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## LEGAL CERTAINTY AND TAXATION: THE PROBLEM OF RETROACTIVE INTERPRETATION

*This article shows that the principle of legality of a tax norm is not exhausted in its “source” component (i.e. that the norm is enacted by parliament) but also encompasses the “content” element – a set of requirements for it to be deemed as good law. It is not just retroactivity of a law that is an issue, but legal certainty is also jeopardized by retroactive interpretation implying changes in interpretation of the same norm by authorities who understood it for a long period in a different sense. A threat to legal certainty also exists when a provision that was dormant for years is suddenly applied. A case study shows that the Serbian Parliament issued an authentic interpretation of a tax norm to assert essentially a different interpretation compared to the one well-established in the past, in order to solve a particular case, while a court used that interpretation to pass judgment in a pending case. Within the EU we find notable cases where not only are norms attributed a certain meaning from their inception, even though 60 years may have passed from their initial introduction to the possibility of the existence of a “new meaning” being suggested for the first time, but taxpayers are made to suffer the consequences of the new interpretation. Had the legislator been able to pay more attention to the content of the bills and apply a more comprehensive approach to current issues, the legal certainty, in terms of avoiding “innovative” retroactive interpretations, could be preserved.*

Key words: *Good law. – Retroactivity. – Authentic interpretation. – Urgent procedure. – Retroactive interpretation.*

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## 1. INTRODUCTION

The principle of *nullum tributum sine lege* is widely accepted and is enshrined in many constitutions worldwide.<sup>1</sup> A rare exception is the Constitution of Germany wherein “the legal basis for taxation rests on the combination of two other constitutional provisions: the provision guaranteeing personal freedom, which cannot be restricted except by law, and the provision requiring a legal basis for any act of administration, including any administrative act of tax assessment and collection”.<sup>2</sup> However, this principle has two interconnected aspects, which will be analyzed in this article: the source and the content of tax legislation.

The first aspect of the *nullum tributum sine lege* principle (“source”) relates to the old slogan of the American Revolution “No taxation without representation.”<sup>3</sup> The introduction of taxes should be the prerogative of the parliament to whose members the electorate has entrusted the exercising of its ultimate sovereignty. The executive branch of government should merely clarify tax laws enacted by the parliament (in the sense where further clarification is required to ease the implementation of the relevant legislation) and only when the parliament saw the need to grant it the authority to do so. Although variations to this aspect of the *nullum tributum sine lege* principle do exist in comparative law (e.g. taxation introduced by virtue of government decrees issued on the basis of delegated legislative competence), it can be found in most democratic jurisdictions in the world today.

The notion that a person’s tax obligations should be regulated by statutes, enacted by virtue of the secondary exercise of his or her sovereignty, leads us to the issue of the retroactivity of tax legislation. A person cannot be expected to obey laws of whose existence he/she was not aware due to the simple fact that they did not exist at the time he/she was supposed to respect them. The prohibition of retroactivity is not without exceptions, but what is absolute is that retroactivity of legislation must be explicitly provided for.<sup>4</sup> The problem of retroactivity is a

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<sup>1</sup> A.P. Dourado, “General Report – In Search of Validity in Tax Law: The Boundaries Between Creation and Application in a Rule-of-Law State”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 30–31.

<sup>2</sup> F. Vanistendael, “Legal Framework for Taxation”, *Tax Design and Drafting*, Vol. I (ed. Victor Thuronyi), Washington, D.C.: IMF, 1996, 17.

<sup>3</sup> The slogan first appeared some years before the beginning of the American Revolutionary War (1775–1783) and was used in regard to the introduction of the 1765 Stamp Act (repealed by the British Parliament after much protest in the American Colonies, in 1766).

<sup>4</sup> For example, there is no constitutional prohibition of retroactivity of laws in the U.S. The Supreme Court considers it permissible if it is rationally linked to a legislator’s

borderline case, since it can be viewed from both the source and the content perspective. It is inherently connected with the principle of legal certainty. However, in discussing the quality of the content of a piece of legislation, one will be analyzing the aspect of legal certainty which is related to the possibility of clearly interpreting a particular provision. When it comes to retroactivity, interpretation as such is not the issue: legal certainty is endangered due to the fact that we are not provided timely instruction on the consequences of our actions – the norm as such is not present at all.

