

PwC Legal achieves favourable ruling in dispute with State Revenue Service 1/44/22



Attorney-at-Law, PwC Legal
Natalja Purina

We informed our MindLink.lv subscribers some time ago that the State Revenue Service (SRS) is increasingly exercising its statutory power to demand that a company's overdue taxes be recovered from its board member if the tax debt cannot be recovered from the company. This article explores how we successfully resolved a court case to release a construction company's former CEO (a client of ours) from the company's tax debt of close to EUR 150,000.

The finer points of law

The decision to recover a company's overdue taxes from its board member ("recovery decision") is based on section 60(1) of the Taxes and Duties Act. This section contains five cumulative criteria for recovering the company's tax debt from its CEO:

1. The overdue taxes total over 50 minimum monthly wages prescribed in Latvia.
2. The decision to recover the overdue taxes has been notified to the entity.
3. It has been established that after the decision was made to conduct a tax audit, a statement of particular discrepancies, found during a compliance review, between the information filed by the taxpayer and the information available to the SRS data was sent, a thematic review statement was drawn up if the thematic review found material offences suggesting tax evasion, and after overdue taxes arose, the entity transferred its assets and the board member's action or omission resulted in failure to duly pay the entity's overdue taxes.
4. A statement has been drawn up to the effect that recovery is impossible.
5. The entity has defaulted on its obligation under the Insolvency Act to file for corporate insolvency.

A new version of the law effective from 1 January 2020 substantially amended section 60(1)(3) of the Taxes and Duties Act applicable earlier. According to the old version, in order to make the recovery decision, the SRS was required to find that after overdue taxes had arisen, the entity transferred assets to a person that fits the definition of an interested party to the board member under the Insolvency Act. Yet establishing this criterion was the most difficult task for the SRS, so the law was improved over time. As we can see from the new version, the status of the person to whom company assets are transferred is no longer relevant. It is now sufficient to establish that while awaiting a tax audit or having a tax debt, company assets have been transferred, and the board member's action or omission has led to the tax debt remaining unpaid.

At the same time, it was the SRS's carelessness in applying the right version that helped us win this case.

The circumstances of the case

The board member was blamed for the transfer of two company vehicles and for omission in paying the tax debt over the period from 2017 to 2018. To ensure the recovery decision is lawful, it was necessary to

meet all of the criteria laid down by the law that was in force when the person was serving on the board and the company incurred the tax debt. As part of the dispute, the SRS was required, among other things, to establish that the company vehicles were transferred to an interested party.

Yet the SRS decided to take a different path and applied the version that was in force when the recovery decision was made (in December 2021), rather than when the potential offence was committed. In other words, the SRS applied a law that substantially altered the range of circumstances the SRS had to ascertain and facilitated the subject matter of proof. The SRS decided not to assess whether the buyers of company vehicles are recognised as interested parties to the company's CEO.

We discovered the SRS's mistake in the subject matter of proof when we were preparing our defence position for the court.

In all fairness, we should note that the SRS might not have been better off even if they had applied the right version. The board member's "misconduct" in transferring the company vehicles was quite debatable because one of them had been transferred before the company incurred the tax debt, and the other was an asset held under a finance lease which the company could no longer keep.

The SRS's arguments

In the court, the SRS put forward some fairly interesting arguments, objecting to the reversal of the recovery decision. The SRS stated that under section 1(3)(5) of the Administrative Proceedings Act, an administrative instrument is not a decision that is made in administrative offence proceedings. Administrative proceedings and administrative offence proceedings are two different types of proceedings governed by different statutes. The SRS noted that administrative proceedings are governed by the Administrative Proceedings Act, while administrative offence proceedings are governed by the Administrative Liability Act. The SRS claimed this meant the claimant's argument that section 60(1) of the Taxes and Duties Act should be applied in its historical version because the person having committed an offence should be held liable for it according to the law that was in force when the offence was committed (as per section 4 of the Administrative Liability Act – the validity of law in time) is recognised as invalid. The SRS emphasised that an administrative instrument was issued on the recovery of overdue taxes from the claimant (in this case the claimant was not held administratively liable). Accordingly, the SRS made the recovery decision validly, applying the law that was in force when the administrative instruments were issued. And in applying the current version of section 60(1) of the Taxes and Duties Act, it is no longer relevant to whom the debtor transferred his assets.

Here we need to explain that for the claimant's defence we never argued that the recovery decision is a decision in a case concerning an administrative offence. The claimant's position was primarily based on section 9(4) of the Official Publications and Legal Information Act, under which a legal enactment or any part of it does not have retrospective effect, except for certain cases that are expressly provided for in the law, and in this case the lawmaker has not elected to determine a different procedure for applying the law. Thus, certainly agreeing that administrative proceedings and administrative offence proceedings are different, under the circumstances of the dispute, the SRS's arguments were neither valid nor reasonable in substance.

The court's findings

In hearing the case on its merits, the District Administrative Court accepted the claimant's arguments as

correct. The court stated that according to a general principle of law, a law is applicable from its effective date. The retrospective effect of a law means that it is applied to situations that arose before its effective date. Thus, a retrospective law applies to past legal relationships as well as current ones. Only the issuer of a law can make it retrospective. In view of this, the retrospective effect of a law is what transitional provisions need to determine separately. A legal relationship that has already been established must be governed by provisions that were in force when it was established. The court correctly noted that in amending section 60(1)(3) of the Taxes and Duties Act, the lawmaker did not make any transitional provisions to prescribe the action of assessing how board members handled the transfer of assets when they were serving on the board. The lack of transitional provisions in the law leads to the conclusion that the most useful and fairest interpretation of the law is such that it is geared towards the future and the new, more stringent requirements are applied to board members handling company assets when the new law is in force, without extending those requirements to any past events that occurred when it was not yet in force. So the SRS had to assess whether the persons to whom the assets had been transferred are recognised as interested parties within the meaning of the Insolvency Act. Yet the SRS has not carried out such an evaluation in the recovery decision.

The court also noted that the SRS's duty to apply the law that was in force when the claimant was serving on the board, and was more favourable to the claimant, is all the more justifiable by the fact that the consequences prescribed by this law are equivalent to criminal law. Section 5(1) of the Criminal Code states that the criminality and punishability of an offence (action or omission) are prescribed by the law that was in force when it was committed. At the same time, the principles summarised in section 5 of the Criminal Code provide that a law that recognises an offence as unpunishable, reduces the punishment, or is otherwise favourable to the person, is applicable retrospectively. In view of this, the SRS has to apply the law that was in force when the claimant was serving on the board unless the new law is more favourable to the private person.

Finally, we note that in this case the defects of the recovery decision could not be rectified during the litigation because the subject matter of the lawsuit was the reversal of an unfavourable administrative instrument. According to insights produced by the case law, the court does not have the power to intervene in another authority's competence or to decide matters that should initially be assessed and decided by the particular competent authority. As stated above, under section 60(1) of the Taxes and Duties Act, the SRS has the power to start proceedings if all the criteria listed in this section are met. Yet one of the criteria that makes the claimant liable to reimburse the company's overdue taxes has not been assessed or proven because the SRS has failed to assess its existence correctly. The SRS has applied the wrong substantive provision of law but the court is not required to evaluate facts for the SRS that have not been evaluated in the decision to determine the claimant's obligation to reimburse the company's overdue taxes. Since the decision is an administrative instrument unfavourable to the claimant and inconsistent with substantive provisions of law, it has been reversed from the date it was made.