



UPDATE 11

MALTA TAX LAW UPDATE

EDITOR'S NOTE

A Budget Bill, two new treaties, a major reform to the VAT penalty system, a CJEU judgement on exit taxation, major judgements on taxation and human rights and ten judgements of the ART. It looks like it is going to be a very busy year. All the ART's main judgements for this quarter are subject to appeal. Discussing them at this stage would be out of place. A propos of the ART's judgements, the ART was asked to adjudicate over an issue over Article 56 (17) ITA. The case highlights the level of uncertainty surrounding 56 (17) ITA and leaves the industry's questions unanswered. How is one to interpret the phrase 'wholly or mainly outside Malta'?

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03/02/14

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1. LEGISLATIVE DEVELOPMENTS

1.1 ACTS OF PARLIAMENT

1.1.1 AMENDMENTS TO THE ITA

None.

1.1.2 AMENDMENTS TO THE ITMA

None.

1.1.3 AMENDMENTS TO THE DDTA

None.

1.1.4 AMENDMENTS TO THE VATA

ACT No. XIV of 2013

This Act reforms the whole tax penalty system.

The rate of interest on late payment of VAT has been changed from 0.75% per month to a rate which the Minister shall, from time to time, by regulations prescribe for each month or part thereof.

Limitations on the maximum amount of additional tax have been introduced too. When the excess, if any, of the output tax over the deductions for the first tax period following registration is two thousand euro (€2,000) or less, the administrative cannot exceed two €250. When the excess of the output tax over the deductions for the first tax period following registration is more than €2,000 such administrative penalty cannot exceed twenty per cent of such excess.

Another important amendment refers to Court of Magistrate's power relating to VAT infringements. The Court has the power to order a convict to adhere to the law and in case of non-compliance an effective prison term is semi-automatic. The Court of Magistrate's power to issue such an order has been confined to the non-filing of a VAT return. The daily fine for non-adherence has been reduced from a maximum of €20 per day to €5 per day.

The last article of the Act provides that the beneficial amendments introduced will have retrospective effect.

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1.2 LEGAL NOTICES

L.N. 25 OF 2013 INCOME TAX ACT (CAP. 123) DOUBLE TAXATION RELIEF (TAXES ON INCOME) (THE KINGDOM OF SAUDI ARABIA) ORDER, 2013

This L.N. transposes the new Treaty with Saudi. Clauses which caught my attention include the following:

- a) The Treaty provides for a services PE but only where activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 6 months within any 12-month period;
- b) The rules on the attribution of income to a PE provide for deduction restrictions on IP and interest expenditure;
- c) The article on Shipping and Air Transport provides that taxation shall occur in the country of effective management and control exclusively proceeding to define profits by the article as including rental income and income from bareboat charter;
- d) Dividends paid by a company which is a resident of the Kingdom of Saudi Arabia to a resident of Malta who is the beneficial owner thereof, the tax so charged in the Kingdom of Saudi Arabia shall not exceed 5 per cent of the gross amount of the dividends;
- e) Income from debt-claims are on taxable in the state of residence;
- f) Royalty income can be taxed both in the source state and the residence state but maximum rates of withholding tax are imposed on the source state (5% for the use of, or the right to use, industrial, commercial, or scientific equipment 7% for all other cases);
- g) The Treaty contains the 'old' article on Independent Personal Services;
- h) Pension income is taxable only in the state of residence;
- i) The Protocol to the Treaty explains that the term 'resident' includes a pension scheme and a philanthropic organisation;
- j) The Protocol provides for a residual tax of 5% in the source state on PE profits.

L.N. 361 OF 2013 INCOME TAX MANAGEMENT ACT (CAP. 372) REMISSION OF INTEREST RULES, 2013

This important Legal Notice implements the decision to reduce interest on late payment of tax. The LN provides that:

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- a) The Commissioner may, at his discretion, remit wholly or in part, any interest chargeable;
- b) The Commissioner may only remit such interest if he is satisfied that the tax due was not paid within the prescribed period due to a reasonable cause but reliance placed on any other person to perform any task is not considered to be a reasonable excuse;
- c) The Commissioner has the right to subject the remission of interest to conditions;
- d) The L.N. provides that Commissioner's discretion to remit interest shall not be questioned in any appeal but we know that in this country the administration is always subject to judicial review;
- e) Interest chargeable on the amount of tax payable under a payment plan not exceeding two years is suspended from the date a person enters into such payment plan;
- f) Tax due can be set-off against any refund payable.

