



THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

JUDGMENT

on behalf of the Republic of Latvia

Riga 6 April 2021

in Case No 2020-31-01

The Constitutional Court composed of the Chairperson of the court hearing Sanita Osipova, Justices Aldis Laviņš, Gunārs Kusiņš, Daiga Rezevska, Jānis Neimanis and Artūrs Kučs,

following a constitutional challenge filed by Jānis Pīlāts,

pursuant to Article 85 of the Constitution of the Republic of Latvia and Section 16(1), Section 17(1)(11), Sections 19² and 28¹ of the Constitutional Court Law

at the court hearing held on 3 March 2021 examined the following case in a written procedure

On the compliance of Section 34(1) of the Law on Taxes and Duties, insofar as it provides for calculation and collection from the taxpayer of a fine in the amount of 100 per cent of the tax payable to the budget, with Article 105 of the Constitution of the Republic of Latvia.

Statement of Facts

1. On 2 February 1995, *the Saeima* adopted the Law on Taxes and Duties that came into force on 1 April 1995.

Pursuant to Section 5 of the Law ‘Amendments to the Law on Taxes and Duties’ of 21 May 2009, Section 34(1) of the Law on Taxes and Duties (hereinafter

– the contested provision) has the following wording: ‘If a natural or legal person who is registered as an economic operator engages in economic activity without registering as a payer of a particular tax or, within 30 days after the deadline set by the tax authority, does not submit the tax returns provided for by tax laws, as well as business and accounting records requested by the tax authority without which the tax administration officers (employees) are unable to determine the amount of the tax liability, then the tax authority shall, on the basis of a tax review (audit), calculate and recover from the taxpayer for the benefit of the budget the tax calculated for the taxation period starting from the date on which the person had an obligation to register as a taxpayer, a late payment charge in the amount provided for in Section 29(2) of this Law, and a fine in the amount of 100 percent of the tax payable to the budget.’ This provision has not been amended and its initial wording is in force.

2. It is the opinion of **the Applicant – Jānis Pīlāts** (hereinafter – the Applicant) that the contested provision does not comply with Article 105 of the Constitution (*Satversme*) of the Republic of Latvia (hereinafter – the Constitution), because it requires the taxpayer to pay a fine of 100 per cent of the tax payable to the budget.

The Applicant had a tax audit conducted which revealed that the Applicant, *inter alia*, had not registered as a payer of the value-added tax, and the Applicant was issued with a fine of 100 per cent of the value-added tax payable to the budget, pursuant to Section 34(1) of the Law on Taxes and Duties. It is alleged that the requirement to pay the fine set out in the contested provision infringes the Applicant’s right to own property guaranteed by Article 105 of the Constitution.

The restriction of fundamental rights established by the contested provision was determined by the law. The contested provision may serve as a means of preventing tax-related violations. However, in the opinion of the Applicant, the restriction of fundamental rights imposed by the contested provision does not comply with the principle of proportionality.

The obligation to pay the fine imposed by the contested provision places a financial burden that hinders the taxpayer's participation in the civil justice process and further payment of taxes by them, and is not aimed at the public good. The Applicant's fundamental rights would be infringed to a lesser degree if the amount of fine set out in the contested provision were determined individually, on the basis of a fixed rate. It is alleged that the nature of the violation and damage caused, the personality of the guilty party, as well as mitigating and aggravating factors should be taken into account when determining the amount of fine.

3. In the opinion of the body issuing the contested legislation – the Saeima, the contested provision is in line with Article 105 of the Constitution.

The Saeima agrees that the obligation to pay the fine imposed by the contested provision restricts the Applicant's fundamental rights enshrined in the first three sentences of Article 105 of the Constitution. This restriction is set out by law and has a legitimate aim of protecting public welfare. Namely, legal provisions establishing liability for violating tax laws encourage appropriate and timely payment of taxes and, in a wider sense, influence the behaviour of taxpayers.

The contested provision is an appropriate means for achieving the legitimate aim of the restriction of fundamental rights imposed by it. The contested provision, in conjunction with other legal provisions of tax law, enables the tax authority to exercise individual approach to any taxpayer and any tax-related violation. Namely, the amount of the fine depends of the amount of tax payable to the budget, and the tax authority may reduce this amount on the basis of the proportionality principle in non-typical situations. What is more, the contested provision only applies in the case of a tax review (audit), and is therefore used rarely.

The fine calculated by the tax authority for unpaid tax has a criminal-law nature, wherefore individual assessment of the violation and individual approach to determining the amount of the fine may be required. However, it is important that the right of specific persons to individual assessment of the violation and individual approach to determining the amount of the fine be balanced against the

responsibility of the State to ensure an efficient tax administration system aimed at protecting welfare of the society as a whole. In the specific case, the public good is greater than the damage caused to the right of the Applicant.

4. The joined party – the Ministry of Justice – notes that the contested provision does not comply with Article 105 of the Constitution.

The general objective of the fine set out in the contested provision is to ensure that taxpayers comply with their tax-related obligations and to punish violators. The fine ensures timely receipt of tax revenue by the State.

The fine set out in the contested provision may be compared with administrative liability for avoidance of paying taxes and similar duties and violating the procedure of taxpayers' registration. Determining the type and extent of an administrative fine involves an assessment of the nature of the violation, the personality of the person held liable (reputation in the case of a legal entity), their financial situation, circumstances of the violation, and mitigating and aggravating factors.

The contested provision does not require that the tax authority assess individual circumstances of the taxpayer in each instance the provision is applied. The possibility to impose a legal obligation to pay the tax and collect the late payment charge, in conjunction with the administrative liability set out in Part XVI of the Law on Taxes and Duties is a means that would allow to achieve the legitimate aim of the restriction of fundamental rights set out in the contested provision with similar efficiency while restricting the individual's rights to a lesser extent.

5. In the opinion of the joined party – the Ministry of Finance, the violation referred to in the contested provision is grave and indicative of the taxpayer's failure to cooperate with the tax authority, wherefore the existing level of fine for this violation is to be retained unchanged.

Violations referred to in the contested provision are connected with a willingness to avoid payment of taxes and other mandatory charges. Therefore, the

task of the legislature in determining the liability for these violations involved not only punishing the guilty parties, but also preventing others from activities that have a negative impact on the national budget.

The legislature assesses the contested provision on a regular basis, and when reducing the applicable sanction is deemed possible, it does so and determines a more lenient measure. However, at the moment it is not possible to set out another, alternative measure that would be similarly efficient. In the opinion of the Ministry of Finance, at the moment it is impossible to remove the punitive regulation altogether or significantly reduce the amount of sanction, especially in view of the economic situation and the level of shadow economy in Latvia.

6. The joined party – the Ombudsman – notes that the contested provision in its current wording creates the risk of disproportionate application and should be amended.

It is an obligation of the State to establish an effective tax collection system in the interests of the society. However, the State also has an obligation to protect individuals from disproportionate penalties even if they are applied for violating tax legislation.

In accordance with the interpretation of the principle of proportionality adopted in the case law of the Court of Justice of the European Union, sanctions applicable to taxpayers who knowingly conceal the taxable object need to be separated from sanctions on taxpayers who commit violations due to inadvertence. In assessing the proportionality of the sanction, it is necessary to take into account the nature and gravity of the violation and whether the amount of the sanction is really necessary for accurate collection of the tax and prevention of fraud.

