CASE TRANSLATION: **ESTONIA**

Case citation:
TlnRnKo 09.01.2017, 1-15-9051

Name and level of the court:
Tallinna Ringkonnakohus (Tallinn Circuit Court)

Date of decision:
9 January 2017

Members of the Court:
Sten Lind, Ivi Kesküla and Urmas Reinola

Appellant:
X

Prosecutor:
Martin Tuulik

Lawyers for the appellant:
Aivar Pilv and Jaak Siim

Estonia; VAT on property; admissibility of evidence collected by surveillance; digital evidence guidelines; continuity of evidence (also known as chain of custody); MD5 hash – whether sufficient to prove evidence not altered; status of opinion of external expert (a lawyer)

IN THE NAME OF THE REPUBLIC OF ESTONIA

Tallinn Circuit Court

Decision

RESOLUTION

1. To partially satisfy the appeal.

2. Annul the judgment of Harju County Court in the following parts:

The conviction of X pursuant to § 389^1 (2) of the Penal Code;

The aggregate the punishment of X;

The obligation to bear the legal costs of the lawyers of X by X himself.

Leave other parts of the judgement unchanged.

3. Acquit X pursuant to § 389^1 (2) of the Penal Code.

4. Not to enforce the sentence of imprisonment of 1 year and 6 months given to X pursuant to § 389^2 (1) on the basis of § 73 (1) and (3) of the Penal Code, if X does not commit a new intentional crime during a probation period of 2 (two) years. The start of the probationary period is considered to be the day the judgment is announced.

5. Reimburse X for the legal costs of the appeal proceedings in the sum of 5,473 euros, the costs of the airplane ticket in the sum of 663.01 euros and the legal costs of pre-litigation and county court proceedings in the sum of 18,628.73 euros.

FACTS AND PROCEDURE

1. By judgment of the Harju County Court of 13.06.2016, X was convicted pursuant to § 389^1 (2) and § 389^2 (1) of the Penal Code. Pursuant to § 389^1 (2) of the Penal Code, he was sentenced to 2 years' imprisonment and pursuant to § 389^2 (1) of the Penal Code, one year and 6 months of imprisonment. On the basis of § 64 (1) of the Penal Code, the court considered the lesser punishment to have been imposed by imposition of the onerous one, i.e. the aggregate punishment imposed was 2 years in prison.

Pursuant to § 73 of the Penal Code, the court decided that the punishment should not be enforced, provided that X does not commit a new intentional crime during a two-year probationary period.

Pursuant to § 389^2 (1) of the Penal Code, X committed an offence, according to the judgment, by knowingly providing false information to the tax authority as a member of the management board of Y OÜ in the VAT declaration of Y OÜ of April 2011. By knowingly giving false information, he incorrectly increased the claim for refund from the tax authority by 80,948 euros. As a result, the sum improperly refunded corresponded to a particularly great damage.

Pursuant to § 389^1 (2) of the Penal Code, he committed an offence by not declaring a fringe benefit on income and social tax: 129,107 euros and 202,833 euros accordingly. As a result, at least 320,000 euros of taxes were not collected.

X did not commit the crime personally: the declarations to the tax authority were provided by Y OÜ-s accountant MK, but X exercised influence over MK with overwhelming knowledge.

The false information submitted to the Tax and Customs Board related to an apartment in Tallinn located at XXX, XXX, XXX and XXX. This apartment was bought by Y OÜ on the 27.04.2011 from OÜ U.

OÜ Y reported the acquired apartment in its tax accounting and submitted it in the declaration as an asset acquired for business or taxable turnover, which allowed Y OÜ to claim for a refund of input value added tax from the state budget. Whereas it was actually bought by X and his XXX TS for personal use, i.e. as a residence. They settled in the apartment as a residence after a major overhaul and refurbishment of the apartment, the cost of which was paid by Y OÜ, in August-September 2012 at the latest.

As the apartment was not acquired for the business activities of Y OÜ or taxable turnover but for X' personal use, Y OÜ and X had no right to deduct the VAT paid on the purchase of the apartment in the amount of 80,948 euros and to claim VAT refund in this respect.

In the course of the tax inspection, Mr X submitted incorrect information to the Tax and Customs Board by reporting that the apartment located at XXX Tallinn, had been rented out for one year as business premise to Cypriot company A starting from 08.07.2012. In fact, X controlled the company in question.

As the cost of the XXX Tallinn apartment is a payment made by Y OÜ in the interests of X, a member of the management board of the company, this constitutes a fringe benefit within the meaning of clause 48 (4) 7) of the Income Tax Act. The fringe benefit should have been subject to income and social tax. However, the fringe benefit was not declared and the taxes were not paid.

2. The appeal against the judgment of the county court was lodged by Aivar Pilv and Jaak Siim, counsel for X. The appellants seek annulment of the judgment of the county court and the acquittal of X pursuant to § 389^1 (2) and § 389^2 (1) of the Penal Code. Alternatively, the appeal seeks to refer the matter back to Harju County Court for reconsideration. If the circuit court upholds the county court's judgement of the conviction of X, the defendants will seek a financial penalty against X.

X is also seeking reimbursement of his legal costs incurred both on appeal and in the pre-litigation proceedings and in the county court proceedings.

The defence counsel submit that Harju County Court has wrongly assessed the evidence that was gathered and investigated, which substantially violated the Code of Criminal Procedure § 339 (1) 7) and (2) and incorrectly applied the substantive law.

2.1. The defence find that Y OÜ did not have to declare income and social tax payable on undisclosed fringe benefits in the form TSD submitted in April 2011 in annex 4 to the tax declaration in relation to buying the apartment located at XXX, Tallinn.

Namely it has been proven that X did not live in the apartment until August or September of 2012. Thus, in April 2011 he did not receive any fringe benefit.

The court also erred on the nature of the fringe benefit: as the amended accusation no longer considered the sale of the apartment between U OÜ and Y OÜ as an ostensible transaction, the fringe benefit could not consist of transferring the apartment ownership to X, but in providing it to use for free. So, it was not a fringe benefit in accordance with the provisions of § 48 (4) 7) of the Income Tax Act.

As a result, the value of the fringe benefit is falsely found to be the acquisition value of the apartment of 485,689.58 euros. The value of the fringe benefit could have been the market price of renting of the property or the difference between the market price of the rent and the discount price. As a result, the taxes that should have been paid on the fringe benefit have also been incorrectly calculated.

2.2. The opinion of the county court, that the amount of VAT paid when buying the apartment was not connected to OÜ Y-s business activities, and that the rent invoices issued to A were ostensible, is wrong. When buying the apartment, X wanted to use it for taxable turnover. He used the apartment for personal use a long time after it was bought by Y OÜ.

2.2.1. In a situation where, on 21 April 2016, as a result of the amended prosecution, the prosecutor's office withdrew the concept of an ostensible transaction regarding the purchase of the apartment located at XXX, Tallinn, it has to be assumed that the economic substance of the transaction was in line with the formal substance. Y OÜ became the owner of the property. In the application dated 19 March 2013

by the Tax and Customs board to initiate criminal proceedings, the tax authority has taken the position that the purchased apartment is an intangible asset of the company that has purchased it. That is why, according to the case law of the European Court of Justice, the VAT was fully and immediately deductible as input VAT. That was accompanied by the obligation to pay VAT to the state if the assets of the company are later used for personal use. This obligation is also fulfilled because the company T OÜ, which is related to the accused, set off the VAT in one of the apartment ownership transfer transactions signed on 2 September 2014 and VAT was paid to the state on 21 October 2014.

2.2.2. Furthermore, the immediate deduction of input tax was justified and legitimate because the apartment located at XXX, Tallinn was furnished with a room as an office from the beginning, and the accused acting as a legal and authorized representative of different companies, used it as an office. The assertions of the county court that the room in question was not conceivable as an office, are erroneous.

2.2.3. The apartment located at XXX, Tallinn is a non-residential property, not a property intended for residence. According to the use and occupancy permit, the apartment located at XXX, Tallinn is to be considered a guest apartment.

2.2.4. The apartment was rented to A, a company registered in Cyprus. According to a contract, the latter used the premises, the legal address, the mailbox and other rights of the rental contract to carry out its economic activity in Estonia. Since September of 2012 the apartment had been furnished with office furniture as well as office equipment, while the apartment also met the definition and requirements of regulation No 43 of the Minister of Economic Affairs and Communications of 23 May 2012 “Requirements for accommodation establishments” and requirements contained in §§ 48-54. X testified, at the hearing of 22 April 2016, that at that time there were situations where the apartment was used to accommodate foreign visitors and business partners.