L.N. 393 OF 2013 DUTY ON DOCUMENTS AND TRANSFERS ACT (CAP. 364)

This Legal Notice implements the Budget measure relating to a duty exemption with respect to properties acquired by first time-buyers. The exemption applies only to transfers executed in 2014. Of course, the duty exemption applies only to the first EUR150,000.

L.N. 422 OF 2013 VALUE ADDED TAX ACT (CAP. 406) VALUE ADDED TAX ACT (AMENDMENT OF FIFTH SCHEDULE) (AMENDMENT NO. 2) REGULATIONS, 2013

This L.N. adds 'Yogurt or similar products' to item 2 of Part Five of the Fifth Schedule (the definition of 'food supplied in the course of catering').

L.N. 447 OF 2013 INCOME TAX ACT (CAP. 123) DOUBLE TAXATION RELIEF (TAXES ON INCOME) (BARBADOS) (AMENDMENT) ORDER, 2013

This amendment order provides for enhanced exchange of information with Barbados.

L.N. 448 OF 2013 INCOME TAX ACT (CAP. 123) DOUBLE TAXATION RELIEF (TAXES ON INCOME) (REPUBLIC OF INDIA) ORDER, 2013

This L.N. transposes the new Treaty with India. Clauses which caught my attention include the following:

- a) The Treaty provides for a services PE but only where activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 90 days within any 12-month period;
- b) The rules on the attribution of income to a PE provide for deduction restrictions on IP and interest expenditure;

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- c) Dividends paid by a company which is a resident of India to a resident of Malta who is the beneficial owner thereof are taxable in India but the tax charged in India may not exceed 10 per cent of the gross amount of the dividends.
- d) Interest paid by an Indian resident to a resident of Malta who is the beneficial owner thereof may be taxed in India but the tax charged in India may not exceed 10 per cent of the gross amount of the interest. Interest received by certain institutions is tax exempt.
- e) The treaty contemplates a special article on royalties 'and fees for technical services'. "Fees for technical services" is defined as meaning payments of any kind, other than those mentioned in Articles 14 and 15 of the Treaty (Independent and Dependant Personal Services) as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel. Royalties and fees for technical services are taxable both in the source state and the residence state but if the beneficial owner of the royalties/fees is a resident of one of the contracting states the tax charged it may not exceed 10 per cent of the gross amount. Should the person deriving income not have a PE in the source state the rules above would not apply and the article on business profits would apply.
- f) The treaty retains the 'old' independent personal services article.
- g) The treaty incorporates an LOB clause which provides that MSA, MFA and persons enjoying a 'special tax treatment' similar to that contemplated in the MSA and MFA are not subject to treaty protection.

L.N. 449 OF 2013 - EXCHANGE OF INFORMATION (TAX MATTERS) (MACAO SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA) ORDER, 2013

This Legal Instrument provides that rules similar to those contained in the Mutual Assistance Directive will apply between Malta and Macao.

L.N. 3 OF 2014 INCOME TAX ACT (CAP. 123) DOUBLE TAXATION RELIEF (TAXES ON INCOME) (SOUTH AFRICA) (AMENDMENT) ORDER, 2014(L.N 392 OF 2013) COMMENCEMENT NOTICE

This LN provides for the entry into force of the Protocol amending the Agreement between the Government of Malta and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income published as a Schedule to Legal Notice 392 of 2013 has entered into force on 17 December 2013.

L.N. 16 OF 2014 INCOME TAX ACT (CAP. 123) HIGHLY QUALIFIED PERSONS (AMENDMENT) RULES, 2014

This LN adds new categories to the list of eligible employment contracts subject to the 15% rate. The L.N. adds:

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“(2) Employments with undertakings holding an aerodrome licence issued by the competent authority, consisting in employment as Chief Executive Officer”

1.3 BILLS

2.3.1 BILL 26 OF 2013, BUDGET MEASURES IMPLEMENTATION ACT, 2014

2.3.2 PROPOSED AMENDMENTS TO ITAS.

2.3.2.1 ADDITIONS TO LIST OF CHARGEABLE ASSETS IN ARTICLE 5

The bill proposes two additions to the list of chargeable assets of Article 5. According to Bill new, the new list will refer to ‘debt claims’ and ‘intellectual property’. Should the Bill become law, cessions of rights over ‘debt-claims’ would become taxable. Furthermore, cessions of right over all intellectual property would become taxable too.