Referring to the second aspect of the *nullum tributum sine lege* principle (“content”), in its 1979 decision the European Court of Human Rights (ECtHR) defined the qualitative elements that a norm must contain in order to be considered as law: “In the Court’s opinion, the following are two of the requirements that flow from the expression ‘prescribed by law’. Firstly, the law must be adequately accessible: the citizen must be able to have an indication that is adequate in the circumstances of the legal rules applicable to a given case. Secondly, a norm cannot be regarded as a ‘law’ unless it is formulated with sufficient precision to enable the citizen to regulate his conduct: he must be able – if need be with appropriate advice – to foresee, to a degree that is reasonable in the circumstances, the consequences which a given action may entail. Those consequences need not be foreseeable with absolute certainty: experience shows this to be unattainable. Again, whilst certainty is highly desirable, it may bring in its train excessive rigidity and the law must be able to keep pace with changing circumstances. Accordingly, many laws are inevitably couched in terms which, to a greater or lesser extent, are vague and whose interpretation and application are questions of practice”.<sup>5</sup>

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legitimate goal. *United States v. Carlton*, 512 US Supreme Court 26, 35 (1994). See also E.K. Lunder, R. Meltz, K.R. Thomas, “Constitutionality of Retroactive Tax Legislation”, 2012, Congressional Research Service, [Online] at <https://fas.org/sgp/crs/misc/R42791.pdf>, 2–3, last visited 9 November 2017. In 1996 the US Congress amended Section 7805(b) of the Internal Revenue Code (IRC) and prohibited Treasury Department regulations relating to the sections of the IRC enacted after 1996 to have retroactive effect (except in the case of preventing abuse). See S.W. McCormack, “Tax Abuse According to Whom?”, *Florida Tax Review* 1/2013, 4. On the other hand, Article 15 (2) of the Constitution of Romania prescribes that a law shall only act for the future, except for the more favorable criminal or administrative law. Between these extremes one may find e. g. the Constitution of Croatia whose Article 90 prohibits retroactivity with the exception that only individual provisions of a law may have a retroactive effect for “exceptionally justified reasons,” or the Constitution of Serbia where Article 197 specifies that a deviation from the general prohibition of retroactivity may be allowed only for individual provisions of a law if so required by general public interest.

<sup>5</sup> ECtHR, Case 6538/74 *The Sunday Times v. United Kingdom*, 26 April 1979, para. 49.

The legal certainty that the ECtHR was referring to implies the following requirements, as stated by Fuller:<sup>6</sup> (1) general character of rules; (2) their promulgation; (3) non-retroactivity;<sup>7</sup> (4) clarity; (5) rules must not require contradictory actions; (6) applicability; and (7) the laws should not be changed too frequently (constancy).<sup>8</sup> The protection of legitimate expectations triggered by a law may also be added to the abovementioned aspects of the principle of legal certainty.<sup>9</sup>

However, one should note that, contrary to the principles of legality (*nullum tributum sine lege*) and equality, in most jurisdictions worldwide (with the notable exception of European countries) “legal certainty is not an absolute desideratum... Important though it may be, the principle of certainty as such is not enshrined in most of the contemporary constitutions or in international treaties with provisions that are binding on all persons. The courts therefore cannot test Acts of Parliament against this fundamental legal principle”.<sup>10</sup> Only its non-retroactivity dimension (followed by the promulgation requirement<sup>11</sup>), which should be placed within the source-of-legislation issues, as a rule, finds its place in the constitutional provisions, thus being directly exposed to the judicial testing. However, within the ECtHR’s approach the courts are required to test whether a law meets the abovementioned requirements regarding its formulation, which should be made with sufficient precision thus enabling a citizen to regulate his/her conduct, i.e. to foresee the consequences which a given action may entail, to a degree that is reasonable under the circumstances.

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<sup>6</sup> L. L. Fuller, *Moralnost prava [The Morality of Law]*, University of Belgrade Faculty of Law, Belgrade 2001, 55–56.

<sup>7</sup> Although Fuller (p. 70) states that “a retroactive law is truly a monstrosity”, he also admits that situations may arise in which granting retroactive effect to legal rules, “not only becomes tolerable, but may actually be essential to advance the cause of legality” (Fuller, 71).

<sup>8</sup> Although Fuller deals with these requirements in light of the principle of legality, these are all also aspects of legal certainty. See H. Gribnau, “Equality, Legal Certainty and Tax Legislation in the Netherlands. Fundamental Legal Principles as Checks on Legislative Power: A Case Study”, *Utrecht Law Review* 2/2013, 70.

<sup>9</sup> K. Tipke, *Die Steuerrechtsordnung*, Verlag Dr. Otto Schmidt, Köln 2000, 147.

<sup>10</sup> H. Gribnau (2013), 54. The Court of Justice of the European Union (CJEU) has interpreted the principles of legal certainty and legitimate expectations as integral parts of EU law (Case 345/06 *Gottfried Heinrich*, 10 March 2009, para. 44). The same approach is followed by the Court of First Instance of the European Communities (Case T-347/03 *Eugénio Branco, L<sup>da</sup> v. Commission*, 30 June 2005, para. 102).

<sup>11</sup> ECtHR decided that, provided the taxpayer is a legal entity (as opposed to an individual) and thus able to rely on the advice of consultants, the claim that a norm with tax implications was published in a financial bulletin rather than in the *Official Gazette* is not justifiable (Case 26449/95 *Špaček, s.r.o. v. The Czech Republic*, 9 November 1999, para. 59).