The decision of the legislature to set a fine of 100 per cent of the amount of unpaid tax is proportionate, insofar as the obligation to pay this fine is applicable to persons whose attitude to fulfilling the legal obligation is indicative of malign intent or gross negligence and disregard of their obligations. By contrast, in cases when a person fails to meet their legal obligations because of lack of

understanding, an error or ignorance the law should provide for a variable amount of fine, ensuring an individualised approach to the fine.

7. In the opinion of the joined party – the State Revenue Service, the amount of the fine set out in the contested provision is proportionate.

The contested provision is only applied in the case of a tax review (audit). Following assessment of the taxpayer's data in a revenue-related risk area, the State Revenue Service may conduct a compliance review, a thematic inspection and a tax review (audit). The type of review in each specific case is determined on the basis of the risks revealed. Prior to issuing a fine the State Revenue Service invites the taxpayer to fulfil their obligations voluntarily.

In non-typical cases the amount of the fine set out in the contested provision may be changed, but no such cases have been identified in the State Revenue Service or court practice.

8. In the opinion of the joined party – Latvian Association of Tax Consultants, the contested provision does not comply with Article 105 of the Constitution because the amount of the fine set out in it is disproportionate.

The objective of the sanction set out in the contested provision is to ensure that taxes are collected accurately and to prevent tax-related fraud. In contradiction with the opinion established in the case law of the Court of Justice of the European Union, the amount of the fine exceeds the necessary amount and is disproportionately high. Specifically, the aim of the restriction set out by the contested provision can be achieved with a reduced maximum amount of the sanction or enabling the tax administration to choose the amount of sanction individually in accordance with the nature and gravity of the violation and the degree of the taxpayer's malignant intent. The legal mechanisms that exist in the tax law, such as calculation of the amount of fine on the basis of the tax payable to the budget, the tax authority's decision as to the type of review to be carried out, application of the principle 'consult first' and signing a settlement agreement, do not ensure individual approach to determining the amount of fine.

9. In the opinion of the joined party – Kārlis Ketners, *Dr. oec.*, the contested provision is in line with Article 105 of the Constitution.

Sanctions set out in tax law are applied in the case of failure to make a timely and adequate tax payment or to meet other secondary obligations. The main aim of these sanctions is encouraging the fulfilment of tax obligations and preventing violations. The process of determining the sanctions is subject to such principles as legitimacy, proportionality, *ne bis in idem* (the double jeopardy rule), individual guilt and due process.

In the process of applying a fine, the competent authority normally does not differentiate the fine depending on such factors as individual circumstances of the person or the degree of their guilt, as such requirements make the operation of the tax collection system significantly more complicated. Even though individual approach to tax-related sanctions or their dropping is acceptable in specific cases, it cannot be applied when it would undermine the public's or the person's understanding of the importance of the violated regulation.

The system of tax-related sanctions in Latvia provides possibilities of differentiating fines based on the gravity and intensity of the violation and the degree of the person's guilt; however, it is impossible to differentiate the amount of the fine set out in the contested provision on the basis of individual circumstances or the degree of guilt because the contested provision is applicable as a result of a tax review (audit) and only in cases where the person evidently did not use the possibilities provided by law to rectify the situation and prevent consequences of the violation.

10. In the opinion of the joined party – Sabīne Vuškāne, *Mg. oec.*, the contested provision is not in line with Article 105 of the Constitution.

The restriction of fundamental rights established by the contested provision was determined by the law and it has a legitimate aim, i.e. ensuring revenue for the national budget, which enables performance of the State's functions, including the guarantee of fundamental rights. However, according to the position adopted in

the case law of the Court of Justice of the European Union, sanctions for tax-related violations should comply with the principle of proportionality and the principle of efficiency.

Violations specified in the contested provision are related to the type of payable tax. Specifically, the obligation to register in the capacity of a taxpayer is connected with payment of value-added tax, but the obligation to pay value-added tax exists independently of whether the obligation to register has been fulfilled, wherefore punishment for failure to register alone is not practicable.

In the case of other taxes, there is no need to register specifically as a payer of a specific type of tax if the person has registered as an economic operator. The submission of tax returns and the fact of tax payment are important in these cases. A person's actions, i.e. failure to submit tax returns or documents specified in the contested provision following a notice from the tax authority, are to be deemed deliberate refusal to cooperate and concealment of income. In this case, a fine of 100 per cent of tax payable to the budget is effective and acts as a preventive measure.

An individual approach is possible when choosing the type of procedure used to reveal a possible violation by the taxpayer and also with regard to reducing the calculated amount of the fine and determining a deadline for its payment; however, the contested provision does not make it possible to use an individual approach with regard to calculating the amount of the fine. Therefore, law should provide for a possibility to reduce the amount of tax taking into account the taxpayer's intent.

11. In the opinion of the joined party – Ieva Liepiņa, *Mg. iur.*, *Mg. oec.* and Santa Ozola, *Mg. iur.*, *Bac. oec.*, the contested provision is not compliant with the principle of proportionality, insofar as it does not provide for an individual approach to a fine in cases of conducting business activity without registering as a payer of the specific tax.

The fine set out in the contested provision targets two violations that need to be considered separately. Firstly, the violation referred to in the contested

provision – failure to register as a taxpayer – has a formal nature. However, this conclusion is not sufficient to consider the amount of the sanction as inadequate to the violation. Application of the sanction set out in the contested provision is justified if the taxpayer is deliberately negligent of meeting mandatory requirements or there was malignant activity with the aim of avoiding the obligation to pay the tax and to conceal the tax payable to the budget. In other cases, a fine of 100 per cent of the amount payable to the budget would, most likely, exceed the amount necessary to ensure responsible attitude of taxpayers to the requirement to register as a payer of the specific tax.

Secondly, the fine set out in the contested provision is applied in cases where the taxpayer does not provide documents necessary to calculate the payable tax within 30 days of the deadline specified by the tax authority. A fine is applicable only in the case where the taxpayer grossly violates the cooperation obligation. Furthermore, typically refusal of the taxpayer to cooperate is connected with deliberate failure to provide the necessary information and documents in order to conceal the payable tax, wherefore in this case the contested provision is in line with the principle of proportionality. In non-typical cases, the amount of the fine set out in the contested provision can be reduced taking into account such factors as the clarity of tax-related legislation and taxpayers' awareness of the tax authority's practice and position in matters of enforcing tax-related legislation.

Conclusions

12. The Applicant requests that the Constitutional Court assess compliance of the contested provision, insofar as it provides for a fine in the amount of 100 per cent of the tax payable to the budget, with Article 105 of the Constitution.

The contested provision sets out a fine for natural and legal persons in the case of engagement in business activities without registering as a payer of a particular tax if the person is registered as an economic operator (hereinafter – violation of the obligation to register) or in the case of failure to submit statutory tax returns and documents necessary for calculating the amount of payable tax by

the specified deadline (hereinafter – violation of the obligation to present documents). Therefore, the contested provision applies to both natural and legal persons and its legal effects may be entailed by two mutually different violations.

12.1. The Constitutional Court has acknowledged the following: in examining the Case initiated following a constitutional challenge, the Constitutional Court, on the one hand, needs to take into account requirements of the Constitutional Court Law and to assess the situation insofar as necessary to protect the fundamental rights of the Applicant, but, on the other hand, it must observe the principle of equality and to assess the situation of all persons whose circumstances are equal or comparable to those of the Applicant filing the constitutional challenge. If the constitutional challenge contests a legal provision that concerns a wide set of various situations, the Constitutional Court has to specify the extent to which it will assess the contested provision (*e.g. see paragraph 11 of the Constitutional Court Judgment of 24 October 2013 in Case No 2012-23-01*). Therefore, in the Case under examination it is necessary to specify the extent of assessing the constitutionality of the contested provision and persons in respect of which it is assessed.