2.3.2.2 NEW RULE ON ASSET VALUATION POST INTRA-GROUP TRANSFER

The Budget Bill proposes the insertion of the following paragraph:

“(iv) Where an asset, qualifying for tax relief under this article, is transferred from one company to another company and the company acquiring the asset issues shares in exchange for the acquired asset, whether to the transferring company or to any other person, the cost of acquisition of the said shares shall, for the purpose of calculating the gains or profits derived from the subsequent transfer of the said shares, be reduced (but not below zero) by an amount determined by deducting from the transfer value of the asset its cost of acquisition to the transferring company:

Provided that this paragraph shall not apply where the said asset is charged to tax under the provisions of subarticle (9A) of this article or article 5A(12A).”

It regulates the tax value of assets transferred intra-group subject to the tax exemption.

2.3.2.3 LIMITATION TO COMMUTATION OF PENSION EXEMPTION

The Bill proposes a restriction to the commutation of pension exemption. Presently, the law does not refer to any restriction but the proposed measure proposes to restrict the exemption as follows:

The wording of the commutation of pension exemption is to be changed as follows:

“commutation of pension (up to a maximum of thirty percent (30%) of the pension)”;

2.3.2.4 CLARIFICATIONS RE DEDUCTION/EXEMPTION FOR ALIMONY PAYMENTS

The Bill proposes new and better wording providing for the recognition of foreign divorce/separation settlement payments.

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2.3.2.5 REMOVAL OF ACCREDITATION REQUIREMENTS WITH RESPECT TO SPORTS/ CULTURAL ACTIVITY DEDUCTION

The Bill proposes additions (new provisos) to Articles 14E (deduction sports activities) and 14G (creative or cultural courses). The proposed new proviso will explain that registration/accreditation of courses will not be necessary for courses organised by entities OUTSIDE MALTA.

2.3.2.6 CHANGES IN TAX RATES

The 32% tax rate bracket introduced last year in respect of individuals earning less than €60,000 will be reduced to 29% and will apply to those individuals applying for the single rates, married rates and parent rates.

Dividend income will continue to be taxed at the rates applicable before the introduction of the 32% marginal tax rate.

The tax-free bracket for individuals opting for the parent rates of tax will be extended from €9,300 to €9,800. Parents will still be able to benefit from the parent rates if they are maintaining a son/daughter aged up to 23 years old attending a tertiary education establishment (age was previously 21 years). Tertiary education establishments will include other colleges and institutions such as MCAST and ITS.

2.3.2.7 MAJOR CHANGE RE USE OF RESIDENT RATES

The Budget Bill proposes an interesting change. A national of an EU/EEA who satisfies the Commissioner that 90% of his worldwide income is Malta source will become entitled to use resident rates even if he is a non-resident. Eligibility remains even when spouse is non-resident but 90% of couple's worldwide income is from Malta.

2.3.2.8 INCREASE IN CAPS FOR CERTAIN DEDUCTIONS

The Article 14C deduction (Childcare fees) cap will be increased from EUR1,300 to EUR3,000.

2.3.2.9 AMENDMENTS TO THE PART-TIME RULES

The limit on which one can apply the 15% beneficial tax rate for those persons qualifying under the part-time rules will be increased to €10,000 for those in employment and €12,000 for the self-employed. The limit previously stood at €7,000.

Previously, part-time self-employed persons could not benefit from the beneficial tax rate if they employed persons with them. The proposal provides that self-employed individuals can still benefit from the 15% rate provided that they do not employ more than 2 persons. Pensioners who are self-

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employed on a part-time basis will benefit from the 15% tax rate on income from their self-employment as long as such income does not exceed the minimum income on which the lowest rate of social security contribution is paid. The tax on income of footballers engaged on a part-time basis will be reduced to a flat rate of 7.5%.

