

Tax controversy series

Administrative court judgment on negligence

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On 10 October 2023, the administrative court of first instance (Tribunal administratif) declared the administrative fine imposed on a tax professional (the complainant) by the Luxembourg tax authorities (Administration des contributions directes) unjustified, on the grounds of "unvoluntary tax fraud" at the occasion of the filing of the corporate tax return for one of its clients (the company or the taxpayer) and consequently annulled such administrative fine (Trib. admin., 10 octobre 2023, n°46043).



Summary of the case

In the case at hand, the tax office notified the company on 20 May 2020 about its intention to challenge the tax return it filed for the fiscal year 2018 and, absent of any reaction from the company, issued its tax assessment on 25 June 2020. The Luxembourg tax authorities ("LTA") disagreed on the tax treatment applied by the taxpayer on i) the gains it realized on the sales of bonds (i.e., considered as tax exempt by the latter) and ii) on the carryforward of tax losses which had already been challenged in the context of the 2016 tax return, which therefore should have since then been considered non-existing.

These errors resulted in a reduction of tax liability declared by the company in its corporate tax return for the fiscal year 2018 compared to the assessment made by the LTA. Assigning responsibility for this alleged mistake to the culpable negligence of the service provider - having prepared such corporate tax return and taking into account the magnitude of the eluded tax amount - the LTA decided to impose an administrative fine to the complainant on the grounds of §402 (1) of the general tax law of 22 May 1931 («Abgabenordnung», AO).

The complainant submitted a request for modification of the decision on 16 September 2020, which was denied by the tax office. The complainant consequently filed an administrative claim (réclamation) on 9 October 2020 to the Director of the tax authorities, which was also rejected by the latter. This led the complainant to ultimately file an appeal on 21 May 2021 with the administrative court of first instance.

Context of the decision

The use of the terms "unvoluntary tax fraud" to refer to the offense foreseen by § 402 AO ("Steuergeführung" according to the German text) is problematic and looks very much like an oxymoron insofar as the intention is a constitutive element of a fraud. This holds considerable significance, as we will see below. The 10 October 2023 judgement and different court cases of the Luxembourg administrative courts on §

402 AO shows that the offense is constituted even without intention to reduce the tax liability or conceal information from the tax authorities. The lack of requirement of a fraudulent intention is key to this assessment. The use of improper terms such as "unvoluntary tax fraud" (or "unintentional tax fraud") is both a symptom and potentially the origin of the misconception that ultimately led to the cancellation of the administrative fine by the first instance judges. For this reason, one should prefer terms like negligence or oversight when referring to the offense foreseen by § 402 AO.

The judgement of 10 October 2023 also echoes another case¹⁾ which was settled earlier this year, where the Luxembourg administrative court of appeal (Cour administrative) took position on an appeal brought against a judgement of the administrative lower court²⁾. The lower administrative court ruled in favor of the taxpayer, judging that the discrepancies challenged were not constitutive of an unvoluntary tax fraud offense.

As tax advisors, our immediate observation from these cases is that the accuracy of the content of submitted tax returns is more important than ever. Particularly noteworthy is that discrepancies in calculations or the application of incorrect tax treatments to certain transactions may quickly lead them - in the absence of timely, well-documented and detailed responses from the audited taxpayer - into considering the commission of an offense of unintentional tax fraud. We further observe the tax authorities' determination to uphold their position, readily filing appeals when the court does not align with their reasoning and deems the offense unfounded.

Even though, based on the developments carried out by both administrative courts, it seems clear that a series of specific and cumulative conditions need to be met to recognize the existence of such an offense, and, in particular, that the mere submission of inaccurate tax returns should not necessarily result in the offense of § 402 (1) AO to be constituted. It nevertheless stresses the importance of professional judgment and common sense when preparing those returns.

Decision of the lower administrative court

In the judgement of 10 October 2023, the administrative tribunal of first instance followed the exact same approach as it did in the decision n°44935, which was later confirmed by the administrative court of appeal in the decision n°47668C. It starts its reasoning by reasserting the definition of unvoluntary tax fraud as outlined by § 402 (1) AO (page 14 of the decision). This offense, to be characterized, requires the fulfillment of four cumulative conditions³⁾:

1. A reduction in tax revenue (or alternatively the granting or preservation of an undue tax advantage for the taxpayer),
2. Caused directly,
3. By intentional misconduct or negligence in fulfilling an obligation imposed on the perpetrator of the offense,
4. The latter being either the taxpayer or any person involved in the management of its affairs.

