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Proportionality in tax disputes: Lithuanian Court practice
# PROPORTIONALITY IN TAX DISPUTES - LITHUANIAN COURT PRACTICE

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1. INTRODUCTION

1.1. Lithuanian tax system and its position in the overall legal system

1.1.1. Lithuanian legal system is built on the Constitution adopted by referendum in 1992. According to articles 6 and 7 of the Constitution, it is an integral and directly applicable act and any law or other act, which is contrary to the Constitution, shall be invalid. The superiority of the Constitution is limited by the international agreements and EU law. The creators of the Constitution have been inspired by historic Lithuanian constitutions and statutes as well as western European constitutions. But a final text was a product of intense negotiations and compromises among various political groups. Therefore direct influence of any particular foreign constitution is hardly identifiable.

1.1.2. Taxation is part of the Lithuanian administrative law which is a natural consequence of adopting western European legal systems in Lithuania after restoring independence in 1990. The classification of tax law as part of the Administrative one was adopted from the German model. Different taxes are regulated by separate laws, ex. Law on Corporate Income Tax, Law on Income Tax of Individuals, Law on Value Added Tax. Implementation of tax laws, the functions, rights and obligations of the tax administrator and the taxpayer, the calculation and payment of taxes, the procedure of

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1 Superiority of International agreements and EU law has been confirmed by the Constitutional Court of Lithuania in its decision of 14 March 2006.
4 20 December 2001, No IX-675.
5 2 July 2002, No IX-1007.
6 5 March 2002, No IX-751.
enforced recovery of taxes as well as the procedure for the settlement of tax disputes is regulated by the Law on Tax Administration.7

1.1.3. Lithuanian administrative law has been created using experience of European countries8 and having in mind a possible future EU membership9. The Constitutional Court started applying principle of proportionality long before Lithuania joined the EU. In 1996 the Court10 applied not only Article 17 of European Convention on Human Rights but took into consideration opinion of foreign legal scholars and ruled that the Court has an obligation to use proportionality in controlling measures adopted by the government. The Court also concluded that Constitution’s provisions protecting private property are essentially the same as those of the international law. In 1997 decision11 the Court elaborated more and ruled that in analysing necessity of the particular restricting measure there’s a need to firstly establish the purpose of the restrictions and then establish whether this measure is proportional to its purpose.

1.1.4. In 1994 Lithuanian Government decided to renew Lithuanian tax system.12 This led to a proposed draft Law on Tax Administration in 1995.13 The draft law was created in consultation with the IMF, US Treasury Department and various international experts with a purpose to create a tax system resembling those of the western countries.14 The adopted version of the Law on Tax Administration already contained several

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7 Art. 1, Law on Tax Administration of the Republic of Lithuania, 13 April 2004, No IX-2112 Vilnius
8 For example an official seminar to the members of Lithuanian Parliament has been organized by Danish school of International public administration in December 14-15 1998.
9 For example initiators of a proposed Law on the Basis of Public Administration and Procedures No. P-1760 have adapted draft legislation to EU law as early as in May 1999.
10 18 April 1996 decision of the Constitutional Court of the Republic of Lithuania
11 13 February 1997 decision of the Constitutional Court of the Republic of Lithuania
12 The programme of the Government was approved by the Parliament 12 July 1994 by the decision No. I-534
13 19 May 1995, No. 1644
14 Explanatory note to the 19 May 1995 Draft Law on the Fundamentals of Tax Administration of the Republic of Lithuania No. 1644
provisions intended to ensure proportionality and legal certainty in tax administration, such as a 5 years limitation for tax investigations\textsuperscript{15} or a right for the taxpayer to suggest to tax authorities which specific property should be arrested in enforcing tax recovery when there is enough property to satisfy tax administrator’s claim.\textsuperscript{16}

1.2. \textbf{Courts which hear tax disputes in Lithuania}

1.2.1. Lithuanian court system consists of general and specialized courts.\textsuperscript{17} General courts are county and district courts which hear disputes at first instance. The Court of Appeals is an appeal instance court. The Supreme Court, being the highest level domestic court, hears cases exclusively on the questions of law. The objective of the Supreme Court, as a court of cassation, is to ensure uniform court practice of courts of general jurisdiction in the State by means of precedents formulated in the cassation rulings. The Constitutional Court ensures the supremacy of the Constitution within the legal system as well as constitutional justice by deciding whether the laws and other legal acts adopted by the Parliament (Seimas) are in conformity with the Constitution, and whether the acts adopted by the President or the Government are in compliance with the Constitution and laws.\textsuperscript{18}

1.2.2. Supreme Administrative Court and Administrative district courts are specialized judicial institutions for hearing administrative cases only.\textsuperscript{19} They are the main institutions to hear all tax related disputes, since taxation, as mentioned above, is part of Lithuanian administrative law.

\textsuperscript{15} Art. 24 (1) of the 28 June 1995 Law on Tax Administration, No. I-974
\textsuperscript{16} Art. 33 (4) Ibid
\textsuperscript{17} Art. 12 (2) Law on Courts
\textsuperscript{18} Art. 102 of the Constitution of the Republic of Lithuania
\textsuperscript{19} Art. 12 (4) Law on the Courts of the Republic of Lithuania
1.2.3. For the tax disputes a pre-trial dispute settlement procedure is obligatory. The designated institution for pre-trial dispute resolution is the Commission on Tax Disputes. The Commission consists of five members appointed by the Government of Lithuania for a period of six years. The main goal of the Commission is to make legal and motivated decisions over the impartially heard taxpayer's appeal. Decision shall be made over a period of 60 days from receipt of an appeal. However, not all tax related disputes are subject to obligatory pre-trial dispute resolution. Such procedure is obligatory only for disputes arising between the taxpayer and the tax administrator over a decision on the approval of an inspection report or any other similar decision on the basis of which tax is calculated anew and the taxpayer is instructed to pay it, also over a decision made by a tax administrator to refuse the refund (crediting) of a tax overpayment (tax difference). Therefore disputes not falling into this category, such as ones related to imposition of interim measures, shall be resolved by the court without pre-trial dispute resolution.

1.3. **Formation of uniform practice and influence over subsequent tax disputes**

1.3.1. It is a settled case-law that Lithuanian courts are bound by the rules of legal interpretation defined in their previous decisions in analogous or essentially similar cases. Such cases may be resolved differently only when there is an objective and inevitable necessity. The Supreme Administrative Court is responsible for the

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20 Art. 145 (1) Law on Tax Administration
21 Art. 147 Law on Tax Administration
22 Art. 8, 15, 16 Regulations of Commission on Tax Disputes under the Government of the Republic of Lithuania, approved by the decision of the Government of the Republic of Lithuania No. 1119 of 02 September 2004.
23 Art. 2 (20) Law on Tax Administration
24 Case No. AS-143-315-11, UAB „PI gamyba“ v. Vilnius apskrities VMI, Supreme Administrative Court of Lithuania.
formation of uniform judicial practice in administrative, including tax, disputes.\textsuperscript{25} However the Supreme Administrative Court has ruled that court practice of interpretation of legal acts in other cases may be relied on only when factual circumstances of the case are identical and legal acts applied to the dispute are the same.\textsuperscript{26} This position is similar to the practice of the ECJ.\textsuperscript{27}

1.3.2. Therefore, decisions of the Supreme Administrative Court of Lithuania in tax disputes have the power of precedent for lower courts and for the Supreme Administrative Court itself. Such decisions serve as important set of guidelines for tax practitioners, taxpayers and tax administrators.

1.4. Application of foreign case-law

1.4.1. The Supreme Court of Lithuania has ruled that domestic courts must take into consideration foreign case-law during interpretation and application of international conventions and other legal acts.\textsuperscript{28}

1.4.2. A decision of the ECJ is binding on the national court which made the reference to it.\textsuperscript{29} Since the main purpose of Article 267 TFEU is to ensure the uniform application of EU law, a ruling of the ECJ also binds national courts other than the one which made the particular reference.\textsuperscript{30}

\textsuperscript{25} Art. 20 (3) Law on Administrative Proceedings of the Republic of Lithuania; also Case No. A-556-984/2010, UAB Aldaila v VMI, Supreme Administrative Court of Lithuania
\textsuperscript{26} Case No. A-146-79-11, RB v Marijampolės apskrities vyriausiajam policijos komisariatum, Supreme Administrative Court of Lithuania.
\textsuperscript{28} 21-12-2000 the decision of the Supreme Court of Lithuania No. 28, „Regarding practice of the court of the Republic of Lithuania in application of private international legal norms”.
\textsuperscript{29} Case 29/68 Milchkontor v Hauptzollamt Saarbrücken [1969] ECR 165, para 2.
1.4.3. Therefore case-law of foreign courts is an important source of legal interpretation rules and may be relied on when domestic case law doesn’t provide a precise explanation of a particular issue. Even more, case-law of the ECJ is obligatory to domestic courts faced with the same issues as previously resolved at the European judicial level.31

1.4.4. The Constitutional Court has repeatedly ruled that European Convention on Human Rights as well as jurisprudence of the ECHR are important sources for interpretation of Lithuanian legal norms. The Constitutional Court must follow practice of the ECHR.32

1.5. Principle of proportionality in EU law

1.5.1. Proportionality in contrast to subsidiarity deals not with the question when to intervene but with the quality of that intervention and with the level of intrusiveness of EU law.33 The meaning of the proportionality principle is not universally settled. According to the legal area at stake (e.g. administrative law, European law, human rights, international law), the proportionality principle will be applied and interpreted differently. The implications of the proportionality principle will often differ even within one legal area, according to the issue at stake.34

1.5.2. The principle of proportionality has been included in Article 5 (4) of the Treaty on the European Union. It provides that “Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives.35

31 Art. 3 (5) of the Code of Civil Procedure of Lithuania; also case No. 2-879/2008 of Court of Appeals of Lithuania; case No. 3K-3-690/2006 Dekont International s.r.o. v Environmental Projects Management Agency of the Ministry of Environment of the Republic of Lithuania, the Supreme Court of Lithuania; decision of the Constitutional Court of Lithuania of 24 October 2007.
of the Treaties.” Including this principle in a document which is superior even to national constitutions\(^35\) indicates the importance of the principle.