2.3.2.10 WITHHOLDING TAX ON RENTAL INCOME

Persons in receipt of rental income in respect of residential properties shall have the option to apply a flat rate of tax of 15% to their gross rental income. Undeclared rental income will be subject to a final tax of 35% calculated on the gross rental income (+ penalties and interest). The Bill proposes the addition of an Article 31D which will explain the remit of the 15% tax rate.

It will apply to rents by 'any person' but only of:

- a) 'a residential tenement';
- b) to an individual/individuals;
- c) Occupying such tenement as his home/residence.

The w/t will be optional. The 15% will be charged on gross rental income. It will be final and will not be subject to set-off. Article 31D income will be considered to be separate from chargeable income. Article 31D income does not have to be declared in the main tax return. The 15% regime can apply to more than one property. Article 31D Income should be allocated to the FTA.

2.3.2.11 FEES IN RESPECT OF CHILDCARE CENTRES

The maximum deduction from income chargeable to tax for fees paid for child care services which previously stood at €1,300 per annum will be increased to €2,000 from basis year 2014.

2.3.3 PROPOSED AMENDMENTS TO DDTA.

Duty on Auction Sales will be abolished. Interest on Late Payment of Duty Causa Mortis will respect the principle of ultra duplum (interest cannot exceed capital). New rules for calculation of duty in emphyteusis will be introduced.

2.3.4 OTHER TAX PROPOSALS.

Provisions on exchange of information between the VAT Department and the IRD will be introduced. A new procedure to contest certain assessments has been proposed too (an adjustment form must be filed within 5 years). Part-timers will have to settle tax by 30 June and to provide a statement of

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accounts. Payment of tax on rental income subject to Article 31D will need to be made by 30 June accompanied by a special return. In article 49 penalty of imprisonment will be removed but the fine will be increased from EUR1500 to EUR5000.

2. JUDICIAL DECISIONS

2.1

DECISIONS OF THE ADMINISTRATIVE REVIEW TRIBUNAL

RIKORS NUMBER. 45/2009 KARL HEINRICH GUENTER HOBEIN VS DIRECTOR GENERAL (INLAND REVENUE)

The above case consisted in an appeal from an assessment to duty on documents and transfers. The Tribunal rejected the application because applicant had failed to prove that the government Architect's valuation had been excessive.

RIKORS NUMRU. 59/2009 NOEL MARSHALL U DOROTHY MARSHALL VS DIRETTUR GENERALI (TAXXI INTERNI)

The Tribunal revoked an assessment to duty on documents because the Government Architect's valuation had ignored material facts.

RIKORS NUMBER. 33/2012 GEORGE THOMAS GOODAL VS COMMISSIONER OF INLAND REVENUE

The Tribunal confirmed an assessment to duty because the Government Architect's valuation was based on a number of incorrect premises.

RIKORS NUMBER. 193/2012 FRANK SPITERI VS DIRECTOR GENERAL (INLAND REVENUE)

This case involved an assessment to duty. Case is still sub judice (case is pending in the Court of Appeal).

RIKORS NUMRU. 71/2011-77/2011 XXX VS KUMMISSARJU TAT-TAXXI INTERNI

This case involved an assessment to income tax. The bone of contention was the tax categorisation of the company's income. With respect to the issue of income classification, the Tribunal agreed with appellant but on the basis of evidence produced it confirmed the assessment. Case is now sub judice (pending in front of the Court of Appeal).

RIKORS NUMRU. 151/2011 XXX VS KUMMISSARJU TAT-TAXXI INTERNI

The case involved 56 (17) ITA. The Tribunal decided in favour of the Revenue because appellant had failed to prove that his contract of employment required him to work wholly or mainly outside Malta. In the Tribunal's words:

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“Ghalhekk indipendentement mit-tul ta’ zmien li r-Rikorrent ghamel jahdem il-Libja matul is-sena 1997, jirrizulta b’mod car li t-tul ta’ zmien per se li huwa kien mistenni jahdem barra minn Malta tul l-impjieg tieghu mad-ditta Mizzi, Scerri, Said & Co. ma kienx kondizzjoni centrali ta’ l-impjieg tieghu ma’ l-imsemmija ditta peress illi dan kien purament diskrezzjonali ghad-ditta u kien ivarja minn zmien ghall-iehor, u konsegwentement ma jistax jinghad u jigi konkluz li l-kuntratt jew ftehim ta’ impjieg tieghu ma’ l-imsemmija ditta kien jehtieg li jsir xoghol principalment barra minn Malta kif intiz ghall-finijiet ta’ l-Artikolu 31(15) tal-Kap.123 tal-Ligijiet ta’ Malta.”

