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The Concept of Preventive Actions Securing the Enforcement of Tax Liability to be Determined in the Future:

Prosperity under the Principle of Prevention in Tax Law

1. Introduction

Public law has taken a direction toward prevention of threat instead of fighting the consequences of it. The importance of the principle of prevention is recognised and accepted in many branches of public law, such as environmental law^{*1} and law-enforcement law^{*2}, reflecting the general tendencies in this regulative area.

The same has emerged in material and procedural tax law with regard to prevention of tax evasion.^{*3} One form of such measures is used for accelerated assessment and enforcement of tax liability that is going to be determined in the future. Namely, when taxpayers face tax assessment procedure, possible tax liability may drive them to hide their assets or, at least, to become apathetic toward the well-being of their business. This can be a consequence of *mala fide* or *bona fide* acts, just as it can be of wilful or negligent acts. No matter the intentions, compulsory execution of tax liability may, in consequence, become considerably more difficult or even impossible. For prevention of such situations with negative value output, the right to secure or enforce payment of potential tax liability before doing so may be possible under customary procedure may be granted

¹ N. de Sadeleer. *Environmental Principles: From Political Slogans to Legal Rules*. Oxford University Press 2002, p. 68 DOI: <http://dx.doi.org/10.1093/acprof:oso/9780199254743.001.0001>. In discussion of the principle of prevention, it becomes necessary to distinguish between the principle of prevention and the principle of precaution. The principle of prevention deals with threats known in consequence of scientific evidence, while the principle of precaution has to do with hypothetical risks. See also E. Rehinder. *The Precautionary Principle in an Environmental Perspective*. *Miljørettens grundspørsmål* 1994, p. 92, referred to in H. Veinla. *Ettevaatusprintsip keskkonnaõiguses* (The Principle of Precaution in Environmental Law). *Tartu Ülikooli kirjastus* 2004, p. 25 (in Estonian). This article discusses measures used for implementing the principle of prevention.

² M. Laaring. *Estonian Law-enforcement Law as Danger-prevention Law*. – *Juridica International* 20 (2013), p. 197.

³ In the EU, the main focus is on prevention of tax evasion through material tax law and cross-border co-operation. For further information, see the Communication from the Commission to the European Parliament and the Council concerning an Action Plan to strengthen the fight against tax fraud and tax evasion. COM(2012)722 final. Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf (most recently accessed on 27.2.2015).

to the revenue authority. It may even be granted before the tax liability has been identified and evidence been collected.

By its nature, this is a preventive method used in a situation of uncertainty. This preventive accelerated-assessment measure, in combination with elements of enforcement of tax liability and the state's privileged position in cases of insolvency, is known in many countries, including Estonia, the United States, Australia, Canada, the Netherlands, Ireland, Japan, Singapore, Sweden, and the United Kingdom.⁴ As there is no uniform term for such sets of measures⁵, the author refers to them as preventive enforcement actions (or PEAs).

PEA measures have a direct negative effect on the taxpayer's right to ownership of property and may affect other fundamental rights and freedoms too. The ultimate effect on the taxpayer may be disastrous, rendering him impecunious and often permanently ruining his business.⁶ Well-defined legal norms are a 'must' if the principle of rule of law is to be honoured and the required taxpayer-protection standards applicable in most jurisdictions.⁷ It is evident that application of such preventive measures require a high degree of justification and due process guarantees, to minimise their negative effect on taxpayers and third persons.

The author aims to discuss the topic not only from an Estonian perspective. There is no significant body of international regulations covering such measures. Article 1 of the First Protocol of the European Convention on Human Rights ('the Convention') provides a few minimum standards that the measures applied for securing payment of taxes must meet (**the minimum standards**)⁸. But the design of these measures is to a great extent open to the discretion of the jurisdictions (which should aim for **the best standards**).

The author discusses the best standards for PEA measures and does not concentrate on the minimum standards. It is the author's contention that ambiguous regulations open PEAs to maladministration and enable restriction of the taxpayer's procedural and fundamental rights under questionable standards. The author undertakes to find answer to the following question: on which criteria should a PEA measure be based if its compatibility with the above-mentioned principles is to be ensured and it is to reflect the balance of interests? Within this discussion, the author concentrates on two main issues: whether and in what extent the assumed tax liability should be identified and under which criteria to identify threat of possible future insolvency.

The method used is twofold. Firstly, this analysis is based mainly on comparison of the regulations set forth in §136¹ of the Estonian Taxation Act (TA) with the summary-assessment institution presented in the Internal Revenue Code (IRC) applicable in the USA.⁹ Secondly, as some issues are related inevitably to minimum standards as well, certain aspects pointed out by the European Court of Human Rights (ECHR) are discussed. Since the author discusses possible design of PEA methods within the EU (the jurisdiction of the Convention), the IRC serves purely as material for comparison.

⁴ OECD. Working Smarter in Tax Debt Management. OECD Publishing 2014, pp. 95–96. Available at <http://www.oecd.org/ctp/administration/working-smarter-in-tax-debt-management-9789264223257-en.htm> (most recently accessed on 27.2.2015).