12.2. It follows from the materials in the Case that the contested provision was applied to the Applicant – a natural person – because of failure to register in the registry of payers of value-added tax, i.e. a violation of the obligation to register (*see vol. 1, pp. 85–86 of materials in the Case*). However, in terms of legal effects, the contested provision is applicable to legal entities specified in it in equal measure, regardless of the type of violation referred to in the provision and whether the violator is a natural or legal person.

Assessing the effect of a legal provision on both a person fined for violating the obligation to register and a person fined for violating the obligation to present documents, regardless of whether the violator is a natural or legal person, ensures comprehensive and objective examination of the Case, as well as procedural economy and existence of a legal system that prevents as comprehensively and exhaustively as possible regulations that do not comply with the Constitution or other legal provisions of superior legal force (*cf. paragraph 12.2 of the*

Constitutional Court Judgment of 14 November 2017 in Case No 2017-07-01). What is more, in the specific case, taking into account considerations given in the rejoinder of *the Saeima* and opinions of the joined parties, materials available in the Case are sufficient to assess the constitutionality of the contested provision in respect of all the taxpayers falling within the scope of the contested provision, regardless of the types of violations referred to in the contested provision and of whether the violator is a natural or legal person.

Therefore, in the Case under examination, the Constitutional Court will assess compliance of the contested provision, insofar as it provides for a fine in the amount of 100 per cent of the tax payable to the budget, with Article 105 of the Constitution.

13. Article 105 of the Constitution: ‘Everyone has the right to own property. Property shall not be used contrary to the interests of the public. Property rights may be restricted only in accordance with law. Expropriation of property for public purposes shall be allowed only in exceptional cases on the basis of a specific law and in return for fair compensation.’

13.1. In accordance with the case law of the Constitutional Court, if the challenge concerns compliance of a contested provision with Article 105 of the Constitution as whole, but the contested provision does not provide for expropriation of property for public purposes, the compliance of the contested provision is to be assessed only with regard to the first three sentences of Article 105 of the Constitution (*e.g. see paragraph 16.1 of the Constitutional Court Judgment of 12 February 2020 in Case No 2019-05-01*).

The obligation to pay the fine set out in the contested provision entails a reduction in the amount of the taxpayer’s money in cases where the taxpayer has committed violations referred to in the contested provision. Therefore, the contested provision does not concern expropriation of property for public purposes and its constitutionality should be evaluated under the scope of the first three sentences of Article 105 of the Constitution.

13.2. The Constitutional Court has acknowledged that Article 105 of the Constitution provides for both unrestricted use of the right to own property and the possibility for the State to restrict this right in the interests of the public. Therefore, this Article, on the one hand, sets out the obligation of the State to protect the right to own property, but, on the other hand, entitles the State to interfere with the exercise of this right to a specific extent in accordance with a specific procedure. The ‘right to own property’ in the meaning of Article 105 of the Constitution denotes all property rights that an entitled person may use for its own benefit and which it can dispose of in accordance with its will, such as property in the meaning of Section 927 of the Civil Law. A person’s money is also subject to the right to own property (*see paragraph 15.2 of the Constitutional Court Judgment of 28 December 2020 in Case No 2019-37-0103*).

It follows that protection of the taxpayer’s property, which is reduced as a result of the obligation to pay the fine set out in the contested provision, falls within the scope of the right to own property set out in the first three sentences of Article 105 of the Constitution.

13.3. The Constitutional Court has acknowledged that the obligation to make compulsory payments set out in legal instruments always entails restricting the right to own property (*see paragraph 23 of the Constitutional Court Judgment of 20 March 2020 in Case No 2019-10-0103*). The obligation to pay a material fine also always infringes a person’s right to own property. Therefore, the obligation imposed by the contested provision, i.e. to pay the fine stipulated in it, infringes on the taxpayer’s property, more specifically, diminishes its amount.

It follows that the contested provision restricts the taxpayer’s right to own property set out in Article 105 of the Constitution.

14. In order to assess the constitutionality of the restriction of the fundamental rights enshrined in the first three sentences of Article 105 of the Constitution, it is necessary to establish the following:

1) if the restriction of fundamental rights was determined by a duly adopted law;

- 2) if the restriction in question has a legitimate aim;
- 3) if the restriction in question is proportionate to its legitimate aim (*e.g. see paragraph 14 of the Constitutional Court Judgment of 6 June 2018 in Case No 2017-21-01*).

15. In order to establish if the restriction of fundamental rights was determined by a duly adopted law, it is necessary to verify the following:

- 1) if the law was adopted in accordance with the procedure established by legislation;
- 2) if the law was promulgated and publicly accessible in accordance with legislation;
- 3) if the law is formulated with sufficient clarity for a person to understand the essence of the rights and obligations derived from it and to anticipate the consequences of its application (*e.g. see paragraph 15 of the Constitutional Court Judgment of 6 June 2018 in Case No 2017-21-01*).

The restriction of fundamental rights must be determined in a legislative procedure that complies with the principle of good legislation (*cf. paragraph 18.1 of the Constitutional Court Judgment of 6 March 2019 in Case No 2018-11-01 and paragraph 13.2 of Judgment of 7 June 2019 in Case No 2018-15-01*).

15.1. The contested provision was adopted by *the Saeima* with the Law ‘Amendments to the Law on Taxes and Duties’ of 21 May 2009. The respective draft law was considered by *the Saeima* at three readings. The State President promulgated the law on 9 June 2009 in the Official Gazette *Latvijas Vēstnesis* No 89, in accordance with a statutory procedure.

15.2. The Constitutional Court has acknowledged that a legal provision restricting fundamental rights of a person must be both clear and expectable. More specifically, the legal provision must be worded as accurately and clearly that a person may understand the essence of the rights and obligations that derive from it and may anticipate the consequences of its application, as well as that the provision may ensure protection against its arbitrary application (*e.g. see*

paragraph 14 of the Constitutional Court Judgment of 8 April 2015 in Case No 2014-34-01).

The contested provision enables a taxpayer to form conclusions and expectations as to the legal effects of violating the obligation to register or the obligation to present documents. Specifically, in this case the tax authority will fine the person in the amount of 100 per cent of the tax payable to the budget. Therefore, the wording of the contested provision is sufficiently clear, and the person can understand its essence and anticipate the consequences of its application.

It follows that the restriction of fundamental rights contained in the contested provision is established by a law, which was adopted following proper procedure.

16. Any restriction of fundamental rights must be based on circumstances and arguments that justify its necessity; namely, the restriction needs to be established on the grounds of important interests, i.e. a legitimate aim (*e.g. see paragraph 18 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

The institution issuing the contested legislation, in this case *the Saeima*, is primarily responsible for demonstrating and justifying the legitimate aim of the fundamental rights restriction to the Constitutional Court (*e.g. see paragraph 20 of the Constitutional Court Judgment of 12 February 2020 in Case No 2019-05-01 20*).