RIKORS NUMRU. 88/2012 XXX VS KUMMISSARJU TAT-TAXXA FUQ IL-VALUR MIZJUD

This case involved a VAT Appeal which had been filed after the lapse of the peremptory term. Appellant had been notified of the VAT Appeal when he was in prison. The ART held that a VAT appeal was null because it had been filed late. The ART held that assessment had been validly served on appellant whilst appellant was in prison and appellant was to blame for the late filing of the appeal.

RIKORS NUMRU. 20/2009 SAVE-ON CO. LTD. LI FIL-MORI TAL-KAZ BIDDLET ISIMHA GHAL MONTFLEUR LIMITED VS DIRETTUR GENERALI (TAXXI INTERNI)

This case involved an assessment to duty. The ART held for appellant because the assessment was based on an incorrect valuation of the property.

2.2

DECISIONS OF THE COURT OF APPEAL

APPELL CIVILI NUMRU. 1105/2008/1 FRANK X. FENECH ET V. KUMMISSARJU TAT-TAXXA FUQ IL-VALUR MIZJUD

The Court of Appeal (Superior Jurisdiction) confirmed the judgement of the First Hall Civil Court relating to the personal responsibility of non-executive directors. The Court of Appeal held that a director who had not been served with a demand note could not be served with a judicial letter creating an executive title against her.

2.3

DECISIONS OF THE COURT OF MAGISTRATES AND THE FIRST HALL CIVIL COURT

CITAZZJONI NUMRU. RIKORS NUMRU. 873/2004 KUMMISSARJU TAT-TAXXI INTERNI VS ANGELO BONANNO

2. JUDICIAL DECISIONS

This is the latest in a long series of judgements upholding the legal principle that prescription applies to tax claims too. Madam Justice Schembri Orland confirmed that the institute of prescription applies against the Revenue too.

CITAZZJONI NUMRU. 323/2012 DIONE BARTOLO VS DIRETTUR GENERALI TAT-TAXXI NTERNI U L-KUMMISSARJU TAT-TAXXI

Plaintiff challenged the validity of a notification of a demand note issued by the IRD. The Court upheld the validity of the notification of the document.

2.4

DECISIONS OF THE FIRST HALL CIVIL COURT (CONSTITUTIONAL JURISDICTION) AND THE CONSTITUTIONAL COURTS

2.5

DECISIONS OF THE MAGISTRATES COURT (CRIMINAL JUDICATURE) AND COURT OF CRIMINAL APPEAL

IL-PULIZIJA (SPETTUR ANTHONY AGIUS) -VS- SILVANA SPITERI KAZ NRU: 885767/10/02/01

This judgement creates an extremely dangerous precedent. A director who had nothing to do with the control of a company was held criminally responsible for a number of infringements of the FSS Rules even though she submitted evidence proving she was unaware of the wrongdoing. An extract from the judgement follows:

“Illi mill-provi minnha prodotti u mis-sottomissjonijiet maghmula f’isimha l-imputata qed tishaq li hija ma kellha l-ebda involviment fil-kumpanija Foresight Holdings Limited u li ghalhekk tapplika fil-konfront taghha id-difiza predisposta f’l-artikolu 13 ta’ l-Interpretation Act ghaliex skond hi la darba ma kenitx taf bin-nuqqasijiet ta’ l-imsemmija kumpanija fil-konfront tal-Kummissarju tat-Taxxi u ma ndunat b’xejn li seta’ jqanqal xi dubbju dwar jekk din il-kumpanija kienet qed tonora l-obbligi fiskali taghha, hija qatt ma tista’ tinzamm responsabbli ghan-nuqqasijiet li jistghu jirrizultaw.