⁵ Section 136¹ (1) of the Estonian Taxation Act (maksukorralduse seadus). – RT I 2002, 26, 150; 23.12.2014, 15 (in Estonian; English text of Estonian legal acts is available via <https://www.riigiteataja.ee/en/>) refers to it as 'performance of acts ensuring enforcement before imposition of financial claim or obligation'. Sections 6861 and 6851 of the United States Internal Revenue Code (Pub. L. 113-296, available at <http://www.irs.gov/Tax-Professionals/Tax-Code,-Regulations-and-Official-Guidance> (27.2.2015)) refer to it as 'jeopardy assessment' or 'termination assessment' or the two together as 'summary assessment'. However, Article 16 of Council Directive (EU) 2010/24 of 16.3.2010 concerning mutual assistance for recovery of tax claims relating to taxes, duties and other measures (OJ L 84, 31.3.2010, pp. 1–12, with EU legal texts available via <http://eur-lex.europa.eu/>) refers to 'precautionary measures', designed to embrace a wider spectrum of measures.

⁶ J.E. Gleason Jr, D.K. Poole. IRS summary assessment powers: Abuse and control. – *Brigham Young University Law Review* 1976/1, p. 237.

⁷ Communication from the Commission to the European Parliament and the Council from 19.3.2014 concerning a new EU framework to strengthen the rule of law. COM(2014)158 final/2, pp. 2–4.

⁸ The European Convention on Human Rights (Rome, 4.11.1950) and the First Protocol to the European Convention on Human Rights (Paris, 20.3.1952). Available at <https://www.riigiteataja.ee/akt/78154> (most recently accessed on 10.3.2015). The convention and its first protocol have been in force in Estonia since 1996.

⁹ The statutory progenitor of all jeopardy provisions is the Revenue Act of 1924, for within a few years a clamour arose for tighter control of the commissioner's powers of jeopardy assessment, as the problems and abuses related to expansive administrative discretion under the provision became apparent. See M.M. Armen. Assessing Internal Revenue Service jeopardy procedures: Recent legislative and judicial reforms. – *Cleveland State Law Review* 26 (1997), p. 419. The US model provides excellent examples of specific termination assessment measures with a long history. Since analysis of the general structure shows that the US version can be used for comparison, the author has chosen the summary assessment procedures applied in the United States for this purpose.

2. The position of PEA methods in administrative law

First of all, in the design of legal instruments, it is important to situate the relevant mechanism within the legal system and legal theory if one is to understand the principles and tendencies applicable to such regulations, in order to design an instrument that actually fits the system.

According to Kaspar Lind's approach in his doctoral thesis on value added tax (VAT) fraud, the shortcomings of the current tax system^{*10} can be divided into three classes. The first set of shortcomings has to do with the nature of the current tax system, in connection with which one can discuss whether it is possible to change something in the tax system (that is, substantive law) itself. The second category involves the consequences – i.e., how it is possible to identify tax fraud and have a systematic overview. The third group of shortcomings is related to bringing action against tax fraudsters under criminal law, in relation to which the discussion explores how to recover tax debts.^{*11}

The PEA approach is applicable to tax liability arising from all kinds of taxes; the ideology behind us is not based on the nature of the current material tax system. The PEA-based methods do not help to prevent tax fraud; PEA may be a reaction to the tax fraud discovered, if any. Therefore, it is not a measure operating to address the second group of shortcomings. Instead, PEA methods can be linked to the third group: PEAs are used for preventing insolvency, which could hinder recovery of tax debt. They are aimed at combating inability to pay tax debts. Under §136¹ (1) of the TA, application of PEA requires the possibility of the compulsory execution of advance tax claims becoming considerably more difficult or impossible on account of the activities of the taxable person. The purpose of it is to prevent loss of tax revenue that may result from insolvency of the taxpayer acting *mala fide* or at least in a manner threatening the enforcement of tax claims. In Estonia, it is therefore directed against taxpayers' active engagement aimed at causing inability to pay tax debts. Estonian regulation describes the essence of this measure.

Secondly, the PEA method as a tool in administrative law can be classed as part of the system of administrative coercive measures. Justice of the Supreme Court of Estonia Mr Indrek Koolmeister once stated the following:

Administrative coercive measures can be divided into two categories – administrative preventive measures and administrative sanctions. The main goal of the administrative preventive measures is prevention of offence as much as prevention of the consequences of the offence. In application of the preventive measures, it must be taken into account that 'the required precondition for it is appearance of the characteristics of the (administrative) offence in the actions of the person'. 'Application of the preventive measure is legitimate only if the characteristics of the offence emerge in the acts of a person and such offence is an administrative offence under the law.'^{*12}

PEA's function is to prevent taxpayers' acts from having negative consequences for fulfilment of tax liability. It is not clear whether not fulfilling obligations arising from public law such as tax liability can be understood as 'offence' in the meaning of the above and PEA measures belong to this system. It may be so, but not always. Both the fundamental problems of PEA and the functional criteria are, however, extremely similar to the ones met by danger-aversion law providing criteria for application of administrative preventive measures. Averting a danger is related to supporting, directing, forward-looking, and preventive state activity.^{*13} The scope of both the legislative and the executive power's activities depends on the probability of danger, the nature of the protected and threatened good, and the fundamental rights at stake.^{*14} Standard

¹⁰ Kaspar Lind used this approach to analyse shortcomings in the VAT system. The author finds it to be equally applicable to tax systems in general.

¹¹ K. Lind. Käibemaksupettused ja nende tõkestamine (VAT Fraud and Its Prevention). – Tartu Ülikooli Kirjastus 2012, pp. 12–13 (in Estonian).

