Communication with Tax Authorities

Tax Commission

Prague, 2014

National Report of Latvia

Elīna Putniņa

"Rödl & Partner Tax consulting” SIA
Kronvalda bulvāris 3-1, Riga
LV-1010, Latvia
+371 67338125
elina.putnina@roedl.pro

General Reporters:

Christian Presoly, Batliner Gasser Rechtsanwälte, Fürstentum, Liechtenstein
Gustavo YanesMonereo Meyer Marinello SLP, Madrid, Spain

15.04.2014
1. **Communication in general**

In Latvia, the majority of tax administration functions are performed by the *State Revenue Service* (the SRS, *Valsts ieņēmumu dienests* in Latvian), an independent direct governance authority. While other authorities may be involved in selected cases (e.g. the Real Estate Tax, the administration of which has been delegated to the respective municipalities), this report will focus on communication and interaction with the SRS, as it is the primary tax administrator, therefore being representative of the taxation system in Latvia as such.

While historically perceived as somewhat oppressive, the SRS has recently applied great efforts towards improving its public image, with one of the first steps being the improvement of communication between the authority and the taxpayers. This could, in a sense, be called a move towards a customer-oriented approach, which has taken place largely due to recent leadership change.

Communication is always direct both in writing and in person, and communication in writing or through secure digital means is always used for official interaction. Written communication carries the future advantage of retaining record of the position of the involved parties, while in-person meetings may be helpful in resolving disagreements of interpretation (where a competent representative is often an advantage). The procedural aspects of written communication will be explained in detail in section 3.

Both legal entities and natural persons may represent themselves or have another act on their behalf by ordinary authorization. There are no statutory requirements for special tax counsel, and taxpayers may freely select and authorize representatives to manage all communication in the same capacity as the principal. The authorized person then may either fulfill the direct instructions of the principal or act independently, depending on the arrangement. Such representatives assume liability for their actions to the extent agreed upon with the principal and at least to the statutory minimums for ordinary authorizations; liability insurance policies are available. Advantages do exist in engaging the services of a qualified consultant, as it frequently expedites communication and ensures that the taxpayer’s interests are represented equally well to those of the state.

2. **The Electronic Declaration System**

The most visible initiative of the SRS is its focus on e-services as another means of direct communication. The *Electronic Declaration System* (the EDS) was set up to ease both the submission and processing of tax declarations, and has been expanded to become a general platform for submissions and communication.

The SRS promotes the platform as the preferred submission method for all documents, declarations and reports. Registration for its use requires approximately one week, is free of charge, and allows the appointment of multiple authorized users for a single entity’s account. EDS supports authentication by electronic ID cards, as well as multiple internet banking services. The security of this system came into
question in 2009, when a large amount of unsecured taxpayer data and documents was downloaded from the EDS and made public, triggering a prominent hacking prosecution. It is presumed to have been improved since then.

If the taxpayer is an EDS user, the SRS will also send all documents, decisions, requests, etc. electronically. Questions (that are not requests for a binding ruling) may be submitted electronically and are often responded to in a matter of days – either responding directly if the issue is simple, or arranging a telephone call or an in-person meeting with a consultant. Alternatively, the correspondence may continue in writing.

The platform is still undergoing development and, while the more technologically-savvy taxpayers and tax professionals have welcomed the added convenience, its user interface may still be intimidating to others. In practice, the faster communication also has disadvantages due to lack of information and human error, as well as misuse. If the registered EDS users are not managed properly, such as in the frequent case of companies where the sole EDS account holder is the CEO, it is easy to neglect the binding communication aspect of the EDS. Though unintentionally, the company may be at a disadvantage due to failure to act upon correspondence that is sent over EDS only. To prevent this, taxpayers are able to appoint multiple users for the same entity’s account. The faster communication has also been misused for applying pressure on taxpayers; as currently there is no statutory minimum time allowance for responses to electronic requests for information by the SRS, officials have occasionally issued such requests with response deadlines as short as two business days. The platform does, however, have a visible impact on an acute issue – the queuing times at the SRS customer service centres.

3. **SRS decisions, binding statements, and agreements**

In situations where a taxpayer is unsure about the legality or consequences of its intended actions, it may apply to the SRS for a binding statement regarding rights. The taxpayer must provide detailed facts of the case, a definite question arising from these facts, the reasoning behind the request, and, at the applicant's discretion – own analysis of the applicable law. The statements are issued free of charge within one month (with a possible – and often exercised – three-month extension period) from the submission of the application.