1.5.3. Proportionality has been analyzed by the ECJ in the *Internationale Handelsgesellschaft*\(^36\) case where the plaintiff tried to rely on German Constitutional law principles. The Court refused to apply German law but agreed that those principles could be relied on if they were common to the Community. Respect for fundamental rights forms an integral part of the general principles of law protected by the Court of Justice. The protection of such rights, whilst inspired by the constitutional traditions common to the Member States, must be ensured within the framework of the structure and objectives of the Community.

1.5.4. In later cases the ECJ has defined a general rule as meaning that for a restrictive measure to be justified, it must comply with the principle of proportionality, in that it must be appropriate for securing the attainment of the objective it pursues and must not go beyond what is necessary to attain it.\(^37\)

1.5.5. According to D. Weber\(^38\) the proportionality principle is an important general legal principle that is fundamental to the Community legal system. First, the proportionality test involves an appropriateness test, which means that the measure must be appropriate (suitable) for ensuring the achievement of the objective being pursued; Secondly, the necessity test is used and it evaluates whether the measure is more extensive than is necessary for achieving the objective pursued. The measure must be indispensible for attaining the objective. Thirdly, the proportionality test is applied

\(^{36}\) Case 11-70 *Internationale Handelsgesellschaft mbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel*, ECR 1970  
\(^{37}\) Case C-334/02 *Commission v France* [2004] ECR I-2229, paragraph 28; Case C-101/05 *Skatteverket v A*, paragraph 56  
strictu senso and national interests are weighted against the EU ones. Other authors provide a different classification, substituting the third test with one requiring that the measure does not have an excessive effect on the applicant’s interest in cases when there are no less restrictive means.

1.5.6. In assessing whether a measure is suitable to achieve its objectives it is relevant to consider the actual effects of the measure. But the fact that the measure has failed to attain its objectives in practice does not mean that it is manifestly inappropriate. In the Schröder case the ECJ ruled that “the legality of a community act cannot depend on retrospective considerations of its efficacy”.

1.5.7. In determining necessity the court must analyze whether the same objective could have been achieved by another less restrictive measure. However, the Court does not always apply this test scrupulously and sometimes relies only on the notion of reasonableness.

1.5.8. The application of the tests of suitability and necessity enables the Court to review not only the legality but also, to some extent, the merits of legislative and administrative measures. Because of that distinct characteristic, proportionality is often perceived to be the most far-reaching ground of review, the most potent weapon in the arsenal of the public law judge. Much depends on how strictly a court applies the tests of suitability and necessity and how far it is prepared to defer to the choices of the authority which has adopted the measure in issue.

40 Case 40-72, I. Schröder KG v. the Federal Republic of Germany, paragraph 14
1.6. Principle of proportionality in ECHR

1.6.1. The European Court of Human Rights (ECHR) has been active developer of the proportionality principle. It ruled that “inherent in the whole of the Convention is a search for a fair balance between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights.”

1.6.2. There is no doubt that the ECHR is engaging in a balancing approach both as method of interpretation and as method of adjudication. This balancing approach known under the term of principle of proportionality “has acquired the status of general principle in the Convention system.”

1.6.3. European Convention on Human Rights (Convention) can be relied on in tax disputes as well. Article 1 of Protocol 1 should be of particular importance to any taxpayer. There are three limbs to that article. The general right is set out, the peaceful enjoyment of possession, then the exceptions and provisos. Deprivation of property needs to be under conditions, lawfulness and in the general or public interest as well as to secure the payments of taxes or other contributions and penalties. The ECHR therefore conducts a proportionality test, i.e. balancing exercise.

1.6.4. It seems that the ECHR will give quite a wide meaning to the public interest in deciding on issues of peaceful enjoyment of possession, and in particular a wide margin of appreciation in tax matters. In other words, the Contracting State's assessment has a range of outcomes that would not violate the Convention rights. In order to maintain a

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43 Soering v. United Kingdom, Judgment of 7 July 1989, para 89
44 Tsakyrakis S., Proportionality: An Assault on Human Rights?, Jean Monnet Working Paper 09/08
45 see for example Sparrong & Longneth v Sweden (A/52) (1983) 5 EHRR at p 69.
claim the ECHR must determine whether a possession exits, and whether there was an interference with the right to own the possession.  

1.6.5. The ECHR extended a right to free enjoyment of property to recoup tax paid in contravention of an EC VAT Directive in a seminal case *S.A Dangeville v France*. The Court ruled that interference with taxpayer’s right to reclaim VAT was disproportionate, as the denial of the company's claim against the French state — and the absence of domestic procedures affording a sufficient remedy to ensure the protection of the company’s right to the peaceful enjoyment of its possessions — upset the fair balance that must be maintained between the demands of the general interests of society and the requirement of the protection of the individual's fundamental rights.

1.6.6. ECHR’s power in tax disputes was most clearly demonstrated in *Shchokin v Ukraine* case where the Court ruled that Ukrainian tax legislation was unlawful because it was so unclear.

2. CASE-LAW ON PROPORTIONALITY

2.1. Proportionality in VAT disputes

2.1.1. Member States transposing EU directives (including the Sixth VAT directive) into their national law must comply with the general principles of EU law. National rules must ensure equal treatment, i.e. they can’t distinguish between repayment claims based on community rights and purely domestic ones. They must also not impose excessive

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47 *S.A Dangeville v France* [2003] STC 771
49 *Shchokin v Ukraine* [2010] ECHR 1518 (14 October 2010)
51 Case C-36/99 *Ideal tourisme S.A v Belgian State*, Paragraph 36
burdens to implement such right and must not go further than is needed (principle of proportionality).\(^{52}\)

2.1.2. The Sixth Directive being the main legal source of rules on the VAT has been confirmed by the ECJ as having direct effect\(^{53}\) and creating rights for the benefit of individuals which the national courts are obliged to protect.\(^{54}\)

2.1.3. **Obligation of the tax administrator to prove fraud when goods/services have been actually sold**

2.1.3.1. In the *Aldaila* case\(^{55}\) the taxpayer was denied VAT deductions on construction services purchased from two other Lithuanian companies – UAB Viskontis and UAB Kortas, which hadn’t paid VAT on those sales. The director of UAB Aldaila was at the same time also working in the other two participants in those transactions. The tax administrator admitted that services were actually rendered however, it found that they were provided by other persons not by UAB Viskontis and UAB Kortas. The deductions were denied solely on the fact that invoices issued misrepresented the real transaction. The tax administrator’s position was upheld at all instances of dispute resolution and reached the Supreme Administrative Court. The Court stated that the principle of proportionality must be observed in the relevant situation and the plain fact that the services were provided by persons other than those indicated in the invoice is not enough to disallow a deduction. The Court cited principles from the ECJ case-law, i.e. that traders who take every precaution which could reasonably be


\(^{53}\) Case C-62/00 *Marks & Spencer plc v Commissioners of Customs & Excise*, paragraph 40;


\(^{55}\) Case No. A-556-984/2010, *UAB Aldaila v VMI*, Supreme Administrative Court of Lithuania
required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct input VAT.\textsuperscript{56} And vice versa - a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.\textsuperscript{57} Consequently the element of fraud must be proven for the taxpayer to be deprived of a right to deduction and the tax administrator has a burden to prove it. The Court stated that the tax administrator failed to analyse the existence of fraud in its own investigation and all lower courts failed to do the same. Since the existence of the fraud is essential for the refusal of VAT deduction the case was referred back to the lower court to perform a proper analysis. The Court correctly applied the requirement to analyse the element of fraud. The tax administrator made a mistake relying solely on the general principle of substance over form. It believed that showing that transactions involved different entities from those indicated in documents was enough to deny VAT deduction. The taxpayer correctly relied on the obligation of tax authorities to analyse fraud in VAT transactions. However, the taxpayer did so in its second (amended) appeal, which was submitted to the court after the expiration of statute of limitations. The court correctly decided to disregard the second appeal and formally took into account only the first one. Nevertheless the second appeal was

\textsuperscript{56} Joined Cases C-439/04 and C-440/04, \textit{Axel Kittel v État belge and État belge v Recolta Recycling SPRL}, para 51.

\textsuperscript{57} Joined Cases C-439/04 and C-440/04, \textit{Axel Kittel v État belge and État belge v Recolta Recycling SPRL}, paras 56
a clever move since it allowed introducing relevant ECJ case law and the national court, without admitting it, was obliged to follow ECJ interpretation.