¹² K. Merusk, I. Koolmeister. Haldusõigus (Administrative law). Õigusteabe AS Juura 1995, pp. 165–171. Referred to in M. Ernits. Preventiivhaldus kui tulevikumudel (Preventive administration as a model for the future). - *Riigikogu Toimetised* 17 (2008) (in Estonian). Available at <http://www.riigikogu.ee/rito/index.php?id=12530&op=archive2> (most recently accessed on 20.2.2015).

¹³ J. Jäätma. The constitutional requirements for averting of a danger: The principles of a state based on democracy, and the rule of law v. averting of a danger. – *Juridica International* 19 (2012), p. 137.

¹⁴ P.M. Huber. Risk decisions in German constitutional and administrative law. – G.R. Woodman, D. Klippel (eds). *Risk and the Law*. Routledge-Cavendish 2008, p. 29 DOI: <http://dx.doi.org/10.4324/9780203891292> . Referred to in J. Jäätma (*ibid.*), p. 137.

measures create a legal base upon which one may restrict fundamental rights and freedoms, but they are more precisely specified than are terms of a general clause.^{*15}

PEA measures can be considered to be standard measures providing a tailored definition of danger and grounds for preventing it. The author finds that, in a similarity to danger-averting law, it is extremely difficult to estimate what the level of certainty of the risk becoming actualised should be and how the administrative body and the court should estimate the occurrence of characteristics of an offence in the actions of the relevant person. This is a question of the standard of proof, which is by all means one of the most central and problematic questions in tax disputes in practice.^{*16} General standards applicable in preventive administrative law are not helpful and do not provide much assistance. However, some concepts from the theory of administrative coercive measures can be considered here. The requirement of having a factual basis of evidence of the existence of threat (of inability to pay taxes) could be such a principle, discussed in Estonian legal theory of law-enforcement law already in 1935.^{*17} It is clear that the principle *audiatur et altera pars*^{*18}, standing for *due-process guarantees*, may be severely restricted since it may jeopardise the functioning of the measure.

3. The general structure of PEA methods

3.1. The Estonian model directed toward seizure of assets

Under Estonian law, PEA measures are regulated under the TA as ‘performance of acts ensuring enforcement before imposition of financial claim or obligation’. Under §136¹ (1) of the TA, if, upon verification of the correctness of payment of taxes, a ‘justified doubt’ arises that after imposition of a financial claim or obligation the compulsory execution thereof may become considerably more difficult or impossible on account of the activities of the taxable person, the measure may be considered.

Estonia has adopted an *ex ante ex parte* probable-cause-type model. Namely, when PEA comes to be desired, the head of the regional structural unit of the Tax and Customs Board may submit an application to an administrative court to be granted permission for the performance of the PEA. The application includes the following information: the reasons for which the compulsory execution of tax obligation may become considerably more difficult, the estimated value of the financial obligation, which kind of guarantee can be used for replacing the one set by tax authorities, concrete collateral, and reasoning as to why the chosen collateral is the best (TA, §136¹ (2)).

With the purpose of pointing out special preconditions that must be presented to the court in any application for seizure of assets, the Estonian Supreme Court issued a binding ruling in case 3-3-1-15-12. According to the facts of the case, Estonia’s tax authority (Maksu- ja Tolliamet) filed an application with the court applying for permission to set a judicial mortgage on the real estate belonging to O.K. The owner, O.K., was a member of the management board of a company that had tax debts, and it was not possible to enforce this liability, because of lack of assets. The tax authorities found that the evidence collected to that point might justify issuing a liability decision to O.K. personally also. The authority relied on the TA’s §136¹ and claimed for PEA measures. The Supreme Court presented a list of conditions that must be met for PEA to be applicable, in paragraph 50 of this ruling, thus:

- (i) tax-audit procedure has been initiated by tax authorities;
- (ii) it is probable that an additional tax obligation is going to be imposed as a result of such procedure;
- (iii) the tax authorities have a justified suspicion that the compulsory enforcement procedure may become considerably more difficult or impossible in consequence of the taxpayer’s activities;
- (iv) the tax liability period has not expired.^{*19}

¹⁵ J. Jäätma (see Note 14), p. 141.

¹⁶ M. Kähri. Tõendamiskoormus maksumenetluses (The burden of proof in tax proceedings). – *Juridica* 1 (2004), p. 53 (in Estonian).

¹⁷ M. Ernits. Preventiivhaldus kui tulevikumudel (Preventive administration as a model for the future). – *Riigikogu Toimetised* 2008 (17) (in Estonian).

¹⁸ In English, ‘let the other side be heard as well’.

¹⁹ GASCr 3-3-1-15-12, 27.11.2012 (in Estonian). In this article, the author has not addressed the specific conditions related to personal liability of the member of the management board discussed in this court ruling.

Proportionality of restriction of fundamental rights (especially the right to ownership) is justified by the taxpayer's due-process rights, as the court's consent is a prerequisite for application of PEA measures. It is important to point out that the measure itself does not have an effect on the assessment of tax liability at all. The normal assessment process continues after this procedure. Since PEA measures do not accelerate the assessment procedure as such, no additional procedural guarantees are provided to taxpayers with regard to tax audit. The measure becomes applicable only after the end of the tax period, as otherwise it would not be possible to estimate whether taxes were paid correctly or not.