2.3. The county court has failed to properly evaluate the evidence that confirms the absence of the subjective elements of the offences claimed to have been carried out by the accused thereby being in violation of criminal procedural law.

2.3.1. The apartment was acquired on behalf of Y OÜ, which specialized in investment property, as a real estate investment with the intention to resell it after having added value to it. It was planned to add security solutions, access system, perimeter surveillance, remote control, heating automation, security system control and similar details to make the apartment more original. The county court has not refuted this explanation because it has not been shown that the apartment was sold below market value.

2.3.2. Secondly, the apartment was rented out to company A. The prosecutor confirmed at the county court hearing that it is not disputed that the invoices submitted to the latter have been paid. At the hearing on 7 April 2016, the Tax and Customs Board reviser TP, who testified as a witness, admitted, when answering the question of defence counsel, that the above-mentioned rental transaction generated taxable turnover for the landlord. The existence of a rent relationship is further supported by the fact that A opened a bank account number XXXXXXXXXXXXXXXXXXX and a securities account XXXXXXXXXXXXXXXXXXX in Danske Bank A/S Estonian branch. In the application for opening an account, the company address is stated as XXX, flat XXX. In addition, A is known to have invested in Estonian company A OÜ, making a total of 825,600 euros in share capital contributions. The address of A OÜ in the Commercial Register was XXX. As it appears from the registry entry.

2.3.3. X has been living at XXX since 2 February 2012. Until November 2011, X’ residence address was YYY. In parallel, X was and is closely associated with the United States, for which he was issued a permanent visa in June 2013, which X started applying for at the end of 2012 with the aim of developing the company’s operations in the United States. X is also a US State of Florida notary on the basis of a certificate of appointment issued by the Governor, for at term of four years.

2.4. The court has also relied on evidence that should not have been relied upon and failed to include the assessment of the relevant external expert SM.

The county court relied primarily on the inspection protocol showing the Skype conversations of X. The defence argues that the court should not have relied on this evidence, but also note that the court has ignored those Skype conversations that show that it

was not an apartment bought with the intention of using it as residence by X.

The defence also finds that, in this criminal case, the evidence obtained by surveillance activities and obtained from electronic communication undertakings cannot be used as evidence, since the collection of information is not duly justified and the ultima ratio principle has also been ignored in the collection. The county court is in serious violation of criminal procedural law by not having taken into account as evidence the written assessment of the accredited external expert SM. The court found that it did not constitute as an expert assessment and since the court has not heard SM, it is not regarded as an opinion by a qualified person either.

According to the appellants, the opinion of SM can be considered to be relevant as evidence to establish the course of criminal proceedings.

The inspection protocol of 3 June 2014 in criminal case no. 12221000084, which is included in the court file, is, in the light of the circumstances in which it was prepared and the unreliable data recorded therein, an unreliable and unacceptable item of evidence. The inspection protocol reflects digital evidence that has not been collected in accordance with the prescribed procedural rules and as a result, it is not possible to verify their authenticity with certainty. The inspection of evidence was carried out by officials who did not have relevant professional competence and the protocol does not meet the content requirements.

2.5. The defence points out that the position of both the various investigative departments of the tax authority and the Circuit Prosecutor's Office in regard to X' tax conduct has been volatile and has changed over time. The appellants consider that it is unreasonable to reproach the accused on the breach of provisions regarding tax and criminal law in a situation where the persons conducting the proceedings themselves have taken years to find out what should have been the correct conduct of tax law in the light of these specific circumstances.

2.6. The appellants submit that, if X is not acquitted, it is not justified to punish him with imprisonment. The county court has ignored the fact that in the case of VAT, a subsequent drawback has been made. X is formerly without a punishment for criminal or misdemeanour offences and has a definite place of residence and employment.

3. At the circuit court hearing, the appellants upheld their appeal and the accused supported the appeal. The prosecutor opposed the appeal and found that the county court's judgement had to be left unchanged.

THE COURT'S OPINION

A

4. First, the circuit court will rule on the questions of evidence raised in the appeal. Firstly, the circuit court deals with the admissibility of evidence collected by surveillance activities and evidence obtained from the electronic communication undertakings. The circuit court then deals with the question whether the county court was right to find that the opinion of the external expert SM was not admissible evidence. Third, the circuit court deals with the question of whether the search report of 14.05.2013 and inspection report of 03.06.2014 are reliable evidence.

I

5. The county court has noted that all the permissions for surveillance activities in the context of the criminal proceedings under review, include the reasons why the evidence had to be collected by means of surveillance and why other means of gathering the evidence are ruled out. For the circuit court, it is unclear how the county court reached such a conclusion. According to the Judicial Chamber, there are no explanations in the Harju County Court ruling of 15.02.2013 nor the justification of State Prosecutor S.-H. under permissions no 1326 and no 1421 issued on 10.10.2012 and 25.10.2012 explaining why the collection of evidence by surveillance was necessary. Also, there is no such information in the permissions issued by the prosecutor's aide AL from 11.01.2013 and 19.02.2013 for permission to request evidence from electronic communications undertakings.

5.1. A large part of Harju County Court's ruling of 15.02.2013 is information about what X is suspected of, along with an explanation that the proceedings were initiated based on information provided by the Finnish Central Criminal Police to the Estonian Central Criminal Police. This information is repeated twice in the ruling. However, there is no information in the ruling as to what kind of evidence had been collected so far and what circumstances had been identified from this evidence. Without referring to any evidence, the court has stated: "It has become apparent that the initiation of the criminal proceedings is caused by the actions of X, the initiator and co-ordinator of

illegal activities, large sums of money are being moved between companies associated with him without the existence of actual economic transactions, with the aim of concealing the origin and beneficiaries of the money and legalizing the assets of an intentional offence." The court further stated: "Since money laundering is a covert offence for which the collecting of evidence by ordinary procedural acts is not possible in due time and is seriously hampered, and may harm[1] the interests of the criminal proceedings in this criminal case, the collection of information through surveillance activities is the only possible and feasible way of gathering evidence to clarify and prove X' illegal activities. As the data in the materials shows that X is trying to completely conceal his activities, it is possible to collect information with adequate and evidential value at this stage of the proceedings only and exclusively in the course of criminal proceedings through surveillance activities requiring authorization, since, as far as public investigative and procedural acts are concerned, prevent the described situation to be stored and the information exchanged in detail." In addition, the court noted that surveillance activities are necessary to ascertain seizable and confiscatable assets.

The circuit court finds that, as described, the ruling of the county court clearly does not comply with the requirements set forth by the Supreme Court to justify the surveillance activities.[2]

First, the court order must contain clear reasons as to what circumstances and available evidence suggest that there is a reasonable suspicion of a crime. Although the county court has argued that X is the initiator and coordinator of money laundering, the county court has not referred to any evidence on which this claim is based.

Secondly, the argument that it is a covert offence and X is trying to conceal his activities in every way is not sufficient to justify the prerequisites of surveillance procedures. The Supreme Court has affirmed that the arguments for issuing a surveillance permit may be based on a high level of organized crime, conspiracy, use of shadow persons, presumed absence of witnesses ready to give testimony, etc. At the same time, the Supreme Court emphasized: "However, the arguments referred to cannot be limited to general utterances. It must be clear from the ruling that the court has considered the use of alternative means of evidence collection on the basis of information available to it." In the ruling on hand, the county court has not explained how X has concealed his activities or referred to the evidence on which it relies.

Based on the foregoing, it is not verifiable that the court has considered the use of alternative means of evidence collection on the basis of information available to it. This is a defect that can no longer be remedied by the court hearing the criminal case.