The Saeima notes that provisions establishing liability for violating tax-related laws encourage accurate and timely payment of taxes. Namely, the taxpayer is deterred from violating tax-related laws, whereas taxpayers who commit violations are fined in order to deter them and other taxpayers from further violations. It follows that the legitimate aim of the restriction of fundamental rights established by the contested provision is the protection of public welfare.

16.1. The Preamble to the Constitution states that the State of Latvia has been established, *inter alia*, to ensure freedom and promote welfare of the people

of Latvia and each individual. The national budget and funds available to the State are an instrument of achieving these aims (*cf. paragraph 25.2 of the Constitutional Court Judgment of 19 October 2017 in Case No 2016-14-01*).

Pursuant to Article 66(1) of the Constitution, *the Saeima* shall determine the State Revenue and Expenditure Budget before the commencement of each financial year, on an annual basis. Therefore, it is an obligation of the legislature to determine the means of ensuring budget revenue. It follows from Part 1 and Section 1 of the Law on Budget and Financial Management and Section 1(1) of the Law on Taxes and Duties that taxes collected and received in accordance with tax-related legislation are one of the means chosen by the legislature to ensure budget revenue and, therefore, to finance the State and local government functions. Tax revenues are used to finance the State and, in some cases, also local government bodies.

Ensuring tax revenues is directly linked to the individual's constitutional obligations to the Latvian State. Such obligations are targeted at a sustainable implementation of the sovereign's will – to live in a democratic rule-of-law state – enshrined in the basic norm of the State of Latvia. Failure to fulfil such obligations threatens the existence of every democratic rule-of-law state (*cf. also Weiler J. H. H. The Crumbling of European Democracy. In.: Graber M. A., Levinson S., Tushnet M. (Eds.) Constitutional Democracy in Crisis? New York: Oxford University, 2018, p. 632*).

The Preamble to the Constitution reminds that everyone must take care of oneself, one's relatives and the common good of society by acting responsibly toward other people and future generations. This care is manifested, *inter alia*, by fulfilling the individual's constitutional obligation to pay taxes set out in Article 66 of the Constitution, and it assumes responsibility to meet the needs of the society and maintain the State of Latvia (*cf. paragraph 26 of the Constitutional Court Judgment of 19 October 2017 in Case No 2016-14-01*).

16.2. Following Latvia's accession to the European Union, the EU law has become an integral part of Latvian legal system. Therefore, EU legal provisions aimed at strengthening democracy and their interpretation enshrined in the case

law of the Court of Justice of the European Union must be taken into account both when adopting national legal provisions and when clarifying the essence of national legal provisions and applying them (*e.g. see paragraph 23.1 of the Constitutional Court Judgment of 11 June 2020 in Case No 2019-12-01*).

Pursuant to Article 325(1) the Treaty on the Functioning of the European Union, the Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies. Pursuant to Part 2 of the above Article, Member States shall take the same measures to counter fraud affecting the financial interests of the Union as they take to counter fraud affecting their own financial interests.

It follows from the case law of the Court of Justice of the European Union that the resources of the European Union include revenue received by applying a single rate of value-added tax base established pursuant to the EU law. It follows that there is a direct link between revenue received from value-added tax in accordance with the EU law and transfer of the respective amount of value-added tax to the EU budget (*e.g. cf. paragraph 26 of the Court of Justice of the European Union Judgment of 26 February 2013 in Case C-617/10 Åkerberg Fransson*). Namely, revenue received by Member States from collecting value-added tax has an effect also on the financial interests of the European Union.

In accordance with Article 3 of the Treaty on European Union, EU budget funds are used, *inter alia*, to maintain an area of freedom, security and justice and to establish an internal market. Hence, the collection of taxes transferred to the EU budget also promotes meeting the needs of society.

16.3. The Constitutional Court has acknowledged that the State has an obligation to establish an effective system for collecting taxes in the interests of public welfare (*see paragraph 17 of the Constitutional Court Judgment of 15 April 2013 in Case No 2012-18-01*). Furthermore, the rules of tax-related laws alone are not sufficient without a functioning system of preventing violations

(see paragraph 11 of the Constitutional Court Judgment of 3 April 2008 in Case No 2007-23-01).

The efficiency of a tax collection system is connected with fulfilment of the obligations of taxpayers, wherefore the State must take measures to facilitate and ensure the fulfilment of taxpayers' obligations. If the State did not properly exercise this responsibility and would therefore receive lower revenue, this would reduce its capability to exercise any functions (see Hood C. *The Tax State in the Information Age*. In: Paul T. V., Ikenberry G. J., Hall J. A. (Eds.) *The Nation-State in Question*. Princeton: Princeton University, 2003, p. 213). Furthermore, this situation would jeopardise the work of institutions that exist in a democratic rule-of-law state (cf. Levi M. *Of Rule and Revenue*. Berkeley: University of California, 1988, p. 2). Therefore, the fulfilment of the above responsibility also facilitates protection of the democratic regime.

It follows that the restriction of fundamental rights imposed by the contested provision has the following legitimate aims: the protection of public welfare and democracy.

17. In establishing whether the restriction of fundamental rights imposed by the contested provision, the Constitutional Court has to verify the following:

- 1) if the restriction is appropriate for achieving the legitimate aim;
- 2) if the aim can be achieved by other means that are less restrictive of an individual's fundamental rights;
- 3) if the benefit gained by the society from the restriction imposed exceeds the damage caused to the individual.

If following the examination of the legal provisions it is found that the fundamental rights restriction imposed by them does not comply with at least one of these criteria, the contested provision will be deemed non-compliant with the principle of proportionality and illegal (see paragraph 18 of the Constitutional Court Judgment of 11 December 2020 in Case No 2020-26-0106).

The fine set out in the contested provision is applicable in cases of violation of the obligation to register and violation of the obligation to present documents.

The legal nature of these obligations differs; therefore, in examining whether the restriction of fundamental rights imposed by the contested provision complies with the principle of proportionality, the Constitutional Court will evaluate the means selected by the legislature with reference to each of the violations referred to in the contested provision.

18. The means selected by the legislature are deemed appropriate for achieving the legitimate aim of the restriction of fundamental rights imposed by the contested provision if the specific rule enables the achievement of this aim (*e.g. see paragraph 13 of the Constitutional Court Judgment of 7 October 2010 in Case No 2010-01-01*).

The Applicant argues that the means chosen by the legislature are not appropriate for achieving the legitimate aim of the restriction of fundamental rights imposed by the contested provision. Specifically, the fine imposed by the contested provision places a financial burden that prevents the taxpayer from continuing their business activity and paying taxes, in this way also worsening public welfare. Conversely, in the opinion of *the Saeima*, fines imposed for tax-related violations encourage appropriate and timely payment of taxes. Therefore, the contested provision is appropriate for achieving the legitimate aim of the restriction of fundamental rights imposed by it.

18.1. In the case of violation of the obligation to register, the taxpayer does not fulfil the statutory requirement to register in the registry of payers of a particular tax. This violation is usually manifested as a taxpayer's registering as an economic operator but failing to register as a payer of value-added tax, and therefore failing to calculate and pay the value-added tax for business transactions.

A violator of the obligation to register set out in the contested provision must pay the specific tax irrespective of whether the taxpayer is registered as a payer of the tax in question, as this violation hampers the collection of the tax. Specifically, if the tax authority has incomplete information on persons subject to the particular tax, the efficiency of tax collection is reduced (*cf. Hood C. The Tax State in the Information Age. In: Paul T. V., Ikenberry G. J., Hall J. A. (Eds.) The*

Nation-State in Question. Princeton: Princeton University, 2003, p. 213; Rozas J. A. Comment Report: Tax Penalties in a Cooperative Compliance Framework. In: Seer R., Wilms A. L. (Eds.) Surcharges and Penalties in Tax Law. 2015 EATLP Congress Milan, 28–30 May 2015. Amsterdam: IBFD, 2016, p. 45).