2.1.3.2. In the *B1* case\(^{58}\) the Commission on Tax Disputes faced a dispute in a case similar to the *Aldaila* case, where the Supreme Administrative Court ordered the tax inspectorate to investigate the possible elements of fraud in the actions of a taxpayer. As in the *Aldaila* case, here in *B1* it was established that the goods were sold to the taxpayer by some other persons and not those indicated in the invoices. The tax authorities had established that the taxpayer hadn’t checked any information about its business partners issuing invoices, those companies had neither premises nor equipment, transport means or employees to carry on trade activities\(^{59}\). The only employees in those companies were formal directors who only signed financial accounts. The tax inspectorate concluded that a prudent business person should have requested at least minimum proof from its counterparties about their capabilities to perform business transactions. The Commission on Tax Disputes has affirmed such position and effectively found the principle of proportionality requiring proof of dishonesty of a taxpayer when attempting to decline a right of VAT deductions when the goods and/or services where actually sold. Such dishonesty was proven by the fact that the taxpayer had failed to act as an average prudent business person should have. Analyzing the situation the Court made some statements contradicting case-law of the ECJ. The Court stated that according to the substance over form the requirements for the

\(^{58}\) Case No. S-261(7-214/2010), *B1 v VMI*, Commission on Tax Disputes under the Government of the Republic of Lithuania

\(^{59}\) However, the Supreme Administrative Court in *Medikona* case (No. A-556-963-09) has clearly ruled that in tax disputes a small number of employees of the company doesn’t mean that good or services haven’t been sold. Tax authorities have an obligation to specifically prove that nothing has been sold.
VAT deduction are twofold: [i] actual performance of commercial transactions and [ii] the reflection of the transaction’s substance in the accounting documents. This statement contradicts the position of the ECJ in the *Teleos* case, i.e. that the Sixth Directive is to be interpreted as precluding the competent authorities of the Member State of supply from requiring a supplier, who acted in good faith and submitted evidence establishing, at first sight, his right to the exemption of an intra-Community supply of goods, subsequently to account for VAT on those goods where that evidence is found to be false, without, however, the supplier’s involvement in the tax evasion being established, provided that the supplier took every reasonable measure in his power to ensure that the intra-Community supply he was effecting did not lead to his participation in such evasion. 60 According to such ruling of the ECJ even if the transaction took place among different persons than those indicated in invoices (substance of the transaction differs from its form) the VAT deduction should be allowed if no fraud is found in the seller’s actions. Therefore, the requirements for VAT deduction defined by the Lithuanian court should be supplemented by the third limb – element of fraud. That actually has been confirmed in other VAT cases, such as in the *Aldaila* 61 mentioned above, which was resolved before this *B1* case.

2.1.4. Obligation of the tax administrator to prove fraud in cases of zero rated exports

2.1.4.1. In the *C1* case 62 a Lithuanian company sold vegetables to a Latvian one and applied zero percent VAT rate for the sale. Latvian company failed to declare

60 Case C 409/04, *Teleos PLC and others v Commissioners of Customs & Excise*, para 68
62 Case No. S-40(7-8-2008), *C1 v VMI*, Commission on Tax Disputes under the Government of the Republic of Lithuania
VAT and terminated all economic activities. Latvian tax authorities informed that this company matches all criteria of a “missing trader”. The Lithuanian Tax inspectorate assessed additional VAT payable on the sales in question at the general VAT rate. The taxpayer appealed. The Commission on Tax Disputes stated that Member States while enforcing the rules on zero rated intra EU supplies must adhere to the principle of proportionality. This principle was explained as requiring Member States to choose such measures which do not threaten the neutrality of the VAT system, i.e. avoid double taxation. Chosen measures must also be proportionate to the goal which is sought. In the particular case the commission stated that even though the seller must take reasonable steps to ensure that the transaction isn’t fraudulent the burden placed on the honest seller must be proportional and reasonable. The requirement to satisfy three conditions by the seller, i.e. that [a] both parties to the transaction were registered VAT payers; [b] the buyer received full ownership rights to the goods and [c] the goods were physically exported to the other Member State, has been ruled to be a proportional measure to the need to prevent tax evasion and fraud. The court also stated that if any of these three conditions is not satisfied, the honesty of a seller should be analysed. In this particular case the seller failed to provide evidence that the goods were actually exported to Latvia, the seller also failed to collect all required documentary evidence regarding the export, i.e. failed to act as a prudent business person should. Consequently the position of the tax authorities was upheld. The Court has followed the position of the ECJ in the Teleos case that zero rate VAT may be applied only when as a result of the dispatch or transportation, the goods have physically left the territory of the Member State of
supply. Also since it is difficult for the tax authorities, because of the abolition of frontier checks between the Member States, to satisfy themselves that the goods have or have not physically left the territory of that Member State, tax authorities must rely on the information provided by the taxpayer. This imposes an obligation for the taxpayer to obtain sufficient proof of the physical transportation of goods to the other Member State.

2.1.4.2. In the *P1* case the situation was quite similar to *C1* described above. The Commission decided that the taxpayer failed to act as a prudent person should have and failed to collect sufficient evidence indicating transfer of goods to Latvia. The CMR waybills were signed by both parties to the contract in Lithuania upon dispatching the goods. The tax administrator established that the vehicles indicated in the CMR waybills didn’t cross the Lithuanian border at indicated times. The waybills also didn’t contain names of specific persons who accepted goods and transported them abroad. The taxpayer made a significant error by providing written confirmations from the buyers that the goods were delivered to Latvia but for some unknown reason failed to translate those confirmations into Lithuanian. The commission declined to take it into consideration since according to Article 153 of the Law on Tax Administration all evidence in tax disputes must be translated into Lithuanian. Also – the CMR waybills have been filled in in Lithuania upon dispatch of goods therefore they prove only transfer of goods to the possession of the buyer in Lithuania, but not the actual transfer of them abroad. The commission has confirmed an obligation

63 Case C 409/04, Teleos PLC and others v Commissioners of Customs & Excise, para 42
64 Case C 409/04, Teleos PLC and others v Commissioners of Customs & Excise, para 44.
to follow ECJ case-law, i.e. that when they exercise their powers, Member States must comply with the general principles of law which form part of the Community legal order, which include, in particular, the principles of legal certainty and proportionality. However, the commission didn’t elaborate on what kind of evidence proving transfer of goods out of Lithuanian would be considered sufficient and proportional in such situation.

2.1.4.3. The Vilnius regional court in similar circumstances as in the P case had to assess the honesty of a taxpayer in applying zero rated VAT for exports of automotive tires and rims to Latvia. One of the main arguments of the taxpayer was that it has sold goods to five Latvian companies on various occasions during a period of about 6-8 months and most of those sales were correctly declared by the buyers and VAT was paid. Only part of the sales were not declared in Latvia however the same types of documents were used in all transactions. The tax administrator didn’t challenge those sales which were properly declared in Latvia but disallowed zero rated VAT for the others. The court stated that in the first group of transactions there were no doubts that zero rate VAT was applied lawfully and the tax administrator didn’t have an obligation to assess the honesty of the taxpayer, while in the rest of transactions honesty was crucial since the taxpayer failed to provide undisputed evidence that goods were actually delivered to Latvia. Once again the taxpayer’s weakest position in the case was that CMR waybills were not filled in properly, names of the persons transporting goods were missing, in some cases companies indicated as transporting those goods denied

66 Case C 409/04, Teleos PLC and others v Commissioners of Customs & Excise, para 45.
67 Case No. I-1049-0624/2009, P v VMH, Vilnius Regional Administrative Court
any involvement in the transactions. However names of persons acting on behalf of the buyer were present as well as company seals. The court relied on some questionable evidence in denying the claim of the taxpayer. The court relied on the fact that most of the payments were made in cash which in itself is a very much legal form of payments under Lithuanian laws. The court also stated that persons signing on behalf of the buyers were not their employees, they were acting according to the powers of attorney and they themselves paid for the goods bought in cash at the place of dispatch. Those powers of attorney also didn’t contain any specific authorizations to receive goods on behalf of the buyers. However, assigning a person to act as an agent on behalf of the company is perfectly legal under Lithuanian laws even if the power of attorney is a general one. Therefore, it seems the Court was struggling to find sufficient arguments to support its inner feeling that the taxpayer must have known about the fraudulent intents of his business partners.

2.1.4.4. The taxpayer appealed the abovementioned decision. The Supreme Administrative Court ruled that the decision of the lower court should be upheld since the taxpayer relied on basically the same arguments as the ones provided in the prior litigation. The Court also stated that each transaction should be analyzed separately even though they look identical from the taxpayer’s point of view. As regards proof of physical transfer of goods abroad the Court explained that CMR waybills should contain a separate entry indicating this fact. And the entry should not be the same as the one indicating the fact of sale of

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68 Art. 2.137 of the Civil Code of Lithuania
69 Case No. A-442-204/2010, P v VMI, Supreme Administrative Court of Lithuania
goods. The taxpayer tried to rely on the narrow interpretation of “sale” taken from the Lithuanian civil law, i.e. that the concept of sale doesn’t include transportation of goods; the sale is completed upon transfer of title if no other conditions were agreed. The taxpayer wrongly ignored specific provisions of the Law on VAT and the Sixth Directive as well as ECJ case law on the subject.

2.1.5. Obligation of tax payer to prove export in cases of zero rated exports

2.1.5.1. The other aspect of application of zero rated VAT was analyzed in the O1 case. The tax administrator denied a right to apply zero rated VAT due to the fact that the taxpayer has failed to prove that ownership of the goods (frozen fish) had actually been transferred to two Latvian companies indicated in invoices of the taxpayer. The Commission on Tax Disputes upheld the position of the tax administrator. However the commission added that tax authorities have a right to demand additional proof about transactions undertaken and the taxpayer has a burden to collect all necessary evidence proving his right to apply VAT at zero rate.

2.1.5.1.1. However the commission’s arguments in this case were prone to criticism. The commission initially stated that burden of proof in such cases should be distributed proportionally among the taxpayer and the tax administrator and a company should be allowed to apply VAT at zero rate if it provides initial evidence indicating such right and it didn’t participate in the fraudulent activities. Later on the commission stated that the taxpayer must provide undisputable evidence that buyers of the goods received full

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70 Case No. S-356(7-316/2009), O1 v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania.
ownership rights to those goods. The commission increased the taxpayer's burden of proof.

2.1.5.1.2. The commission also relied on the fact that invoices issued by the taxpayer were not signed by the buyers however Lithuanian law explicitly states that signatures on the invoices are not required\(^1\). This has also been confirmed by the Court of Appeals\(^2\).

2.1.5.1.3. The commission also relied on the fact that criminal investigations had been initiated against the buyer of the goods and the intermediary who allegedly performed transportation services for the goods sold. Such arguments clearly contradict the presumption of innocence defined in the Constitution\(^3\).