Illi pero l-punt krucjali fil-proceduri odjerni mhux jekk l-imputata kellhiex it-tmexxija tal-kumpanija f’idejha jew le, jew kellhiex xi involviment kwalunkwe fil-kumpanija, imma jekk kenitx direttur jew le, u dan irrispettivament mir-rwol li kellha jew ma kellhiex fil-kumpanija, jew is-sehem li kienet taghti fil-gestjoni tal-kumpanija u/jew in-negozju taghha; punt krucjali iehor huwa x’passi hadet l-imputata, in kwantu direttur, biex tinforma ruhha dwar, u tassigura li l-obbkigi fiskali kienu qed jigu onorati.”

3. DECISIONS OF THE COURT OF JUSTICE OF THE EUROPEAN UNION

C-431/12 SC RAFINĂRIA STEAUA ROMÂNĂ SA

The CJEU concluded that Article 183 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as precluding a situation in which a taxable person, having made a claim for refund of excess input value added tax over the value added tax which it is liable to pay, cannot obtain from the tax authorities of a Member State default interest on a refund made late by those authorities in respect of a period during which administrative measures precluding the refund, which were subsequently annulled by a court ruling, were in force.

C-440/12 METROPOL SPIELSTÄTTEN UNTERNEHMERGESELLSCHAFT (WITH LIMITED LIABILITY)

This judgement is interesting because it involves the gaming sector. The CJEU held that:

- a) Article 401 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, read in conjunction with Article 135(1)(i) thereof, must be interpreted as meaning that value added tax and a special national tax on games of chance may be levied cumulatively, provided that the special national tax cannot be characterised as a tax on turnover;
- b) The first sentence of Article 1(2) and Article 73 of Directive 2006/112 must be interpreted as not precluding a national provision or practice whereby, in the operation of gaming machines offering the possibility of winnings, the amount of the cash receipts from those machines is used after a set interval as the basis of assessment;
- c) Article 1(2) of Directive 2006/112 must be interpreted as not precluding a national system regulating an unharmonised tax, under which the value added tax owed is to be set in full against that tax.

IN CASE C-164/12, DMC BETEILIGUNGSGESELLSCHAFT MBH V FINANZAMT HAMBURG-MITTE

This is the CJEU latest case on exit taxation. The CJEU held that Article 63 TFEU must be interpreted as meaning that the objective of preserving the balanced allocation of the power to impose taxes between Member States may justify the legislation of a Member State which requires assets in a limited partnership contributed to the capital of a capital company with its registered office in the territory of that Member State to be assessed at their value as part of a going concern, thus giving rise to the taxation, before they are actually realised, of the capital gains relating to those assets generated in that territory, if it will in fact be impossible for that Member State to exercise its powers of taxation in relation to those gains when they are in fact realised, which is a matter for the national court to determine.

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The national legislation of a Member State which provides for the immediate taxation of unrealised capital gains generated in its territory does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States, provided that, where the taxable person elects for deferred payment, the requirement to provide a bank guarantee is imposed on the basis of the actual risk of non-recovery of the tax.

CASE OF GÁLL v. HUNGARY (APPLICATION NO. 49570/11)

Gall filed a case against Hungary on the grounds that a Hungarian tax and interest for late payment of tax on terminal benefits was disproportionate. The ECtHR found that there had been a violation of the right to property because the Hungarian tax under review created an excessive burden.

CASE OF ROUSK v. SWEDEN (APPLICATION NO. 27183/04)

This case involved a taxpayer who had accumulated a debt with the Swedish tax authorities. The applicant's total enforceable debts amounted to SEK 255,329 but the tax authorities seized taxpayer's home which was worth over SEK 1,372,000. As a consequence taxpayer ended homeless. The ECtHR held that it accepts that it will sometimes be necessary for the State to attach and sell property, including an individual's home, in order to secure the payment of taxes due to the State through enforceable debts, it emphasises that these measures must be enforced in a manner which ensures that the individual's right to his or her home is properly considered and protected. Having regard to the lack of effective procedural safeguards for the applicant to protect his interests, the ECtHR found violations of Article 8 and Article 1 of the First Protocol (Right to property).

