Ongoing disputes over Covid-19 aid refund claims 3/11/23

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The pandemic and related safety and aid measures seemed already behind us, but the tax authority keeps fighting for refunds of the aid awarded earlier.

Background

On 10 November 2020 the Cabinet of Ministers passed Rule No. 676 on aid to secure working capital flows in companies affected by the Covid-19 crisis (the “Aid Rules”). Several companies having suffered a drop in working capital that matched the level specified by the Aid Rules applied for the aid and received it.

The Aid Rules were amended with effect from 8 June 2021 to add a condition that for revenue drop purposes the State Revenue Service (SRS) considers the taxable person’s total ex-VAT value of transactions appearing on the VAT return for the tax period. For companies that are not registered for Latvian VAT, the revenue drop is assessed on the basis of their business revenue.

The SRS then began to launch inquiries into the legality of the state aid received and used, and required the businesses to repay it voluntarily. The decisions that made the aid recoverable were based, among other things, on the fact that the revenue drop stated in the company’s aid request was greater than what could be inferred from its VAT returns. So the SRS began to extend the revenue drop criterion based on VAT returns to the aid that was awarded and paid before this condition was inserted into the Aid Rules.

The SRS approach is wrong and disputable

For a start, section 9(4) of the Official Publications and Legal Information Act provides that an enactment or any part of it is not retroactive, except for cases specifically prescribed by the law. In this case there is no reason to believe that by adding an extra criterion to the Aid Rules the lawmaker has determined the applicability of this criterion to a relationship created earlier (the aid award). The lawmaker has the power to change the rules over time but this usually affects the future. So it is legally incorrect to revise the favourable aid decisions issued to taxpayers over the period from 10 November 2020 to 8 June 2021, considering subsequent legislative amendments and a change of conditions.

The period of dispute included cases where the taxpayer’s revenue recognition followed the accrual principle, so the true monthly revenue could justifiably be different from the total invoices the taxpayer had issued for the month. Such a revenue recognition procedure is permitted and, for the most part, logically defensible. Therefore, before a new criterion was added to the Aid Rules, the taxpayer had the full right to assess their compliance with the aid conditions, considering the accepted revenue recognition. So during the period of dispute, the revenue figures stated in the aid requests cannot be automatically called incorrect only because they do not match the total value of transactions appearing on the VAT returns for the period.

The SRS approach was based, among other things, on the fact that the SRS believes the legal framework

originally linked the revenue figure to VAT returns, and what the lawmaker did with the later amendments to the Aid Rules was merely enact the procedure that in fact already existed and was applicable when an aid request was considered after being filed. This argument is not valid either, though.

Firstly, it was discovered in several cases that a qualifying revenue drop could not be established from VAT returns when the aid was requested, yet the SRS, having considered the applications, made favourable decisions and awarded the aid. Secondly, if such an approach existed originally and the SRS failed to apply it correctly, meaning the SRS would have wrongly awarded the aid despite an insufficient revenue drop, then such conduct by an institution would be treated as an unjustifiable error or negligence. As you may know, section 10 of the Administrative Procedure Act provides that an institution's error must not cause unfavourable consequences to a private person, especially where the benefit in question is awarded to the taxpayer by decision of the same institution. In other words, if an administrative instrument has been issued to a person, they can generally rely on the fact that it is lawful and will not be cancelled and that the person can safely plan their future around the rights awarded by the instrument. Thirdly, legal theory makes it clear that a change in how a rule is understood is never considered a change of (legal) circumstances that could be grounds for changing (cancelling) an earlier administrative instrument that favours the addressee. And legal theory particularly emphasises that the time that has passed after the administrative instrument was issued may affect the mutual assessment of the interests of the public and of the addressee – the longer the time that has passed after the administrative instrument was issued, the more protection any legitimate expectations deserve.

Several taxpayer petitions that challenge the SRS decisions to reclaim the Covid-19 aid are awaiting a review and an explanation from the SRS Director General. We will keep our MindLink.lv subscribers informed of how those cases are settled.

If your company is facing the problem described in this article, please reach out to lawyers at PwC Legal for help and advice.