Thus, in order to be deemed a law, tax norms must not only comply with the source criterion, but their content must also meet certain qualitative standards as well. In summary, in order for a tax norm to be deemed a *good law* the following conditions have to be met: (1) it should be provided for in a statute enacted by parliament, or in a regulation issued by the executive branch of government on the authority granted to it by the parliament; (2) it should not, unless explicitly provided for, have a retroactive effect; and (3) it should at the very minimum meet the quality standards set by the ECtHR (relevant for legislation in Europe).

## 2. AIMS AND METHODOLOGY OF THE RESEARCH

In this article, we will deal with the problem of endangered legal certainty caused by radical changes in the interpretation of enacted tax norms with ambiguous wording, by the sudden “awakening” of norms that had not been applied for many years following their enactment, or by retroactive authentic interpretations. The empirical basis for the analysis has been found in a number of states in Southeast Europe – both EU candidate countries (Serbia) and EU member states (Greece). Thus the topic at hand is most certainly a regional one, at the very least. However, the recent approach applied by the European Commission in state aid cases, which emanated from its investigations, launched in 2013<sup>12</sup> regarding the tax ruling practices of members states,<sup>13</sup> shows that some of the outlined issues have a far broader impact and thus deserve our attention.

The methodology applied will consist of investigating the standards of legal certainty established by the ECtHR, and comparing their application in Serbia and select comparative jurisprudence. A case study from Serbia’s jurisprudence, with wide implications for understanding the risks involved in retroactive interpretations of tax norms, will be analyzed and correlated with the right to a fair trial, as understood by the ECtHR.

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<sup>12</sup> [http://ec.europa.eu/competition/state\\_aid/tax\\_rulings/index\\_en.html](http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html)

<sup>13</sup> Commission Decision (EU) 2016/2326 of 21 October 2015 on State aid SA.3837 (2014/C ex 2014/NN) which Luxembourg granted to Fiat (notified under document C(2015) 7152), *Official Journal of the European Union*, L 351, 22 December 2016; Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks (notified under document C(2015) 7143), *Official Journal of the European Union*, L 83, 29 March 2017; Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605), *Official Journal of the European Union*, L 187, 19 July 2017; Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon (notified under document C(2017) 6740), *Official Journal of the European Union*, L 153, 15 June 2018.

### 3. OPEN ISSUES RELATED TO THE SOURCE AND CONTENT OF TAX LEGISLATION

Once the “source-content” link of a tax norm has been established, two dilemmas deduced from the empirical examples emerge.

*The first dilemma* can be formulated through the question whether the requirement that, in order to be considered as law, a particular tax norm must be enacted by parliament (or stipulated in regulations issued on the authority granted by parliament) has both an objective and a subjective component.

If a provision is adopted by the parliament, following all formal rules of parliamentary procedure, but where it can be deduced that it is questionable that the members of parliament understood the rules that they were enacting, the issue arises whether such a provision can still be regarded as a *good law*. In other words, should there be an evident will (or an intellectual) element in the business of enacting (tax) legislation and if it can be proved that it is missing, is this sufficient grounds to claim that a rule is not based in law?

While we are able to find examples where a legal norm which has been duly enacted by parliament has no coherent meaning,<sup>14</sup> the issue of the legality (in the constitutional sense) of such provisions may be dealt with through the content criterion. However, there are numerous examples of rules where the legislator is *prima facie* making a clear statement, where he is providing the taxpayer with an instruction that can be understood and followed, but a more detailed analysis of the way in which the norm has been introduced shows that the legislator objectively did not understand (or to be more precise, could not have understood) the legislation he enacted. For example, if the time allotted to debating and analyzing the amendments to a certain law can be measured in just minutes, while these amendments are highly technical in nature, it can be objectively stated that most if not all members of parliament were unaware of what they were voting on. Comparative analysis shows that the executive branch of government has the dominant influence in the process

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<sup>14</sup> The now abolished Corporate Income Tax Law of the Federation of Bosnia and Herzegovina (*Official Gazette of the Federation of Bosnia and Herzegovina*, No. 97/07) Art. 5(2) provided a definition of the agency PE which stated: “An agent who independently acts in the name of the non-resident and what [the use of the term “what” is deliberate as the wording of the law simply does not connect the agent with the part of the sentence after the comma – *D. P., S. V. K.*] is connected with the activities of concluding contracts in the name of and for the non-resident, maintains a stock of goods which it delivers in the name of the non-resident, shall be deemed a permanent establishment of a non-resident.” (“Poslovnom jedinicom nerezidenta smatra se zastupnik koji samostalno djeluje u ime nerezidenta, a vezano je za aktivnosti sklapanja ugovora u ime i za nerezidenta, drži zalihe proizvoda koje isporučuje u ime nerezidenta.”)

of drafting and ultimately adopting tax legislation in numerous jurisdictions worldwide.<sup>15</sup> As “members of parliament generally lack (technical) know how, experience and time to be able to draft bills, tax bills included,”<sup>16</sup> this work is predominantly done by the executive branch of government. Furthermore, not only are legislative proposals prepared outside parliament, while its members are not provided the means to place government proposals under adequate scrutiny, but they are also quite frequently passed using “urgency” procedures, which limit the debate process to, in certain cases, only a couple of days.<sup>17</sup>

Most jurists’ first instinctive reaction is that the described problems are to be dealt with within the ambit of the political sphere and that the courts are powerless to combat such abuses. On the other hand, if the ECtHR can curtail the power of the legislature and demand a degree of quality of the content of the norms it enacts, one may wonder whether it is not logical that we require at least some evidence of an effort being made to understand these provisions prior to the “show of hands” (i.e. not the quality of the content, but the quality of the form).