The Court of Justice of the European Union has stated that the obligation to register in the registry of taxable persons for VAT purposes constitutes only a formal requirement and acknowledged that the penalty for the failure to observe this obligation is not designed to ensure recovery of the tax from the party liable for it; however, it does not prevent Member States from providing in their national law for appropriate penalties to sanction the failure to observe this obligation in order to ensure the correct collection of the tax and to prevent fraud (*cf. paragraphs 45, 48 and 49 of the Court of Justice of the European Union Judgment of 19 July 2012 in Case C-263/11 Rēdlihs*). The case law of the Senate contains similar acknowledgements (*e.g. see paragraph 14 of the Senate's Administrative Cases Department Judgment of 27 November 2013 in Case No SKA-430/2013*).

Legal liability for violating the obligation to register motivates the taxpayer to observe the obligation. Namely, the fine set out in the contested provision, which is applicable without individual assessment in the case of violation of the obligation to register, seeks to influence the taxpayer's behaviour and has a preventive effect. Therefore, the fine set out in the contested provision, which is applicable without individual assessment in the case of violation of the obligation to register, facilitates the efficiency of tax collection and in this way indirectly promotes protection of national and EU finances, while at the same time ensuring the operation of institutions of a democratic state.

18.2. In the case of violation of the obligation to present documents, the taxpayer fails to submit to the tax authority tax returns set out in tax-related legislation or documents pertaining to business activities and accounting requested by the tax authority in accordance with the procedure established by the contested provision, without which the tax authority is unable to determine the amount of payable tax.

Pursuant to Section 32² of the Law on Taxes and Duties, within a specified term, the taxpayer shall provide the informative statements provided for in this Law or required under the provisions of the specific tax laws or additional information (documents supporting business revenues and expenditures, accounting records, as well as other information describing the activities which affected or could have affected the assessment and payment of tax) upon request of the tax administration officer, by not receiving which the determination of the tax amount due to the budget or a refund is not possible or made difficult. Specific tax-related laws set out similar requirements. These requirements specify the taxpayer's obligation to cooperate, which is derived from the person's constitutional obligation to pay taxes. Violation of the obligation to present documents, in essence, is connected with failure to observe the taxpayer's obligation to cooperate (*see also opinion of Ieva Liepiņa and Santa Ozola in vol. 2, p. 49 of materials in the Case*).

Pursuant to Section 34(4) of the Law on Taxes and Duties, where it is not possible to assess the amount of tax, the tax authority shall determine the taxable base and the tax liability by assessment having regard to the increase in the assets or capital held by the taxpayer or the information at the disposal of the tax authority. It means that, in the case of violation of the obligation to present documents, the tax authority has to invest additional resources to determine the amount of tax. Furthermore, in this case the taxpayer's actions delay the observation of the taxpayer's obligations and receipt of budget revenue. Therefore, violation of the obligation to present documents not only reduces the efficiency of tax collection, but also poses a direct threat to the financial interests of the State and, in some circumstances, also of the European Union.

In a legal system where the taxpayer is obligated to cooperate with the tax authority in the field of taxation, punitive measures mainly have a preventive function, i.e. to prevent, reduce and anticipate the risk of failure to observe tax obligations (*see Rozas J. A. Comment Report: Tax Penalties in a Cooperative Compliance Framework. In: Seer R., Wilms A. L. (Eds.) Surcharges and Penalties in Tax Law. 2015 EATLP Congress Milan, 28–30 May 2015. Amsterdam: IBFD,*

2016, p. 54). The fine set out in the contested provision, which is applicable without individual assessment in the case of violation of the obligation to present documents, also has a preventive effect. It promotes the efficiency of tax collection and protects the financial interests of the State and the European Union, while at the same time ensuring the operation of institutions of a democratic state.

18.3. The Constitutional Court has concluded the following: the legislature has a degree of discretion in exercising its obligation to ensure tax revenue for the national budget and determining the sanction policy in the field of taxation, insofar as general principles of law and other provisions of the Constitution, the European Union law and international law are observed. One of the aspects of such discretion is the power to provide for punitive measures to impact the taxpayer's behaviour and thus ensure that tax revenues are received. The fine set out in the contested provision, which is applicable without individual assessment in case of violation of the obligation to register and violation of the obligation to present documents, is deemed such a punitive measure.

Thus, the restriction of fundamental rights imposed by the contested provision contributes to the protection of public welfare and the democratic structure of the state both when the obligation to register is violated and when the obligation to present documents is violated.

It follows that the means chosen by the legislature are appropriate for achieving the legitimate aim of the restriction of fundamental rights contained in the contested provision.

19. In verifying whether the selected measures are necessary for the achievement of the legitimate aims, the Constitutional Court assesses if the legitimate aims can be achieved by other equally efficient measures that are less restrictive of the individual's fundamental rights.

In the opinion of the Applicant, a legal regulation providing for an individual approach to determining the amount of the fine on the basis of a fixed rate would be a measure less restrictive of their fundamental rights. By contrast,

the Saeima notes that some individualisation is already possible in cases of violations referred to in the contested provision.

The Constitutional Court has acknowledged that the legislature has a degree of discretion in determining the fine for a specific violation (*e.g. see paragraph 5 of the Constitutional Court Judgment of 6 January 2011 in Case No 2010-31-01*). However, when adopting a legal regulation providing for liability for violation of tax-related laws, it is the obligation of the State to ensure an individual approach to determining the fine, i.e. its proportionality to the violation, insofar as it is permitted by the nature of the specific legal relationship (*cf. paragraph 11 of the Constitutional Court Judgment of 3 April 2008 in Case No 2007-23-01*). The Court of Justice of the European Union also states that sanctions imposed by Member States for tax-related violations affecting the financial interests of the European Union must be consistent with the principle of proportionality. More specifically, penalties for tax-related violations must not go beyond what is necessary to attain the objectives of ensuring the correct levying and collection of the tax and preventing fraud. In order to assess whether a penalty is consistent with the principle of proportionality, account must be taken, *inter alia*, of the nature and the degree of seriousness of the infringement which the penalty seeks to sanction, and of the means of establishing the amount of the penalty (*see paragraphs 59 and 60 of the Court of Justice of the European Union Judgment of 26 April 2017 in Case C-564/15 Farkas*).

The Organisation for Economic Co-operation and Development, of which Latvia has been a member since 1 July 2016, prepared Guidance Note on Tax Compliance Risk Management – an authoritative recommendation. It follows from the above Guidance Note that the efficiency of penalties for tax-related violations is ensured at the highest level if penalties are subject to a severity rating in accordance with the risk of a specific violation. Furthermore, assessment of individual circumstances of the taxpayer is one of the instruments of assuring taxpayers that respective measures to encourage tax compliance are just. The existence of such an assessment in a legal relationship between the taxpayer and the tax administration that is based on cooperation will, in turn, encourage the

taxpayer's trust to the tax authority and therefore voluntary compliance (see *OECD Guidance Note. Compliance Risk Management: Managing and Improving Tax Compliance. Available at www.oecd.org; see also Feld L. P., Frey B. S. Deterrence and Tax Morale: How Tax Administrations and Taxpayers Interact. Available at: www.oecd.org). The control measures taken by the State need to vary depending on the nature of the taxpayer's violation (cf. *Lederman L. Tax Penalties as Instruments of Cooperative Tax Compliance Regimes. In: Seer R., Wilms A. L. (Eds.) Surcharges and Penalties in Tax Law. 2015 EATLP Congress Milan, 28–30 May 2015. Amsterdam: IBFD, 2016, p. 39*).*

Therefore, in the Case under examination the Constitutional Court has to examine whether individualisation of the fine provided for in the contested provision is necessary in cases of violation of the obligation to register and violation of the obligation to present documents depending on the nature of the violation.

