it is published in the official law gazette, is *always* legitimate. Allowing the legislator to go back to a date before promulgation *without justification* would undermine the role of publication.

2.4.5. The need for justification of retroactive enforcement until announcement

Consequently, no matter what the quality of the specific announcement the tax legislator *always* needs a justification for making tax statutes retroactive to the date of their announcement.

In the balancing process of the justification one has to distinguish two aspects:
- the means and legal quality of the announcement and
- the reasons of the tax legislator for going back to the announcement date.

Both aspects are interdependent with each other. The more vague the announcement is the stronger the reasons needed by the tax legislator. On the other hand, if the taxpayer knows for sure not only *that* the law will change but also *how* it will change, the legislator might need less strong reasons for the retroactivity.

In some countries, it is getting to the point where the legislator does not need any further justification to go back to the date of announcement if the announcement meets certain requirements.

The Swedish constitutional statute 'Instrument of Government'[11] for example explicitly provides for a ban on retroactive tax legislation. At the same time it provides for an exception to this ban if either the government or a committee of the parliament submitted a proposal to the parliament, or even earlier, if the government sends a written communication to the parliament announcing the forthcoming introduction of such a proposal[12]. In this concept, application of a law from the date of the governmental communication is considered real/formal retroactivity, but *not* a *prohibited* one.

Similarly, the German Constitutional Court in its settled case law denies a need for a special justification for the period between adoption of a bill in parliament and promulgation[13]. The tax legislator therefore frequently makes amendments applicable from the date of their adoption in parliament. After adoption in parliament, one could argue that the democratic procedure has taken place. Nevertheless, the court's practice has been criticized[14], because in the field of taxation adoption in parliament is just an intermediate

11. Regeringsformen (1974:152).
12. See in detail the Swedish report, A.Ia and B.8.
13. See e.g. Federal Constitutional Court Judgment of 14 May 1986, reference number 2 BvL 2/83, *BVerfGE* 72, at pp. 200.
14. J. Jekewitz, 'Der Zeitpunkt wirksamer Zerstörung des Vertrauensschutzes bei rückwirkenden Rechtsnormen', *Neue Juristische Wochenschrift* (NJW) 1990, at p. 3114ff, at p. 3118ff); E. Henseler, 'Vergütung von Vorsteuerbeträgen an nicht im Gemeinschaftsgebiet ansässige Unternehmer unter Berücksichtigung des Jahressteuergesetzes 1996', *Der Betrieb* (DB) 1996, p. 2152ff, at p.2153); J. Lang, 'Verfassungsrechtliche Zulässigkeit rückwirkender Steuergesetze', *Die Wirtschaftsprüfung* (Wpg.) 1998, at p. 163.

stage. For most tax laws the Federal Council has to agree; otherwise the new law fails. Thus, also after adoption in parliament it is not sufficiently clear whether and how the amendment will finally be enacted. Despite this criticism, in a recent decision the Constitutional Court has taken into consideration an even earlier date: From the moment of the tabling of a bill in parliament the taxpayer may not any longer count on the prevailing legal situation; he may not rely on the fact that the law will remain unchanged[15].

Yet, in my opinion, even if it does not need any other legislative act, the date of adoption in parliament cannot replace the official promulgation because it might be difficult or at least less easy to get to know the actual content of the adopted bill other than from the law gazette. In these cases as well an exception to the justification requirement cannot be accepted. The legislator may need less weighty reasons for the retroactive application. However, there is also no reason to give the legislator dispensation from the general rule that the earliest date of application of a new law is the date of promulgation. Otherwise the promulgation loses its guarantee function.

2.4.6. The weighting process

2.4.6.1. Quality of the announcement

a. Categorization by originator and content

The quality of the announcement can be categorized from the viewpoint of the separation of powers, taking into account the originator of the announcement, which can be a private institution (e.g. private media, scientific organizations), a member of the executive (e.g. the cabinet, ministry of finance, tax administration) or a legislative organ (parliament, Federal Council/Senate). From the viewpoint of the separation of powers an announcement by the parliament should rank higher than one from the executive. One could make an objection because in most countries due to the high technicality of tax statutes the parliamentary law-making process is greatly influenced by the tax administration, one could almost say they 'make' the law[16]. Therefore, the executive – unlike a private institution – is a reliable and competent source of information about upcoming changes in the tax law. However, from the viewpoint of the separation of powers it *does* make a difference whether a member of the executive or the legislator announces an envisaged change of the legislation.