5.2. The circuit court must agree with the appellants that the permissions issued by the State Prosecutor, S.-H. Evestus[3] are not duly reasoned. The permissions do not make it clear why evidence gathering by other procedural means is excluded or severely hampered. The reasoning in the rulings merely confines itself to arguing that at the initial stage of the procedures, other means for gathering evidence is difficult or even excluded without prejudice to the criminal proceedings: "Considering that X may be involved in criminal activities (large-scale money laundering, which constitutes a serious first-degree economic crime) for which the gathering of evidence using public proceedings in the early stages of criminal proceedings without compromising the criminal proceedings, is significantly difficult or even excluded, it is necessary to gather evidence using surveillance procedures. For verifying suspicions and following procedural tactics it is necessary to carry out surveillance procedures, regarding the telephone subscriptions… used by X, provided for in § 117 of the Code of Criminal Procedure…".[4]

The wording of the Code of Criminal Procedure (CCP), which was in force at the time when the State Prosecutor S.-H. Evestus issued these permissions, did not state that faults in the surveillance permission would automatically render the evidence, collected on the basis of those permissions, inadmissible. Whether the collecting of evidence by other procedural means were excluded or significantly hampered, must be assessed by the court hearing a criminal case,

[1] In the ruling the word "suspect" was used, but it is clear from context that it was a spelling error. In Estonian "kahjustada" – harm, damage vs. "kahtlustada" – suspect something.
[2] See the Supreme Court ruling of 30.06.2014 in criminal case no. 3-1-1-14-14, p. 772
[3] Permission no. 1326 issued on 10.10.2012 and permission no. 1412 issued on 25.10.2012.
[4] Taken from permission No 1362.

whereby the court must verify adherence to the principle of ultima ratio with special care.[5]

The chamber is forced to conclude that from the permissions of the State Prosecutor, issued on 10.10.2012 and 25.10.2012, it is not possible to establish that the surveillance activities stated in § 117 of the CCP were necessary and duly reasoned.

The permissions, as stated therein, are based on the fact that the Police Central Criminal Recognition Bureau received information that several Estonian companies conducted large-scale transactions with Finnish companies suspected of offering unlicensed financial services. The Finnish companies in question are related to X and there is a basis to assume that the Estonian companies are also related to X. It has also been pointed out that X' lifestyle refers to the use of funds of dubious origin. The foregoing gives reason to believe that Estonian companies, which dealt with financial resources acquired in criminal transactions to conceal the origin and real nature of the proceeds of criminal assets and real owners, are linked to X.

The permissions do not indicate whether and what evidence has already been collected in the proceedings. Nor is the purpose stated for which the information specified in the permit is collected, i.e. why is it important to the criminal proceeding. As noted above, the permission is confined to general terms in this respect claiming that the surveillance is "necessary to verify the suspicions raised and developed according to procedural tactics." Such a declarative statement does not answer the question of how the information obtained contributes to confirming or refuting the suspicion. Nor does the chamber consider that a surveillance measure is justified by the procedural tactics used, but the principle of ultima ratio demands justification as to why this particular surveillance tactic is necessary.

It is obvious that data obtained from a communications undertaking may be relevant for the investigation of a money laundering crime. Identifying whether and with whom the person suspected of money laundering interacted can help track money laundering transactions and find out who else may be involved in the transactions. At the same time, it should be noted that transaction data could have been obtained, for example, from queries to different banks. The court has no information that these queries were made before permission was granted for surveillance activities.

5.3. During the issuing of the permissions by the prosecutor's aide AL on 11.01.2013 and 19.02.2013, the CCP did not consider the actions as surveillance actions. However, § 90^1 (3) of the CCP states that an inquiry may only be made if it is strictly necessary for the purpose of achieving the aim of the criminal proceedings. The circuit court finds that none of the permissions contain any justification as to why the inquiries are strictly necessary. It is merely stated in general terms: "This inquiry is strictly necessary for the purpose of the criminal proceedings, because only an inquiry can gather objective and reliable evidence to establish the facts of the subject of the criminal proceedings for clarifying the activity of the person who may be involved with in the commission of the crime and who may assist him. It is not possible to collect data obtained in the course of an inquiry from public investigative or procedural acts."

The circuit court acknowledges that it is difficult, if not impossible, to obtain information on the fact of communication through other procedural means. Unfortunately, the permit remains unclear as to why the information itself is necessary for the purpose of the criminal proceedings. In the complete absence of information on what the suspicion is based on and on what evidentiary basis the authorization is granted, it is not possible for the court to reach a subsequent conclusion. Therefore, the circuit court does not consider it possible to rely on information obtained under these permits.

5.4. Based on the foregoing, the circuit court dismisses evidence-based surveillance actions based on the permissions and proceedings of the Harju County Court and State Attorney S.-H. granted on 11.01.2013 and 19.02.2013, by the prosecutor's aide AL. Such evidence is the surveillance protocol of 15.10.2013 from the period of 15.02.2013-17.03.2013 on the interception of the subscriber number used by X and the transcript of the data protocol of 26.05.2014 with the data received from the communications undertaking.

II

6. In the opinion of the circuit court, the county court lawfully ruled the opinion of SM, presented by the defence, as inadmissible evidence.

In their appeal, the appellants claim that they agree with the court's view that the opinion of external

[5] Ruling by the Supreme Court of 30.06.2014 in case no. 3-1-1-14-14, p. 779, 781.

expert SM cannot be considered to be an expert report, because statements given by an expert or a qualified person are specified in § 63 (1) of the Code of Criminal Procedure. However, the appellants consider this is evidence to establish the course of the criminal proceedings, that is evidence not listed in § 63 (1), but which can be relied on based on § 63 (2).

The circuit court disagrees. Provisions of § 63 (2) of the Code of Criminal Procedure allow the use of evidence not stated in subsection 1 (free evidence) only very narrowly to identify the facts of the proceedings themselves.[6] The opinion of SM does not contain information on the course of a particular procedural act, but – as noted in the appeal – it "explains the principles for handling digital evidence". Thus, § 63 (2) of the Code of Criminal Procedure does not provide a basis for admitting the opinion of SM as admissible evidence.

III

7. The chamber does not see a reason to find the search report of 14.05.2013 and of 03.06.2014 inspection protocol as unreliable evidence.

7.1. The appellant has questioned whether the search of 14.05.2013, which, among other things, the "Windows 2008 Enterprise R2DC_2-flat.vmdk" file was confiscated (copied), followed all the rules of procedure.

The defence finds that the in the confiscating of the file the directive No. 225 from 02.06.2011 of the General Director of Police and Border Guard Board, which deals with approved physical evidence, other seized items, confiscated property, seized property, and requirements for handling physical evidence, was not followed. The appeal also raises the question of whether the handling of the file was in accordance with the instructions approved by the Estonian Forensic Science Institute Director's directive of 19 January 2012. The appellants' complaint is that the chain of custody does not appear in the observation protocol.

The circuit court considers the cited directives to be relevant. The directive of the General Director of Police and Border Guard Board does not deal specially with the collection and retention of electronic evidence. However, point 2 of the directive provides that what the directive says about physical evidence applies to all items and property seized in criminal or misdemeanour proceedings. From this, the circuit court concludes, that to the extent it is possible, the provisions of the directive must also be applied to electronic evidence.

At the circuit court hearing, the prosecutor found that that the procedures established by the Director of Estonian Forensic Science Institute are not relevant evidence, since they regulate the conduct of the assessment of the information technology expert. The circuit court disagrees with the position of the prosecutor. It is true that these documents are internal Estonian Forensic Science Institute regulations governing the conduct of expert assessment. However, these documents have a broader meaning, as the Police and Border Guard Board's response of 19.04.2016 to X states that the police follow the Estonian Forensic Science Institute guidelines for the collection of digital evidence.

The circuit court disagrees with the issues raised in the appeal that the search protocol does not indicate what action was taken to retrieve the data unaltered during copying. Subsection 7 of the inspection protocol "Search Procedure" indicates that before the start of any investigative actions, at 12:31, the objects subject to the proceedings, the (servers), the internet connection was cut off. In addition, it must be taken into account that the search is carried out in the presence of the person at whom the search is being carried out, or his representative.[7]

However, the circuit court has to admit that neither the search protocol nor the inspection protocol describes the steps taken in such detail to allow unequivocal compliance with the guidelines set out in each of these directives. The main drawback to be mentioned is the fact that neither the search report of 14.05.2013, nor the inspection report of 03.06.2014, show that the storage medium on which the seized files were stored is packaged and/or sealed. The procedures established by the directives of both the Director General of Police and Border Guard Board and the Director of Estonian Forensic Science Institute require packing and sealing of the media. However, this alone does not constitute a basis for declaring the evidence unreliable.[8]

[6] Ruling by the Criminal Chamber of the Supreme Court of 07.03.2007 in case no. 3-1-1-125-06, p. 16.

