RAIDLA LEJINS & NORCOUS

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Dear Reader,

In these Tax Flash News prepared by law office Raidla Lejins & Norcous you will find the summary of recent court developments related to Latvian tax regime.

We will be happy to answer your specific questions or to assist in dealing with a particular tax issue.

Kind regards,

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Constitutional Court will decide whether it is acceptable to apply confiscation and administrative fine and to charge tax fine for one and the same offence

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On the basis of a claim filed by the Administrative District Court, the Constitutional Court has initiated a case “On compliance of the words “and a fine in accordance with the Law “On Taxes and Fees”” of Section 33 (5) of the Law on Excise Duties with the second sentence of Article 92 of the Constitution of the Republic of Latvia and Article 4 of Protocol No. 7 of the European Convention for the Protection of Human Rights and Fundamental Freedoms”.

A person has contested the decision of the Director General of the State Revenue Service (SRS) by which the person was subjected to payment of an excise tax for tobacco products, as well as a tax fine and a late payment interest. Previously the person was held administratively liable for the same activities as for smuggling of tobacco products and subjected to an administrative fine in the amount of LVL 70 and confiscation of all tobacco products. The person considered that he has been punished twice for one and the same offence and appealed the decision of the Director General of SRS.

The European Court of Human Rights in the judgment of 16 June 2009 in the case *Ruotsalainen v. Finland* and in the judgment of 10 February 2009 of the case *Sergey Zolotukhin v. Russia* has ruled that Article 7 of Protocol No. 7 must be understood as prohibiting the prosecution or trial of a second “offence” in so far as it arises from identical facts or facts which are substantially the same. Appropriate starting point for determination of whether the facts in both proceedings were identical or substantially the same is the statement of facts in the final decision of the first proceedings. Identity of protected legal interests in both cases is of no relevance.

On the basis of the above judgments of the European Court of Human Rights the Latvian administrative courts have already ruled that a person cannot be punished for the same offence both under the Latvian Administrative Offence Code and the Law on Taxes and Dues (see, for example, judgment of 22 November 2010 of the Administrative Department of the Senate of Supreme Court in case No. A42504307).

Therefore, most probably also the Constitutional Court will rule that the current practice of

fining offences in the area of excise goods circulation is contrary to the principle of *ne bis in idem*.

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The Administrative Department of the Senate of Supreme Court resolves on repayment of overpaid VAT in relation to the construction of access road to the shopping mall on the land owned by municipality

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On 6 February 2012 the Administrative Department of the Senate of Supreme Court in the case SKA-40/2012 reviewed cassation complaint of SRS about the ruling of the Regional Administrative Court by which it satisfied the claim of SIA "OK Ipasumi" for the repayment of overpaid VAT.

SIA "OK Ipasumi" constructed a shopping mall on its own land near A6 road. It also constructed the access road connecting road A6 and the shopping mall. The constructed access road was located on the land owned by the local municipality and in accordance with the legal acts qualified as a city street. Moreover, the access road built was not the only driveway to access the mall and was used also by the nearby gas station.

SRS considered that the input VAT paid by SIA "OK Ipasumi" is related to the construction of the common use object (public road) owned by the municipality and is therefore not related to commercial activities of SIA "OK Ipasumi". For the above reasons SRS refused the repayment of overpaid VAT to SIA "OK Ipasumi".

The Senate disagreed with the SRS pointing out that the Regional Administrative Court did not have to take into consideration the fact that the access road is not the only driveway to the mall and that it is also being used in the commercial activities of the nearby gas station. The Senate's opinion was not affected by the fact that the access road was constructed on the land owned by the local municipality and that the road qualifies as a city street to be maintained by municipality.

The Senate noted that the access road is connected to the mall owned by SIA "OK Ipasumi" and secures its day-to-day operations. The Senate stressed that the materials of the case do not provide grounds to assume that the construction of the access road is activity carried out in order to hide any other transaction or fictitious mechanism having no relation to the commercial reality and used to gain tax benefits only.

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The Administrative Department of the Senate of Supreme Court resolves on the right to deduct expenses for purchasing advertising items for the CIT purposes

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On 27 January 2012 the Administrative Department of the Senate of Supreme Court in the case SKA-203/2012 reviewed cassation complaint of SIA "Merks" appealing the part of the ruling of the Regional Administrative Court by which it approved the decision of the SRS on unfounded deduction of VAT and extra CIT charged. By this ruling the Senate has substantially increased the scope of the expenses which can be regarded as costs for purchasing advertising items for the purposes of CIT calculation.

SIA „Merks" purchased souvenirs from SIA "St.Brothers Brand Agency" for advertising of "Arena Riga" which was initially planned to take place during the World Ice Hockey Championship taking place "Arena Riga" owned by SIA "Merks". SRS was of the opinion that there is neither proof that the sale of souvenirs generated income nor proof that the said souvenirs were used for SIA "Merks" advertising activities. As a result SRS claimed that the taxable base of CIT has been wrongfully decreased. Regional Administrative Court agreed with the opinion of the SRS referring to the types of items attributable to the advertising under the Cabinet of Ministers Regulation and concluded that the items purchased by SIA "Merks" are not of the nature which would permit their costs to be attributed to SIA "Merks" commercial activities.

Assessing the right to attribute costs of advertising materials to company's commercial activities, the Senate stated that the legal acts shall be applied taking into account market reality. There is no reason to limit companies to specific types of advertising activities as defined by the Cabinet of Ministers Regulation if the market reality shows that there are also other ways of advertising (including brand new ones) which can be employed for marketing of goods and services. The market is constantly changing and the rules of economics require an ongoing search to find new ways for marketing goods and services, therefore, the contents of the Cabinet of Ministers Regulation shall be approached critically if they in essence restrict ability of companies to deduct as their commercial

activity expenses such advertising costs which by their nature are related to company's commercial activities.

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The Administrative Department of the Senate of Supreme Court resolves on the right to deduct VAT for construction works performed after the suspension of construction permit

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On 17 April 2012 the Administrative Department of the Senate of Supreme Court in the case SKA-162/2012 reviewed cassation complaint of SRS regarding the Regional Administrative Court ruling of 6 October 2011 ordering repayment of input VAT to SIA "Juglas skati".

SIA "Juglas skati" contracted third parties for the construction of residential buildings and deducted the respective input VAT. The construction permit issued to SIA "Juglas Skati" was suspended on the basis of complaint of the neighboring residents. SIA "Juglas skati" carried out conservation works of construction performed and deducted the input VAT.

SRS decided to make only partial repayment of input VAT stating that the part of the works for which the input VAT had been deducted were performed after the construction permit was suspended. SRS stated that the tax payer cannot benefit from the right of input VAT deduction with regard to the transactions which have been performed to ensure illegal commercial activities of the company.

The Senate in its ruling noted that the applicable law does not assess the validity and legal force of the transactions; the main precondition for deduction of input VAT is for the transaction to be performed within the framework of company's commercial activities. The commercial activity is any systematic activity carried out for remuneration. The Senate explained that for the purposes of acquiring the right of input VAT deduction it is essential to determine whether certain activity qualifies as a commercial activity carried out in order to ensure performance of taxable activities. Likewise, in the opinion of the Senate, it is important to determine that such activity has not been excluded from the scope of private law.

It was illegal for the company to perform the construction works after the suspension of the construction permit. The company may be ordered to demolish the constructed object, however, the law does not require any tax adjustments to be made.

The Senate ruled that for the purposes of this case it is not essential to distinguish between construction works and conservation works as there is no dispute that all the works performed were carried out within the framework of company's commercial activities.

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