3.2. The US model employed for accelerated-assessment procedure

In the US, accelerated-assessment models have been used instead. Under normal Internal Revenue Service (IRS) assessment and collection procedures, a taxpayer has ample notice that the tax commissioner proposes to assess additional taxes and collect these from him. In fact, after informally notifying the taxpayer that more tax is owed, the IRS will usually attempt to negotiate a settlement with the taxpayer.^{*20} Under special circumstances, however, the IRS is empowered to bypass these normal procedures for notice and a prepayment hearing, moving immediately to an assessment, a demand for payment, and collection by seizure of the taxpayer's assets (summary procedures). These summary procedures are of two fundamental types: jeopardy assessments (IRC, Section 6861) and termination assessments (IRC, Section 6851).^{*21} Jeopardy assessments and termination assessments both are performed in situations wherein, prior to the assessment of a deficiency at some level, it is determined that collection of the amount lacking would be endangered if standard assessment procedures were followed.

Section 6861 of the IRC defines jeopardy assessment:

If the Secretary believes that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213 (a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary for the payment thereof [...]

The seizure of assets follows immediately. In some cases, the entire process can take less than two hours.^{*22} The statutory notice of deficiency, or 90-day letter, which ordinarily precedes and forestalls assessment and collection, is still required in the jeopardy assessment context but need only be sent within 60 days **after** the jeopardy assessment has been made.^{*23} The property may be sold after the statutory notice of deficiency has been issued and the taxpayer's 90-day period for filing a petition with the United States Tax Court has expired.^{*24}

Section 6851 of the IRC's definition of termination assessment states the following:

If the Secretary finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act (including in the case of a corporation distributing all or a part of its assets in liquidation or otherwise) tending to prejudice or to render wholly or partially ineffectual proceedings to collect the income tax for the current or the immediately preceding taxable year unless such proceeding be brought without delay, the Secretary shall immediately make a determination of tax for the current taxable year or for the preceding taxable year, or both, as the case may be, and notwithstanding any other provision of law, such tax shall become immediately due and payable.[...]^{*25}

²⁰ J.E. Gleason Jr, D.K. Poole (see Note 7), p. 237.

²¹ *Ibid.*, p. 235.

²² *Ibid.*, p. 237, Note 21.

²³ *Ibid.*, p. 237.

²⁴ *Ibid.*, p. 238.

²⁵ When it comes to the assessment procedure, it follows from the same section that such determination and assessment is to be supplied to the taxpayer, together with a demand for immediate payment of the accordant tax.

Termination assessment, on the other hand, is carried out for the tax year that has not yet ended and for which the due date of returns has not passed.^{*26} Because either the taxpayer or the IRS can reopen the question of liability at any time until the end of the year, any mid-year 'deficiency' is, in effect, meaningless.^{*27} The final tax liability cannot be determined until the end of the taxpayer's taxable year. Consequently, there is no obligation to provide the taxpayer with a statutory notice of deficiency within 60 days after the jeopardy assessment has been made. This regulation is aimed not at determining tax liability in unclear cases but at determining it in an accelerated way, triggered by *mala fide* acts of the taxpayer.

Although the measures applied in Estonia and the US are similar in their **rationale**, the US regulation provides more effective powers to tax authorities, by enabling PEA actions before the end of the taxable period. This is, however, an extremely invasive method, for it is not even clear how the taxpayer may pay taxes at the end of the year. Under Estonian law, such measures are rather uncommon and classified as involving recommendations or notices. The jeopardy assessment procedure, on the other hand, provides an attractive example for Estonia and for PEA measures' design in general. Having a restricted, 90-day period for statutory notice of deficiency during the jeopardy assessment protects taxpayers from unpredictably long assessment procedures. In Estonia, the tax assessment procedure follows its usual course, without acceleration.^{*28} In the author's opinion, such difference is derived from the fact that the US model places the assessment procedure at the centre of the PEA process while the Estonian model is directed at seizure of assets *per se*, providing a privileged situation for the state in situations of insolvency.

4. Whether and how existence of tax liability should be assessed

4.1. Relevance of the tax liability

The author finds that the main trigger for PEA should be the understanding that there may be tax liability. There is no justification for PEA without tax liability. There is no relevance to tax assessment procedure when a person is becoming insolvent or acting *mala fide* but there is no obligations arising from tax law. Insolvency is regulated by other legal means, which neither are within the scope of tax assessment procedure nor fall under the regulatory purview of tax law and, moreover, are covered by the **rationale** of PEA measures. The PEAs enter in when there is a certain level of doubt, concern that some taxes may be unpaid. The question arises of what the legal standard of proof related to emergence of tax liability should be: what should be the threshold for PEA measures?

4.2. The Estonian approach: No clear standard

Under the TA, it is not mandatory to show evidence of the existence of a tax claim upon application for PEA. Only the information on the estimated value of tax liability must be provided to the court. It is, of course, understandable for the tax authority not to be able to estimate the value of the claim unless it has some kind of information available on the tax liability. The law does not, however, state that the court should take into account the basis for tax liability when deciding on the applicability of PEA or that it should be presented to the court.

The relevance of tax liability within the PEA procedure was discussed by the Tallinn Circuit Court in its 12.1.2015 decision on case 3-14-52363. According to this, issuing consent under the TA's §136¹ (1) does not require a certain belief that tax liability will be determined or tax evasion emerge. The court must verify whether tax liability may be 'possible and probable'.^{*29} However, as can be seen from the reasoning

²⁶ *Walker v. U.S.*, 650 F. Supp. 877, 87-1 U. S. Tax Cases (CCH) P 9237, 59 A.F.T.R.2d 87-651 (E.D. Tenn. 1987). Available via <http://international.westlaw.com/> (most recently accessed on 25.2.2015).