20. The requirement for an economic operator to register as a payer of a specific tax is formal (see *paragraph 18.1 of this Judgment*). Failure to observe this requirement does not prevent the tax authority from taking control measures and collecting the tax due.

20.1. Violation of the obligation to register may be manifested in different ways. Namely, there can be situations where this violation is due to ignorance or inadvertence, as well as situations where it is committed knowingly in bad faith and is related to tax evasion. Therefore, the fine imposed by the contested provision in the case of violation of the obligation to register addresses non-compliance situations of different severity in a similar way.

It follows that the fine for a violation of the obligation to register requires individualisation depending on the nature of the violation.

The Saeima pointed out a number of legal mechanisms that, in its opinion, ensure the individualisation of the fine imposed for violating the obligation to register. Specifically, the tax authority can provide initial consultations for the taxpayer in line with the principle 'consult first', choose a type of review for the

taxpayer that does not permit the fine set out in the contested provision, and reduce the amount of the fine if a cooperation agreement is signed with the taxpayer. Reducing the amount of the fine is also possible by amending the tax return following the procedure laid down in Section 33²(2) of the Law on Taxes and Duties.

However, these legal mechanisms constitute legal effects of legal provisions the legal essence of which is different from that of the contested provision. Namely, these mechanisms are applicable in different situations. More specifically, the principle ‘consult first’ is applicable before a tax review (audit) is commenced, whereas, when a settlement agreement is signed and the taxpayer consents to the amount of additional tax and late payment charge, the tax authority, pursuant to Section 41(6) of the Law on Taxes and Duties, grants a relief from the interest on the amount of tax, without a separate assessment of individual circumstances of the taxpayer. Pursuant to Sections 33²(1) and (2) of the Law on Taxes and Duties, the taxpayer may amend the tax return before the tax review (audit) is commenced; therefore, the fine set out in this provision is not applied as a result of a tax review (audit), in contrast to the fine set out in the contested provision. Furthermore, the fact that no fine can be issued to the taxpayer as a result of other types of tax control measures does not affect the compliance and proportionality of the fine issued as a result of a tax review (audit). The type of review in each case is determined based on the risks identified in order to ensure that the tax authority’s resources are used effectively and taxes are collected promptly (*see opinion of the State Revenue Service in vol. 2, pp. 10–11 of materials in the Case*).

It follows that the legal mechanisms pointed out by *the Saeima* cannot be deemed to ensure individualisation of the amount of fine set out in the contested provision in the case of violation of the obligation to register.

20.2. The Constitutional Court has acknowledged that a less restrictive measure is not just any other measure, but a measure that enables achieving the legitimate aim with at least similar quality (*see paragraph 14 of the Constitutional Court Judgment of 7 October 2010 in Case No 2010-01-01 and paragraph 20 of*

Judgment of 11 December 2020 in Case No 2020-26-0106). Furthermore, a less restrictive measure is not just any other measure, but a measure that enables achieving the legitimate aim with at least similar quality and does not require disproportionately large contribution from the State and the public (*e.g. see paragraph 19.3.3 of the Constitutional Court Judgment of 25 March 2021 in Case No 2020-36-01*).

The contested provision may only be applied in the case of a tax review (audit). Pursuant to Section 1(16) of the Law on Taxes and Duties, a tax review (audit) is a review performed by the tax authority during which the accuracy and conformity of calculation, payment, and transfer into the budget of one or more taxes, tax return items or duties and other statutory payments with the laws and regulations is controlled for a specific taxation period. The rationale of a tax review (audit) is not establishing a new, previously non-existent tax obligation, but rather to verify if and how the taxpayer complied with the obligation to pay taxes that is derived from the law (*see paragraph 8 of the Senate's Administrative Cases Department Judgment of 31 May 2017 in Case No SKA-116/2017*).

The tax authority performs a tax review (audit) in cases where an assessment of the taxpayer's data in the field of the risk posed to tax revenue (risk assessment) reveals a high risk of failure to comply with tax obligations (*see opinion of the State Revenue Service in vol. 2, p. 14 of materials in the Case*). This serves as a basis for calculating additional taxes, but the fine set out in the contested provision is only rarely applied. For example, in 2019, the tax authority carried out 497 tax reviews (audits), but a fine of 100 per cent was issued only in 10 per cent of the cases (*see opinion of the Ministry of Finance in vol. 2, p. 6 of materials in the Case*). Given that the fine set out in the contested provision is applied relatively rarely, it can be concluded that an individual approach to the amount of the fine for violating the obligation to register does not require excessive use of the State or public resources.

It follows that the legitimate aims of the restriction of fundamental rights imposed by the contested provision in the case of violating the obligation to register may be achieved with less restrictive measures. Hence, the restriction of

fundamental rights imposed by the contested provision does not comply with the principle of proportionality.

It follows that the contested provision, insofar as it provides for a fine of 100 percent of the amount of tax payable to the national budget, applied without an individual assessment, for a violation of the obligation to register, is not compatible with the first three sentences of Article 105 of the Constitution.

21. A violation of the obligation to present documents is a manifestation of a taxpayer's failure to observe the obligation to cooperate (*see paragraph 18.2 of this Judgment*).

According to Section 1 and Section 2(1) of the Law on Accounting, an undertaking is obliged to keep accounting. The accounting shall clearly reflect all economic transactions of the undertaking, as well as each fact or event causing changes in the state of the property of the undertaking. Accounting shall be kept in such a way that a third party which is qualified in the area of accounting could obtain a true and clear overview of the financial position of the undertaking at the date of the balance sheet, the results of the activities thereof, the cash flow for a specific time period, as well as be able to determine the beginning of each economic transaction and trace its course. Furthermore, pursuant to Sections 6, 7 and 10, an undertaking is obliged to store documents on its business activities and accounting documents. Pursuant to Section 15(1)(3) of the Law on Taxes and Duties, the taxpayer is obliged to submit the tax returns and informative statements provided for in this Law or laws on the specific taxes in the form of an electronic document to the tax authority within the time periods laid down in laws and regulations. Therefore, persons subject to the contested provision have a statutory obligation to prepare and store documents referred to in the contested provision, and this obligation must be observed irrespective of whether the tax authority has initiated a tax review (audit) and requested the documents in question.

The fine set out in the contested provision for violating the obligation to present documents is payable only in those cases where the taxpayer failed to

present the documents referred to in the contested provision within the time frame specified by the tax authority and within further 30 days following the end of the deadline. Taking into account the fact that the taxpayer is obliged to keep the documents in question irrespective of the tax authority's request, typically a violation of the obligation to present the documents is indicative of deliberate actions of the taxpayer with an intention to avoid paying taxes (*see also opinion of Ieva Liepiņa and Santa Ozola in vol. 2, p. 49 of materials in the Case*).