The binding nature of these statements refers to the authority instead of the recipient – the recipient is free to act differently than stated in the request or disregard the statement entirely. The general principle is – even in the event that the statement is later discovered to be incorrect, if the binding statement's recipient has provided truthful and complete facts and has acted in good faith in accordance with the position of the SRS in the statement, the further decisions of the authority may not be more adverse than as given in the statement.
The decisions of the SRS are subject to the Latvian administrative procedure rules. In general, an authority’s external document that creates, modifies, or terminates particular legal relationships of named parties or entities in certain circumstances is referred to as an administrative act. The aspect of interest is the appeals procedure – such acts are first challenged before the issuing authority before review by courts. Since the SRS is an independent institution without a direct superior, and the binding statements are issued by the general director of the SRS, further internal appeals are impossible, while being non-binding to the recipient means that the statements are not considered to be administrative acts, and as such cannot be challenged in court.

Other administrative acts issued by the SRS may be first appealed to the general director. Such appeals take place strictly in writing, with no meetings possible. If the decision of the general director is still unsatisfactory to the taxpayer, the matter may then proceed to court, as explained in section 4 below.

In the event that additional tax liabilities and fines are assessed by a tax audit and the taxpayer is disputing the results, it is possible to request the SRS to enter into a tax agreement. The agreement may be concluded at any stage of the dispute, even during litigation. Under such agreements, the taxpayer recognizes the assessed tax liability, in return receiving a reduction of fines by 50-85% depending on the reason for the additionally assessed liabilities. Such option may be attractive even to taxpayers who do not agree with the position of the SRS, as the amount of resources required to continue contesting the assessment may be greater than the potential gain in lengthy proceedings. The agreement is terminated if the taxpayer fails to make the payments agreed upon within two months.

The confidentiality of taxpayers’ information is ensured by the general disclosure prohibition for tax administration officials in the law On Taxes and Fees. Information may be disclosed in certain circumstances to the Ministry of Finance, other institutions and authorities or other tax administrations in the EU or tax treaty partner states. In the event that information is being provided to a foreign tax administration, the Latvian tax officials must also inform the respective taxpayer – either immediately or within 90 days, depending on whether the exchange of information is associated with a tax evasion investigation. Furthermore, the SRS may also refuse information requests from other EU tax administrations if the requested information is associated with commercial, industrial, or professional secrets.

In the context of confidentiality, the practice of the SRS to publish anonymized versions of its binding statements may be somewhat questionable, considering that the Latvian business environment is somewhat compact. On the other hand, the published rulings often provide useful guidelines for other taxpayers in situations with ambiguous legal regulation, as the tax administration tends to follow such case law.

2014 04 15 WS National Report
Latvia - EP eng rev1.doc
4. Remedies

Provided that a disagreement is not resolved with the internal appeal, a taxpayer may dispute an administrative act of the SRS in court. Cases regarding decisions and conduct of state authorities are heard by the administrative court branch. Separate courts for tax matters do not exist and few judges have a specialization in tax law, which means that cases are frequently decided on the basis of whether there has been formal compliance with the procedural norms, without analyzing disagreements over interpretation. In such cases, a solid analysis on the merits of the case is most often only provided at the cassation instance – from the Senate of the Supreme Court.

The process in these courts is somewhat similar to general litigation – with the court of first instance, an appeals instance, and a cassation instance for procedural objections. Recent changes in the civil procedure rules made the participation of sworn attorneys mandatory in the cassation instance – this change has not yet been adopted in the administrative procedure, and taxpayers are free to represent themselves or be represented by others.

A factor that can discourage further appeals beyond the internal one is the SRS’s institutional reputation for pursuing its cases through all instances in almost all cases. The State Audit Office (the supreme state internal audit institution) plays a role behind this reputation – considering the position of the SRS as the tax administration, the actions of its staff are subject to closer scrutiny, requiring justification for each dropped case. In situations where other authorities would relent after defeat in the first instance, SRS officials tend to ensure that disputes regarding their decisions are resolved in a way that exhausts all possibilities of appeal, therefore eliminating any doubt regarding the legality of their actions. In recent years, approximately one fourth of the disputed SRS decisions have been overturned in the first instance.

This institutional practice leads to very lengthy appeals processes, with cases frequently requiring 3 – 5 years to achieve a final resolution, often due to the case load of the courts. The number of cases that are resolved each year fluctuates at approximately the same level as the number of new cases being filed, and, with a considerable backlog, litigation against the SRS in the first instance mostly requires 1.5 – 2.5 years (up to 2 years in the appellate instance).

The length of the proceedings has a direct impact on the costs. While the state fees associated with administrative litigation are negligible (approx. EUR 30 for courts of first instance), the actual cost must be measured by both the legal fees (which are non-recoverable; a small compensation is available at the court’s discretion for representatives of natural persons in complex cases), as well as the disputed tax liability being in effect until a final ruling to the contrary.