Another way to categorize the announcement can be more content-wise, based on the criteria whether the change of the law *and* the retroactive effect is announced in a way that the economic operators are 'enabled to understand the consequences of the legislative amendment planned for the transactions they carry out'[17]. In *Stichting Goed Wonen II* the European Court of Justice emphasized that the announcement (in the case at hand a press release) needs to be clear, and that there were no substantial changes and amendments during the passage of the legislation. In this context one should be distinguish between announcements which only involve the envisaged change of the law, and announcements which also already announce the retroactive application of the new law.

Especially if the announcement is published at an early stage of the reform process, its content will normally be quite vague. It will just say *that* the law will change but not *what* the new law will look like, or at least will not render the exact content of the new law, or the

15. Judgment of the Federal Constitutional Court 7 July 2010, reference number 2 BvL 1/03, www.bverfg.de/entscheidungen/ls20100707_2bvl000103.html, at marginal no. 74.
16. See in detail to the interdependences in the legislative process between the legislative and the executive A. Dourado, General report, in: A. Dourado, ed., *EATLP International Tax Series. Separation of Powers in Tax Law*, Vol. 7, 2010, at pp. 29-37 and the national reports.
17. See ECJ, 26 April 2005, Case C-376/02 *Stichting Goed Wonen II*, [2005] ECR-I-03445 summary No. 2 and at p. 45.

exact date of its first application[18]. Vague announcements condemn the taxpayer to inactivity[19]. He can act neither on the grounds of the prevailing law, nor on the grounds of the new law. The law is not longer capable of guiding the taxpayer's behaviour. Published insecurity may not be confused with legal certainty as guaranteed by the rule of law. Only after the bill is drafted and the draft has been published will the taxpayer get a sufficient base to determine the tax consequences of his economic activities under the new law – as already mentioned, always with the risk that the proposed change might substantially change during the legislative procedure or even fail totally.

The national reports show that it is not possible to generalize at what stage of the legislative procedure announcements have the capability of weakening the taxpayer's confidence significantly or even destroying it, because it depends on the structure of the legislative procedure. Apparently in some countries there is an almost official procedure of announcement by press releases and communiqués of the tax authorities[20]. In other countries it is less clear which pre-legislative step will be regarded as having an announcement effect. Certainly, the adoption of the bill in parliament is an important step. However, its recognition depends on the specific parliamentarian system; it has less weight if the bill needs to be adopted not only in parliament but also in a second chamber (Federal Council/Senate).

But even beyond the differences in the constitutional legislative procedure, the political culture of tax legislation can also differ quite a bit from country to country[21]. There are apparently countries where bills drafted by the executive will normally pass the legislative procedure without significant amendments. In such a country, after publication of the final draft of the bill, the taxpayer knows not only that the law may change, but furthermore he also gets quite reliable information as to how the change will take place. If he carries out transactions according to the draft bill the risk that the change might not take place as proposed is reasonably low. In contrast, in a country like Germany with a two-house system, especially in situations of diverging political majorities between the two houses it is quite unclear how the draft bill will come out of the procedure. The more groups involved in the legislative process, the more likely it is that there might be major changes of the amendment during its passage through parliament.