Furthermore, if it is evident that a piece of tax legislation has been introduced without any comprehensive debate (e.g., through urgent legislative procedure, wherein several legislative proposals are jointly tabled before the parliament and where the ensuing debate lasts only a few minutes), and was supported with only laconic argumentation prepared by the executive branch of government, which can provide little,

<sup>15</sup> J. Heinrich, I. Prinz, “Austria”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 57–58; B. Peters, E. van de Velde, “Belgium”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 66–67; J.G. Nielsen, “Denmark”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 89–90; E. de Crouy-Chanel, A.M. de la Motte, “France”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 98; L. Del Federico, R. Castigione, F. Miconi, “Italy”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 129–130; H. Gribnau (2013), 56.

<sup>16</sup> H. Gribnau, “Netherlands”, *Separation of Powers in Tax Law* (ed. A.P. Dourado), EATLP International Tax Series, IBFD, Amsterdam 2010, 158.

<sup>17</sup> A. Ágh, “Parliaments as Policy-Making Bodies in East Central Europe: The Case of Hungary”, *International Political Science Review* 4/1997, 417–432; P. Kopecký, “Power to the Executive! The Changing Executive-Kegislative Relations in Eastern Europe”, *The Journal of Legislative Studies* 2–3/2004, 142–153; K.H. Goetz, R. Zubek, “Government, Parliament and Law-making in Poland”, *The Journal of Legislative Studies* 4/2007, 517–538; V. Pettai, Ü. Madise, “The Baltic Parliaments: Legislative Performance from Independence to EU Accession”, *The Journal of Legislative Studies* 3–4/2006, 291–310; D. Vuković, “Hollowing Out of Institutions: Law-Making and Policymaking in Contemporary Serbia”, Paper presented to the 8<sup>th</sup> Central and Eastern European Forum for Young Legal, Political and Social Theorists: Central and Eastern European Socio-Political and Legal Transition Revisited – Theoretical Perspectives, Budapest 2016.

if any, detailed insight into the nature, scope and intended impact of the proposed and subsequently adopted norms, concerns may be raised as to whether that piece of legislation can be the subject of subsequent interpretative laws or authentic interpretations. In other words, it is disputable that parliament (particularly a different one in terms of its members from the parliament which enacted the respective provision) can issue interpretative laws or authentic interpretations in circumstances where it is evident that there are no substantial sources on which to base the presumption of the legislative intent.

*The second dilemma* refers to the notion of retroactive interpretation of tax norms, in contrast to the notion of retroactivity of tax legislation *per se*, which has been much deliberated on. The scenario to concentrate on is the one where the same norm was interpreted one way for a period of time and then the authorities started understanding it in a different sense. Pursuant to this change in perspective, the authorities audit a taxpayer and apply the new interpretation in determining the tax consequences of an event that took place at the time when the old interpretation was dominant (the statutes of limitation for tax audits usually allows tax administrations to go back several years). It should be noted that the norm itself remained static and that we cannot talk of either retroactivity or retrospectivity of tax legislation in their proper sense.<sup>18</sup>

The issue of retroactive application of tax laws requires that the problem of dormant tax legislation is also addressed. The “reform fever” which many a legislator has caught, combined with the absence of sufficient administrative capacities, often leads to the introduction of legislation that is neither understood, nor have any advance preparations been made for its implementation at the level of the tax administration (e.g. transfer pricing or permanent establishment provisions in an economy in transition). Such norms may remain virtually unnoticed in a country’s statutes for many years (thus the use of the term *dormant*), wherein an urgent need for more tax revenues (as witnessed in these austerity times) may lead to their unexpected and sudden application by the authorities in an audit process. Therefore, one may wonder whether a law that has been “dormant” for some time (there are examples of provisions where there has been a time gap of more than 15 years between their enactment and first application by the authorities)<sup>19</sup> is still a *good law* and whether the unannounced commencement of auditing of its application by the tax

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<sup>18</sup> We define *retroactivity* as the situation where a law is applied to a taxable event that had occurred before the law entered into force. The term *retrospectivity* refers to the situation where a law is being applied to the future consequences of a taxable event that had occurred before the law entered into force (without a grandfathering clause).