2.1.5.1.4. According to the facts of the case several third parties paid the seller on behalf of the buyers of the goods. The Commission relied on this fact as evidence indicating that goods were sold to other persons than those indicated in the invoices. However, a right for a third person to perform an obligation on behalf of a third person is provided in article 6.50 (1) of the Lithuanian Civil Code and remains a valid way of conducting payments. The Supreme Court of Lithuania has confirmed that a person has a right to perform an obligation to the creditor on behalf of the debtor either at his own will or at the request of the debtor\(^4\). In such case the rights of the

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\(^1\) Article 13 (8) of the Accounting Law of the Republic of Lithuania, 6 November 2001 No. IX-574  
\(^2\) Case No. 1A-180/2011, the Court of Appeals of Lithuania  
\(^3\) Art. 31 of the Constitution of Lithuania  
\(^4\) Case No. 3K-3-299/2011, the Supreme Court of Lithuania
creditor are automatically transferred to the person who performed the obligation.\footnote{Article 6.50 (3) of the Lithuanian Civil Code. This automatic transfer of rights of claim has been confirmed in a settled case law, ex. Case No. 3K-3-369/2010, the Supreme Court of Lithuania; Case No. 2-252/2009, the Court of Appeals of Lithuania}

2.1.5.1.5. The position of the taxpayer in the \textit{OJ} case was severely weakened by the failure to provide any substantial evidence that the taxpayer has ever met representatives of the buyer in person or maintained any substantial communication with them. The taxpayer claimed that all negotiations were carried out through the intermediaries. The taxpayer also didn’t have written contracts of sale, just invoices and CMR waybills which didn’t have any indication of the names of physical persons who actually received and transported goods.

2.1.5.2. In 2010 the Supreme Administrative court brought some light into the application of the proportionality principle in distributing the burden of proof in zero rate VAT disputes. In \textit{Šiaulių tiekimo bazė} case\footnote{Case No. A-556-1047/2010, \textit{Šiaulių tiekimo bazė} v VMI; \textit{Šiaulių apskritis} VMI, Supreme Administrative Court of Lithuania} the court faced a standard situation where goods were sold to Latvia, the buyer failed to declare and pay VAT, some information was missing from the CMR waybills and the seller was required to pay full amount of VAT. The court overruled decisions of the tax administrator, Commission on Tax Disputes and lower court and fully upheld the position of the taxpayer. The court cited the position of the ECJ in \textit{Collée} case\footnote{Case C 146/05, \textit{Albert Collée, as full legal successor to Collée KG v Finanzamt Limburg an der Lahn}.} that a national measure which, in essence, makes the right of exemption in respect of an intra-Community supply subject to compliance with formal obligations, without any account being taken of the substantive requirements and, in
particular, without any consideration being given as to whether those requirements have been satisfied, goes further than is necessary to ensure the correct levying and collection of the tax. The principle of fiscal neutrality requires that an exemption from VAT be allowed if the substantive requirements are satisfied, even if taxable persons have failed to comply with some of the formal requirements. The court stated that Lithuanian Law on VAT does not define a list of evidence required to prove export of goods, a CMR waybill should be considered the main document, evidencing export of goods abroad. The requirements for filling-in CMR waybills defined in the CMR Convention have been satisfied in this case, the waybills have been sealed by the buyer and the transport company. The fact that some information was omitted didn’t deny the fact that the goods were exported. The fact that the taxpayer didn’t have power of attorney of persons signing the waybills or the fact that the buyer failed to declare VAT in Latvia don’t deny the fact that the goods were transported out of Lithuania. The position of a taxpayer was stronger in this case because it could provide written confirmation from the truck driver that the goods were really transported to Latvia. He also provided documents that the truck indicated in the CMR waybill actually travelled from Lithuania to Latvia on the date of sale. The court of lower instance had also confused some facts of the case related to the route of the goods in question.

2.1.6. Conclusions

2.1.6.1. Most of VAT disputes evolve around transactions undertaken with Latvian counterparties. This could be explained by the fact that Latvia is the biggest importer of Lithuanian goods and services. In first five months of 2011
exports to Latvia amounted to more than 2,5 billion litas. Interestingly enough, other biggest export destinations (Poland - 1,9 billion and to Estonia - 1,6 billion, UK – 1,1 billion) hardly ever surface in tax cases.

2.1.6.2. The cases tend to be decided mostly depending on specific circumstances of every case. Neither the courts nor the Commission on Tax Disputes has established definite objective requirements for proving that a sale of goods or services really took place or that the goods were transported out of Lithuania. The courts remain free to apply the principle of proportionality in distributing the burden of proof upon their own discretion without providing any legal certainty for the taxpayers.

2.1.6.3. Case-law of Lithuanian courts has to follow rules established by the ECJ. However, in certain cases domestic courts fail to do so. Lithuanian courts haven’t directly recognized the principle of Axel Kittel that: “the question whether the VAT payable on prior or subsequent sales of the goods concerned has or has not been paid to the Treasury is irrelevant to the right of the taxable person to deduct input VAT. According to the fundamental principle which underlies the common system of VAT, and which follows from Article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components. In that context it is settled case-law that the principle of fiscal neutrality prevents any general distinction between lawful and unlawful transactions.” Lithuanian courts

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78 Information available at the official web site of Lithuanian Department of Statistics at www.stat.gov.lt
79 Ibid
81 Joined Cases C-439/04 and C-440/04, Axel Kittel v État belge and État belge v Recolta Recycling SPRL, paras 49-50
try to avoid allowing any benefit to be received out of unlawful transactions. On the other hand the courts have accepted that: “traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT”.82

2.1.6.4. Lithuanian courts have followed the ECJ’s established principle that a taxpayer seeking to deduct input VAT or to apply a zero rate VAT in cases where fraud has been established in the actions of the counterparty of the taxpayer, must prove he acted reasonably and have taken all reasonable measures to inspect his business partner. However, the courts haven’t analyzed the issue of the level of this knowledge. In certain cases the transaction may occur and only later the evidence of the fraud may become available. Checking or not checking the counterparty before the transaction would provide the same result. Therefore, a simple failure to inspect information about the counterparty shouldn’t be considered a proof of participating in the fraud. Availability of information proving fraudulent intent of the counterparty at the time of the transaction should be an essential element of the analysis. As the UK High Court stated in the BSG83 case “first the burden is on HMRC to prove that the taxpayer ought to have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT. It is not for the taxpayer to prove that it ought not. Second, it is not sufficient to demonstrate that the taxpayer was involved in

82 Ibid, para 51.
83 Blue Sphere Global Ltd v The Commissioners for Her Majesty's Revenue & Customs, [2009] EWHC 1150 (Ch), 2009 WL 1403417
transactions which “might” turn out to have undesirable associations. The relevant knowledge is that the taxpayer ought to have known that by its purchases it was participating in transactions which were connected with the fraudulent evasion of VAT; that such transactions might be so connected is not enough”.

2.1.6.5. The ECJ-defined principles are not entirely in line with the general anti avoidance principle of substance over form. In VAT cases the ECJ approves the form of the transaction even if it is established that its substance differs. This deviation from the general principle wasn’t fully understood by the tax administrator and the lower court in the Aldaila\textsuperscript{84} case and led to the taxpayer’s victory.

2.2. Proportionality in transfer pricing

2.2.1. Only a reasonable amount of information needs to be collected by the taxpayer

2.2.1.1. Article 40 (2) of the Law on Corporate Income Tax provides that where the conditions created or prescribed by mutual transactions or economic operations between associated persons are other than those created or prescribed by a mutual transaction or economic operation between non-associated persons, any profit (income) that would be attributed, if no such conditions existed, to one of such persons but due to such conditions is not attributed to him, may be included in the income of that person and taxed accordingly. The rules for implementing the provisions of this paragraph shall be established by the Minister of Finance.

\textsuperscript{84}Case No. A-556-984/2010, UAB Aldaila \textit{v} VMI, Supreme Administrative Court of Lithuania
2.2.1.2. Paragraph 68.1. of the rules implementing transfer pricing norms\textsuperscript{85} (hereinafter – Rules) provides an annual turnover threshold which renders collection of transfer pricing documentation obligatory. That threshold is LTL 10 million per financial year of a taxpayer. The abovementioned threshold eliminates a big number of Lithuanian entities from the additional burden to prepare thorough documentation. Only 762 Lithuanian companies received more than LTL 10 million income in 2010.\textsuperscript{86} Compared to the total number of about 144'000 registered companies\textsuperscript{87} at the end of 2010 it is evident that only 0.5\% of them are obliged to undertake additional efforts in gathering and storing transfer pricing documentation. This provision is intended to ensure that only the wealthiest companies have additional expenses and such burden isn’t excessive for them.

2.2.1.3. Paragraphs 70-73 of the Rules define a list of documents which should be gathered and kept by the taxpayer. However paragraph 74 allows a taxpayer to use any other documentation which would allow proper assessment of transactions undertaken by the taxpayer with related parties. The Rules also allow a taxpayer to keep documents in any form if authenticity of the documentation can be inspected. The taxpayer is also allowed to maintain documentation in any language desired and can submit such documents to the tax authorities upon their request.

\textsuperscript{85} Rules implementing article 40 (2) of the Law on Corporate Income Tax and article 15 (2) of the Law on Personal Income Tax, approved by the Finance minister of the Republic of Lithuania by decision No. 1K-123 of 09 April 2004.
\textsuperscript{86} Information available at http://archyvas.vz.lt/print.php?id=10262264
\textsuperscript{87} Information available at http://www.registrucentras.lt/jar/stat/for.php
2.2.1.4. However, the Rules do not contain any provisions providing specific benefits for the taxpayer in maintaining contemporaneous transfer pricing documentation, such as in the US which allows escape from a penalty for unpaid taxes. On the other hand taxpayers could try invoking article 139 of the Law on Tax Administration which provides for a possible penalty from 10 to 50 percent of unpaid taxes, but it also provides that the amount of the actual penalty imposed shall be conditional on the type of violation, on whether the taxpayer has cooperated with the tax administrator, on the acknowledgment of having committed a violation of tax laws and on other circumstances which the tax administrator deems to be relevant when imposing a smaller or larger fine. Preparation of contemporaneous transfer pricing documentation could be used to minimize the amount of penalty but not to eliminate it completely.