SRS decisions assessing tax debts and fines come into force within 30 days from the date of the internal appeal decision regardless of whether the matter is further referred to court. It is possible to request the court to suspend the decision for the
duration of the proceedings, but these requests are rarely granted. Instead, regardless of whether a decision is appealed or not, the SRS is often willing to agree upon postponing the payment or dividing it in installments if the taxpayer is able to present reasonable economic justification for the request.

The SRS also participates in the criminal procedure for crimes associated with the state revenue, tax fraud, customs, money laundering, etc. Criminal investigations on behalf of the SRS are conducted by the Financial Police Department (which acts as the authority’s operational arm and internal affairs service) independently or in cooperation with the state police. Officials of the department themselves do not conduct criminal prosecution in court, instead transferring the findings of their investigations and management of the case to state prosecutors.

5. Sanctions

SRS-imposed sanctions often stem from findings made during tax audits. While no specific statute of limitations exists for tax matters, the maximum scope of the SRS tax audits plays a similar role – taxpayers may be subject to a general tax audit with a scope of three years from the respective payment due date, and a transfer pricing audit with a scope of five years.

Tax audits may also be initiated as part of criminal proceedings, in which case the respective criminal statute of limitations applies. The limitation then depends on the maximum possible prison sentence for the crime the taxpayer is charged with (e.g., a statute of limitations of 10 years for tax evasion, which carries a maximum sentence of 4 years).

There are multiple possible types of tax audit depending on the intended scope – from partial audits of a single declaration or transaction to single-tax and complex audits. Data verification inspections and thematic inspections (used for random data verification in a pre-defined set of areas, such as cash transactions, employment, accounting records, etc.), as well as facility visits and observation are used to monitor taxpayer compliance, and their findings may serve as the basis for tax audits.

Targets for tax audits are selected by centralized SRS risk management software. With the data available to the SRS, the software is used to filter out taxpayers whose submissions are inconsistent with the submissions of other taxpayers and other evidence. Not all inconsistent results are subjected to tax audits – instead, shortlists of multiple risk levels are created, and those in a low-risk tier are sent an informational notification. Such reminders are helpful because taxpayers have the ability to adjust any of their submissions about any of the taxes for three years after the submission date, unless the particular aspect has already been subject to a tax audit. In practice, this option is used to both correct mistakes in submissions and to regularize the tax situation if an audit is likely, and taxpayers are able to avoid fines altogether, provided that they act before the audit is initiated.
In general, tax fines are calculated on the basis of the difference between the amount of payable tax reported by the taxpayer and the amount assessed by the tax audit. A late payment fine of 0.05%/day and an additional fine based on the ratio between the difference and the taxpayer’s total tax liability (depending on whether the difference exceeds 15% of the tax amount to be declared, the additional fine is 20/30%) are applied to this difference. The additional fine is doubled for taxpayers who are classed as repeat offenders (the same or similar violation identified as part of a tax audit within three years) and may be halved for taxpayers who have otherwise acted in good faith, complied with the regulations in regard to other taxes, and have cooperated with the tax administration.

Various other percentage-based fines are assessed for other violations, such as an additional fine of 100% of the payable amount if an entity conducts business activities without registering for the relevant taxes or fails to submit tax declarations. More specific fines are associated with individual taxes – for example, in order to combat the frequent payroll tax fraud and illegal employment, the fine for unpaid social insurance contributions is assessed as triple the payable amount.

Taxpayers must pay the additionally assessed amounts and fines within 30 days, if no agreement is reached. After this term expires, the relevant decision of the SRS becomes eligible for compulsory enforcement – referable to bailiffs for action against the taxpayer’s assets. A temporary stay is granted if the decision is disputed, but it ends after the pre-trial period.

6. Conclusion

The recent direction of the SRS towards a customer-oriented approach has been a move welcomed by those who conduct economic activities in Latvia. In its constant state of development, the e-services initiative has already simplified the reporting duties and improved communication for both individuals and legal entities, and could be considered a visible success. It has not, however, removed the need for tax professionals, who are usually engaged during transaction planning or before a tax dispute – or after.

Tax professionals in particular have found a more open reception in discussing problematic points of interpretation of the tax laws. Where an inexperienced taxpayer would undergo a tax audit and, upon receiving an unfavorable decision, would proceed to appeal it, a tax consultant could be engaged to manage the cooperation and communication with the SRS during the audit, discussing disagreements regarding the interpretation of data as they arise and substantiating the taxpayer’s position, which can often lead to a more cost-efficient result than litigation, all expenses considered. Justified appeals with well formulated arguments are often successful in court, but recently there has been an increase in successful cases at the internal appeals stage, and tax consultants are becoming a more common part of the legal team during hearings in tax litigation.