



# CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

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## JUDGEMENT

on Behalf of the Republic of Latvia

in Riga, on 11 April 2018

in Case No. 2017-12-01

The Constitutional Court of the Republic of Latvia comprised of: chairperson of the court hearing Ineta Ziemele, Justices Sanita Osipova, Aldis Laviņš, Gunārs Kusiņš, Daiga Rezevska, and Artūrs Kučs,

having regard to an application by the Supreme Court,

on the basis of Article 85 of the *Satversme* of the Republic of Latvia and Para 1 of Section 16, Para 9 of Section 17 (1), as well as Section 19<sup>1</sup> and Section 28<sup>1</sup> of the Constitutional Court Law,

at the court hearing of 14 March 2018, examined in written procedure the case

**“On compliance of Part 12<sup>3</sup> and Part 12<sup>5</sup> of Section 12 of the Law “On Value Added Tax” (in the wording that was in force from 1 January 2010 until 31 December 2012), insofar as they restrict the right to have tax over-payment refunded within a reasonable term, with the first, second and third sentence of Article 105 of the *Satversme* of the Republic of Latvia”.**

### The Facts

1. Prior to 1 January 2013, when the Value Added Tax Law entered into force, the object, the circle of taxpayers, the procedure for calculating and paying the value added tax (hereinafter – VAT), as well as other VAT related matters,

including handling a taxpayer's over-paid amount of VAT (hereinafter – the over-paid VAT) was regulated by the law “On Value Added Tax”.

**1.1.** Until 31 December 2009, the handling of a taxpayer's over-paid VAT was regulated in Part 10 to 12 of Section 12 of the law “On Value Added Tax Law”. Pursuant to the aforementioned norms, the State Revenue Service (hereinafter – SRS) had a general obligation to refund the over-paid amount of VAT to the taxpayer within 30 days following the receipt of a substantiated request and documents ascertaining the transactions. SRS could channel the over-paid amount of VAT for covering the taxpayer's other payments, specified by the State, only if the taxpayer requested it. However, in the presence of pre-requisites set in the law, SRS could refuse refunding of the over-paid VAT. Firstly, if the taxpayer had debts of the State specified payments then SRS had to use the over-paid VAT of the taxpayer to cover these debts. Secondly, if within the taxation period the taxpayer requested a refund of the over-paid VAT but the value of transactions, to which 0 per cent rate was applicable did not exceed 50 per cent of the total value of taxable transactions SRS had to hold the over-paid VAT until the end of the taxation year. Thirdly, SRS could refuse to refund the over-paid VAT if it was requested by a taxpayer, who had been registered on the register of persons to which VAT applied but had been excluded from it and later registered repeatedly if six months had not passed from the moment of repeated registration.

**1.2.** With the law of 1 December 2009 “Amendments to the law “On Value Added Tax”, which entered into force on 1 January 2010, *inter alia*, Parts 10 to 12 of Section 12 of the law “On Value Added Tax” were deleted from the law, at the same time adding Parts 12<sup>2</sup> to 12<sup>1</sup> to this Section.

Parts 12<sup>2</sup> to 12<sup>11</sup> of Section 12 of the law “On Value Added Tax” established a new procedure, in which the over-paid VAT that had occurred in the current taxation period was transferred to the subsequent taxation periods for covering the taxpayer's tax, duty and other State specified payment debts and the current tax payments or was refunded to the taxpayer.

Section 12 (12<sup>3</sup>) of the law “On Value Added Tax”(here and hereafter – in the wording that was in force from 1 January 2010 to 31 December 2012) provides:

“The State Revenue Service, upon carrying out tax administration measures, shall, within 30 days following the receipt of the tax declaration for the taxation period, transfer the approved over-paid amount of tax to the subsequent taxation

period until the end of the taxation year, covering the amount of tax payable into the State budget in subsequent taxation periods.”

Whereas Part 12<sup>5</sup> of the aforementioned Section sets out:

“If a taxable person, after direction of the over-paid amount of tax referred to in Paragraph 12<sup>4</sup> of this Section, still has an over-paid amount of tax, it shall be transferred to the subsequent taxation periods in accordance with that specified in Paragraph 12<sup>3</sup> of this Section.”

**2. The applicant – the Supreme Court** (hereinafter – the Applicant), in its decision of 28 March 2017 in Case No. SKA-65/2017 to submit an application to the Constitutional Court and to suspend legal proceedings in this administrative case until the ruling by the Constitutional Court enters into force, expresses the opinion that Part 12<sup>3</sup> and Part 12<sup>5</sup> of Section 12 of the law “On Value Added Tax” (hereinafter jointly – the contested norms), insofar they restrict the right to refund of the over-paid VAT within a reasonable term, are incompatible with the first three sentences of Article 105 of the *Satversme* of the Republic of Latvia (hereinafter – the *Satversme*).

In the administrative case referred to above, a taxpayer requests recognising as unlawful the decision by the Director General of SRS, by which, on the basis of the contested norms, the refund of the taxpayer’s over-paid VAT has been transferred to the subsequent taxation period until the end of the taxation year.