2.2.1.5. An obligation to maintain documents proving the expenses of a Lithuanian entity has been briefly confirmed in the G1 Lietuva case by the Commission on Tax Disputes. It stated that such requirement is logical and reasonable and the taxpayer must keep evidence of its costs incurred due to providing services to the related party abroad.

2.2.1.6. In the long saga of the AstraZeneca litigation the Supreme Administrative Court held that the case should be returned for repeated hearing back to the lower court because the Commission on Tax Disputes and the court

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88 US section 482 Treasury Regulation § 1.6662-6(d)(2)(iii) provides that the taxpayer's pricing decisions could be subject to an extensive penalty regime. A taxpayer that chooses the inappropriate transfer pricing method is subject to penalties, but a taxpayer can avoid sanctions if it prepares contemporaneous documentation that substantiates its transfer pricing methodology; see also Levey M. M. and Wrapp S. C., Transfer Pricing Rules, Compliance and Controversy, CCH (2007), pages 214-216.

89 Case No. S-114(7-38/2009), UAB „G1 Lietuva“ v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania.

90 Case No. AS-756-242-08, VMI v UAB „Astra Zeneca Lietuva“, Supreme Administrative Court of Lithuania.
of first instance had differently interpreted the obligation to maintain transfer pricing documentation. The Commission stated that the tax administrator must analyze it but the court of first instance failed to do it during the appeal process. However the court didn’t elaborate on what should be understood as the proper maintenance of such documentation.

2.2.1.7. In the T1 case the Commission on Tax Disputes extended the obligation to maintain transfer pricing documentation. T1 was a member of a large group of Lithuanian companies, it used to obtain credits from its parent company and then immediately provide loans at higher interest rate to its other associated entities. T1 was a regular joint stock company, it didn’t have any license to provide financial services but its only business was the above mentioned loan transactions. Its turnover didn’t exceed the threshold of LTL 10 million which requires obligatory preparation of transfer pricing documentation and the company didn’t have it. The tax administrator argued that the transactions of T1 fully matched the definition of financial intermediary services provided in the Law on Financial Institutions. Since transfer pricing documentation is obligatory for all financial institutions, this obligation was imposed on T1 as well. The Commission upheld those arguments since T1 had received most of its income from interest and its biggest expenses were interest as well. T1 has also indicated

91 Case No. S-66(7-27/2011), UAB „T1” v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania
92 Paragraph 68.1. of the rules implementing transfer pricing norms
93 Law on Financial Institutions of the Republic of Lithuania, 10 September 2002, No IX-1068. It provides that a financial institution shall be a financial undertaking or a credit institution which [a] has a declaration of the provision of financial services in the documents regulating economic activities (founding documents, licences, patents, etc.); [b] its activities mainly consist of the provision of financial services; [c] provides any services described in article 3, such as financial mediation (activities of an agent) or engages in lending.
94 Paragraph 68.2. of the Rules implementing article 40 (2) of the Law on Corporate Income Tax and article 15 (2) of the Law on Personal Income Tax, approved by the Finance Minister of the Republic of Lithuania by decision No. 1K-123 of 09 April 2004.
in its financial accounts that its main type of business was provision of financial services.

2.2.2. Conclusions

2.2.2.1. Lithuanian legislation provides a certain amount of discretion to the taxpayer in collecting transfer pricing documentation. Certain guidelines for proper documentation are defined in the Rules, but the taxpayer is free to maintain its own documents as long as they provide enough evidence of the pricing methods used.

2.2.2.2. The courts haven’t had an opportunity to decide whether the burden imposed on the taxpayer is proportional to the purpose sought. The obligation to keep documents has been affirmed and the obligation of the tax administrator and the court to take it into consideration has been upheld as well.

2.2.2.3. Rules provide a direct link into the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, naming them as a direct source for issues unregulated by the Rules. Paragraph 4.98 of the 2010 OECD Guidelines provides that application of the arm’s length principle may require collection and analysis of data that may be difficult to obtain and/or evaluate. In certain cases, such complexity may be disproportionate to the size of the corporation or its level of controlled transactions. Paragraph 5.6. provides that when requesting submission of these types of document, the tax administration should take great care to balance its need for the documents against the cost and

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95 Rules implementing article 40 (2) of the Law on Corporate Income Tax and article 15 (2) of the Law on Personal Income Tax, approved by the Finance minister of the Republic of Lithuania by decision No. 1K-123 of 09 April 2004
administrative burden to the taxpayer of creating or obtaining them. For example, the taxpayer should not be expected to incur disproportionately high costs and burdens to obtain documents from foreign associated enterprises or to engage in an exhaustive search for comparable data from uncontrolled transactions if the taxpayer reasonably believes, having regard to the principles of OECD Guidelines, either that no comparable data exists or that the cost of locating the comparable data would be disproportionately high, relative to the amounts at issue.

2.2.2.4. Therefore, Lithuanian taxpayers could use those provisions in their defense challenging the obligation imposed by the tax administrator to collect unnecessary amounts of evidence. A threshold of LTL 10 million for the application of this obligation might not be a sufficient way to ensure proportionality. A corporation with income over LTL 10 million might be not profitable at all and any additional documentation requirement imposed by the tax administrator could be too difficult to satisfy.

2.3. Proportionality in relation to interim measures in tax disputes

2.3.1. Articles 71 and 92 of the Law on Administrative Proceedings provide a right for a court to make an interlocutory decision regarding application of measures to ensure proper execution of an expected court order. Such order should be issued at any stage of the administrative proceedings if there is a threat that without such measures it will be more difficult to execute an expected court order. A threat must be real, i.e. it must
be shown that restoration of the factual situation existing prior to the issue of the court order will not be possible or restoration will be difficult to achieve.97

2.3.2. Interim measures must be proportional to the threat

2.3.2.1. The Supreme Administrative Court98 has defined a general principle that the court considering an application for interim measures must analyze: [a] probability of positive court decision in the main dispute; [b] risk that such positive court decision will be difficult to execute; it must also take into account [c] the need for the sought measure; [d] its proportionality to the needed result; [e] balance of contradicting interests of both parties; [f] protection of the public interest.

2.3.2.2. Interim measures may be applied as soon as the tax administrator starts the investigation and establishes that there was a potential breach of tax law99. The Supreme Administrative Court has ruled100 that a mere risk of taxpayer losing his property is enough to apply interim measures in tax disputes, no decisive proof is needed.

2.3.2.3. Only the property belonging to the particular taxpayer can be seized as a result of applied interim measures. This simple notion has been central in the J. N. B. case101. The tax payer was an individual company – which is a company with unlimited liability. Property of the owner of the company may be transferred to

97 Case No. AS-143-473-11, D.K. v VTEK, Supreme Administrative Court of Lithuania.
98 Case No. AS-146-88-10, Veiverita v Utenos RAAD Zarasų rj. agentūra, Utenos apskrities VMI, Supreme Administrative Court of Lithuania
100 Case No. A-442-1497-11, UAB „Vailida“ v Taurages apskrities VMI, Supreme Administrative Court of Lithuania
101 Case No. A-556-100-11, J.N.B. v Kauno apskrities VMI, Supreme Administrative Court of Lithuania
the entity but the transfer must be officially recorded. The tax administrator, however, seized property of the spouse of the owner of the entity. According to Lithuanian legislation unless agreed otherwise by the prenuptial agreement the property of spouses is held in joined ownership. The tax administrator believed that the owner of the individual company is fully liable for the obligations of the company and property held in joint ownership by the owner and his spouse can be used to discharge obligations of the company. The Court ruled that the principle of legal certainty must be observed and state authorities cannot act *ultra vires*. Its rights cannot be extended beyond those provided in law. The tax obligation is individual in its nature and cannot be transferred to any other person besides the taxpayer himself therefore the Court changed the decision of the tax administrator and removed the seizure. This however doesn’t restrict the possibility of the tax administrator waiting till the amount of taxes is ultimately assessed and then enforcing the decision by way of bankruptcy process if needed. In such case personal property of the owner of the bankrupt individual company must be pooled together with the property of the company as well as his individual obligations and then all obligations must be discharged from the pooled property.

2.3.2.4. The Supreme Administrative Court has found that interim measures requested by the taxpayer in the *Trevis* case were not proportionate since the taxpayer failed to specify their type. The taxpayer simply requested that all

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102 Art. 8 of the Law on Individual Enterprises of the republic of Lithuania, 6 November 2003 No. IX-1805.
103 Art. 3.87 of the Civil Code of Lithuania.
104 Article 2.50 (94) of the Civil code; Article 10 (7)(1) of the Enterprise Bankruptcy Law; Case No. 3K-3-160/2011, *AB SEB bankas v II „Sakiu agencijas“*, Supreme Court of Lithuania.
procedures related to the tax investigation were suspended until the appeal was heard by the court and its decision entered into force. The taxpayer failed to name specific injunctions sought and didn’t prove their proportionality to the intended result. Hence proportionality of the measure to its purpose couldn’t be evaluated if it wasn’t known what the measure exactly was.

2.3.2.5. In the TI-VI case\textsuperscript{106} the Supreme Administrative Court noted that in the fields regulated by EU law it (the EU law) has priority over national legislation. The field of customs taxation has been regulated at EU level and article 244 (3) of the Community Customs Code\textsuperscript{107} provides that where the disputed decision has the effect of causing import duties or export duties to be charged, suspension of implementation of that decision shall be subject to the existence or lodging of a security. However, such security need not be required where such a requirement would be likely, owing to the debtor's circumstances, to cause serious economic or social difficulties. In this case the Court had to decide whether the Russian company would suffer serious economic or social difficulties if the collection of customs duties is not suspended till the company’s appeal was heard in court. The taxpayer argued that the amount of assessed customs duties was equal to the company’s income for the previous financial year, that it doesn’t have any material property or available funds and that forced collection of taxes would result in bankruptcy. However, the only substantial evidence provided was an income declaration which proved only one point – that in 2009 the company received income which was more or less equal to the amount of assessed customs duties.