²⁷ E. Gleason Jr, D.K. Poole (see Note 7), p. 239.

²⁸ Indeed, in some rulings, the Estonian courts have set certain time limits after which the PEA measure becomes ineffective. This impels tax authorities to carry out assessment procedures in a short span of time and collect significant amounts of evidence before turning to the court to obtain permission for seizure. It is, however, a matter of the court's discretion to decide whether to apply such a time limit or not. The law does not require it.

²⁹ See Note 19, paragraph 50.b.

presented later in the same ruling, the court actually assessed whether determination of the amount of tax would be 'clearly impossible or not'.^{*30} This can be seen in many other cases as well.^{*31} The Estonian Supreme Court, on the other hand, has indicated, in court case 3-3-1-15-12, that the court must assess whether it is 'probable' that additional tax obligation is going to be imposed as a result of such investigation.^{*32} It is evident that the standard of proof for tax liability varies, and it is not clear what standard is necessary for applying PEA. Regrettably, the law provides no clear instructions.

What is more, the application submitted to the court need not include much evidence: the application must be substantiated under the Code of Administrative Court Procedure (CACP)'s §63.^{*33} Under the relevant clause, substantiation means explaining a factual assertion to the court such that the court finds that assertion credible; there is no requirement for evidence to be presented. The standard of reliability required of the reasoning behind said assertion is therefore low.

The legislator has tried to minimise the vagueness of tax liability by imposing a procedural requirement. Namely, according to TA §136¹, the formal procedure of a tax audit must be started by tax authorities before it is possible to apply PEA. However, according to the Estonian Administrative Procedure Act (APA)'s §35 (1) 3) the administrative procedure starts automatically with the first acts employed for review of the taxpayer's activities.^{*34} This standard is apparently a formal one, related as it is to the mere fact of whether the tax authority has performed the first procedural act or not.

The Supreme Court has tried to limit the broadness of this procedural criterion. In case 3-3-1-7-13, it was argued that the procedure must have taken place in the extent necessary to create doubt with respect to the compulsory execution of expected tax being hindered.^{*35} In many cases, however, such doubt has been created easily by means of the taxpayer's public company records and the available data on assets, with the addition of perfunctory reference to the taxpayer's bad-faith actions supported by the same, unproved doubts about existing tax liability. Firstly, this criterion is clearly related to inability to enforce tax liability and not to emergence of tax liability. Secondly, the criteria and this limitation are rather formal, providing no material criteria for the description of such doubt. It is up to the tax authority to demonstrate such doubt. In real terms, this clarification provides little help for the taxpayer against maladministration and no solid grounds from which the judge can estimate whether there may be a tax liability or not.

4.3. The US approach: Factual basis

Sections 6851 and 6861 of the IRC provide rather clear regulation regarding the existence of tax liability. Under these sections, the tax authority must assess the tax liability; only after that may the jeopardy assessment be carried out. The law does not allow PEA actions in the case of no assessment having been made. It can be done more rapidly, however. The US Internal Revenue Service has stated, in its Revenue Manual (2014), that the assessed amount must be supported; i.e., there must be a reasonable, factual basis for determining that the taxpayer has received income.^{*36} Uncertainty covers the question of whether the collection procedure can be threatened by certain factors and whether there is reasonable doubt in that respect.

It is crucial to note that after the assessment of tax is performed for jeopardy or termination assessment, the actual notice of deficiency must be provided by the tax authority within 60 days of the start of application of jeopardy assessment measures. This prevents the tax authorities from undertaking jeopardy assessment without any real and factual basis, as the notice of deficiency must be delivered within this strict time limit. In Estonia, on the other hand, the usual assessment procedure can continue; the requirement is that it reach its conclusion within reasonable time, which could easily be two to three years.^{*37}

³⁰ *Ibid.*

³¹ See also Tallinn Circuit Court ruling 3-13-70224, of 24.3.2014, paragraph 10; Tallinn Circuit Court ruling 3-14-50489, of 1.7.2014, paragraph 13. Available via <https://www.riigiteataja.ee/> (in Estonian).

³² See Note 19.

³³ According to the Tallinn Circuit Court ruling 3-14-52363, of 12.1.2015, paragraph 6 (in Estonian).

³⁴ Haldusmenetluse seadus (Administrative Procedure Act). – RT I 2001, 58, 354; 23.02.2011, 3 (in Estonian).

³⁵ ALCSCr 3-3-1-7-13, of 14.5.2013, paragraph 12.

³⁶ R.A. Steco. IRS Internal Revenue Manual, 23.10.2014, version 5.17, Section 5.17.15.2.2.2. Available at http://www.irs.gov/irm/part5/irm_05-017-015.html (most recently accessed on 20.2.2015).