A possibility of an individual approach to determining the amount of the fine set out in the contested provision cannot be deemed a goal in itself. If the specific violation is characterised by sufficiently uniform circumstances, the legislature may determine the amount of fine that is unchangeable in typical situations. The legal doctrine also states that an individualised approach to penalties imposed for tax-related violations alone will not convert individuals who violate tax-related legislation deliberately and malignantly to exemplary taxpayers (*see Lederman L. Tax Penalties as Instruments of Cooperative Tax Compliance Regimes. In: Seer R., Wilms A. L. (Eds.) Surcharges and Penalties in Tax Law. 2015 EATLP Congress Milan, 28–30 May 2015. Amsterdam: IBFD, 2016, p. 39*). Therefore, no individualised approach is required to determining the amount of the fine set out in the contested provision for violating the obligation to present documents in typical instances of such violation.

It follows that in the case of a violation of the obligation to present documents, no other, more lenient, means exist which would allow to achieve the legitimate aims of the restriction of fundamental rights imposed by the contested provision with at least the same quality.

22. In verifying the compliance of fundamental rights restrictions with the principle of proportionality, it is also necessary to make sure if adverse consequences for a person that result from restrictions of their fundamental rights do not exceed the benefit of the restrictions for the society in general. Specifically, it is necessary to establish the interests to be balanced in the Case and which of

these interests have priority (e.g. see paragraph 15 of the Constitutional Court Judgment of 7 October 2010 in Case No 2010-01-01).

In the Case under examination, the Constitutional Court needs to establish a balance between the right of a taxpayer to own property and the responsibility of the State to establish a system of collecting taxes that is effective and, therefore, facilitates the protection of public welfare and democratic state structure.

22.1. The Constitutional Court has acknowledged that tax regulations that provide for liability for tax-related violations must be efficient. Its efficiency is ensured by both the inevitability of punishment and the severity of penalty (cf. paragraph 11 of the Constitutional Court Judgment of 3 April 2008 in Case No 2007-23-01). Likewise, according to the Court of Justice of the European Union, sanctions imposed for tax-related violations must be in line with the principle of effectiveness. For example, penalties imposed by Member States must be effective and dissuasive to counter infringements of harmonised VAT rules and protect the financial interests of the European Union (cf. paragraph 33 of the Court of Justice of the European Union Judgment of 2 May 2018 in Case C-574/15 *Scialdone* and paragraph 30 of Judgment of 17 January 2019 in Case C-310/16 *Dzivev*).

Therefore, to state that the adverse consequences arising for the taxpayer as a result of restriction of their fundamental rights do not outweigh the benefit gained from this restriction by the whole of society, the Constitutional Court needs to examine whether the fine provided for in the contested provision, applied in case of a violation of the obligation to present documents, is effective and dissuasive.

22.2. According to the legal doctrine, the effectiveness and dissuasiveness of a fine in the field of tax depends on the general social and economic situation, including the proportion of shadow economy and tax compliance culture (see *Lederman L. Tax Penalties as Instruments of Cooperative Tax Compliance Regimes. In: Seer R., Wilms A. L. (Eds.) Surcharges and Penalties in Tax Law. 2015 EATLP Congress Milan, 28–30 May 2015. Amsterdam: IBFD, 2016, pp. 40–41*). A number of the joined parties expressed a similar opinion, stressing that no significant reduction of the fine set out in the contested provision is currently

possible because of the above circumstances (*see opinion of the Ministry of Finance in vol. 2, p. 6 and opinion of Kārlis Ketners in vol. 2, p. 22 of materials in the Case*).

22.2.1. The tax compliance culture in Latvia is connected with the consequences of the USSR occupation.

Following the restoration of its independence, Latvia saw not only a transformation of the political and legal system, but also transition from a planned economy to a market economy. Furthermore, a reform of the tax system was also required at the same time.

On 28 December 1990, the Supreme Council adopted the Law on Taxes and Duties in the Republic of Latvia that established, *inter alia*, the types, objects and payers of taxes, as well as principles to underlie specific tax laws. On the same day, the Supreme Council adopted the Decision on the procedure of the coming into force of the Law on Taxes and Duties in the Republic of Latvia, pursuant to paragraph 5 of which USSR legislation in the field of taxes and duties became invalid in the Republic of Latvia at the moment of coming into force of the above Law.

However, changes in the regulatory framework alone were not sufficient, as a change of paradigms in the legal culture of Latvia was also required, i.e. the concepts of law, the sources of law, legislative innovation and application methods, as well as common fundamental values and view that exist in a social reality and change with the time (*see Hoecke Van M., Warrington M. Legal Cultures, Legal Paradigms and Legal Doctrine: Towards a New Model for Comparative Law. The International and Comparative Law Quarterly, 1998, Vol. 47, No. 3, pp. 495–536*). For example, the concept of a compulsory force of tax compliance in the legal consciousness of individuals was incomplete, because the taxpayer's obligation to cooperate in the modern sense did not exist during the USSR occupation (*cf. Torgler B. Tax Morale, Eastern Europe and European Enlargement. Available at openknowledge.worldbank.org; Martinez-Vazquez J., McNab R. M. Tax Systems in Transition Economies. In: Hildreth W. B., Richardson J. A. (Eds.) Handbook on Taxation. New York: Dekker, 1999, p. 911*).

However, changes in the legal culture, including the concept of the individual's constitutional obligation to pay taxes, do not happen quickly.

In 1995, a new reform of the Latvian tax system took place, which was aimed, firstly, at ensuring consistent budget revenues and, secondly, at encouraging economic growth (*see Annex 1 'Development of the tax and duties system' to Guidelines for the development of the tax and duties system of 3 June 2003. Available at polsis.mk.gov.lv*). However, shortly after this reform the Latvian tax system was found to be characterised, *inter alia*, by a complicated and ambiguous mechanism of calculating and payment of taxes, weak and expensive system of tax administration and frequent amendments to tax laws (*see Zelgalvis E. Latvijas Republikas nodokļu sistēma (The Tax System in the Republic of Latvia). Latvijas Vēstnesis, 2 July 1997, No 169*). There were also significant problems in tax administration. The tax administration did not have sufficient supporting systems for efficient tax control measures, because the number of taxpayers increased significantly along with the transition to market economy. On top of that, the enforcement process was not based on legal methods applicable in a democratic rule-of-law state, but rather occurred in a formal manner characteristic of the socialist school of law (*cf. Torgler B. Tax Morale, Eastern Europe and European Enlargement. Available at openknowledge.worldbank.org; see also Levits E. Latvijas tiesiskā iekārta transformācijas procesā (The legal system of Latvia in transition). Likums un Tiesības, 1999, No 1, pp. 6–12*).

The low quality of legal regulation in the field of taxation along with formal and mechanistic enforcement reduced the taxpayers' trust in the State and law, including trust to the tax authority. As a consequence of these historic circumstances, Latvia still has a low level of voluntary tax compliance.

22.2.2. The latest studies suggest that the shadow economy index in Latvia in recent years varied between 22 and 24 per cent of the gross domestic product (*see Ēnu ekonomikas indekss Baltijas valstīs 2009–2019 gadā (The shadow economy index in the Baltic states in 2009 – 2019). Available at www.sseriga.edu*). Public opinion polls also suggest that the number of respondents who consider it necessary to pay all taxes essentially corresponds to the number of respondents

who admit that taxes may be paid only partially (*see Sabiedriskās domas pētījums par finanšu un nodokļu politiku. Latvijas iedzīvotāju aptauja (Public opinion poll on financial and tax policy. A survey of Latvian residents). December 2017. Available at petijumi.mk.gov.lv*). Therefore, the level of shadow economy in Latvia is still high, while the understanding of the individual's constitutional obligation to pay taxes is still insufficient.