\textsuperscript{106} Case No. AS-146-14-11, TI-VI v. MD; Vilniaus teritorine muitinė, Supreme Administrative Court of Lithuania

\textsuperscript{107} Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code
The court stated that the taxpayer failed to provide any evidence indicating the amount of funds in the possession of the company or the amount of property owned by it. Hence the decision of the lower court was upheld and the taxpayer was denied a right to suspend collection of owed taxes. The taxpayer evidently could have had a much stronger position if more evidence was provided to support its arguments about significant economic effect of the assessed taxes.

2.3.2.6. Article 111 of the Law on Tax Administration provides an obligation of the tax administrator to repay all taxes collected in breach of the law. Proving the existence of a threat to the restoration of the situation existing prior to the court order in tax disputes is somewhat difficult due to the popular argument of the courts that the provision of article 111 above avoids difficulties to get unlawfully collected taxes back. Therefore, the courts believe there’s no reason to apply interim measures against the state.

2.3.2.7. Some clarification of proportionality to the threat in application of interim measures has been provided in the S.Z case. The taxpayer was assessed with an additional tax obligation, the decision of the tax administrator was appealed but the taxpayer lost and the court order entered into force. The execution of the court order was forwarded to the court bailiff who seized a land plot of the taxpayer since not enough funds were located in his bank accounts. At this stage the taxpayer submitted a request to renew litigation due to some newly discovered facts. The taxpayer also requested the court to apply interim measures – suspend execution of the court order. The court upheld the request based on

108 Case No. AS-556-123-10, Z.Š. v Klaipėdos teritorinė muičinė, Supreme Administrative Court of Lithuania
109 Case No. AS-143-98-10, S.Z. v Vilniaus apskrėtis VMI, Supreme Administrative Court of Lithuania;
the fact that the threat of irreparable damage was reasonable. The court recognized that if the court bailiff proceeded with selling the seized land plot it would be highly difficult to restore the situation existing prior to the court order – to return the land plot to the taxpayer if needed.

2.3.3. Interim measures must be removed once the threat ceases to exist

2.3.3.1. In the V/B case\textsuperscript{110} the Supreme Administrative Court admitted that the seizure of taxpayer’s property after the circumstances changed and grounds for the seizure disappeared, would amount to the unlawful, unreasonable and disproportionate restriction of the taxpayer’s rights. This would allow the tax administrator to abuse given powers and act contrary to the purpose of the institution (tax inspectorate) itself. Thus a taxpayer must have a right to request removal of interim measures at any time in the administrative proceedings if he thinks that grounds for the application of such measures have ceased to exist. In this particular case the taxpayer was assessed with additional customs duties in Germany on imported cigarettes. German authorities issued the writ of execution and asked the Lithuanian customs to collect taxes on behalf of Germany. The taxpayer asked the court to apply an interim injunction and force the tax administrator to suspend forced recovery of assessed duties. The taxpayer also argued that the German authorities had issued an unjustified writ of execution which should be annulled as well since it was issued in breach of various EU law provisions. The court ruled that as a general rule all taxes collected in breach of law must be returned to the taxpayer once the court decides so. This provides sufficient means to expect quick restitution of the taxpayer’s rights in case the

\textsuperscript{110} Case No. AS-403-184-07, V.B. v Utenos apskrities VMI, Supreme Administrative Court of Lithuania;
court decides against the tax administrator. Therefore no real threat exists that such court decision wouldn’t be enforced if issued. The Court effectively extended the “easy recovery of overpaid taxes” rule to other EU Member States. This position could be criticized since rules of recovery of overpaid taxes might differ significantly in other EU countries and might be more cumbersome than Lithuanian ones. Also the taxpayer might be required to incur additional non recoverable expenses due to the need to translate documents into local language, hire a domestic attorney, etc.

2.3.4. Value of property seized must correspond to the anticipated amount of unpaid taxes

2.3.4.1. The Supreme Administrative Court has stated that proportionality should be understood as requiring the tax administrator to seize property with the value corresponding to the amount of a possible tax obligation\(^{111}\). The exception to this rule is provided in article 24 of the Rules of decision enforcement\(^{112}\), which states that a court bailiff may seize more property than needed to fully enforce the court decision only if the seized object cannot be divided and the debtor doesn’t possess enough other property to guarantee enforcement of the court decision, or the property lacks liquidity or the debtor himself requested seizing that particular object.\(^{113}\)

\(^{111}\) Case No. A-143-1172/2010, Est Merrain v VMI; Tauragės apskrūtis VMI, Supreme Administrative Court of Lithuania.

\(^{112}\) Rules of decision enforcement, approved by the order No. 432 of the Finance Minister of the Republic of Lithuania on 31 December 2002.

\(^{113}\) Case No. 3K-3-161/2007, V. K. V. v. antstole R. Stašienė, Supreme Court of Lithuania
2.3.4.2. In the *AK and SK case*¹¹⁴ the court ruled that, while applying interim measures in tax disputes, article 675 of the Code of Civil Procedure of Lithuania should be applied *mutatis mutandis*. This provision states that the court bailiff cannot seize essentially more property than is needed to recover adjudged amount. The Supreme Court has ruled that interests of the creditor and debtor should be defended equally. Before seizing the property the court bailiff should appraise it according to the market prices taking into account its depreciation and opinion of both parties to the dispute. If either the claimant or respondent disagree with the valuation made by the bailiff or if the bailiff has reasonable doubts about its value, he must obtain an expert valuation report. Later on, during the enforcement of the court decision, if the property's value changes the court bailiff should appraise it again according to the same procedure.¹¹⁵

2.3.4.3. If the court bailiff has seized property of the debtor (taxpayer) valued essentially more than is needed to implement the decision of the court the debtor has a right to challenge such actions in court.¹¹⁶

2.3.4.4. Evaluation of arrested property might be problematic in cases of previously pledged or mortgaged items since the value of the property is diminished by additional obligations undertaken by the debtor and tied to the particular object. When the value of the property is exceeded by the amount of the obligation which is secured by the pledge the courts consider such property almost worthless.¹¹⁷ The court has also confirmed that directing enforcement of

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¹¹⁷ Case No. 2-154/2006, *UAB „Tradicija“ v UAB „Serneta“, Court of Appeals of Lithuania*
court decisions against a pledged property is restricted significantly\textsuperscript{118}, it is also uncertain as to the final outcome of the sale\textsuperscript{119} and takes much longer to sell such property\textsuperscript{120}.

2.3.4.5. Determining the value of real estate which is not pledged might be also problematic. The official real estate registry of Lithuania conducts a common valuation of property once a year. The price is determined according to economic formulae but without taking into consideration any specific features of each particular object. Therefore, prices determined that way are somewhat indicative but they definitely do not indicate true market value. This value is available to all court bailiffs through the electronic database of the real estate registry. Since it is often the only available indication of the value, court bailiffs refer to it if no other evidence is available. In the \textit{Mimina} case\textsuperscript{121} the court bailiff, while enforcing a decision of the tax administrator, seized taxpayer’s property – a coffee shop - and valued it according to the information provided in the real estate registry. The taxpayer appealed and argued that market value of the property was 13 times bigger. However, the taxpayer based its arguments on the appraisal made by the independent expert three years before – prior to the economic downturn and

\begin{itemize}
\item \textsuperscript{118} According to article 626 of the Code of Civil Procedure of the Republic of Lithuania the court bailiff must suspend forced realization of pledged property if the creditor (the pledgee) declines to consent to such realization.
\item \textsuperscript{119} The pledgee has priority over all proceeds received from the sale of pledged property (article 4.198 (2) of the Civil Code of Lithuania), since actual price of the pledged property is not clear until actually sold it is difficult to predict if anything will be left to other creditors once pledgee’s claim is satisfied. Also the price of property sold in auction is set to be 80\% in the first one and 60\% in the second one from the value defined by the bailiff (articles 718 and 722 of the Code of Civil Procedure); also Case No. 2-884/2010, Court of Appeals of Lithuania.
\item \textsuperscript{120} According to the provisions of the Code of Civil Procedure, pledged real estate, as well as any other property with value exceeding LTL 100'000 or which must be registered in the public registry must be sold in public auction (article 694). Notice about the upcoming auction must be posted at least one month in advance (article 706). If the first auction fails due to the lack of any participants or due to the fact that the winning bidder failed to pay the price, court bailiff must offer the pledgee to acquire property for the initial auction price (article 719). If the pledgee refuses to acquire property second auction is obligatory in a month (article 721).
\item \textsuperscript{121} Case No. A-442-117-11, \textit{Mimina v Utenos apskrities VMI}, Supreme Administrative Court of Lithuania
\end{itemize}
plunge of real estate prices. The court dismissed the appeal and stated that the taxpayer’s appraisal was out-dated and there was no other evidence to indicate that price defined in the real estate registry doesn’t correspond to the real market value. The taxpayer’s argumentation was flawed by the fact that he admitted that real estate prices have significantly decreased during past years but he failed to provide any evidence to indicate that decrease amounted to maximum 50% but not 1300% to match value defined by the court bailiff. Additional investment in a new appraisal could have saved the case for the taxpayer. The court probably failed to investigate all circumstances and indirectly confirmed that the price of that particular coffee shop could have diminished 13 times in three years which didn’t happen in reality. Therefore, the court allowed non-proportional amount of taxpayer’s property to remain arrested in enforcement of the tax administrator’s claim. The court failed to apply a “less restrictive means” test in this case. The taxpayer argued that it had two buildings – office and a coffee shop. The market value of the office was bigger than the amount of taxes assessed therefore the tax administrator should have seized only the office building and would have had enough security for the whole amount of taxes sought. The tax administrator argued that the office building wasn’t being used and its location makes it hard to sell if needed, therefore in order to ensure good liquidity of the seized property both buildings were arrested. The court failed to acknowledge that firstly, the less restrictive measure would be arresting only the office building which fully covered the tax administrator’s claim. Especially when the tax authorities admitted that the value of the building was higher than their claim. Market value is the value at
which the goods can be sold in the open market\textsuperscript{122}. The tax administrator argued that market price exceeded the amount of their tax claim and at the same time argued that the property couldn’t be sold at such price, and so contradicted itself. Secondly, the measure had an excessive effect on the taxpayer since all of its property was seized and it couldn’t be used as collateral to get financing for business and consequently couldn’t expand its sales and raise more taxes.