It may also depend on the tax policy style of the governmental branch that is proposing the first draft of the bill, most often the ministry of finance. The ministry may come up right away with a reasonable and balanced proposal, which increases the chance that the draft will be accepted without major amendments. However, in a tense atmosphere between the ministry and the taxpayer the first draft may be unreasonably strict just to give the legislator a bargaining chip in the following discussions with all kinds of lobby groups.

b. Relevance of possible adjustments of behaviour to the changed legal circumstances

One important aspect in the approach of the German Constitutional Court towards retroactivity until the date of announcement is the idea of transferring the legal insecurity to the level of the parties to the transaction. In a recent decision on the abolishment of the favourable tax treatment for redundancy pay-outs the Constitutional Court suggests that from the moment the parties to the contract know about the risk of a change (in the decided case: the

18. Regarding the problem of a 'lack of precision' of the announcement see also Sampford, *supra* note 1, at p. 158.
19. Sampford, *supra* note 1, at p. 158 seems to have no problem with the fact that in these cases the taxpayer has to be cautious.
20. See national report of the Netherlands, section 3.1.
21. See the comparative analysis by Gordon/Thuronyi, *Tax Legislative Process*, in: V. Thuronyi, ed., *Tax Law Design and Drafting*, Vol. 1 (Washington: IMF, 1996), at pp. 1-14.

tabling of the draft bill in parliament) they should negotiate revision clauses[22]. The Court specified, that especially in long-term contracts, the parties should negotiate clauses to share the risk of future tax aggravations. However, the taxpayer will only negotiate such clauses if he is aware of the change, which again is linked to the quality of the announcement and the question whether it is disseminated in a way that a broad public is able to notice it.

c. Announcements in connection with a change in the case law

A special problem with announcements can be found in cases of a 'non-validation' law, if the tax legislator wants to react to a change of the case law by 'overruling' the court decision[23]. In this situation the tax authorities often announce right away that the new (advantageous) case law will not be applied in other cases and that the former (disadvantageous) case law will be (re-)enforced by a legislative act. The retroactivity in this situation is defended on the grounds that the taxpayer is not able to build up trust in the new legal situation created by the tax courts if parallel to or shortly after the publication of the new court decision the restoration of the status quo ante is announced[24].

The categorization of this kind of announcement is closely related to the concept and function of the judicial decision making: Is it creating new law or just interpreting what the law always was? In the latter case it cannot be argued, that the taxpayer cannot built up confidence by relying on the new court practice because actually he is not relying on the court practice but on the law as it it always was, and only now has been understood correctly by the courts. If one takes the opposite position, that the new court decision has law-creating effect and is changing the legal situation, one could argue that the announcement is only continuing the legal situation as it was before the change in the court practice. In this case there are indeed no grounds for confidence in the new advantageous rule if the restoration of the former practice is announced right away. However, also taking this view, it should be pointed out that the announced change has to exactly resemble the former case law, and may not contain any more burdensome beyond the former court practice.

2.4.6.2. Reasons for the retroactivity

Looking at the reasons of justification we have to distinguish between the legitimacy of the given reason of justification as such, its weightiness, and the question whether the retroactivity is suitable to meet the aims of the tax legislator. In the following I will deal only with reasons of justification connected to the fact that the change was announced which means that the taxpayer had the chance to adjust his behaviour to the forthcoming worsening of the tax burden.

The announcement as such cannot be equated with the justification of retroactivity[25]. Basically there is only one serious reason for enactment back to the date of announcement: That is the avoidance of announcement effects, whereas it is far from clear what is meant by an 'announcement effect'. Almost every change of the legal situation affects the taxpayer's behaviour, and any reaction to a proposed aggravation of the tax burden has an effect on the tax revenue. If the tax legislator manages to blind-side the taxpayer, he will

22. Judgment of the Federal Constitutional Court 7 July 2010, reference number 2 BvL 1/03, www.bverfg.de/entscheidungen/ls20100707_2bvl000103.html, at marginal no. 74.
23. See general report, section 1.7.
24. See judgment of the German Federal Constitutional Court (BVerfG) of 23 January 1990, reference number 1 BvL 4/87, *BVerfGE* 81, at p. 228 (239).
25. See above 5.

enjoy the full tax plus from the moment of enactment. Nevertheless, *mere* budget effects cannot be considered to be an announcement effect justifying retroactivity[26].

However, particular announcement effects might occur especially in fields of tax minimization:

- by making use of tax expenditures or
- by making use of loopholes of the law.