[7] See also E. Kergandberg, P. Pikamäe (eds.): KrMS. Kommenteeritud väljaanne. Tallinn 2012 - E. Kergandberg, § 91. 15.1.

[8] Ruling of the Criminal Chamber of the Supreme Court of 28.03.2011 in Case No. 3-1-1-31-11, p. 18.3.

The circuit court, in present proceedings, considers the integrity of the files that were seized have been demonstrated in the present proceedings, despite the flaws of the protocols.

First, from the testimony given in the county court proceedings by the police investigator TS that conducted the inspection, it was found that the copy was locked in a cabinet. Thus, the witness's testimony shows that the evidence was kept in a manner that ensures its preservation.

Second, the integrity of the file is verified by the hash code.

7.2. The appeal finds that, since the inspection protocol does not contain a detectable conclusion by the investigator on the compliance of the hash code of the object under consideration, it is not possible to reliably validate the authenticity of the data.

The inspection protocol does not simply state that the inspection has been checked, but the calculated hash code is also included, and the program necessary to calculate the hash value, Windows MD5 Sum generator is also named in the technical tools used for the inspection. Also, the hash value calculated for "Windows 2008 Enterprise R2DC_2-flat.vmdk" is listed in the search protocol. Thus, it is possible to compare these hash codes and make sure they match. In the testimony given in the county court TS, who carried out the inspection, confirmed that he had checked that the hash value matched. The appeal does not contain any allegations of why these statements should be considered unreliable.

7.3. According to the appeal, the MD5 algorithm is unreliable and out-dated, because it is possible to provide appropriate content to the file without changing the originally calculated MD5 hash value. According to the appellant, that statement has been proven by the experiment the accused conducted at the county court hearing of 22 April 2016.

These claims are wrong. The appellants have dealt with the shortcomings of the MD5 hash superficially, without distinguishing between different hash function requirements/expected properties such as pre-image resistance, second pre-image resistance and collision resistance. Pre-image resistance means that it is not possible to derive the input only from the output of the hash value (i.e., to identify the contents of the file based on the hash of the file). Second pre-image resistance means that it is difficult, by knowing the input of the hash value (contents of the hashed file), to find another input (file with another content) that would give the same output. Collision resistance means that it is difficult to find two different inputs that would give the same output. So if in case of collision resistance, the only question is how big a risk it is that different bits of data provide the same hash value. Then in the case of second pre-image resistance, the question is the degree of probability that the existing input, for which the hash value has already been calculated, can be given new content without changing the hash value. Thus, the claim that the MD5 algorithm is unreliable and out-dated because the file can be given the appropriate content without the originally calculated MD5 hash value changing, can be true if weakness of second pre-image resistance is detected. However, the well-known weaknesses of the MD5 hash function are related to collision resistance.[9] In essence, the experts MJ and AV, who were heard in the county court proceedings, have confirmed the same. The latter explained in the county court, that the disadvantage of MD5 is that it is possible to create a conflict, i.e. two different contents of a file that have the same hash value if the hash value has not been calculated beforehand. At the same time, AV assured the court that if the MD5 value for the files had been calculated beforehand, a file with the same MD5 value, but different in content, has not yet been created by anyone. It is not apparent from any the sources cited in the appeal that the second pre-image resistance for the MD5 hash function has been successfully questioned.

That a file can be given appropriate content without changing the MD5 hash value calculated beforehand without the originally calculated MD5 hash value changing is not proven by the demonstration by X. It is true that in the county court session on 22 April 2016 (and again at the circuit court hearing), X demonstrated that when opening two visually different image files the calculated hash value was the same.

First of all, it should be pointed out that, although the appeal alleges that it is possible to provide

[9] Deficiencies in MD5 hash relating to collision resistance are publicly available, such as cited in the appeal Carnegie Mellon University Vulnerability Notes Database Vulnerability Note VU # 836068, but also Life Cycle Survey of Cryptographic Algorithms Ordered by Information System Agency, p 2.3.1: https://www.ria.ee/public/PKI/kruptograafiliste_algoritmide_elutsukli_uuring_II.pdf.

appropriate content to the file without the originally calculated MD5 hash value changing with a file for which a hash value has already been created. The minutes of the county court hearing do not show that X had demonstrated changing the file for which the hash value had been calculated beforehand, so that its hash value remains the same. X showed only two jpg files with the same hash value. Mr X could not answer the questions of the court and the prosecutor on how the hash value match-up of the two files had been achieved. He admitted that these files were apparently processed to get the same hash value, but not by him. He took the pictures and forwarded the files to a "smarter person" in the field.

A tutorial can be easily found on the internet on how to create two of the same MD5 hash value image files.[10] It is a chosen prefix collision type conflict that requires all files to be manipulated before calculating their hash value. A study on the possibility of such a collision states that this method does not make it possible to create another input with the desired content beside the existing one for the given hash output: "An existing executable with a known and published hash value not resulting from this construction cannot be targeted by this attack (Gauravaram et al., 2006): our attack is not a pre-image or second pre-image attack. In order to attack a software integrity protection or code signing scheme using this approach, the attacker must be able to manipulate the files before they are hashed (and, possibly, signed)."[11]

Since there is no evidence in this case that the hash value of the image file has been matched in any other way than described before, the examples given to the court by X do not prove that the hash value already calculated can be given the desired content in the manner that the files hash value would stay the same.

Secondly, the circuit court finds it important that the feasibility of achieving the same hash value reflected in the observation protocol was demonstrated with another type of file. That the same hash value could be achieved with jpg files does not mean that it is possible (among other things) with a vmkd file containing Skype logs, this means it was not proven that different types of files can be processed in the same way.

7.4. According to the appeal, the reliability of the inspection protocol as evidence is questioned by the fact that, as a participant of the proceedings, the Police Special Investigator KT[12] has no IT education. The circuit court finds that such an abstract doubt about the competence of an official who participated in a procedural act do not justify considering the protocol as unreliable evidence. Although KT (as well as TS) was heard in court, and the accused was able to question them in the course of the proceedings, the appellant has not referred to any specific case as to the role of the participants in the proceedings, which would call into question the competence of KT.

The circuit court also does not see that the protocol is unreliable because TS was not able to explain in the county court when he began the inspection.

B

8. The circuit court agrees with the county court that the XXX apartment was not acquired for business purposes or for taxable turnover.

8.1. The circuit court finds that the official address of X' residence, or whether the apartment was non-residential by nature, is irrelevant in determining whether the apartment was acquired for business purposes or for taxable turnover.

According to the appeal, as X had a residence at YYY until November of 2011 and at XXX from 2 November 2012, the apartment XXX could not have been acquired for and used as X as a residence. The circuit court disagrees. In addition to the residence, which the person himself has declared his main residence, he may use other places to live. This is demonstrated in the appeal itself, as it is noted that X had been closely associated with the United States of America. In addition, X himself made statements in the county court, which admitted that he used – though allegedly temporarily – to live in the apartment, because the apartment where he formerly lived in XXX in Estonia had started to be renovated.

The county court also considers it irrelevant to the appellants' claim, that the acquired apartment is essentially a non-residential space since the XXX

[10] See e.g. http://natmchugh.blogspot.com.ee/2014/10/how-i-created-two-images-with-same-md5.html.

[11] M. Stevens et al., Chosen-prefix collisions for MD5 and applications. - International Journal of Applied Cryptography, Vol. 2, No. 4, 2012. P. 349; available online: https://documents.epfl.ch/users/l/le/lenstra/public/papers/lat.pdf.

[12] According to the protocol the inspection was carried out by investigator TS of the PPA Criminal Investigation Bureau and the specialist investigator KT was involved in the proceedings.

property is situated on 100 per cent commercial land. The appeal itself refers to a judgment by the Administrative Chamber of the Supreme Court which explains that the distinction between living and commercial premises have to take into account the criteria set out in § 272 (1) of the Law of Obligations Act (LOA), and consequently are not based solely on the purpose of the building indicated in the detailed plan and in the building permit or permit for use (residential or non-residential), but also the intention and the real possibility to use the space for one or another purpose.[13]

Therefore, it does not follow that if the XXX property is situated on 100 per cent commercial land the apartment owned by Y OÜ or H OÜ should be considered a guest apartment. The appeal refers to the fact that according to different legislation, the apartment could have been used to provide accommodation, but there is no evidence that this has been done or had been planned.