The Applicant notes that, pursuant to Parts 12<sup>3</sup> to 12<sup>7</sup> of Section 12 of the law “On Value Added Tax”, a taxpayer’s over-paid VAT, within the current taxation period, is first of all used to cover his tax, duty and other State specified payment debts, as well as to cover the current tax payments. The remaining sum is carried over to the subsequent taxation periods until the very end of the taxation year. The over-paid VAT is refunded to the taxpayer only at the end of the taxation year after SRS has approved the over-paid VAT for the taxation year. It can be refunded within the period of 30 days following the current taxation period only if any of the exceptional circumstances referred to in Section 12 (12<sup>7</sup>) have set in.

In general, a taxpayer, allegedly, does not have the right to receive the over-paid VAT after the current taxation period, unless this taxation period happens to be at the end of the taxation year. Thus, if in the subsequent taxation period the taxpayer does not have to make such payments into the State budget, to cover which

the over-paid VAT that has been transferred from the previous taxation period would be needed, or if it is much larger than these payments then the State can keep at its disposal for a prolonged period of time the free resources of a taxpayer, which are not used for paying taxes and which the taxpayer could use for business activities. With respect to the applicant in the administrative case, this situation could last even up to 10 months.

It is alleged that the contested norms restrict a taxpayer's right to property, enshrined in Article 105 of the *Satversme* since they prohibit him from recovering the over-paid VAT immediately. This restriction has been established by law and has a legitimate aim – protection of public welfare, by reducing the risk of non-payment of taxes and ensuring effective tax collection. However, this restriction is said to be disproportional since the benefit that society gains from it does not outweigh the damage inflicted on the taxpayer.

The contested norms had been adopted in compliance with Article 183 of the the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter – Directive 2006/112/EC), which envisages the right of the Member States of the European Union (hereinafter – the Member States) to carry over, in accordance with regulations adopted by them, to the subsequent taxation period or to refund to the taxpayer the over-paid VAT, which has occurred in the current taxation period. The Court of Justice of the European Union (hereinafter also – CJEU) also has recognised that the regulation adopted in accordance with Article 183 of the Directive 2006/112/EC must comply with the principle of tax neutrality. Pursuant to this principle, the taxpayer should not assume a tax burden (become subject to financial risk) as the result of applying the regulation adopted by the Member State. This is said to mean that the taxpayer should recover the over-paid VAT within a reasonable term, irrespective of whether it is transferred to one or several taxation periods. The refunding of the over-paid amount within a term that could not be deemed as being reasonable is admissible only if the economic burden that the taxpayer incurs is compensated for by an interest payment, thus abiding by the principle of tax neutrality.

The Applicant holds: if it was recognised that the national legal regulation is incompatible with the requirements derived from the principle of tax neutrality then it should be recognised as being incompatible also with the principle of proportionality since such economic burden would be created for the taxpayer, the negative impact of which would significantly outweigh the benefit that the society

gains from full or partial payment of his debts. CJEU has recognised the term of three months as a reasonable term for VAT refund. Whereas the transfer of the over-paid amount to several taxation periods, as the result of which the over-paid amount is not refunded within a period up to one year, has been recognised by CJEU as being incompatible with the principle of tax neutrality. In accordance with the contested norms, in a case, where the taxpayer's – thus, the applicant's in the administrative case – taxation period is three months, the taxpayer can be made to assume the tax burden for a period lasting even for 10 months. If the taxation period is one month then a situation is possible that the burden must be assumed for even a longer period. Refunding of the over-paid amount after 10 months from the moment it occurred, in view of the CJEU's findings, should be considered as being incompatible with the principle of tax neutrality. However, the Latvian regulatory enactments do not envisage compensating for the economic burden caused to the taxpayer by interest payment.

The public benefit from covering an individual's possible tax payments or tax debts in the amount of over-paid VAT is said to be relatively small, in particular, because the over-paid VAT, which reached the amount of 8000 Lats, had to be refunded immediately after the current taxation period. Moreover, the failure to refund the over-paid amount within a reasonable term prohibits the taxpayer from using his financial assets and could have a negative impact on his ability to engage in business activity. Depending on the scale of the business activity, this burden may be unbearable.

**3. The institution, which issued the contested act, – the *Saeima* – holds that the contested norms comply with the first three sentences of Article 105 of the *Satversme*.**

The contested norms have become void before the hearing of the case, therefore can be applied only in those administrative proceedings, which had been initiated at the time when these norms were in force and have not been completed yet. Hence, in assessing the constitutionality of the contested norms, only the circumstances of the particular administrative proceedings and the possible infringement on the fundamental rights of the applicant in the administrative case rather than the general impact of these norms should be reviewed.