The involvement of businesses in shadow economy depends on their perception of the likelihood of legal liability in the case of failure to pay taxes and severity of the consequences of this violation (*see Ēnu ekonomikas indekss Baltijas valstīs 2009–2019 gadā (The shadow economy index in the Baltic states in 2009 – 2019). Available at www.sseriga.edu*). Namely, the lower the likelihood of legal liability and the lower the amount of the fine, the higher number of taxpayers will consider participating in shadow economy (*see Schneider F. The Shadow Economy in Europe: Using Payment Systems to Combat the Shadow Economy. Available at www.feelingeurope.eu*).

Taking into account the above considerations and the culture of tax compliance in Latvia, a fine of 100 per cent of the tax payable to the budget applicable in accordance with the contested provision without an individual assessment for violating the obligation to present documents while failing to cooperate with the tax authority is deemed effective and dissuasive. Therefore, as far as a violation of the obligation to present documents is concerned, the adverse consequences arising for the taxpayer from the restriction of fundamental rights imposed by the contested provision do not outweigh the benefit gained from the said restriction by society as a whole. It means that, in respect of a violation of the obligation to present documents, the restriction of fundamental rights imposed by the contested provision complies with the principle of proportionality.

It follows that the contested provision, insofar as it provides for a fine of 100 percent of the amount of tax payable to the national budget, applied without an individual assessment for a violation of the obligation to present documents, is compatible with the first three sentences of Article 105 of the Constitution.

23. Pursuant to Section 32(3) of the Constitutional Court Law, a legal provision declared by the Constitutional Court non-compliant with a legal provision of superior legal force is to be deemed void as of the date of publication of the Constitutional Court Judgment, unless the Constitutional Court provides otherwise. Pursuant to Section 31(11) of the Constitutional Court Law, the Constitutional Court may specify in its judgment the moment when a contested provision declared non-compliant with a legal provision of superior legal force becomes void.

23.1. The Constitutional Court has concluded the following: in deciding on the moment when the contested provision becomes void, in a case initiated following a constitutional challenge it is necessary to take into account that the task of the Court is to remedy, to the extent possible, the infringement of the individual's fundamental rights. Furthermore, the Court must ensure that the situation that may occur following the contested provision becoming void does not give rise to new infringements of fundamental rights enshrined in the Constitution and does not cause significant damage to the interests of the State or the public (*e.g. see paragraph 25 of the Constitutional Court Judgment of 17 December 2020 in Case No 2020-18-01*).

The Applicant requests that the contested provision be declared void from the moment of infringement of the Applicant's rights, insofar as this provision imposes a fine of 100 per cent of the tax payable to the national budget. The moment of infringement can be identified as 14 November 2011, when the contested provision was imposed on the Applicant for a violation of the obligation to register. In order to mitigate as far as possible the adverse consequences arising for the Applicant from imposing the contested provision, in respect of the Applicant, the contested provision is deemed void, insofar as it sets out a fine of 100 per cent of the tax payable to the budget without individual assessment for economic operations carried out by a person registered as an economic operator but not registered as a payer of the particular tax, from the moment of infringement of the fundamental rights.

23.2. In establishing the specific moment when the contested provision becomes void, the Constitutional Court also assessed if there were any considerations that would require declaring the contested provision void with retroactive effect also for persons other than the Applicant (*e.g. see paragraph 20.2 of the Constitutional Court of 6 June 2018 in Case No 2017-21-01*).

The Constitutional Court has acknowledged that tax-related law is an important area of operation of the State, wherefore it is necessary to prevent a situation where declaring a contested provision void would require subsequent revision of a large proportion of the tax authority's decisions that came into effect and where the provision may have been applied (*see paragraph 22 of the Constitutional Court Judgment of 15 April 2013 in Case No 2012-18-01*). It is possible, however, that the contested provision needs to be applied in on-going administrative proceedings concerning a violation of the obligation to register that is in progress in an authority or at a court, wherefore other taxpayers' fundamental rights enshrined in the first three sentences of Article 105 of the Constitution may also be infringed. Protecting fundamental rights of these taxpayers requires that the contested provision in respect of taxpayers who have initiated and continue the process of protecting their fundamental rights using general legal remedies in the case of a violation of the obligation to register be declared void from the moment of infringement of fundamental rights of these taxpayers. The amount of the fine imposed for a violation of the obligation to register is to be individualised by the authority or the court depending on the circumstances in which the respective violation was committed, for which purpose the first three sentences of Article 105 of the Constitution, the principle of proportionality, and the findings contained in this Judgment are to be applied directly. In respect of other taxpayers, the contested provision is void as of the date when this Judgment is published.

23.3. The Constitutional Court Law does not only grant powers to the Constitutional Court, but also makes it responsible for ensuring that its judgments secure legal stability, clarity and peace in a social reality (*e.g. see paragraph 31 of the Constitutional Court Judgment of 22 June 2010 in Case No 2009-111-01*).

The Constitutional Court states the following: considering the will of the legislature manifested in the contested provision and current social and economic circumstances in Latvia, a situation where taxpayers face no fine at all for violating the obligation to register contradicts the interests of the public. For that reason, until such time when the legislature, recognising the necessity of a fine for violating the obligation to register, adopts a solution that ensures compliance of the fine for violating the obligation to register with the principle of proportionality, the amount of the fine is to be individualised depending on the circumstances in which the respective violation was committed, for which purpose the first three sentences of Article 105 of the Constitution, the principle of proportionality, and the findings contained in this Judgment are to be applied directly.

Substantive Part

Pursuant to Sections 30–32 of the Constitutional Court Law, the Constitutional Court

held:

1. To declare Section 34(1) of the Law on Taxes and Duties, insofar as it, without an individual assessment, imposes a fine in the amount of 100 per cent of the tax payable to the budget for engaging in economic activity after registering as an economic operator but without registering as a payer of a particular tax, incompatible with the first three sentences of Article 105 of the Constitution of the Republic of Latvia.

2. In respect of Jānis Pīlāts and those taxpayers who have initiated and continue the process of protecting their fundamental rights using general legal remedies, to declare Section 34(1) of the Law on Taxes and Duties, insofar as it, without an individual assessment, imposes a fine in the amount of 100 per cent of the tax payable to the budget for engaging in economic activity after registering as an economic operator but without registering as a payer of a

particular tax, incompatible with the first three sentences of Article 105 of the Constitution of the Republic of Latvia and void from the moment of infringement of their fundamental rights.

3. To declare Section 34(1) of the Law on Taxes and Duties, insofar as it, without an individual assessment, imposes a fine in the amount of 100 per cent of the tax payable to the budget for failure to submit, within 30 days after the deadline set by the tax authority, tax returns specified in tax laws, as well as the business and accounting records requested by the tax authority, without which the tax administration officers (employees) are unable to determine the amount of tax liability, compatible with the first three sentences of Article 105 of the Constitution of the Republic of Latvia.

The judgment is final and not subject to appeal.

The judgment enters into force on the day of its publication.

Chairperson of the court hearing

Sanita Osipova