8.2. The appeal states that since X used apartment XXX to live in from August or September 2012, but before that it was not a place of residence for 1.5 years, then according to case law of the European Court of Justice and the Supreme Court, VAT paid on the purchase of apartment ownership as input tax is in its entirety and immediately deductible. When a taxable person uses capital goods at the same time for both professional and personal purposes, as a business asset, in principle, the input tax paid on the acquisition is deductible in its entirety and immediately. Also in its recent case law, the Supreme Court has clarified that if the immovable property has been acquired for taxable transactions by the taxable person, he can, according to the principle of neutrality of VAT, deduct input tax even if he does not immediately use the acquired immovable for business purposes.

The county court notes that the judgments of the European Court of Justice cited in the appeal do not give a company the right to deduct the input tax in any event when purchasing immovable property. In deciding if the taxable person had the right to deduct VAT, the case law of the Court of Justice states that it has to be established if the taxable person was also acting as a taxable person when purchasing the goods. Whether the taxable person acted as such at the time he made the transaction subject to VAT is to be objectively proven that he had the intention to use the goods or services is for his economic activity.[14] If the taxable person acquires the goods for personal use only, he acts as a private individual and not as a taxable person.[15] Whether the taxable person acquired the property in fact for their own business or not, is for the court to decide. Among the objective factors on which you can rely when assessing whether the taxable person acquired the goods for his economic activity, are in particular, the type of goods concerned and the time period between their acquisition and the starting point of the economic activities and use of the goods by the taxable person.[16] Consequently, the circuit court does not consider it important the fact highlighted in the appeal that X started to use apartment XXX about 1.5 years after its acquisition. It does not matter how much time later the apartment started to be used for personal purposes by X. The decisive question is whether at all and how long after the acquisition the taxable person started to use the apartment for economic activities.[17]

The circuit court considers it proven that the apartment had been acquired from the beginning by X and TS to be used for personal use, for the following reasons.

8.3. Although the circuit court found that the surveillance protocol and the protocol of the data received from the communications operator compiled on 26.05.2014 had to be rejected, it is still proven that X and TS used the XXX apartment to live from August 2012 onwards.

8.3.1. The Skype chat on 06.08.2012 between TS and ES and between TS and X on 08.08.2012 shows that in the beginning of August TS and X were moving into the XXX apartment.

In a conversation on 21.08.2012, KK asked X whether he remembered correctly that X was now living in XXX; X confirmed that this was the case.

Later conversations also show that X and TS were using the XXX apartment as their home. For example, on 03.09.2012 TS was interested in whether X is at home because E had to stop by XXX. On 24.02.2013 X said that a search had taken place and his mother had

[13] Ruling of the Administrative Chamber of the Supreme Court of 02.03.2016 in case no. 3-3-1-47-15, p. 14.

[14] *X v Staatssecretaris van Financiën*; C-334/10, p. 19.
[15] *X v Staatssecretaris van Financiën*; C-334/10, p. 17.
[16] Lennartz; C-97/90, p. 21; *X v Staatssecretaris van Financiën*; C-334/10, p. 23.
[17] *X v Staatssecretaris van Financiën*; C-334/10, p. 23; Klub OOD, p. 41.

to tell the police that documents are held at XXX. To this TS replied: "This is the last thing that we need now. Soon they will be at the door here." To this X instructed: "Look if we have some things at home that can cause doubts or confusion." So, TS was at home in the XXX apartment and both her and X were worried that the police might come to conduct a search there.

In addition, the county court has found that TS was present at XXX on 02.11.2012, as the Tax and Customs Board officials wanted to make an unannounced observation in the apartment. TS was present in the XXX apartment on 04.03.2013 during a search.

X admitted the fact that they used the XXX apartment since August 2012, in his testimony, claiming that they were forced to use this apartment temporarily because the previous one had begun to be renovated.

X' claim that they were forced to use the apartment temporarily in connection with their previous apartment being renovated has been disproven by Skype conversations. For example, on 06.08.2012 in a Skype conversation with ES, TS does not justify moving to the new apartment to start renovations, but says she is moving to a larger apartment. That moving to the XXX apartment was not an urgent necessity in August 2012 is indicated clearly, in the opinion of the circuit court, because of a conversation between X and TS on 21.11.2011 in which they discussed how long they were going to stay in Estonia. TS wrote: "I think that, back to Mia for the turn of the year. Maybe we can stay already at XXX, on a mattress or something. Before the New Year's Eve airline tickets will definitely be more expensive, but on 28 or 29 we could fly back." So, in November of 2011 they already had the plan to use the XXX apartment when staying in Tallinn.

The evidence shows that X had the intention to start using the apartment for living with TS immediately after the purchase of the apartment. Skype conversations show that X and TS immediately considered the apartment as their future home and prior moving to the apartment, they were in the process of designing it to meet their wishes.

In doing so, X realized that when he bought the apartment on behalf of the company, he would receive a VAT advantage. This is indicated by X' message to TS, in which he commented that a friend who bought an apartment under his own name was not smart because he had to pay VAT. Therefore, X was making false statements in order to increase the right of recourse, thus acting intentionally.

The circuit court does not agree with the appellants' claim that the county court misinterpreted the content of the Skype conversations. Like the county court, the circuit court finds that the conversations between X and TS show that they considered the apartment as their home from the beginning. For example, TS asked on 27.04.2011, i.e. on the day of purchase of the apartment ownership: "Will we go to the new home for a while?" Thus, TS named the apartment instantly a new home. The fact that TS did not consider this apartment as an investment by a company owned by X becomes apparent, as two days later she proposed to order pizza for the night and go to the "object" to enjoy the view. Although in these posts, the apartment was considered as the future home by TS, the fact that she did so when communicating with X (who did not refute her claim), shows that X had the same opinion.

However, these phrases are not the only ones showing that the apartment was purchased as the home of X and TS. It can be seen that in subsequent conversations, the apartment is considered as a future home by X himself. On 13.05.2011 X announced: "We have been registered as owners on 10.05." The appeal finds that X may not have thought of TS and X as "we", but rather himself and Y OÜ. This statement is refuted by further conversation. TS replied to X message: "Congratulations, owner of the apartment with the highest and best view in Estonia!" in turn X replies: "you too". So, TS and X congratulated each other on becoming the owners of Estonia's highest apartment with the best view. It is not the only time when X and TS used the "us" form when talking about the XXX apartment. Already on 11.05.2011 X sent TS hyperlinks to apartments for sale on Miami South Beach, commenting: "Our purchase was 2x more expensive." TS asked: "So we sell XXX apartment and buy in Mia?" X found: "I think we will finish our own."

On 14.05.2011 X said: "Everyone has already been informed that we bought the apartment.)", and adding: "Grandmother and grandfather already knew." TS said: "At least they won't go to town to talk about it, you cannot tell mine about anything at all, the information will spread like wildfire."

On 15.09.2011, X and TS talked about replacing or adding a second door lock. TS asked: "The upper lock then requires that if we close it when we leave home, then whenever we come home, it must be opened

before the card lets you in?" X replied, "Yes, if we don't put one on there with a motor." In light of this conversation, there is no doubt that X thinks of himself and TS "us" and TS calls the apartment their home.

The majority of the Skype chats between X and TS, reflected in the observation protocol, concern the construction work and furnishing of the apartment. According to the circuit court, the fact that X and TS thoroughly discussed interior design issues shows that they were personally interested in the result and furnished the apartment for themselves. At times it is clear from the conversations that X and TS followed their own wishes when furnishing the apartment. As stated in the judgment of the county court, on 14.09.2011 X wrote to TS: "What we are doing with the sauna controls – if we want remote control, the same panel must remain. If you want a more modern one, you can't remote control it." On 08.05.2012 TS wrote that she was going to test a mattress for the bed and wants to know whether X would join her, to which the latter replies that he cannot come. Before buying the chosen mattress TS again wanted to know whether X would like to try it himself before buying. As X and TS had a dog, it shows that the apartment's furnishings were ordered for them to use, that they ordered from OÜ K, among other furniture, a dog bed.

X' Skype chats with MH also confirm that X bought the apartment for himself to live in. On 17.05.2011 X wrote to MH: "I bought one apartment recently and probably will do it for myself, it is a little bigger than the current one, maybe I am bothered to do something more there". X further explained that he is not going to be in Estonia very much in the future but sees this apartment as a suitable stopover in Estonia, adding: "City apartment from time to time". Further, Mr X praised the choice: "With slippers I can go to Stockmann, your own spa, gym, cafes, restaurants, etc."