Allegedly, the dispute in the case pertains only to the matter, whether the restriction on fundamental rights established in the contested norms is proportional,

i.e., whether the public benefit from the restriction outweighs the damage inflicted on some individuals. CJEU has not defined a particular term for refunding the over-paid VAT that should be recognised as being proportional. The Applicant has referred to a number of judgements by CJEU, in which the legal regulation of Member States, envisaging taxation periods from one month to one year and the possibility to transfer the over-paid VAT to a number of taxation periods, had been examined. In these judgements, CJEU had recognised as significant exactly the condition that the over-paid VAT was carried over to a number of subsequent taxation periods, irrespectively of the length thereof. In difference to the legal regulation of the Member States referred to above, the contested norms, allegedly, set a restriction on the term for carrying over the over-paid VAT – until the end of the taxation year. Hence, the contested norms do not allow, in the case of a taxation period of six months or a year, that the over-paid VAT would be transferred to a number of taxation periods and that the taxpayer would have to wait for the refund for more than a year. Whereas the European Court of Human Rights had established a violation of the right to property in the case, where the over-paid VAT was not refunded for several years, without disbursing to the taxpayer any compensation for it.

The contested norms had been adopted during the period of economic recession when effective tax collection and combatting non-payment of taxes or fraud had been particularly important, and they comply with the opinion provided by the experts of the International Monetary Fund in 2009 regarding Latvia's system of tax collection. Likewise, CJEU had also established that both carrying over of the over-paid VAT and refunding are forms of recompense, which Article 183 of the Directive 006/112/EC does not prohibit from applying simultaneously.

Allegedly, the law “On Value Added Tax” comprises a number of measures for protecting a taxpayer's rights and interests. Firstly, the over-paid VAT, which has occurred within the current taxation period, is swiftly and effectively channelled for covering those payments that the taxpayer would have to cover soon from his assets. Secondly, the over-paid VAT can be transferred to the subsequent taxation period only within the framework of the taxation year. Hence, the time, within which the over-paid VAT is refunded, is said to depend on the taxation period, in which the over-paid VAT has occurred. If it has occurred in the first taxation period of the year then it could be paid into the taxpayer's account within approximately 10 months, however, if it had occurred in the last taxation period – within 30 days.

Moreover, Section 12 (12<sup>7</sup>) of the law “On Value Added Tax” envisages conditions, in the presence of which the over-paid VAT has to be refunded to the taxpayer immediately after the taxation period. In accordance with the explanation provided by the Ministry of Finance, these are the cases, where the occurrence of over-paid VAT can be expected and is economically substantiated. This norm defines the maximum amount of the over-paid VAT to be carried over, i.e., the over-paid VAT, which exceeded the amount of 8000 Lats, had to be refunded to the taxpayer after SRS had received a tax declaration for the particular taxation period.

Hence, the *Saeima* holds that the restriction on fundamental rights established in the contested norms is proportional and ensures to a taxpayer the possibility to recover the over-paid VAT appropriately and fully, without causing a financial risk to him.

**4. The summoned person – the Ministry of Justice** – notes that, pursuant to CJEU’s judgements, the principle of tax neutrality does not demand immediate refunding of the over-paid VAT and that the proportionality of the term of refunding had been assessed on a case-by-case basis, taking into account the circumstances of the particular case. CJEU’s considerations regarding compliance with the principle of tax neutrality cannot be unambiguously applied to any other hypothetically possible procedure for refunding the over-paid VAT, which follows from the national regulatory enactments, including the contested norms. Allegedly, CJEU’s judgements do not indicate either particular considerations regarding a reasonable term of refunding in such circumstances that would be identical to the circumstances of the case under review nor the term that should be considered as being proportional in the meaning of Article 183 of the Directive 2006/112/EC. However, the conclusion follows from the judgements by CJEU that the carrying over of the over-paid VAT to several taxation periods lasting three months, in general, could be compatible with Article 183 of the Directive 2006/112/EC if it does not cause a financial risk for the taxpayer. Hence, the contested norms are said to comply with Article 183 of the Directive 2006/112/EC.

The Ministry of Justice, allegedly, is unable to assess the economic impact of the contested norms and to express an opinion on whether the contested norms have created to the particular or any other private persons a financial risk that is not commensurate with the public interests. However, the Ministry of Justice holds that

Section 12 (12<sup>7</sup>) of the law “On Value Added Tax” could be aimed at ensuring the principle of tax neutrality by reducing or fully preventing a financial risk.

**5. The summoned person – the Ministry of Finance** – underscores that the contested norms had been adopted in accordance with the European Union law and the findings provided by the experts of the International Monetary Fund in conditions of economic crises, when protection of the State budget against non-payment of taxes and tax fraud had been of particular importance.

The procedure established by the contested norms, allegedly, allows SRS to verify systemically the validity of the over-payment indicated in the VAT declarations to protect the interests of the State budget. SRS is able to establish, whether VAT payments have been made correctly, at the end of the taxation year, upon receiving the last VAT declaration and the annual declaration, if the taxpayer has to submit it. The transferring of the over-paid VAT is said to be in the interests of the taxpayer himself since it is used to cover his tax debts and debts of other State specified payments, if he has accrued such debt. Moreover, special cases have been defined, when the over-paid VAT has to be refunded immediately after the taxation period ends. Moreover, the contested norms do not create a disproportional burden for the taxpayer, and, at the same time, the protection of the State budget interests is ensured.

The Member States are said to have a certain autonomy in developing the rules on refunding the over-paid VAT – on the condition that the refunding is done within a reasonable term, without causing a financial risk for the taxpayer. Since SRS assesses the validity of the occurrence of the over-paid VAT not only after the taxation period but also after the end of the taxation year, the benefit that the society gains is said to be commensurate with the restriction on a taxpayer’s right to property.