³⁷ The Civil Law Chamber of the Supreme Court has referred to four criteria that must be considered in decisions upon reasonable time of procedure: '1) complexity of the case; 2) activities of the applicant; 3) activities of relevant public institutions

4.4. Minimum standards from the Convention: What to aim for

When analysing the design of measures used for securing the payment of taxes for jurisdictions within Europe, one finds that the absolute minimum standards based on protection of human rights are stated in the Convention.^{*38} The Convention indeed has significant relevance for tax matters. Professor Philip Baker writes: 'Some would say that taxation and human rights is an oxymoron. [...] I personally do not believe that taxation and human rights are in any way irreconcilable or conflicting; I think human rights are a fundamental aspect of taxation. Human rights limit what governments can do to their citizens – to people affected by their decisions [...] provid[ing] limits to what governments can do to taxpayers.'^{*39} The right to peaceful enjoyment of possessions and the right to ownership, regulated in Article 1 of the First Protocol (the Protocol) to the Convention, are the central rules with a bearing on PEA.^{*40}

One type of interference with the substance of property regulated under Article 1 of the Protocol is interference justified by the need to secure payment of taxes.^{*41} Article 1 (2) states that the right to ownership shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary for controlling the use of property in accordance with the general interest or for securing the payment of taxes or other contributions or penalties. The author emphasises that the meaning of the condition 'in any way' has been significantly narrowed by the practice of the ECHR, which stated that this justification for interfering with the right to ownership is not absolute and that it can be applied only if certain general principles are followed.^{*42}

The test accepted by the ECHR involves three main criteria to be analysed: the principle of legality, principle of legitimate aim, and principle of fair balance (proportionality).^{*43} The author does not analyse the first and the second thoroughly, since these are not at issue except in cases of serious infringement.^{*44} What the legislator should, however, keep in mind is that the application of such preventive measures must be sufficiently foreseeable and precise.^{*45} Norms regulating application of PEA should, therefore, be designed to be as precise as possible, with foreseeable applicability. When it comes to not requiring a certain evidentiary basis for the tax liability for seizing property under PEAs, the applicability of the PEA norm

(state); 4) what is at stake for the applicant.' CLCSCd 3-1-1-43-10, of 18.6.2010, paragraph 30. The same criteria are applicable when one is assessing the duration of tax assessment procedures.

³⁸ In addition to the Convention, protection of human rights in the EU is regulated by the EU Charter of Fundamental Rights as well. In the present article, the author does not discuss the relevance and applicability of the charter. The charter applies inasmuch as the legal issues are related to EU law (see Article 51). The terms set forth in the Convention shall be applied through Article 53 of the charter. Therefore, the Convention has fundamental importance with respect to the issues discussed in this article and can be seen as a higher-level legal act than the charter. Accordingly, the author examines only the Convention here.

³⁹ M.A. Grau Ruiz. Decisions of the ECHR affecting domestic laws. – *Lex ET Scientia International Journal – Juridical Series* 2011/1 (XVIII), p. 9. As for the general situation, apparently trivial issues of tax procedures reach the European Court of Human Rights.

⁴⁰ This article applies *expressis verbis* both to legal-person and to natural-person taxpayers. M.K. Addo. Human rights standards and the responsibility of transnational corporations. – *Kluwer Law International* 1999, p. 187. See also W.H.A.M. van den Muijsenbergh, S Rezaei. Corporations and the European Convention on Human Rights. Presentation at the University of the Pacific, McGeorge School of Law Symposium on the Global Impact and Implementation of Human Rights Norms, Sacramento, California, 2011. Available at http://www.mcgeorge.edu/Documents/Conferences/GlobeJune2012_Corporationsandthe.pdf (most recently accessed on 28.2.2015).

⁴¹ L. Sermet. The European Convention on Human Rights and Property Rights. *Human Rights Files*, No. 11, revised. Council of Europe Publishing 1998, p. 8.

⁴² ECHR judgement of 21.2.1986 in *James and Others v. United Kingdom*, Series A, No. 98, paragraphs 29–30 and 37; ECHR judgement of 23.9.1994 in *Sporrong and Lönnroth v. Sweden*, Series A, No. 52, paragraph 24; ECHR judgement of 9.12.1994 in *The Holy Monasteries v. Greece*, Series A, No. 301-A, paragraph 31; ECHR judgement of 20.9.2011 in *OAQ Neftyanaya Kompaniya Yukos v. Russia*, application no. 14902/04, paragraph 554. The ECHR judgements are available via <http://hudoc.echr.coe.int/> (most recently accessed on 20.3.2015).

⁴³ L. Sermet (see Note 42), p. 32.

⁴⁴ In legal literature and court practice, it has been acknowledged that applicants encounter difficulties when relying on claims of breach of the two principles, due to the state's high level of discretion in these matters. Please see the *OAQ Neftyanaya Kompaniya Yukos v. Russia* decision (see Note 43), paragraph 598; C. Sheldon. Article 1 of Protocol 1 of the European Convention on Human Rights: Taxation, p. 7, paragraph 23. Available in <http://www.11kbw.com/uploads/> (most recently accessed on 8.4.2015).

⁴⁵ ECHR judgement of 22.9.1994 in *Hentrich v. France*, Series A, No. 296-A, paragraph 42; ECHR judgement of 8.7.1986 in *Lithgow and Others v. the United Kingdom*, Series A, No. 110, paragraph 42.

disposition becomes highly unpredictable. Consequently, this solution is not favoured by the ECHR and should be avoided at least within ECHR jurisdiction.

When considering the principle of fair balance, the ECHR has instructed that public interests and infringement of the taxpayer's property rights must be balanced. One of the fundamental cases connected with tax matters is *Gasus v. Netherlands* (1995)⁴⁶. The ECHR stated that, while the legislator must have ample discretion to adopt the fiscal legislation required to secure payment of taxes (para. 60)⁴⁷, the resulting legislation must strike a 'fair balance' between means and ends (para. 62) and impose no special and exorbitant burdens on owners of property rights (para. 67).⁴⁸ There must, therefore, be a reasonable relationship of proportionality between the means employed and the aim pursued (para. 62).