The appeal emphasizes that, in the same conversation, X has also written that he actually bought the apartment for sale. The circuit court states that X said in writing at the end that the completion of the apartment will take a few months, and he will then see whether he will retain it for himself or sell it on. However, the chamber accepts the county court's assessment that although X does not exclude that the apartment can also be sold, the idea in the conversation is that the apartment is acquired for living in it himself: first, X announced that he had bought the apartment for himself, explaining why this apartment will be needed in the future and why he thinks the choice is good.

X also said in a conversation on 04.12.2011, that the apartment should be put up for sale if it turns out he does not need it. At the same time, he was not very keen on selling or renting the apartment. In this conversation, X complained that the completion of the apartment would take a long time. To MHs question as to why he needs the apartment, if X is not going to live in Estonia, X replies: "Don't know yet, for what." To MHs comment that then there was no rush and maybe he would not need the apartment, X replied: "Then it should be sold at least." He complained that a sale would take time.

When MH suggested that the apartment could be rented out, Mr X replied: "It is also difficult to find someone and not sure if it is worth it."

8.3.2. The foregoing contradicts X' claim that the apartment was purchased with the intention of reselling it. The circuit court also disagrees with the appellants that the plan for selling the apartment is presented to the court in e-mail correspondence and Skype conversations between X and SV on 18 March 2013.

The correspondence shows that in March 2013, JN wrote to X that businessmen from Russia are interested in his apartment and asked for information about the apartment. In response to this letter, X briefly described the apartment. Although the letter from X does not show that the apartment is not for sale, the reply also shows that X has no serious interest in the sale. The description of the apartment is limited to the list of rooms. Although JN was also interested in furniture and equipment in the apartment, X did not provide a description of the furniture or equipment in the apartment.

The Skype conversation between X and SV on 18.03.2013 also shows that X did not have a serious plan to sell an apartment, but he was only willing to consider a sale if there was a good offer.

X announced to SV: "For the XXX apartment the Russians offered 1mio:)". In response to SV however, on the question of whether the apartment was for sale, X responded negatively. He also explained that interest in buying was based on old pictures on the internet. On that basis the appeal claims that there was information on the internet that the apartment was for sale. The circuit court notes that the reference

to the old pictures shows that there is information that is no longer relevant. In this respect, it should be noted that it is not clear from the printout presented by the defence who is selling the apartment or when the advert was posted. X could not answer the prosecutor's question regarding that topic at the county court hearing. Also, it has to be noted that the appeal itself is contradictory in terms of offering the apartment for sale: it references the sales advert but at the same time it is indicated that such exclusive apartments are not sold through sales adverts.

According to the judicial chamber, the conversation between X and SV as a whole gives the impression that the apartment was not actively being offered for sale. X summarized his position as follows: "After the last events I have many emotions – I would like to give up big ties with Estonia." The fact that X was considering selling the apartment to cut his own Estonian ties, shows that the apartment was not intended for a business investment, but for personal use.

The view that the apartment was purchased for personal use, not as a business investment, is supported by the fact that even though on 02.09.2014 T OÜ sold the apartment to M, the apartment remained essentially under the control of X, since X is also associated with M. According to the sales contract, X represented both parties.

8.3.3. The right to deduct VAT did not come from the rental agreement with A. The circuit court agrees with the county court that H OÜ entered into an ostensible rental agreement with A. This was used to create the apparent taxable turnover and the fact that X used the apartment together with XXX in his personal capacity was concealed.

H and X used the claim with Tax and Customs Board and the police, that the apartment had been rented to A, to show that X did not have access to the apartment. In a letter sent to the North Tax and Customs Centre on 8 November 2012, H's lawyer claimed that the apartment belonging to H is rented to another company and H is not able to provide the tax administrator access to the apartment. On 4 March2013, X also claimed that he had no access to the XXX apartment because the apartment had been rented. In fact, X had access to the apartment. This can be seen vividly in the search protocol of 4 March 2013. According to the protocol, the apartment could finally be entered, thanks to the fact that X telephoned TS who was inside the apartment and opened the door. Moreover, X was associated with A. With a power of attorney issued on 20.01.2012 in Cyprus, A authorized X to act as a representative on behalf of the company. With this Power of Attorney, X had very broad powers to act on behalf of A. Hence, X had decision-making powers for both parties of the contract.

As noted above, it has been proven that X lived with XXX in XXX since August of 2012. They used the apartment at the same time when it was allegedly rented to A. Clause 3.2.1 of the rental agreement concluded on 8 July 2012, states that the rooms with accessories had to be provided to the landlord[18] on 1 August 2012, and according to clause 4.1 the apartment was rented to A for one year. So, X with TS started to live in that apartment almost immediately after the apartment was supposed to be taken over by A. Since the rental agreement shows that A was supposed to rent the whole apartment, the circuit court does not consider relevant the appeals' claim that X, who acted on the behalf and in the interest of the company, had the possibility to use a room of the apartment as an office regardless of whether he and/or TS at the same time used the rest of the apartment for living purposes.

There is no evidence to show A's actual activity in the XXX apartment. The search protocol of 4 March 2013 does not show that any representative or employee of A was present when the apartment was entered. Nor does it appear from the protocol that there were any documents or other items related to A. That A used the postal address of XXX does not indicate the use of the apartment itself. Nor do the facts that A opened a banking account in Danske Bank or that A created a subsidiary, A OÜ in Estonia, show that A used the XXX apartment in connection with its business.

Although X acted on behalf of A, his answers to the questions about how A used the apartment were conspicuously general. To the defendant's counsel J. Siim's request to describe A's activities in Estonia and to explain why A had needed this office, X replied: "A actually invested in a financial project and he had a subsidiary here in Estonia, A. A in turn had a branch in Finland and if I am not mistaken, in Sweden and similar subsidiaries, which then engaged in the provision of credit services and collection services and also A in fact this summer 2012 through Estonian patent bureaus registered trans-European trade

[18] In the ruling the word "tenant" was used, but it is clear from context that it was an error.

marks, so that under specific trademarks they could offer services". X essentially failed to answer the question by the defendant's counsel A. Pilv, if A had more individuals who organized its activities here. Namely, X replied: "The contact originated in the past, it was their desire that this project be carried out through this A." Such vague responses give rise to the conclusion that this company actually had no activity in this apartment.

Given that X had the power to carry out transactions on behalf of A, even the fact that A paid the rental invoices sent to it, would not prove that the apartment was used by A. However, the circuit court finds unfounded, the claims arising from the appeal, that the statement in the county courts' judgement, which states that the observation protocol from 15 March 2013 and the bank statement do not show that A had made payments in connection with the rental agreement to H OÜ from its Danske Bank Estonian branch account. According to the appeal, the invoices were paid on 12 July 2012 from the account XXX in a bank of Cyprus. The appeal does not refer to any evidence of payment of the invoices. Instead, it is noted that the defence counsel was prepared to provide evidence in the county court, but did not do so because, according to the prosecutor, there was no dispute on this issue.

The circuit court points out that the Code of Criminal Procedure (CCP) has not provided any legal significance for the admission of a fact. According to § 60 (1) of the CCP, a court may, in criminal matters, rely on facts that it has declared to be proved or a matter of common knowledge. Thus, the prosecutor's statement that there is no dispute regarding this argument does not replace the evidence supporting the argument. As the defence counsel did not provide evidence, the county court's position is justified.

8.3.4. At the same time as the claim that the apartment was rented to A, the appellant claims that the immediate deduction of input tax was lawful because one room of the apartment was furnished as an office space from the start and X, who was the legal and authorized representative of different companies, used it as an office.

The circuit court finds that the credibility of this argument is undermined by the conclusion of the ostensible rental agreement. If X had used the apartment from the start for the business purposes of H OÜ, there would have been no need to conclude an ostensible rental agreement. The circuit court notes that, according to the case law, if different claims are made at the same time about the purpose of the apartment being acquired, it shows that there was no serious business plan to use the apartment for taxable turnover.[19]

The county court has referred to a series of items of evidence showing that the apartment was used for living, not in connection with business purposes of H OÜ as a successor to Y OÜ (although the appeal states that X used the office space in the apartment as a representative of various companies, the circuit court finds that the only relevant issue is whether the apartment was used for business purposes by the company who deducted the input tax).