On the basis of economic considerations, instances when the over-paid VAT has to be refunded after the respective taxation period are defined in the law “On Value Added Tax”, including the cases, where it exceeded a certain amount. The fact that this amount had been decreased over the years proves that SRS has reinforced its capacity and improved its system of risk analysis. Hence, the contested norms are said to reach the legitimate aim, whereas the taxpayer’s rights are restricted to a lesser degree.

Allegedly, the contested norms ensure to the taxpayer the possibility to regain duly and in full the amount of over-paid VAT within a reasonable term and do not cause a financial risk to him. Hence, they are said to comply with the first three sentences of Article 105 of the *Satversme*.

**6. The summoned person – the Ombudsman** – holds that the application of the contested norms can result in a number of different situations. A situation, where the over-paid VAT is transferred for a period up to three months, is said to comply with Article 183 of Directive 2006/112/EC and the principle of tax neutrality enshrined in CJEU's judgements. In a situation like this, the restriction on a taxpayer's right to property is said to be proportional. However, in the hypothetical situations referred to in the application, proportionality, most probably, would not be ensured. It follows from CJEU's judgments that the fact whether the principle of tax neutrality has been complied with and whether the restriction on the right to property is proportional must be assessed individually on the case-by-case basis. In general, taking into account the considerations presented in the application and the situation described, the system for transferring the over-paid VAT, established by the contested norms, could be recognised as being incompatible with the first three sentences of Article 105 of the *Satversme*.

**7. The summoned person – the Latvian Tax Consultant Association** – upholds the Applicant's arguments; however, it underscores: although both the Applicant and the *Saeima* indicate prevention of the risk of non-payment of taxes and duties and effective collection thereof as the legitimate aim of the restriction on fundamental right established in the contested norms, in accordance with the contested norms, the over-paid VAT is held also in the case if the taxpayer has no tax debts or debts of other State specified payments.

Pursuant to the contested norms, only such over-paid VAT that does not exceed 8000 Lats is to be held. *Prima facie*, this regulation might indicate that the risk of non-payment of taxes is decreasing, with the increase of the amount of the over-paid VAT; however, actually, it is the opposite. Therefore the aim of holding the over-paid VAT is said to be decreasing the administrative burden of SRS and artificial improvement of the VAT collection indicators rather than decreasing the risk of non-payment of taxes. Allegedly, the contested norms do not reach their legitimate aim and therefore the infringement on a taxpayer's rights is not

commensurate with the benefit gained by the society. The proportionality of the restriction on fundamental rights established in the contested norms should be assessed relatively rather than absolutely since, for one company, 8000 Lats could be an impressive amount, whereas for another – an insignificant amount.

The retained over-paid VAT is said to be a guarantee that the current tax and duty payments expected in the future will be made. A taxpayer, who has no over-paid VAT, does not provide such a guarantee. Therefore a taxpayer, who has incurred over-paid VAT, should be given compensation for the holding thereof in the form of interest payment. The economic burden linked to the freezing of the over-paid VAT can significantly differ in various stages of business activities. The over-paid VAT should be held only within the framework of the taxation period, whereas in the case when it is transferred for a period that exceeds one taxation period compensation should be disbursed in the form of interest payment. By providing a guarantee and not receiving compensation for it, a taxpayer assumes a financial burden in the amount of this guarantee; however, allegedly, this is incompatible with the principle of tax neutrality and Article 183 of Directive 2006/112/EC, which allows transferring the over-paid tax only for one taxation period rather than several taxation periods, which might exceed even 12 months.

**8. The summoned person – the lecturer at the Department of Finance and Accounting of the Faculty of Business, Management and Economics, the University of Latvia *Mg. oec. Līga Leitāne*** – holds that the contested norms do not comply with the principle of tax neutrality and that the restriction on fundamental rights created by them is not proportional. The actual situation reflected in the application is said to be incompatible with Article 183 of Directive 2006/112/EC since a financial risk is caused for the taxpayer, which is not compensated for in any way, and the time period for which the over-paid VAT is held exceeds the length of the taxation period.

Pursuant to the contested norms, the over-paid VAT is refunded later than the reasonable time for the settlement of accounts applicable in economic relationships. From the point of view of economics, the over-paid VAT is a debtor's debt but, in practice, the period of three months for the settlement of accounts is applied to a debtor's debts. Moreover, in the case of retaining the over-paid VAT, interest is not paid for the use of this resource. The contested norms are said to create an unequal

relationships between the State and the taxpayer because the taxpayer's property – asset – cannot be used in business activity and the taxpayer does not receive compensation for it, whereas the State can use this asset to perform its functions and not pay for the use of capital, referring to the tax payments expected in the future. The longer the over-paid VAT is held without paying compensation, the more prolonged and difficult is the economic burden caused for the taxpayer.

**9. The summoned person – the sworn advocate Sandija Novicka** – holds that the actual situation reflected in the application is contrary to the first part of Article 183 of Directive 2006/112/EC and the principle of tax neutrality.