<sup>19</sup> For example, Serbian transfer pricing rules, which were introduced in 1991, but were first substantially applied by the Serbian Tax Administration in a tax audit procedure in 2008.



authorities is comparable to the introduction of retroactive legislation. A similar question may be raised when it is not an alternative interpretation that is being applied (different in comparison to an established one), but when a completely new aspect of a norm is being discovered (when a principal provision of e.g. human rights law/constitutional law finds an application in an area of law previously thought to be unaffected by it, such as tax law).

#### 4. THE ABUSE OF AUTHENTIC INTERPRETATIONS: A SERBIAN CASE STUDY

It was in the second half of 2017 that the Court of Appeals in Belgrade overturned a judgment of the first instance court in a case that presents an outstanding opportunity to analyze most of the aforementioned open issues related to the source and content of tax legislation.<sup>20</sup>

Namely, a corporate taxpayer in 2008 relied on an interpretation found in an Opinion of the Serbian Ministry of Finance issued in 2002<sup>21</sup> to determine its corporate income tax obligations. At the time the opinions of the Serbian Ministry of Finance were not binding for the taxpayers or the Serbian Tax Administration, but they were relied upon to clarify areas of law that presented interpretative dilemmas. The interpretation found in the 2002 Opinion of the Serbian Ministry of Finance was widely respected and was cited as a *good law* in the *2007 Manual for the Application of the Corporate Income Tax Law*, which was issued by the Director of the Serbian Tax Administration, as a binding internal guide for its inspectors.<sup>22</sup>

It was not until 2010 that the Serbian Corporate Income Tax Law was amended in a way that made the 2002 Opinion obsolete.<sup>23</sup>

The respective corporate taxpayer was audited in 2012 by the Serbian Tax Administration and a deficiency was found in the application of the provisions to which the 2002 Opinion applied. The Serbian Tax Administration essentially took the position that the relevant provisions should have been interpreted differently (in line with the spirit of the 2010 amendments to the Corporate Income Tax Law) and completely

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<sup>20</sup> Judgment of the Court of Appeals in Belgrade, Kž1 Po 1 2/17 of 6 September 2017.

<sup>21</sup> Opinion of the Serbia's Ministry of Finance No. 430-07-306/2002-04 of 2 October 2002.

<sup>22</sup> *Priručnik za primenu Zakona o porezu na dobit preduzeća [Manual for the Application of the Corporate Income Tax Law]*, Ministry of Finance – Tax Administration, Belgrade 2007, 240.

<sup>23</sup> Law on Amendments of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 18/10.

disregarded the existence of the 2002 Opinion. The Serbian Tax Administration not only assessed additional tax obligations on the corporate taxpayers, but also brought criminal charges for tax evasion against a number of individuals related to the corporate taxpayer.

The criminal court of first instance faced a significant problem as there was simply no evidence that in 2008, at the time the relevant taxable event took place, there were any publicly available sources that would suggest that the taxpayer should have acted differently from the way it did. Furthermore, the evidence suggested that at the time the Serbian Tax Administration adhered to the same interpretation as did the taxpayer when determining its tax obligations.

In an attempt to find a solution to the presented problem, the criminal court of first instance approached the Serbian Parliament for an authentic interpretation of the relevant legal provisions which was issued, after some procedural difficulties, on 3 November 2015.<sup>24</sup>

Despite the fact that in Serbia authentic interpretations of legislative provisions issued by the Serbian Parliament have the same status as a statutory law, thus being general legal acts, no attempt was made to disguise the fact that this authentic interpretation was issued for the purposes of the particular case.<sup>25</sup> However, what was even more worrying was the fact that the quality of the content of the authentic interpretation was completely unacceptable. In order to substantiate such a grave assessment we will offer two examples:

Namely, by virtue of the 2010 changes and amendments to the Corporate Income Tax Law the title of this act was changed: by applying

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<sup>24</sup> *Official Gazette of the Republic of Serbia*, No. 91/2015. The court's request was not considered, on constitutional grounds, since the number of subjects entitled to initiate such procedure is limited, but the authentic interpretation was nevertheless issued at a subsequent request made by a member of parliament.

<sup>25</sup> See Para. 12 of the Authentic Interpretation of Articles 27, 28, 40 and 71 of the Corporate Income Tax Law (*Official Gazette of the Republic of Serbia*, No. 25/01, 80/02, 80/02, 43/03, 84/04 and 18/10) and Article 41 (3) of the Law on Tax Procedure and Tax Administration (*Official Gazette of the Republic of Serbia* No. 80/02, 84/02, 23/03/ 70/03, 55/04, 61/05, 85/05, 62/06 and 61/07), which states: "The withholding tax shall apply to a non-resident legal entity, in accordance with Article 40, paragraph 1 of the Law, and in the sense of the provision of Article 71, paragraph 1 of the Law, the resident legal entity is obliged to calculate and pay the respective tax (in the name of and to the account of the non-resident taxpayer) at the rate of 20%, unless otherwise provided by a double taxation treaty (*the foreign legal entity is registered as a private limited liability enterprise in the Netherlands Antilles [emphasis added – D.P., S.V.K.]*)." ("Obveznik poreza po odbitku u skladu sa članom 40. stav 1. Zakona je nerezidentno pravno lice, a u smislu odredbe člana 71. stav 1. Zakona, rezidentno pravno lice je dužno da obračuna i plati predmetni porez (u ime i za račun nerezidentnog obveznika) po stopi od 20%, ukoliko međunarodnim ugovorom o izbegavanju dvostrukog oporezivanja nije drukčije uređeno (strano nerezidentno pravno lice je registrovano kao privatno preduzeće sa ograničenom odgovornošću u Holandskim Antilima)").