The Skype chats referenced in the county court's ruling show that XXX went to the apartment in the evenings as if to a home, and it was not used as an office.

The county court has also referred to a search protocol of 04.03.2013, according to which X claimed that no documents from any companies were stored in the apartment. The appeal disputes this, indicating that the defendant's handwritten notes annexed to the search report show that he only claimed the lack of documentation from the Finnish companies and not all company documents. The circuit court notes that in the handwritten notes about the search protocol, it is emphasized that X does not hold any documents of a Finnish company. At the same time, it should be noted that X also did not provide any documents of Estonian companies, though the proposal to provide documents also included Estonian companies (including H OÜ). Instead, he stressed that the apartment is rented and H OÜ does not have access to the apartment.

Based on the above, the county court was right to conclude that the XXX apartment was not used, even partly as a business office. Therefore, no deduction of VAT was permitted by law.

C

9. The circuit court finds that X must be acquitted for the crime under § 389[1] (2) of the Penal Code (PC). It has not been proven that Y granted X a special advantage from which income and social tax not paid

[19] See the ruling of the Supreme Court from 14.12.2012 in case no 3-3-1-33-12, p. 12 and from 26.10.2016 in case no 3-3-1-28-16.

was to such extent that it complies with § 389[1] (2) of the PC or at least paragraph (1).

According to the indictment, the act of X, qualified under § 389[1] (2) of the Penal Code, consisted of him as an interim executor not declaring, in April 2011, fringe benefit and social tax in the sum of 129,107 + 202,883, which resulted in failing to collect taxes in the sum of over 320,000 euros, thereby fulfilling the lower limit of § 389[1] (2) of the Penal Code.

The indictment is based on the view that the cost of ownership of the XXX Tallinn apartment by Y OÜ is a disbursement in the interest of X, a member of the board of directors of the company, which constitutes a fringe benefit in the sense of the Income Tax Act (ITA) § 48. More specifically, the charge states that the it constitutes a free transfer, which means a fringe benefit specified in § 48 (4) clause 7 of the ITA.

The chamber agrees with the appellants' view that the free transfer named in the ITA § 48 (4) clause 7 means the transfer of the property free of charge.

First of all, it is worth noting that beside the transfer of a thing, security, property right or service for free, § 48 (4) 7) of the ITA mentions sales or exchange below the market price as fringe benefits. Both sale (§ 208 (1) of LOA) and exchange (§ 254 (1) of LOA) imply transfer of ownership. Consequently, the free transfer must imply a transfer of ownership (i.e. in essence it is a gift within the meaning of § 259 (1) of the LOA).

The view that the transfer referred to in § 48 (4) 7) of the ITA must imply a transfer of ownership is supported by the fact that the free use of the property is mentioned in other sub clauses of § 48 (4) of the ITA. Giving the use of employer's property free of charge or at a preferential price for activities not related to employment or service duties or to the employer's business constitute a fringe benefit according to § 48 (4) 2) of the ITA. In turn the full or partial covering of housing expenses is separately mentioned (§ 48 (4) 1) of the ITA).

Finally, this interpretation is confirmed by the fact that the transfer referred to in ITA § 48 (4) p 7 implies a transfer of ownership and is supported by the pricing arrangements for fringe benefits. The provisions of § 2 (2) and (3) of the regulation 2 of 13.01.2011 by the Minister of Finance sets out the rules governing the pricing arrangements for fringe benefits. It follows from paragraphs 2 (2) and (3) of the rules governing the fixing of the fringe benefit that in the case of the transfer of a thing or right, the fringe benefit shall be the value of the thing or right. In contrast, when the property is given free to use, the fringe benefit value is the market price for the renting of these assets (§ 2 (1) of the regulation).

Based on the foregoing, the circuit court finds that a disbursement in the sum of the purchase price of the apartment or the free transfer of the apartment to X would have occurred if the company had purchased the apartment in the name of X, or if the sale of the apartment to a company could be seen as a transaction to conceal another transaction (transfer of ownership of the apartment to X).

The initial indictment against X was based on this last view. However, on 21.04.2016 the prosecutor amended the allegation against X, which omitted the position. Although the amended text of the indictment still maintains that "the transaction being formalized as such sought to conceal the actual acquirer of the apartment and the actual purpose of the apartment", the references to the Taxation Act (TA) and the General Part of the Civil Code Act, which reference a sham and a ostensible transaction, are expressly excluded from the indictment. At the hearing of the Harju County Court on 22.04.2016, the prosecutor explained: "… so I say in essence, in the indictment, I have abandoned the construction in which I referred to § 83 (4) and § 84 of the TA, that is, the construction that it was then a sham deal between U and Y in the sense of civil law the public prosecutor's office then has no claims as to the validity of that transaction and therefore, I have removed these references to these sections and also there are some minor changes to the wording there, which are then outlined in the following paragraphs, but still the qualification of the crime and everything else remains the same."

Thus, the prosecutor declared that he did not question the fact that under the notarised sales agreement of the apartment property and the real estate agreement, Y OÜ purchased the apartment together with its significant parts and accessories. Accordingly, the county court has determined that the ownership of the apartment was transferred on 27.04.2011 to Y OÜ, who also was registered as owner in the land register. That finding is not disputed in the appeal.

The indictment does not show that Y OÜ, in turn, transferred the apartment free of charge to X. The prosecutor has not provided the court with specific legal grounds regarding the construction of how X

could be considered the actual acquirer of the apartment despite the fact that the contract of 27.04.2011 was not a sham transaction. The only fact mentioned in the indictment is the fact that the apartment was acquired for the personal use of X and TS. However, the purpose of buying an apartment does not change the ownership of the apartment by a company.[20]

Based on the above, there is no identifiable act to demonstrate that Y OÜ acquired the apartment for X and had carried out a fringe benefit payment in April 2011 to X corresponding to § 47 (4) 7 of the ITA, on which the income and social tax had not been paid.

As mentioned above, the free use of property also constitutes a fringe benefit. However, on the basis of the indictment of X, it is not possible to establish that by giving X free use of the apartment and not paying any income or social tax thereon, was to the extent that it would have been a crime committed under § 389^1 (2) of the PC (or at least under the first paragraph of the same provision).

Failure to provide tax authorities with information with the intention to reduce tax or withhold tax would constitute a crime under § 389^1 (2) of the PC if the sum of unpaid tax was 320,000 euros or more. The conviction under § 389^1 (1) of the PC would have a basis, under the PC § 12^1 p 2, which entered into force 1.01.2015, when the sum of unpaid tax was more than 40,000 euros.[21]

Pursuant to § 2 (1) of the Procedure for Determining the Price of Fringe Benefits, the fringe value when using an asset for free is the market price for renting these assets. There is no data in the indictment about the rental market price of the apartment. Nor does the indictment allow conclusions to be drawn for the period during which X used the apartment free of charge. X is accused of making false statements only in the April 2011 income and social tax return declaration, that is, fringe benefit given in April 2011. At the same time, X was accused of using the apartment significantly later: The indictment states that X and TS moved into the apartment at the latest in August-September of 2012.

It follows that it cannot be established that when X was given the apartment to use free of charge, and the failure to pay taxes was at least equal to the amount of serious damage.

D

10. The appeal finds (without reference to the law on which the position is based) that it is unreasonable for X to be accused of tax and criminal law infringements in a situation where legal assessment of various structural units of the Tax and Customs Board, as well as of the Circuit Prosecutor's Office has altered over time. In the opinion of the circuit court, the claim has been made that X' guilt is essentially excluded under § 39 (1) of the PC because he was not able to understand the unlawfulness of his conduct.

The circuit court does not consider the allegation that X could not understand the unlawfulness of his act as justified.

First, it should be noted that the legal assessment is influenced by the circumstances on which it is based. It is clear that collection of evidence may result in a change of the legal assessment. This also explains the fact that the tax administrator initially accepted the claim for reimbursement by Y OÜ – the circumstances that did not justify it were identified by the tax authorities only after the individual case inspection commenced with order of 02.11.2012.

Throughout the criminal proceedings, the basic construction of suspicion and accusation has remained the same: since the apartment was used by X for personal use only, Y OÜ was not entitled to deduct the VAT on the purchase of the apartment as input tax. The fact that input tax may be deducted only for purposes of taxable turnover, or in connection with business goods or services, is clearly derived from § 29 (1) and (2) of the Value Added Tax Act. In turn § 389^2 (1) of the Penal Code, clearly states that it is a criminal offence to knowingly submit incorrect information to tax authorities for the purpose of reduction of an obligation to pay a tax or obligation to withhold, or increase a claim for refund, if a tax liability or obligation to withhold is thereby concealed or a claim for return is unfoundedly increased by an amount corresponding to or exceeding major damage.