On the one hand, if an investment's economic success relies on a tax subsidy or the exploitation of a loophole the tax planning industry will aggressively try to safeguard its advantages before the new law comes into force. The announcement might induce a heavy rush for the tax incentive. Especially where tax avoidance is concerned the announcement can act like an 'invitation' to exploit the loophole as long as it is still possible. From the perspective of the fairness of the tax system it is difficult to accept that a group of taxpayers makes use of unjustified tax advantages and might even keep them for the future; nonetheless, the tax legislator changes the law.

Furthermore, announcement effects can result in economic distortions. The German Constitutional Court – in a judgment regarding the retroactive abolishment of shipbuilding subsidies[27] – considered the risk of overcapacities in the shipping area because of last-minute investments to be a sufficient reason for setting the cutoff date even earlier than at first announced[28]. The reasoning of the Court was not fully convincing because the German legislator knew for years about the overcapacities, but delayed starting the legislative procedure. It also was questionable whether denying the incentive to shipbuilding contracts concluded before the promulgation could really solve the overcapacity problem, at least not if they were carried out the way they were concluded. By including such contracts the tax legislator counted on the expectation that the parties would either renegotiate the already concluded shipbuilding contracts or would fail to fulfil them.

In the case of the retroactive closing of loopholes there are two different aspects of justification: One is that the confidence in a loophole might be considered not worthy of being protected. However, this argument does not necessarily corresponding to the announcement and would justify even a retroactive period further back than the announcement. The other aspect related to the announcement is that loopholes are often exploited by the contractual design of a transaction and that taxpayers who make use of the loophole react especially sensitively, one could even say aggressively, if their business models are jeopardized by a possible change of the tax law. Therefore, they might try to preserve their former tax advantages by last minute contracts on a grand scale.

On the other hand, the legislator is responsible for abolishing tax subsidies, avoiding loopholes, and closing existing loopholes as soon as possible. The longer it waits to start the legislative procedure the less plausible the need of retroactive legislation becomes. But even if he starts the legislative initiative right away, the procedure to bring the bill through the legislative organs can be quite time-consuming especially if the change is controversial. This may motivate the legislator to take a short cut by enacting the law with effect from the

26. See also judgment of the Federal Constitutional Court 7 July 2010, reference number 2 BvL 1/03, www.bverfg.de/entscheidungen/ls20100707_2bvl000103.html, marginal no. 82.
27. Judgment of the Federal Constitutional Court of 3 December 1997, reference number 2 BvR 882/97, *BVerfGE* 97, at pp. 67; see the detailed review of this decision J. Hey, 'Die rückwirkende Abschaffung der Sonderabschreibung auf Schiffsbeteiligungen', *Betriebs-Berater* (BB) 1998, at pp. 1444.
28. In the case at hand, the tax legislator really aimed to blind-side the taxpayer. The Cabinet decided to abolish the tax incentive for the shipping industry on 25 April 1996 and announced in a press release of the same day that this should apply for all contracts concluded after 30 April 1996. In the final bill the cut-off date was 25 April 1996. The Constitutional Court did not grant protection of the confidence in the announced cutoff date, because within these five days between the 25th and the 30th a real rush for ship building contracts took place.

beginning of the procedure[29]. However, if a tax change does not tolerate any delay, then the legislator has to accelerate the procedure within the constitutional boundaries. If it excessively delays the procedure the need for retroactive enactment from the announcement becomes less reasonable[30].

In my opinion, economic distortions, which can justify a retroactive enactment from the date of announcement, have to be seen apart from the lost tax revenue, which is due to last-minute transactions if the transaction as such has no immediate negative effect on the economy. For example, a looming increase in the inheritance tax usually gives rise to a flood of anticipated successions. As a result of such transfers the increase of revenue will be lower after the increase of the inheritance tax than without these transactions. However, I cannot see a distortive effect which would harm the national economy apart from the budget effects. If we do not clearly limit the justification to avoid announcement effects to distortions other than the loss of revenue, retroactive enactment from the date of announcement would become the rule instead of a rare exception.

29. Sampford, *supra* note 1, at p. 157.
30. Sampford, *supra* note 1, at p. 158 and at p. 161.