a literal translation from Enterprise Profits Tax Law (*Zakon o porezu na dobit preduzeća*) to Legal Entities' Profits Tax Law (*Zakon o porezu na dobit pravnih lica*). Nevertheless, despite the fact that the authentic interpretation refers to the version of the Corporate Income Tax Law which encompasses the 2010 changes and amendments, it refers to the respective law under its old name.

Although one might claim that the first example is just a legalistic pedantry without any substantial implications, the second one is more to the point.

Paragraph 10 of the authentic interpretation states “Withholding tax on income from Article 40, paragraphs 1, 2, 3 and 12 of the Law, shall be calculated, withheld and paid to the designated accounts for every taxpayers and every individually generated or distributed income, on the day the income has been generated or distributed.”

The term “Law” from the cited paragraph refers to the Corporate Income Tax Law, as it stood with all the changes and amendments up to and including the ones from 2010. Surprisingly, we find that after the 2010 changes and amendments to the Corporate Income Tax Law, Article 40 had only six paragraphs. In other words, paragraph 10 of the authentic interpretation by the Serbian Parliament refers to a provision – Article 40, paragraph 12 of the Corporate Income Tax Law, which at the relevant moment in time simply did not exist. Actually, it was only in 2013 that paragraph 12 was introduced to Article 40 of the Corporate Income Tax Law.<sup>26</sup>

## 5. THE QUALITY OF CONTENT OF THE AUTHENTIC INTERPRETATION

Despite all the evident flaws in the content of the 2015 authentic interpretation of the provisions of the Serbian Corporate Income Tax Law, the criminal court of first instance relied upon it to issue guilty verdicts, while the Court of Appeals in Belgrade overturned the decision primarily on the basis of a breach of the constitutional principles regarding the separation of powers between the legislative branch of government and the judiciary.

However, in light of the questions raised in section 3 of this article, one cannot help but be further puzzled by the evident sloppiness of the Serbian legislator in drafting the text of the authentic interpretation. In

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<sup>26</sup> Article 10 of the Law on Amendments of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 47/2013.

other words, how is it possible that a tax law of such a low normative standard is passed by the nation's highest legislative body?

Although in the cited 1979 *Sunday Times v. United Kingdom* decision the ECtHR did elaborate on the standards that the content of a norm must meet in order to be recognized as law (within the prescribed-by-law meaning),<sup>27</sup> the question arises as to whether there is a required standard of form (i.e. of the procedure in which the legislation is passed) for it to be endowed with the attributes of law. For example, the authentic interpretation not only fails to provide any arguments to substantiate the position taken, but it also does not refer to any part of the debate that took place when the norm in question was initially adopted and even fails to cite the argumentation provided by the government in support of its proposal, which was subsequently adopted by Parliament in 2001, when the norms subject to authentic interpretation were introduced into the Serbian tax system.<sup>28</sup>

## 6. THE DOMAIN OF APPLICATION OF AUTHENTIC INTERPRETATIONS

The “no taxation without representation” requirement is generally directed *vis-à-vis* pretensions of the executive branch of government to enact tax rules. However, whenever a legislator establishes that the subjects applying the law constantly show disorientation and variation with respect to its application, it is entitled to address its binding interpretation to them. It may take the form of “interpretative laws”, like

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<sup>27</sup> In a more recent tax case (23759/03 and 37943/06 *Shchokin v. Ukraine*, 14 October 2010, para. 51 and 56), the ECtHR stated that the concept of *law* requires firstly that the measures should be based on domestic law. It also refers to the quality of the law in question, requiring that it be accessible to the persons concerned, precise and foreseeable in its application. The Court concluded that it is not satisfied with the overall state of domestic law, existing at the relevant time, on the matter in question (the application of a tax administration's instruction supported by a presidential decree rather than of a ministerial decree, deemed to be an act of parliament resulting in an increased tax burden). It noted that the relevant legal acts had been manifestly inconsistent with each other. As a result, the domestic authorities applied, at their own discretion, opposite approaches as to the correlation of those legal acts. In the Court's opinion the lack of the required clarity and precision of the domestic law, offering divergent interpretations on such an important fiscal issue, upset the requirement of the “quality of law” under the Convention and did not provide adequate protection against arbitrary interference by public authorities with the applicant's property rights. To summarize: the ECtHR found that a part of the tax legislation of a country (Ukraine) was so unclear as to be unlawful.