E

11. The appeal seeks the imposition of a pecuniary punishment of X. The circuit court does not find that X' pecuniary punishment is justified and considers

[20] See ruling of the Administrative Chamber of the Supreme Court of 26.10.2016 case no 3-3-1-28-16, p. 12.
[21] See ruling of the Criminal Chamber of the Supreme Court of 17.06.2015 case no. 3-1-1-54-15, p. 37-41.

that the sentence imposed on X, by the county court pursuant to § 389^2 (1) of the PC, shall be maintained.

The circuit court finds that the level of guilt of X already precludes the imposition of a pecuniary punishment. The circuit court considers it important that the unjustified claim for repayment of 80,984 euros is more than double the amount of major damage set out in § 12^1 2) of the Penal Code. Consequently, the circuit court holds X level of guilt as high.

The circuit court also finds that it is not possible to impose a pecuniary punishment on the grounds of general or specific preventive purposes. According to the statement in the file, X' average daily income in 2012 was 109.3 euros. However, this data does clearly not reflect X' real standard of living. First of all, in 2011, for example, X received dividends from I OÜ amounting to 235,000 euros. Also noteworthy are the events of a Skype conversation on 11.02.2013 where X complains to TS that he has misplaced more than 100,000 euros. TS replies that she could not find a larger sum of money at home, and assures that if she has taken money, she has later returned it. TS's response shows that the money lost was X' personal money.

It appears from the case file of the criminal case that X is connected to many different companies tied to each other, including foreign companies such as A and M in Cyprus. It is clear from the case file that X used assets of various companies, for example motor vehicles (e.g. the BMW X5 used by X belonged to H OÜ, and the Lamborghini Aventador belonged to A LTD). Because the court has no information on X' income from abroad and the determination of X' real standard of living is hindered by the use of different company assets, X has made it virtually impossible to ascertain his real income and standard of living. Given this, and the fact that the daily penalty under the income statement would also result in a pecuniary penalty corresponding to the upper limit of the pecuniary punishment set forth in § 44 (1) of the PC, the pecuniary penalty would lie significantly below the amount of the unjustified tax claim, the circuit court finds that the pecuniary punishment cannot serve a specific or general preventive purpose. In a situation where the income daily rate, as established during the proceedings, does not obviously correspond to the person's actual standard of living, would render the imposition of a pecuniary punishment pointless.[22] Also, the circuit court finds that it would give an incorrect signal to the public if the punishment imposed were to remain modest in proportion to the damage caused.

The circuit court does not regard as a mitigating circumstances pursuant to § 57 (1) 2) of the PC the fact that T OÜ, which is connected to the accused, redacted the VAT calculation on 2 September 2014 when selling the property, and paid the VAT on 21 October 2014. It was not voluntary compensation for the damage caused, but T OÜ was fulfilling a legal obligation arising from the sale of the apartment. Since the purchase price of the apartment did not include VAT, T OÜ was obliged to refund the deducted input tax.

F

12. It follows from the foregoing that the circuit court partially upholds the appeal by annulling Harju County Court judgment in respect of and pursuant to § 389^1 (2) of the Penal Code and acquits X pursuant to § 389^1 (2) of the PC. Consequently, the judgment of the county court must also be annulled in respect to the aggregate punishment and not to apply the aggregate punishment. Because the conditional imprisonment sentence has not been contested or actual imprisonment applied for, the aggregate punishment, pursuant to § 73 of the Penal Code, has to be replaced by the conditional imprisonment for 1 year and 6 months.

The circuit court finds that X must be in part be reimbursed for the legal costs of the appeal.

13. According to the application, X' legal costs in the appeal proceedings are 6,721 euros. Pursuant to § 175 (1) 1) of the CCP, procedural expenses consist of reasonable fees paid to the chosen defence counsel.

The circuit court does not consider, as part of the costs of the appeal, the participation in the county court judgement announcement (35 min). The circuit court also finds that the full reimbursement of composing of the appeal (i.e. about 23 hours) is not reasonable.

According to the case law of the Supreme Court, when a circuit court hears a criminal case on the basis of a defence counsels' appeal, when considering whether the legal costs are reasonable, the court must also

[22] See ruling of the Criminal Chamber of the Supreme Court of 17.03.2013 case no. 3-1-1-44-13, p. 23.

consider to what extent the appeal is satisfied.[23] Also, in determining reasonable expenses, it has to be considered whether and to what extent the arguments in the appeal are based on arguments used in lower ranked court proceedings where the fee payable for their development can be regarded as costs incurring in the county court proceedings.[24] The circuit court upheld the appeal in part, acquitting X on one of the two charges. The circuit court also notes that the arguments of the appeal largely coincide with those of the thesis presented in the county court, and the grounds of those arguments in the appeal and in the thesis are almost entirely word for word. In other words, the text of the theses is repeated in 2/3 of the appeal. Consequently, the time taken to prepare the appeal is justified by approximately 1/3.

As a result, the amount of legal aid to be reimbursed must be reduced by the amount corresponding to 8 hours, which equals 1,248 euros. Accordingly, X will therefore have to be reimbursed the legal costs of the appeal in the sum of 5,473 euros.

The cost of a flight ticket for X, in the sum of 663.01 euros, must also be reimbursed, which is also a procedural cost according to § 175 (1) 1) of the CCP, because of the place of residence of X.

As the circuit court partially annulled the county court's judgment, X must be partially reimbursed for the legal costs of the pre-trial and county court proceedings, which are in total in the sum of 37,257.46 euros.

Pursuant to the first sentence of § 180 (1) of the CCP, the convicted person shall pay the procedural costs in the case of a conviction. § 181 (1) of the CCP provides that in the case of acquittal, the costs of the proceedings shall be reimbursed by the state (with some exceptions in civil actions). Consequently, in the event of a partial acquittal of the accused, the state shall bear the costs of the criminal proceedings relating to the part of the prosecution for which the person is acquitted. If the lawyers' invoices do not indicate which part of the invoiced amount relates to that part of the charge proceedings in which the accused person was acquitted or criminal proceedings to be terminated, the court will establish this fact on an approximate basis.[25] The circuit court acquitted X on one count of two charges. The invoices in the case file do not indicate what part of the invoices related to the part of the prosecution on which X was acquitted.

Mr X must therefore be reimbursed 50 per cent of the costs of the county court proceedings, that is to say to the extent of 18,628.73 euros.

/signed digitally/

Sten Lind Ivi Kesküla Urmas Reinola

Partially annulled by the decision of the Supreme Court of 06.10.2017

RESOLUTION

1. Annul the judgment of the Tallinn Circuit Court of 9 January 2017, in so far as it reimbursed X for the legal expenses incurred in the pre-trial proceedings and the county court in the amount of 18,628.73 euros;

2. Order the Republic of Estonia to pay X 9,828 (nine thousand eight hundred and twenty-eight) euros in respect of the costs of the pre-trial procedure and the county court;

3. In other points, uphold the judgment of the district court.

4. Partially uphold the appeal in cassation.

5. Order the Republic of Estonia to pay X 624 (six hundred and twenty-four) euros to cover the fees paid to selected lawyers in cassation proceedings.

With thanks to **Tõnu Mets** for reviewing the translation.

Corrigendum

The appellant sent a request to the editors to have their name removed from the judgment. The appellant did not obtain a court judgement ordering the redaction, but they requested the court service

[23] See ruling of the Criminal Chamber of the Supreme Court of 19.06.2015 case no. 3-1-1-58-15, p. 14.
[24] See ruling of the Criminal Chamber of the Supreme Court of 30.06.2014 case no. 3-1-1-14-14, p. 1056.
[25] See ruling of the Supreme Court of 20.11.2015 case no. 3-1-1-93-15, p. 138.

to remove their name because of the passing of time. We have been made aware that the Estonian Official State Record has been amended to change the name of the appellant to 'X' in the judgment. We have no indication when this was undertaken, by whom or under what authority. However, given the Official State Record of Estonia now only refers to 'X' in the judgment, we have decided to amend the original translation as published in Volume 16 (2019).