The principle of proportionality is subject to a wide margin of evaluation by national courts, and this is recognised by the ECHR⁴⁹, which mostly examines whether the national court has considered all relevant aspects of the test. With the test as applied by the Estonian Supreme Court, to meet the proportionality requirement, the measures must be necessary as applied.⁵⁰ A measure is deemed to be necessary if no other measure has a less interfering effect while still being capable of achieving the intended goal (in this case, preventing loss of tax revenue).⁵¹ The author finds that PEA can reach its goals both when it is materially not related to the status of tax assessment procedure (as in Estonian law) and when it is designed as accelerated assessment procedure or the procedure is given clear limits after application of a PEA measure (as under the US model). But when it comes to assessing the measure's burden on the taxpayer, the latter way shows much less negative effect on the taxpayer, encouraging a short assessment period and foreseeability of the measure's effects on the taxpayer's proprietorship.

Such procedural considerations in the fair-balance test were discussed by the ECHR in the *Riener v. Bulgaria* case (2006), in which the Court considered the issue of violation of Article 2 of the Fourth Protocol to the Convention, regulating freedom of movement. The Court concluded that the authorities had failed to give due consideration to the principle of proportionality in their decisions and that the travel ban imposed on the applicant had been an automatic measure of indefinite duration.⁵² Although considered under a different article of the Convention, the indefinite length of application of preventive measures can lead to a non-proportional result of the method used for securing payment of taxes.

The author argues that material guarantees should be preferred to due-process guarantees, where appropriate and possible to apply. Material guarantees are easier to enforce, as these are set by law (whether via material or procedural regulations), while exercising due-process rights requires initiating or at least participating in a court procedure, which can be onerous for the taxpayers. Material guarantees provide a higher level of protection also. Setting a specific time limit for tax assessment procedure taking place after application of PEA measures supports conducting assessment procedures in reasonable time, given the possible serious negative effect on the taxpayer's fundamental right to ownership (whether in the form of deprivation of property or interference with the peaceful enjoyment of property). Other material factors, such as taxpayer intentions or standards of proof related to the existence of tax liability, should be regulated by law too in the maximum extent, with a minimal role left for due-process guarantees, with an ancillary function.

⁴⁶ ECHR judgement of 23.2.1995 in *Gasus Dossier- und Fördertechnik GmbH v. the Netherlands*, Series A, No. 306-B, paragraph 59. The facts of the case were the following. Applicant company Gasus had sold a concrete-mixer to Atlas, subject to retention of title until the full price had been paid. Possession of the machine was given to Atlas, but its ownership remained with Gasus. The tax authorities in the Netherlands seized the machine and subsequently sold it on account of Atlas's tax liability.

⁴⁷ Per the *paritas creditorum* principle, the Court pointed out that when passing such laws the legislature must be allowed a wide margin of appreciation, especially with regard to the question of whether – and, if so, to what extent – the tax authorities should be put in a better position to enforce tax debts than ordinary creditors are in to enforce commercial debts. The Court showed respect toward the legislature's assessment of such matters except where it is devoid of reasonable foundation (para. 60). A negative effect in relation to the *paritas creditorum* principle has *per se* relatively little importance in this connection.

⁴⁸ See also: L. Sermet (see Note 42), p. 36.

⁴⁹ ECHR judgement of 23.10.1997 in *National & Provincial Building Society and Others v. United Kingdom*, Reports 1997-VII, paragraph 80.

⁵⁰ Judgement of the Estonian Supreme Court Constitutional Review Chamber of 17.7.2009, No. 3-4-1-6-09, paragraph 21; judgement of the Estonian Supreme Court Constitutional Review Chamber of 15.12.2009, No. 3-4-1-25-09, paragraph 24.

⁵¹ *Ibid.*

⁵² Taxation and the European Convention on Human Rights. Fact Sheet – Taxation. European Court of Human Rights Press Unit, May 2013, pp. 6-7. Available at http://www.echr.coe.int/Documents/FS_Taxation_ENG.pdf (most recently accessed on 3.5.2015).

4.5. Some suggestions related to tax liability in the PEA model

In analysis of Estonian PEA regulations as discussed above, it emerges that the standard for application is overwhelmingly low, per existence of tax liability, and can lead to tax assessment procedure taking place over an indefinite period of time. The author finds that it is not appropriate to create the criteria for assessing the legality of an administrative act in the manner employed by Estonian courts, let alone apply it in an inconsistent way. Criteria should be set by law in this connection, to ensure adherence to the rule-of-law principle and provide a just and legal basis for limiting the right to ownership as required by the Convention on the minimum-standard basis. Applying PEAs should require a factual grounding for the tax liability, as existence of such liability provides overall meaning for this procedure.

The author finds the accelerated-assessment procedures applied in the US to provide better balanced and more proportional regulation than does the one used in Estonia. Accelerated assessment with certain time limits meets the minimum standards set by the ECHR and provides more balance among the various interests. The risk of conflict with the requirement of foreseeable application of the measure is lower, as is that of non-proportionate nature. This would motivate tax authorities to apply PEA measures only to those cases in which they have certain knowledge about possible tax liability. It would lift the heavy burden of reasoning from the court and place it with the tax authorities instead. With accelerated-assessment procedure applied, there must be certain knowledge of the existence of liability, supported by certain evidence. The author suggests including the requirement of presenting evidence of existence of a tax claim in the PEA norm's disposition for the purposes indicated above.