CASE OF R.Sz. v. HUNGARY (APPLICATION NO. 41838/11)

The merits of this case were similar to those of the GALL case discussed above but in R.Sz. the Court's discussion of the concept of proportionality was somewhat more thorough and the Court discussed the phenomenon of retrospectivity in tax law. An extract from the judgement follows:

"In particular, as regards the existence of a "reasonable relationship of proportionality between the means employed and the aim sought to be realised"... tax rates exceeding 50% have been found unconstitutional in Germany, a Member State of the Council of Europe (see paragraph 19 above). However, in several European countries – such as Sweden, Belgium, the Netherlands, Portugal and Italy – personal income tax rates reached about 75% in the past – although those rates were usually applicable only to the highest income brackets, related to revenues clearly exceeding the amount that is contemplated in the context of the present case. It is also to be noted that the OECD average of top combined statutory personal income tax rates was 65.7% in 1981, 50.6% in 1990, 46.5% in 2000 and 41.7% in 2010.

55. The applicable threshold in the present case was HUF 3.5 million, the amounts of severance pay falling below this limit being subject to the general personal income tax rates (a maximum of 32% in the period, see paragraph 7 above). By contrast, a tax rate of 98% was applied to that part of severance pay which

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exceeded the threshold.

56. In the instant case, the Court takes into consideration in the proportionality analysis that the tax rate applied exceeds considerably the rate applicable to all other revenues, without determining in abstracto whether or not the tax burden was, quantitatively speaking, confiscatory in nature. For the Court, given the margin of appreciation granted to States in matters of taxation, the applicable tax rate cannot be decisive in itself, especially in circumstances like those of the present case.

57. The Court observes that the applicant, who was entitled to severance pay according to his labour contract and whose acting in good faith has never been called into question, was subjected to the impugned measure notwithstanding the fact that the severance pay served the specific and recognised social goal of labour reintegration....

58. As regards the personal burden which the applicant sustained on account of the impugned measure, the Court notes that he had to suffer a substantial deprivation of income in a period of presumable considerable personal difficulty, namely subsequent to the loss of employment. The Court would observe in this context that Article 34 of the Charter of Fundamental Rights of the European Union (see paragraph 18 above) endorses benefits providing protection in the case of loss of employment, and that according to the European Court of Justice, the aim pursued by severance pay – that is, helping dismissed employees find new employment – belongs within legitimate employment policy goals (see paragraph 18 above).

Moreover, the Court cannot overlook the fact that the applicant received the benefits in question, reduced by the then applicable taxes, several months before the change in the revenue rules, and might have disposed of it already, unaware that subsequently he would have to surrender this money, almost in its entirety, in the levying of an additional tax. For the Court, this element – that is, the absence of a transitional period within which to adjust himself to the new scheme – is likely to have exposed the applicant to substantial personal hardships. In this connection the Court recalls that taxation at a considerably higher tax rate than that in force when the revenue in question was generated could arguably be regarded as an unreasonable interference with expectations protected by Article 1 of Protocol No. 1 (see M.A. and 34 Others, cited above). The tax complained of was not intended to remedy technical deficiencies of the pre-existing law, nor had the applicant enjoyed the benefit of a windfall in a changeover to a new tax-payment regime (compare and contrast, National etc., cited above, §§ 75 to 83).

59. Against this background, the Court finds that the measure complained of entailed an excessive and individual burden on the applicant's side. This is all the more evident when considering the fact that the measure targeted only a certain group of individuals, who were apparently singled out as having been paid, directly or indirectly, out of the public purse. Assuming that the impugned measure served the interest of the State budget at a time of economic hardship, the Court notes that the majority of citizens were not obliged to contribute, to a comparable extent, to the public burden.

60. The Court concludes that the specific measure in question, as applied to the applicant, even if meant to serve social justice, cannot be justified by the legitimate public interest relied on by the Government. It affected the applicant being in good-faith standing and deprived him of the larger part of an acquired right (statutorily guaranteed to a large extent), serving the special social interest of labour-market reintegration. In the Court's opinion, those who act in good faith on the basis of law or contracts should not be frustrated in their expectations without specific and compelling reasons. Therefore the measure cannot be held to be reasonably proportionate to the aim sought to be realised.

61. The foregoing considerations are sufficient to enable the Court to conclude that there has been a violation of Article 1 of Protocol No. 1."