2.4. **Proportionality in determining penalties for unpaid taxes**

2.4.1. The Constitutional Court has ruled that principles of justice and legality presuppose that remedies for the breach of law in all cases must be proportionate (adequate) to the breach itself. They must also correspond to the legal aims important to the public and must not restrict a person more than it is objectively needed to achieve those aims\textsuperscript{123}.

2.4.2. The Supreme Administrative Court dealing with tax penalties\textsuperscript{124} has followed the position of the Constitutional Court and stated that legislative regulation must ensure proper and timely payment of taxes.\textsuperscript{125} To guarantee effectiveness of such legislation various measures can be used, i.e. penalties, interest and etc. However, all such measures must be proportionate.\textsuperscript{126}

2.4.3. According to Lithuanian legislation, the tax administrator doesn’t have a right to rely on the principle of proportionality, justice or prudence in imposing late payment interest at a rate lower than the one defined in law. The only possible relief may be in the form of total exemption from such interest. Such relief is provided in articles 100 and 141 of the Law on Tax Administration, i.e. in cases when [a] the taxpayer proves

\textsuperscript{122} Article 2 (20) of the Law on Personal Income Tax; Article 2 (37) of the Law on Corporate Income Tax
\textsuperscript{123} 06 December 2000 decision of the Constitutional Court of Lithuania.
\textsuperscript{125} 26 September 2006 decision of the Constitutional Court of Lithuania.
\textsuperscript{126} 24 January 2006 decision of the Constitutional Court of Lithuania.
the absence of his fault with regard to the violation; [b] the tax law was violated due to circumstances beyond the taxpayer’s control and which he could not and did not foresee; [c] where a separate act of the taxpayer, though in violation of the provisions of a tax law, causes no damage to the budget; or [d] where the taxpayer violated the law due to the faulty explanation or consultation of the tax law by the tax administrator; or [e] it is not feasible to recover late payment interest in economic and/or social terms.

2.4.4. Penalties must be adequate to the unpaid taxes

2.4.4.1. In 2006 the Constitutional Court was referred a question whether the system of calculating late payment interest for unpaid taxes as defined in the Law on Tax Administration was in breach of the Constitution. The provision in question was current article 99 of the Law on Tax Administration. It provides that the amount of late payment interest and the procedure of its calculation shall be established by the Minister of Finance, taking into account the weighted average of the annual interest rate for Treasury bills of the Republic of Lithuania, issued in Litas by auction in the previous quarter. The amount of late payment interest shall be established by increasing the said interest rate by 10 percentage points. The current rate defined by the Finance Minister is 0.03 % per day. The Constitutional Court stated that the legislator has certain discretion in defining measures to combat breaches of tax obligations. The legislator has a right to choose whether to impose late payment interest at a fixed rate or at a floating one depending on certain indexes. However, as in choosing any other measures related to enforcing tax obligations, the legislator must follow principles of

127 26 September 2006 decision of the Constitutional Court of Lithuania
128 24 May 2011 decision of the Finance minister of the Republic of Lithuania, No. 1K-193
proportionality, justice and legal certainty. The court also noted that, after joining the EU, Lithuanian constitutional jurisprudence must be formed in the light of EU law. The court finally decided that the provision of the law stated above does not contradict constitutional order and doesn’t breach any provisions of the Constitution. Interestingly enough the Court partly denied the test of least restrictive measure. It stated that measures chosen by the legislator can’t be questioned later even if it appears that better alternatives were available for the legislator unless at the time of choosing the measure the legislator made a decision clearly infringing fundamental constitutional principles and values.

2.4.4.2. In the *JB* case\(^{129}\) the taxpayer had been assessed with a penalty for unpaid amounts of tax exceeding the tax almost 12 times. Interestingly enough the case had to reach Supreme Administrative Court to have the principle of proportionality applied. The unpaid amount of tax was quite insignificant and the taxpayer had paid it but was late one month. Additionally the taxpayer was of an old age and provided evidence that he was earning a minimal wage and had almost no property. In light of those arguments the court was able to apply an exception and reduce the imposed fine eightfold at a level lower than the minimum amount prescribed in law. The taxpayer was right to argue that the imposed fine was an excessive burden for him. But he could have also argued that the chosen measure wasn’t suitable for the objective sought. He had paid taxes voluntarily without prior reminder of the tax administrator therefore illegal intent was missing.

\(^{129}\) Case No. N-146-128-08, *J.B. v. Panevėžio RAAD*, Supreme Administrative Court of Lithuania
2.4.4.3. According to articles 150 and 151 of the Law on Tax Administration, decisions of the local tax administrator are firstly to be appealed to the central tax administrator and their decisions can subsequently be appealed to the Commission on Tax Disputes. Disputes regarding penalties are considered to be tax disputes and must follow the above stated steps of appeal. However, the taxpayer in the S1 case tried to argue with both - the central tax administrator and the commission, that a penalty twice the amount of unpaid taxes is not proportionate and unjust in the light of the provisions of the Lithuanian Constitution and decisions of the Constitutional Court. The Commission stated that according to the legislation neither the commission nor the central tax administrator has a right to refer any issues to the Constitutional Court hence none of them had a right to give opinions about the constitutionality of any legislative provisions. The penalty in question was applied according to the provisions of the Law on Social Security not the Law on Tax Administration. The former law is a special norm in relation to the later one and therefore different prescribed amounts of penalties in both laws do not contradict each other and a special norm should be applied. This position actually deprived the taxpayer of the possibility to use the Constitution as a directly applicable legal act of highest power even though such direct application is provided in the Constitution itself. The Commission failed to apply the principle of proportionality in this case because the tax administrator didn’t have any freedom to vary the amount of imposed fines. Interestingly enough the correct position of the taxpayer was

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130 Art. 2 (20) Law on Tax Administration
131 Case No. S-134(7-110-2007), S v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania
132 Art. 6 of the Constitution of the Republic of Lithuania
confirmed later on when four months after the court ruling in the S1 case Parliament changed article 16 (2) of the Law on Social Security\(^{133}\) and reduced the amount of penalty from 200% to 50%. Unfortunately the change came too late for the taxpayer in the S1 case.

### 2.4.5. Individual circumstances of the taxpayer must be taken into the account

2.4.5.1. The Constitutional Court has ruled that all types of penalties for administrative offences must be such as to ensure not only the punishment of a person but also a fair punishment. Therefore, administrative penalties must be proportionate (adequate) to the type of offence and aims sought. They must be differentiated in such a way as to allow taking into account the nature of the offence, mitigating and aggravating circumstances as well as to allow imposition of a penalty smaller than the minimum one provided in law. In light of those considerations the court stated that penalties imposed for the breach of tax law must be of such size as is necessary to ensure proper performance of an obligation to pay taxes.\(^{134}\)

### 2.5. Limits to tax investigations

2.5.1. Investigations must be ended in a defined period of time

2.5.1.1. The Commission on Tax Disputes has ruled\(^{135}\) that state institutions are created to serve the people. This provision means that state institutions have an obligation to ensure the most favourable regime implementing rights of both individuals and legal entities as well as to protect those rights, not restrict them

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\(^{133}\) Law No. X-1396 of 20 December 2007, Official gazette (Valstybes Zinios) 2007, No. 138-5651

\(^{134}\) 06 December 2000 decision of the Constitutional Court of Lithuania

\(^{135}\) Case No. S-2507-233/2007, R.K. v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania
and not let others restrict them. In working for the benefit of the people those institutions need to follow principles of honesty, legal certainty, proportionality and superiority of the law. Prompt execution of procedures, which could modify rights and obligations of a person, is a fundamental element of justice. The principle of reasonable timing in proceedings is also defined in article 6 (1) of the Convention for the Protection of Human Rights and Fundamental Freedoms. Until the act ending the administrative proceedings has been issued the legal situation remains uncertain. State institutions in deciding the cases have a discretion to choose among several available legal solutions but the institution must make a decision in a reasonable period of time. Therefore, the tax administrator must conduct tax investigations is such a way as to avoid any repeated litigation arising out of that investigation. Every taxpayer has a legal expectation that the tax administrator will act in such a way. When tax authorities breach their obligation to properly administer taxation and that leads to increase in the late payment interest calculated for the taxpayer, the principle of legal expectation is breached. In such case a taxpayer has a right to demand from the state compensation for suffered losses.

2.5.2. Statute of limitation for tax investigations – 5 years

2.5.2.1. Article 68 (1) of the Law on Tax Administration provides a general rule that the taxpayer or the tax administrator may calculate or re-calculate taxes in respect of a period not exceeding the current calendar year and five preceding calendar years counting back from January 1st of the year when taxes were started to be calculated or re-calculated. The running of the statute of limitation is
suspended upon the initiation of tax investigation by the tax administrator.\textsuperscript{136} Interestingly enough the act which initiates the investigation is a list of instructions by the head of the tax administrator and also includes: [a] full names and positions of inspecting officers; [b] the name of the taxpayer to be inspected; [c] the object of inspection; [d] the dates of commencement and completion of the inspection. The investigation itself may be started much later. Since initiation of investigation doesn’t require many resources, in practice, the number of such orders tends to increase at the end of every December\textsuperscript{137} to maximize the number of years covered by the investigation while the tax administrator’s act needs only contain minimum information. Therefore, parties are not on the same footing.