Allegedly, a conclusion follows from CJEU's findings that a year-long or a longer term of refunding cannot be considered as being reasonable and does not comply with the principle of tax neutrality. Likewise, a term of 10 months cannot be deemed to be reasonable. It is a sufficiently long period of time, in which the financial assets, taken out of circulation, could cause a notable impact on the taxpayer's cash flow and hinder his business activities. Moreover, this term is more than three times longer than the three months, which have been recognised by CJEU as a reasonable term, which falls with the Member States' autonomy, in defining the procedure for refunding the over-paid VAT. Since the procedure established in the contested norms is applicable only to an over-paid VAT in the amount of 8000 Lats the contested norms, allegedly, are not suitable for preventing non-payment of taxes. Whereas the need to take administrative actions for correct collection of the tax or prevention of VAT fraud cannot justify this term.

Pursuant to the contested norms, the refunding of an overpaid VAT in the amount less than 8000 Lats can be postponed even up to 14 months, without paying late payment interest to the taxpayer. Thus, the taxpayer is made to assume VAT burden contrary to the principle of tax neutrality. For persons engaged in business activities and economic operations with small turnover or restricted cash flow, inaccessibility of this amount of money may hinder the settling of accounts with suppliers or employees. The second part of Article 183 of Directive 2006/112/EC allows the Member States to not refund or transfer the over-paid VAT, if the over-paid amount is insignificant. However, in the meaning of this norm, only such over-paid VAT can be deemed insignificant, for the processing and refunding of which the resources used by the State would be more valuable than the sum to be refunded. A taxpayer should be ensured the right to be refunded the over-paid VAT no later

than within three months. Otherwise, appropriate late payment interest should be paid. The term of refunding that follows from the contested norm is said to be incommensurate with the financial risk caused for the taxpayer.

**10. The summoned person – the professor of the Civil Law Department of the Faculty of Law, the University of Latvia, *Dr. iur. Kaspars Balodis*** – notes that Article 183 of Directive 2006/112/EC defines the general right of the Member States to choose, whether to refund the over-paid VAT or to transfer it to the subsequent period, as well as to set out that such actions should not be taken if the over-paid sum is insignificant. Directive 2006/112/EC, allegedly, defines neither the amount of over-paid VAT that should be deemed insignificant nor the term, within which the over-paid VAT should be refunded or should be recognised as being reasonable. Hence, no substantiation for the view that the contested norms are incompatible with Article 183 of Directive 2006/112/EC can be discerned. The principle of tax neutrality does not reveal the content of the concept “reasonable term”. The judgements by CJEU, referred to by the Applicant, confirm that the reasonability of the term has been assessed in relation to the factual and legal circumstances of the particular case.

Both the Constitutional Court and CJEU have recognised that the aim of the recovery of undue payments is to neutralise the financial burden and risk for a taxpayer who is not the final recipient of goods or services. Moreover, the Constitutional Court has recognised the State’s noteworthy discretion in the field of taxes. However, the discretion in regulating the procedure and the terms for refunding the over-paid tax is said to be narrower compared to the instance, where the legislator establishes the obligation to pay a tax. The legislator should take particular care in assessing the proportionality because the State, by keeping the over-paid VAT for a certain period, benefits from the taxpayer’s property – his financial resources.

The contested norms allow a situation, where the taxpayer’s financial resources remain at the State’s disposal for a long period and he is made to assume an economic burden, which is not commensurate to the public benefit, for a disproportionately long period of time – exceeding 10 months. This could leave a negative impact on the taxpayer’s business activities, *inter alia*, jeopardise the normal course of it. Moreover, a financial burden of this kind also could cause losses to many taxpayers. In assessing the proportionality, the fact that the amount of over-

paid VAT does not exceed 8000 Lats is said to be of no significance. Even financial resources, the amount of which is significantly smaller than the aforementioned sum, could be significant in the taxpayer's business activities. Hence, the restriction on fundamental rights established in the contested norms is said to be disproportional and incompatible with Article 105 of the *Satversme*.

**11. The summoned person – the visiting associate professor of the Department of International and European Union Law of the Faculty of Law, the University of Latvia, Dr. iur. Christoph Johann Ulrich Schewe** – provided his opinion on the incompatibility of the contested norms with the European Union law.

Chr. Schewe notes that neither Directive 2006/112/EC nor judgements of CJEU comprise a clear definition of the principle of tax neutrality. However, CJEU has recognised that, pursuant to Article 183 of Directive 2006/112/EC, the Member States enjoy certain discretion in defining the procedure for refunding the over-paid VAT, also, it has examined, what kind of term for refunding the over-paid VAT should be deemed reasonable. In some cases, CJEU had recognised a term as being unreasonable. In the particular cases, taking into account the facts thereof, CJEU has recognised that the term of 180 days is unreasonable and that the term of eight months is considerable. Both CJEU and some Advocates General have noted that the system of transferring the over-paid VAT cannot be used to replenish the State budget at the taxpayers' expense. The Latvian legal acts should reflect these considerations, insofar the period of refunding complies with the restrictions that follow from CJEU's judgements. Moreover, granting of compensation to the taxpayer for the losses inflicted could be envisaged in the regulatory enactments.