5. The taxpayer's contribution to negative prospects of expected enforcement procedure – are *mala fide* activities a prerequisite?

Threat of insolvency can be a natural outcome of unsuccessful business, or it may be encouraged by the taxpayer's activities (or, in the case of legal-person taxpayers, those of its representatives). Such activities may be *mala fide* or *bona fide*. In the design of PEA measures, the legislator must determine whether the purpose of these is protection against insolvency *per se* or, instead, it should provide protection against activities of the taxpayer, whether acting in *bona fide* (lack of knowledge in this field of business) or in *mala fide* (as with intentional insolvency). The first scenario may place tax authorities in an advantageous position in possible-bankruptcy procedure in jurisdictions where creditors with surety will receive the payments in the first round.

Section 136¹ (1) of the Estonian TA refers to compulsory execution becoming considerably more difficult or impossible in consequence of the activities of the taxable person. The law relies on the principle of active participation of the taxpayer regardless of intentions. Estonia's Supreme Court has confirmed this approach in its case 3-3-1-15-12.^{*53} The actual court practice, however, relies also on criteria that are not related to the taxpayer's active contribution to possible insolvency, such as amount of share capital or lack of assets. In some cases, acting in *mala fide* has been emphasised also.^{*54}

In the IRC, the system is two-pronged; how it plays out depends on which of the two measures is used. While jeopardy assessment does not require active engagement of the taxpayer, the more invasive alternative – termination assessment – requires certain actions taken by the taxpayer to become applicable. A fine examples of the latter is fleeing the country and distributing all or some of one's assets.

US court practice diverges somewhat from the wording of the law, providing a wider range of criteria under which the inability to pay tax may become evident. In the IRS's Internal Revenue Manual, it is stated that the court, for instance, may consider whether the taxpayer is involved in illegal activity.^{*55} The court also may consider whether the taxpayer possesses, or deals in, large amounts of cash; whether prior tax

⁵³ See Note 19, paragraph 50 (in Estonian).

⁵⁴ Tallinn Circuit Court ruling 3-14-50822, of 6.11.2014, paragraph 8 (in Estonian).

⁵⁵ *Mueller v. CIR* (S.D. Fla. 1995); *Harvey v. United States* (S.D. Fla. 1990); *Young v. United States* (S.D. Fla. 1997). All referred to in R.A. Steco (see Note 37).

returns report little or no income despite the taxpayer's possession of a large amount of cash; whether there is a lack of assets from among which potential tax liability can be collected; and whether the taxpayer has used multiple addresses, rendering it hard to find the taxpayer.^{*56} Evidence of pending bankruptcy does not on its own establish insolvency.^{*57}

The author first concludes that the written law and court practice are not identical, both in the US and in Estonia. As the legal criteria require certain 'acts' to be undertaken by the taxpayer, the conclusion of possible jeopardy may be justified also by means of other criteria, which do not consist of 'acts' of the taxpayer. In the IRC and US court practice, however, criteria not falling within the category 'acts' cannot be used as the only justification for jeopardy, though they may be supporting considerations. The author finds this a reasonable approach, one that could be followed in Estonia and in other jurisdictions as well. The PEA method should not be an additional measure, placing the tax authorities in a better position in bankruptcy proceedings and deviating from the *paritas creditorum* principle; it should be aimed at protection against *mala fide* taxpayers. If it is designed to be part of the body of insolvency regulations, its suitability in connection with the existing insolvency law system should, however, be analysed.^{*58}

6. Conclusions

Prerequisites for applying PEA measures vary with the jurisdiction and are generally open to misuse. On account of several minimum requirements rooted in the Convention and also constitutional principles, the criteria and due-process guarantees for identifying (possible) tax liability and (possible) future problems with enforcement of such liability ought to be stricter than foreseen in Estonian legislation. Although the Estonian model provides due-process guarantees with its *ex ante ex parte* probable-cause-type model, the US model used for comparison has some clear advantages in certain respects. The US model meets the minimum standards set by the Convention to a greater extent and, accordingly, can be used as a comparative example for PEA measures' design.

Firstly, the author suggests that accelerated-assessment procedures should be used instead of mere seizure of assets. This would provide the taxpayer with more guarantees against excessively long and invasive assessment procedures and motivate tax authorities to apply PEAs only for those procedures in which they have some certain level of knowledge of possible tax liability. Secondly, a reasonable and factual basis for the conclusion that there is tax liability and is a threat of incapability of enforcing that liability should be demonstrated to the court upon application for PEA measures by tax authorities. Thirdly, a clear standard for assessing the existence of tax liability should be put forth. *Bona fide* actions, as well as 'non-acts' of the taxpayer, should be excluded for reason of being covered by other legal tools (such as bankruptcy procedure).

⁵⁶ *Maqluta v. United States* (S.D. Fla. 1996); *Mesher v. United States* (D. Or. 1990). Referred to in R.A. Steco (see Note 37).

⁵⁷ Refer to R.A. Steco (see Note 37).

⁵⁸ This was discussed by the ECHR in the case *Gasus Dosier- und Fördertechnik GmbH v. the Netherlands* (see Note 47), paragraph 65.