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Retroactivity of tax legislation

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Table of contents

Summary

Preface  
About the authors  
List of abbreviations  
List of Tables

Part 1
General report
Hans Grubinou and Melvin Puuwels

Part 2
Special topics

2.1. Legal certainty: a matter of principle  Hans Grubinou

2.2. Retroactive and retrospective tax legislation: a principle based approach; a theory about ‘priority principles of transition law’ and ‘the method of the catalogue of circumstances’  Melvin Puuwels

2.3. Retroactive interpretative statutes and validation statutes in tax law: an assessment in the light of legal certainty, separation of powers and the right to a fair trial  Bruno Peeters and Patricia Popelier

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

2.5. The law and economics approaches to retroactive tax legislation  Charlotte Crone

2.6. It's the outcomes, not the rules – transition issues in the process of tax reform  Henk Vording, Koos Boer and Allard Lubbers
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 role of law 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.

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. 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

2. See recent report, section 3.1.
Hey

other party involved in the law-making process, as, for example, the State Secretary of Finance in the Netherlands. 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. An announcement of the tax authorities can never override 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.

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 over-stated 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.

Consisting 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. However, in my view one should take the

5. See general report, section 2.2.
6. E.g. judgment of the Bundesfinanzhof (German Supreme Fiscal Court) of June 20, 2009, reference number 1 B 8/08, 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.

Part 2. 2.4. Legislation 'by' press release - 2.4.4.
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
- 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 taxayer 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’ 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.11 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 promulgation12. 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 criticized13, because in the field of taxation adoption in parliament is just an intermediate

12 See e.g. the Swedish report A.9a and 8.8.

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 earlier date. From the moment of the tabling of a bill in parliament the taxayer may not any longer count on the prevailing legal situation; he may not rely on the fact that the law will remain unchanged14.

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 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 law15. 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"16. In Stichting Good Women 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 not will not render the exact content of the new law, or the
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Table 2: Legislation by press release - 2.4.6.2.

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

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 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. 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 correspond 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 beginning of the procedure. 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.

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 investments 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.

28. See also judgment of the Federal Constitutional Court 7 July 2010, reference number 2 BvL 1/10, www.bverfg.de/entscheidungen/7/2010/0727/2vbl1001100031mdm, marginal no. 82.
30. 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 cut-off date, because within these five days between the 25th and the 30th a real rush for shipbuilding contracts took place.