Depending on the area of activities, Latvian companies compete with other Latvian and foreign companies within the internal market of the European Union. Therefore they have to plan their operations and costs meticulously. Moreover, the interest rates in the commercial law circulation in Latvia are higher than, for example, in Germany, and, thus, the Latvian companies are in more adverse conditions of competition. One could uphold the view that the contested norms have a legitimate aim – ensuring the public welfare, which, from the point of view of the Latvian constitutional law, could justify the restriction on fundamental rights following from them. However, the answer to the question, whether this utterly general, abstract aim that should be interpreted narrowly could be used as

justification in accordance with the European Union law, is not necessary if the outcome of the application of the contested norms exceeds the level required for reaching the aforementioned aim.

### **The Findings**

**12.** The Applicant requests recognising the contested norms, insofar they restrict the right to have the over-paid VAT refunded within a reasonable term, as being incompatible with the first, the second and the third sentence of Article 105 of the *Satversme*.

The Applicant holds that the damage, which manifests itself in the form of a financial burden and is caused to a taxpayer by the transfer of the over-paid VAT, defined in the contested norms, outweighs the benefit that the society gains from savings of state resources as the result of this transfer. Hence, the restriction on a taxpayer's fundamental rights established in the contested norms is said to be disproportional.

The Applicant contests the constitutionality of two norms. The two contested norms, in their interconnection, establish the procedure, in which the part of over-paid VAT, which has not been used to cover the taxpayer's debts of State specified payments and his current VAT payments, is transferred to the subsequent taxation periods within the framework of the particular taxation year. Since the contested norms are interconnected, the Constitutional Court will examine them as united regulation, which envisages transferring the over-paid VAT that has not been used for covering the State specified payments for all the subsequent taxation periods until the end of the taxation year.

**13.** Article 105 of the *Satversme* envisages a guarantee for comprehensive right of economic nature. The first three sentences of Article 105 of the *Satversme* comprises all rights of economic nature, which a person may exercise without interference for his own benefits and handle as one wishes to, and also define the owner's social duty vis-à-vis society – to not use the property contrary to the public interests, and also envisage that the right to property may be restricted (*compare, see Judgement of 15 November 2016 by the Constitutional Court in Case No. 2015-25-01, Para 10 and Para 10.2.*). The right to property defined in the first three sentences of Article 105 of the *Satversme* may be restricted only if the restrictions

have been set for the sake of a legitimate aim and are proportionate to this aim (*compare, see, for example, Judgement of 15 November 2016 by the Constitutional Court in Case No. 2015-25-01, Para 10.2.*).

With the ratification of the Treaty concerning the accession of the Republic of Latvia to the European Union, the European Union law has become an indispensable part of the Latvian legal system. Hence, the legal acts of the European Union and the interpretation thereof enshrined in the judicature of CJEU must be taken into account in establishing the content of the national regulatory enactments and in applying them (*compare, see Judgement of 17 January 2008 by the Constitutional Court in Case No. 2007-11-03, Para 24.2.*). Accordingly, the legislator, in adopting legal norms, in particular, such by which the requirements of the European Union directives are transposed into the national legal system, must abide by the general principles of law and other norms of the *Satversme* as well as the legal principles of the European Union. The Constitutional Court has already examined the scope of the right to property included in the first three sentences of Article 105 of the *Satversme* in interconnection with the European Union law and the judicature of CJEU (*see, for example, Judgement of 13 October 2015 by the Constitutional Court in Case No. 2014-36-01, Para 15 –22*).

The contested norms were adopted in transposing the requirements of the European Union directive. It follows from the annotation to the law of 1 December 2009 “Amendments to the law “On Value Added Tax”” that they had been drafted in accordance with Article 183 of Directive 2006/112/EC (*see Para 2 of the annotation to the draft law No. 1545/Lp9 “Amendments to the Law “On Value Added Tax”*”).

**Hence, in reviewing the compliance of the contested norms with the first three sentences of Article 105 of the *Satversme*, the principles that follow from Article 183 of Directive 2006/112/EC must be taken into account.**

**14.** The field of tax law is characterised by certain discretion granted to the legislator. Whereas in regulating matters that are related to the tax field but do not fall within it, the legislator does not enjoy as broad discretion (*compare, see Judgement of 3 April 2008 by the Constitutional Court in Case No. 2007-23-01, Para 11*).

The contested norms, in interconnection with the norms of Para 12<sup>2</sup> to 12<sup>11</sup> of Section 12 of the law “On Value Added Tax” define the way SRS must handle the

over-paid VAT, which occurs when the taxpayer performs his duty to pay VAT. However, the over-paid VAT, essentially, is the taxpayer's financial resources that have come at the State's disposal and should be refunded to the taxpayer. Therefore the legislator, in regulating the procedure for refunding the over-paid VAT, does not enjoy the discretion that is typical to the area of tax law. Likewise, the summoned person K. Balodis expresses the opinion that, in regulating the procedure and terms for refunding the over-paid tax, the legislator's discretion is narrower compared to the instance, where the legislator establishes the very obligation to pay the tax.