<sup>28</sup> A cynic may note that perhaps the reason for such an attitude lay in the fact that there was nothing in the parliamentary debate that took place when the norms in question were introduced into Serbian legislation, nor in the argumentation provided by the government to support the approach adopted in the authentic interpretation.

e.g. in Italy<sup>29</sup> or Greece,<sup>30</sup> where these pieces of legislation are prescribed (indirectly or directly) by constitutions, or of “authentic interpretation of laws”, like in Slovenia, Croatia or Serbia, where the measure is simply regulated by the parliament’s rules of procedure. But in the latter situation the authentic interpretation has the same legal force as the statute, with the effects being retroactive in both situations.<sup>31</sup>

That conclusion raises the issue of the impact of an authentic interpretation on a pending case. The aforementioned authentic interpretation, issued by the Serbian Parliament on 3 November 2015, did not serve only the purposes of the criminal proceedings, but was transplanted *ad litteram* in the judgment of the Administrative Court in Belgrade<sup>32</sup> trying the tax case based on identical factual situation. In addition to making the error of relying on the authentic interpretation of a piece of legislation that entered into force several years after the disputed taxable event occurred, the Court overlooked the existence of the established jurisprudence of the ECtHR with respect to the impact of an authentic interpretation on pending cases. In its judgment in the case *Stran Greek Refineries and Stratis Andreadis v. Greece*, the ECtHR found that “the principle of the rule of law and the notion of fair trial enshrined in Article 6 of the Convention preclude any interference by the legislature with the administration of justice designed to influence the judicial determination of the dispute.” By enacting an authentic interpretation (in the form of an interpretative law) “the State infringed the applicants’ rights under Article 6 (1) by intervening in a manner which was decisive to ensure that the – imminent – outcome of proceedings in which it was a party was favourable to it.”<sup>33</sup> An administrative judicial dispute in tax matters *per se* would not fall under the procedure of “the determination of [a person’s] civil rights and obligations or of any criminal charge against him,” which is stipulated in Article 6 of the European Convention on

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<sup>29</sup> Consiglio di Stato, sez. IV, decisione 21/12/2009 n° 8513, <http://www.altalex.com/documents/massimario/2010/02/01/legge-retroattiva-legittimita-precisazioni-limiti>, last visited 5 November 2017.

<sup>30</sup> Article 77 of the Constitution, <http://www.wipo.int/edocs/lexdocs/laws/en/gr/gr220en.pdf>, last visited 5 November 2017.

<sup>31</sup> “The Court reaffirms that while in principle the legislature is not precluded in civil matters from adopting new retrospective [*retroactive*, in the sense indicated in footnote 18 – *D.P., S.V.K.*] provisions to regulate rights arising under existing laws, the principle of the rule of law and the notion of fair trial enshrined in Article 6 preclude any interference by the legislature – other than on compelling grounds of the general interest – with the administration of justice designed to influence the judicial determination of a dispute.” (ECtHR, Case 38703/97 *Agoudimos and Cefallonian Sky Shipping Co. v. Greece*, 28 June 2001, para. 30).

<sup>32</sup> Judgment of the Administrative Court in Belgrade, No. 5 U. 14047/13 of 3 November 2016.

<sup>33</sup> ECtHR, Case 13427/87, 9 December 1994, paras. 49 and 50.

Human Rights as a domain where the right to a fair trial must not be violated. However in *Janosevic v. Sweden*<sup>34</sup> the ECtHR took the position that when the issue of deterrent and punitive surcharges is involved in proceedings related to a tax decision, Article 6 of the European Convention on Human Rights should also refer to such judicial disputes. A surcharge with these features was imposed in this tax case.

To conclude: Although we do not contest the assertion that authentic interpretations of laws are inherently retroactive,<sup>35</sup> in light of the jurisprudence of the ECtHR, we find that an authentic interpretation given for the purpose of solving a specific issue in a specific manner is unacceptable, because it determines the outcome of the dispute in a pending case, thus violating the right to a fair trial.

## 7. CONCLUSION

Although we may be tempted to think that most of the abovementioned issues are related to societies in transition, where legal culture and the adherence to the rule of law principle are yet to fully mature, more recent developments in EU law lead us to conclude that the questions raised in this article have broader relevance. Namely, in 2013 the European Commission started investigations into the practices of various Member States when issuing tax rulings to taxpayers in order to determine whether these countries were providing prohibited state aid to a select few (primarily large multinational corporations). The norm that was and still is being tested is embodied in Art. 107(1) of the Treaty on the Functioning of the European Union<sup>36</sup> which states:

“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

The cited rule has been one of the corner stones of European law and has been present in the primary law of the European Communities since their very formation in 1957.<sup>37</sup> However, in 2016 the European Commission published guidance on the interpretation of a rule almost 60 years old, which implies that certain tax principles – principles which are

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<sup>34</sup> ECtHR, Case 34619/97, 23 July 2002, paras. 68–71.