2.5.2.2. On the other hand the taxpayer has a right to amend his declarations for the period calculated according to the same rule, therefore a taxpayer would also be able to make amendments at the end of December in order to be able to amend the maximum number of years. But unlike the tax administrator the taxpayer must employ all available resources in this process since the amended declaration should contain precise numbers calculated upon inspection of all relevant taxpayer’s documentation.

2.5.2.3. Article 68 (3) of the Law on Tax Administration provides an exception when the tax administrator has a right to assess taxes for a period longer than five years preceding the current one. This is possible in the event that a criminal case

\textsuperscript{136} Article 120 (1) Law on Tax Administration
requires that the damage caused to the State be determined and the limitation periods set out in the Criminal Code for passing a conviction have not expired.

2.5.2.4. In the RC case\textsuperscript{138} tax investigation had started in June 2010 and the tax administrator assessed taxes for years 2004-2010, i.e. year 2004 should not have been investigated under the general rule. The tax administrator argued that investigation was started upon receiving a report from the Financial Crime Investigation Service which disclosed certain facts previously unknown to the tax administrator. The Commission on Tax Disputes ruled that the extension of the limitation period was not lawful. The exception provided in article 68 (3) of the Law on Tax Administration should be interpreted narrowly and could be applied only in cases when during criminal investigation a government files a civil claim in criminal proceedings for damages (unpaid taxes). The commission stated that criminal and administrative proceedings are fundamentally different ones with different burdens of proof, rules of proceedings and statues of limitations. Since in the RC case the tax administrator started administrative proceedings by instigating tax investigation the longer limitation period available in criminal process was not available in this case. The commission upheld the taxpayer’s position and disallowed assessment of additional taxes for the year 2004.

2.5.3. Tax collection must be undertaken in a reasonable manner.

2.5.3.1. Article 119 of the Law on Tax Administration provides that tax inspection conducted at the tax administrator’s office shall not be limited in its

\textsuperscript{138} Cases No. S-21(7-337/2010), RC v VMI; and No. S-20(7-336/2010), VC v VMI, Commission on Tax Disputes under the Government of the Republic of Lithuania
duration, but the tax administrator must complete it within the shortest objectively possible period of time.

2.5.3.2. In the *Lidina* case\(^{139}\) the tax administrator had been conducting tax investigation for a period of five years. The investigation had been suspended on several occasions due to various reasons, such as court litigation, request for information from other institutions and failure of the taxpayer to provide requested evidence. The Supreme Administrative Court stated that the tax administrator has a discretion to decide on the length of the investigation only limited by the single imperative condition – the necessity to ensure that investigation is completed within the shortest objectively possible period of time. This means that the tax administrator’s right must be realised according to objective factors: objective necessity to perform certain actions (ex. demand some additional documents or evidence). According to the rules of conducting tax investigations\(^{140}\), the tax investigation must be resumed and finished immediately after circumstances which led to the suspension of the investigation cease to exist.

In this case the investigation was suspended due to litigation, a court order was issued in April but the tax administrator resumed its investigation only at the end of October. The court ruled that the tax administrator had abused its powers and ordered it to finish investigation in two months. The tax administrator’s weakest argument was that it received the decision of the court in the summer when most of its employees were on holidays and therefore the investigation was resumed in the autumn only. It also argued that the taxpayer was uncooperative and didn’t


\(^{140}\) Rules of conducting tax investigations, formulating and certifying their results, approved by the Minister of Finance of Lithuania, 28 May 2004, No. VA-108
respond to requests of the administrator to provide evidence or appear in person. The court stated that the tax administrator being a state institution had enough powers and tools to conduct investigation and collect evidence on its own, therefore cooperation of the taxpayer was not an obstacle to finish the investigation. Besides, the tax administrator had an obligation to be active and perform its obligations in due manner without waiting for help from the taxpayer. The frustration of the court is understandable in this case since according to statistical data average tax investigations took only about 50-60 days in 2009.141

2.5.3.3. In the V/P case142 the court denied the tax administrator a right to conduct a new tax investigation at all. The tax administrator finished the first investigation of a private individual regarding personal income tax. During the investigation the tax administrator discovered that the taxpayer has received a house as a gift from his parents and afterwards sold it. The tax administrator suspected that the person was engaged in commercial activity of real estate sales and wanted to assess additional taxes accordingly. For that it decided to conduct a second investigation for the same period of time in order to establish additional circumstances. The taxpayer appealed and the case finally reached the Supreme Administrative Court. The court ruled that tax administrator has such a right under the Law on Tax Administration. However, the tax inspectorate is an institution of public administration. As such it must obey general principles of good administration, proportionality being one of them. The tax investigation must be conducted without excessively restricting taxpayer’s rights and with

141 Draft legislative proposal of the Government of the Republic of Lithuania No. 10-0088-01-13
142 Case No. A-556-158-08, V/P v Vilnius apskrities VMI, Supreme Administrative Court of Lithuania
minimal disturbance of his activities. The tax administrator’s defeat was mostly influenced by the fact the tax administrator relied on the sole need to re-evaluate transactions of the tax payer. The court ruled that since no new evidence was needed and the tax administrator has a right to do evaluation itself there is no need for repeated investigation. The taxpayer’s position was also somewhat strengthened by the fact that in order to declare that he was conducting commercial activities an element of seeking profitability must be present at all steps in the transaction chain. Here the taxpayer received real estate as a present, meaning he didn’t influence the transaction and therefore couldn’t seek anything by it. Even though the case dealt only with the issue of initiating tax investigation, the reasoning of the court implies that the court kept in mind thin chances of the tax inspectorate prevailing in the main dispute.

3. CONCLUSIONS

3.1. The very limited and narrow application of proportionality principle in domestic case-law

3.1.1. Current Lithuanian legal system in general and Lithuanian tax law were significantly influenced by western European and American legal systems. Foreign experts worked on creating national legislative acts as well as the Constitution. This cooperation led to adoption of general western legal principles into Lithuanian legislation and jurisprudence. National courts started relying on the principle of proportionality long before Lithuania joined the EU.

3.1.2. Various Lithuanian legal acts contain provisions intended to ensure a fair balance between contradicting rights and interests of the state and individual. Transfer pricing
rules impose additional burden to prepare and maintain pricing documentation only for the very few biggest companies. The tax administrator’s right to seize taxpayer’s property is limited. Value of the seized property cannot be higher than the amount of unpaid taxes. Any interim measures applied in tax disputes must be proportional to the threat that taxes might not be collected. Principle of legal certainty is ensured by prohibiting investigation and/or amendment of any tax returns preceding current financial year and 5 previous years.

3.1.3. Lithuanian courts dealing with tax issues have applied the principle of proportionality in various different situations. However, so far they have failed to analyse it deeper. In most of the cases the courts just stated that certain measures or actions must be proportionate to the aim sought and then ruled on the particular issue in question.

3.1.4. Domestic courts almost never perform a full analysis of the principle. They often fail to analyse the situation at hand according to the ECJ or ECHR established tests. For example any consideration about the availability and type of less restrictive measures is scarce. Reliance on the ECHR case-law in tax disputes is especially rare in jurisprudence of Lithuanian courts.

3.1.5. The ECJ rules are more applied in VAT cases only, but in the rest of tax related disputes the position of the ECJ is usually cited only formally without any real substantial application to the dispute.

3.1.6. Lack of reasoning is also a problem since the courts often simply state that the measure is or isn’t proportional. Such a situation makes it difficult to predict future developments of the case law. It also doesn’t help to understand what particular aspects made the greatest influence on the decision.
3.2. Increasing application of ECJ case-law during past years

3.2.1. It must be remembered that Lithuania joined the EU only in 2004 so the Lithuanian legal system is still getting used to the principles of EU law. For some judges being 10-20 years on the bench this is quite a new field and they have learnt to use EU law gradually. This partly explains their reluctance to analyse ECJ case-law more than is absolutely necessary.

3.2.2. The increasing number of areas regulated at the EU level inevitably makes ECJ case-law more and more important in Lithuanian tax litigation. VAT disputes are the ones where ECJ case-law is cited mostly.

3.2.3. In 2011 the EU Commission proposed amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity. It also continues work on the Common Consolidated Corporate Tax Base and presented a long awaited proposal in March 2011. EU Financial Transactions Tax has also been discussed for some time now. With CCCTB and other projects in view it might be expected that this trend of increasing EU level tax regulation will continue for the foreseeable future. This should expand the applicability of the proportionality principle in Lithuanian case-law as well.

3.3. Since the ECJ has been applying and developing this principle for much longer it is expected to shape the Lithuanian tax system as well

3.3.1. The principle of proportionality has been developed by the ECJ for many years now. It has been applied in various fields besides taxation. Its significance is illustrated by including it in the text of the EU Treaty and the large number of ECJ cases applying it.
3.3.2. Lithuanian courts are bound to apply ECJ case law in certain cases and sometimes even when no obligation exists courts have a right to follow ECJ reasoning when no domestic precedents exist.

3.3.3. The significance of this principle is further enhanced by the accession of the EU to the European Convention on the Protection of Human Rights and Fundamental Freedoms. The European Court of Human Rights has been developing this principle and applying it as well\(^\text{143}\). Case-law of the ECHR has been given new importance.

3.3.4. Therefore, it could be presumed that Lithuanian courts dealing with tax disputes will increasingly rely on the developments in the application of the principle of proportionality in the ECJ and ECHR. This also provides new opportunities for tax practitioners since wider application of internationally accepted principles and international case-law should facilitate better predictability of outcome of litigation and widen selection of available arguments in court.

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