In establishing the procedure, in which the over-paid VAT must be refunded to the taxpayer, the legislator must comply with the principles that are included in Article 105 of the *Satversme* and follow from Directive 2006/112/EC. Directive 2006/112/EC envisages uniform rules, pursuant to which the Member States must draft the national regulation in the VAT area. Article 183 of Directive 006/112/EC comprises rules on the Member States handling the over-paid VAT. CJEU has repeatedly underscored: although in accordance with Article 183 of Directive 2006/112/EC the procedure for refunding the over-paid VAT falls within the scope of the Member States' procedural autonomy, this procedure may not jeopardise the principle of VAT neutrality by fully or partially imposing this tax burden upon the taxpayer (*see CJEU Judgement of 28 February 2018 in Case No. C-387/16, Para 21–24*).

**15.** In the present case, it must be established what kind of content the legal norms of the European Union comprise, i.e., to establish the content of Article 183 of Directive 2006/112/EC and the principle of VAT neutrality. Article 269 of the Treaty on the Functioning of the European Union provides that the CJEU has the jurisdiction to give preliminary rulings concerning the interpretation of the Treaties and the validity and interpretation of the legal acts of the European Union. Where such a question has been raised in a case pending before a court of a Member State and the court considers that a ruling by CJEU is necessary to enable it to give a judgement, this court may request CJEU to give such a ruling. If such a question has been raised in a case pending before a court of a Member State whose decisions are not subject to appeal in accordance with the national regulatory enactments, then that court must bring the matter before CJEU. The rulings by the Constitutional Court are not subject to appeal therefore in those cases, where the outcome of a case depends on the interpretation of legal acts of the European Union, the Constitutional

Court must ascertain, whether the provisions of the respective legal acts are sufficiently clear, but, if the respective norms are not sufficiently clear, whether this matter has not been previously explained by CJEU (*compare, see, for example, Judgement of 13 October 2015 by the Constitutional Court in Case No. 2014-36-01, Para 14*).

The first part of Article 183 of Directive 2006/112/EC provides: “Where, for a given tax period, the amount of deductions exceeds the amount of VAT due, the Member States may, in accordance with conditions which they shall determine, either make a refund or carry the excess forward to the following period.” Pursuant to the first part of Article 183 of Directive 2006/112/EC, the Member States may determine independently the form, in which the over-paid VAT must be refunded to the taxpayer. The Member States may choose – to refund the over-paid VAT to the taxpayer immediately after the taxation period, to carry forward the over-paid VAT to the subsequent taxation period, using it to cover the current VAT payments or to cover the debts of the State specified payments, or to combine these two forms (*see CJEU Judgement of 12 May 2011 in Case No. C-107/10, Para 47*). Hence, the carrying forward of the over-paid VAT may be even beneficial for the taxpayer – he does not need to use the financial assets at his disposal to pay the current calculated VAT amount and the debts of other payments specified by the State. In such a case, the taxpayer does not receive his financial assets back from the State budget directly but, essentially, regains them by saving the financial assets at his disposal.

However, CJEU has noted: although Article 183 of Directive 2006/112/EC does not envisage an obligation to pay interest for the over-paid VAT amount to be refunded nor the date, as of which such interest payment should be made, this circumstance *per se* cannot be interpreted to mean that the procedure for refunding the over-paid VAT established by the Member States should not be subject to any review with respect to its compliance with the European Union law (*compare, see, CJEU Judgement of 28 February 2018 in Case No. C-387/16, Para 21*). In this respect, the principle of VAT neutrality limits the Member States’ autonomy.

In accordance with the principle of VAT neutrality, the procedure, in which the State refunds to the taxpayer the over-paid VAT, should such to ensure that an eligible taxpayer could regain the whole amount of over-paid VAT. This means that the procedure for refunding the over-paid VAT should not cause a financial burden for the taxpayer (*compare, see, CJEU Judgement of 28 February 2018 in Case No. C-387/16, Para 22 –24*). In this respect, it is important to take into account the

following: although the first part of Article 183 of Directive 2006/112/EC envisages the possibility to transfer the over-paid VAT only to the subsequent taxation period, transferring it to several taxation periods that follow the period, in which this over-payment occurred, should not be necessarily immediately considered as being incompatible with the first part of Article 183 of Directive 2006/112, insofar the over-paid VAT is refunded to the taxpayer within a reasonable term (*compare, see CJEU Judgement of 12 May 2011 in Case No. C-107/10, Para 49, and Judgement of 28 July 2011 in Case No. C-274/10, Para 55*).

CJEU has recognised: if a reasonable term of refunding is exceeded in refunding the over-paid VAT to the taxpayer then the principle of VAT neutrality requires to compensate to him the losses caused to him by the inaccessibility of the respective amount of money by paying late payment interest to him. Since this issue is not regulated in the European Union, the national legal system of each Member State, in compliance with the principle of VAT neutrality, must envisage conditions for making late payment interest payments, *inter alia*, the interest rate and the method of calculation should be established (*compare, see CJEU Judgement of 28 February 2018 in Case No. C-387/16, Para 25*).