<sup>35</sup> Cf. Teodor Antić, “Vjerodostojno tumačenje zakona” [Authentic Interpretation of the Law], *Zbornik Pravnog fakulteta Sveučilišta u Rijeci* 1/2015, 623.

<sup>36</sup> *Official Journal of the European Union* C 326, 26 October 2012.

<sup>37</sup> See Art. 92(1) of the 1957 Treaty Establishing the European Economic Community (the Treaty of Rome).

a part of direct tax law and with respect to which the European Union has no prerogatives – were always somehow enshrined in state aid provisions.<sup>38</sup> In other words, despite the fact that neither European primary nor secondary legislation expressly obliged Member States to apply the so-called “at arm’s length” principle when determining corporate tax obligations stemming from related party transactions, they had (we may logically conclude since 1957) the duty to do so on the basis of the state aid rules. Furthermore, the European Commission suggests that the interpretation of the “at arm’s length” principle for the purposes of EU state aid rules may differ, (although it does not say how or when) from the well-established understanding of this principle in international tax law (e.g. the OECD Transfer Pricing Guidelines).<sup>39</sup>

The European Commission supported its approach by invoking the jurisprudence of the Court of Justice of the European Union,<sup>40</sup> but numerous authors, with whom we would have to agree, provide arguments to the contrary.<sup>41</sup> At this moment in time the Court of Justice of the European Union is facing cases in which Member States have been challenged by the European Commission for not applying an existing rule in a way in which, when taxable events occurred, no one had understood to be a possibility.<sup>42</sup> The position of the U.S. Treasury in respect to EU state aid cases clearly resonates what has been proposed with respect to the Serbian case of retroactive interpretation: “[P]ublic guidance – including Commission decisions and notices as well as EU case law – suggested that the tax rulings issued in the State Aid Cases were consistent with the Commission’s application of State aid rules to transfer pricing cases. Moreover, Member States made tax assessments pursuant to these rulings for a long period of time – in some cases for well over ten years

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<sup>38</sup> *Commission Notice on the notion of State Aid as referred in Article 107(1) of the Treaty on the Functioning of the European Union*, 2016/C 262/1, para. 172.

<sup>39</sup> *Ibid.*, para. 173.

<sup>40</sup> Judgment of the Court of Justice of 22 June 2006, *Belgium and Forum 187 v. Commission*, Joined Cases C-182/03 and C-217/03, ECLI:EU:C:2006:416.

<sup>41</sup> For example, R. Mason, “Special Report on State Aid – Part 3: Apple”, *Tax Notes*, 6 February 2017; H. L. E. Verhagen, “State Aid and Tax Rulings – An Assessment of the Selectivity Criterion of Article 107(1) of the TFEU in Relation to Recent Commission Transfer Pricing Decisions”, *European Taxation* 7/2017; U. S. Department of the Treasury, *White Paper. European Commission’s Recent State Aid Investigations of Transfer Pricing Rulings*, Washington, D. C., 24 August 2016, <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf>, 15 September 2018.

<sup>42</sup> For example Case T-892/16: Action brought on 19 December 2016 – Apple Sales International and Apple Operations Europe v. Commission; Case T-892/16: Action brought on 19 December 2016 — Apple Sales International and Apple Operations Europe v Commission, *Official Journal of the European Union* C 53, 20 February 2017; Case C-678/17: Action brought on 5 December 2017 – European Commission v. Ireland, *Official Journal of the European Union*, C 22, 22 January 2018.

– with no enforcement action by the Commission or any other indication from the Commission that its approach to analyzing tax rulings under State aid law was about to change. This could have reasonably reinforced an understanding among all parties that the legal determinations of Member States were consistent with EU law and practice. None of the companies under investigation had identified the risk of State aid investigations in audited financial disclosures made prior to June 11, 2014 (the date that the Commission announced and opened its formal investigations of Ireland, Netherlands, and Luxembourg concerning Apple, Starbucks, and Fiat, respectively). Moreover, it is our understanding that, until the Commission had started its inquiries and investigations, neither internal review nor third-party review and audit of the affected firms by tax and audit professionals gave rise to any determination that their tax treatment could potentially be subject to State aid rules.”<sup>43</sup>

It is a worrying trend that the executive branch of government, even in the most developed parts of the world, attempts to confront problems that warrant a solution with a perhaps even more ominous weapon of retroactive interpretation, which undermines the essential principle of legal certainty. While perhaps it may be unfair that wealthy taxpayers managed to minimize their tax obligations due to inadequate legislation, it would be more prudent to apply the wisdom of being wary of succumbing to populist instincts and defending the ancient *dura lex sed lex* principle. Furthermore, it is with this standard in mind that the legislators (with the essential help of the executive branch of government) should attempt to find more durable solutions to accomplish the legitimate goals of fair taxation.

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<sup>43</sup> U.S. Department of the Treasury, *White Paper: European Commission’s Recent State Aid Investigations of Transfer Pricing Rulings*, 15.



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