Methodically, and on a case-by-case basis, the administrative tribunal of first instance investigates the facts and circumstances of the case to check whether the aforementioned conditions are met in order to decide whether or not the error made by the taxpayer should be constitutive of a negligence in the meaning of § 402 (1) AO. In the case at hand, the judges stopped their reasoning on the first criterion, namely the condition related to the reduction of tax revenue. On this, the judges draw an interesting parallel between the negligence governed by § 402 (1) AO and the tax fraud as defined in § 396 AO which is, by definition, intentional, and for which a similar condition related to the reduction of tax revenue exists.

Analogously to the jurisprudence applicable in cases of tax fraud, the lower court emphasizes that this condition (of the reduction of the tax revenue) requires the alleged offense to be consummated in order for it to be sanctioned. This consummation of the offence occurs only if the reduction of tax revenue (or unduly granted or preserved tax advantage) has become definitive.

The judges further explain that, contrary to what is expressly provided for aggravated tax fraud and the tax swindle by § 397 AO, that the simple attempt at "unvoluntary tax fraud" or negligence is not possible. According to a now-established jurisprudence of the Luxembourg administrative courts, the offence of § 402 (1) AO is hence a result-based offence that was involuntarily obtained ("infraction de résultat"), as opposed to a means-based offense ("infraction de moyen"). This is the consequence of the lack of requirement of a fraudulent intention for the offense of § 402 (1) AO to be potentially constituted.

To summarize, the offense of negligence should be considered consummated not at the time of the submission of the disputed tax return by the taxpayer, contrary to what the tax authorities tried to argue (i.e., at this stage, it may only constitute an attempt that is not sanctioned), but rather at the issuance of the tax assessment by the tax office. The offense sanctioned by § 402 (1) AO should be regarded as effectively committed, if and when an incorrect tax assessment has been issued on the basis of the tax return that was itself incorrect due to a negligence of the taxpayer or the preparer. Not before.

In light of those considerations, and after pointing out that the tax assessment notices for the fiscal year 2018 applied the adjustment sought after by the tax authorities (the taxpayer not having taken any position when invited on 20 May 2020 to do so), the judges consequently concluded that in the case at issue, no actual reduction of tax revenue could be observed, and thus, the first condition listed above could not be considered as being met. The four conditions constituting the negligence of § 402 (1) AO being cumulative, the judges did not proceed further in the analysis and ruled that the offense was not characterized. The administrative fine fixed by the LTA on the complainant was therefore subsequently cancelled.

It seems that the Grand Duchy of Luxembourg has renounced to lodge an appeal against the decision as it did a few months ago (for the case dated June 2022 - n°44935). Possibly it would have expected the administrative court of appeal to remain aligned with the judge of first instance had it decided to proceed in

the litigation procedure. This should however not alter our recommendation to be thorough when preparing tax returns (or selecting who should be assisting you in this task) to avoid unnecessary complications.

1) C. administrative, 4 juillet 2023, n°47688C

2) Trib. administratif, 7 juin 2022, n°44935

3) This other case happened in the context of a USD currency request by a taxpayer after conversion of its share capital from EUR to USD. The transitional USD tax return was prepared by a tax expert, not in charge of the preparation of the accounts and the tax authorities noted an error in the account conversion from EUR to USD, ultimately causing a discrepancy in the result brought forward and resulting in a decrease of the taxable basis (i.e., from a positive tax result using the correct EUR/USD exchange rate to a negative one). The tax office's position in this case was to consider that the tax expert in charge of the preparation of the tax return should have been able to identify the error of EUR/USD conversion through the - admittedly obvious - discrepancy of the results brought forward. This was therefore regarded as a negligent act. It followed that the tax authorities sought to impose an administrative fine to the company on the grounds of unvoluntary tax fraud.

4) «i) une diminution des recettes d'impôts sinon du moins l'octroi ou le maintien d'un avantage fiscal indu pour le contribuable, ii) causé directement par iii) un manquement, intentionnel sinon par négligence, à une obligation incombant à l'auteur de l'infraction, iv) l'auteur pouvant être soit le contribuable, soit son représentant, sinon toute personne qui participe à la gestion des affaires du contribuable.