The second part of Article 183 of Directive 2006/112/EC, in turn, envisages the Member States' rights to waive both the transferring the over-paid VAT to subsequent taxation periods and the refunding of it to the taxpayer if the amount of over-paid VAT is insignificant. An insignificant amount of VAT has been defined for example, in the Estonian Taxation Act, Section 106 (6) of which provides that the over-paid tax, the amount of which does not exceed 10 euro, is to be refunded only if a written request by the respective person to refund it has been received; whereas in the case if such request has not been submitted the responsible institution retains the over-paid amount at its disposal to cover the subsequent State specified payments that this person has to make. The second part of Article 183 of Directive 2006/112/EC, essentially, allows the Member States to not refund or discharge a taxpayer's overpaid VAT. This means that, in the meaning of the second part of Article 183 of Directive 2006/112/EC, only such amount of over-paid VAT is to be deemed insignificant, the irreversible loss of which would not cause for the taxpayer notable adverse consequences and the refunding of which would require the investment of larger resources than the value of this over-paid amount.

**Hence, the Constitutional Court finds that the content of Article 183 of Directive 2006/112/EC and the principle of tax neutrality is clear and,**

**therefore, requesting a preliminary ruling from the Court of Justice of the European Union is not necessary.**

16. The Constitutional Court must verify, whether the contested norms cause a restriction on a taxpayer's fundamental rights established in the first three sentences of Article 105 of the *Satversme*.

It follows from the norms of the law "On Value Added Tax" that the occurrence of over-paid VAT depends on the business activities of the particular taxpayer. In each taxation period, the VAT that the taxpayer must pay into the State budget consists of the amount of VAT received from business partners, from which the input tax is deducted – the amount of VAT that the taxpayer has already paid to business partners within this taxation period. If the paid input tax is smaller than the amount of received VAT the difference constitutes the VAT that the taxpayer must pay into the State budget. If in the particular taxation period the taxpayer has over-paid VAT he does not have to make the VAT payment into the State budget in this taxation period but, quite to the contrary, the over-paid VAT, first of all, must be used to cover the debts of State specified payments, whereas the remaining amount of the over-paid VAT must be transferred to the subsequent taxation period for covering his current VAT payments or covering the debts of State specified payments, or must be refunded to the taxpayer on certain conditions.

If the over-paid VAT is transferred, in the subsequent taxation period, the taxpayer calculates the amount of VAT to be paid into the State budget but deducts from this amount the over-paid VAT and pays into the State budget only the difference between the calculated VAT and the transferred over-paid VAT. If the amount of over-paid VAT exceeds the current calculated VAT then SRS channels the remaining over-paid VAT for covering the taxpayer's other debts of State specified payments. If over-paid VAT remains even after that SRS continues transferring it to the subsequent taxation periods and uses it in the same procedure to cover the taxpayer's current payable VAT and debts of State specified payments.

The over-paid VAT is refunded to the taxpayer immediately after the current taxation period if this taxation period happens to be at the end of the taxation year or, if it is not at the end of the taxation year, but one of the requirements defined in Section 12 (12<sup>7</sup>) of the law "On Value Added Tax" has been met. Four requirements are linked to a taxpayer's specific business activity, whereas the fifth defines a general limit or the amount of over-paid VAT, which cannot be transferred to the

subsequent taxation period. I.e., if the amount of over-paid VAT reaches this limit, which initially was set in the amount of 15 000 Lats but later – in the amount of 8000 Lats, it must be refunded to the taxpayer immediately. Hence, the contested norms provide that such over-paid VAT, which has not been used to cover the taxpayer's current VAT payments and debts of the State specified payments but does not reach the amount stipulated in law, is kept at the State's disposal until the end of the taxation year, irrespectively of the taxation period, in which this over-paid amount occurred.

Also, in the particular administrative case, in the framework of which the Applicant decided to turn to the Constitutional Court, on the basis of the decision by the Director General of SRS, the applicant in the administrative case was refused the refunding of the over-paid VAT for the second quarter of the year in the amount of 781.25 Lats since none of the circumstances envisaged in Part 12<sup>7</sup> of the law "On Value Added Tax" had set it; likewise, it was decided to transfer this over-paid VAT to the subsequent taxation period until the end of the taxation period.

Thus, although the over-paid VAT occurred because the taxpayer performed his legal obligation to pay VAT, it, essentially, is the taxpayer's property – his financial recourses, which should be refunded to the taxpayer, either by using it cover his debts of State specified payments or by refunding it to him (*compare, see, Judgement of 19 June 2010 by the Constitutional Court in Case No. 2010-02-01, Para 5.2.*). Pursuant to the contested norms, the State may temporarily retain the taxpayer's financial resources at its disposal, and, in such a case, the taxpayer is absolutely denied the possibility to use the resources in the particular period, *inter alia*, use them in his business activities and gain profit from them.

**Thus, the contested norms create a restriction a taxpayer's fundamental rights, established in the first three sentences of Article 105 of the *Satversme*.**

17. The Constitutional Court must verify, whether this restriction has been established by law, whether it has a legitimate aim and whether it is proportional to this aim. To assess, whether the restriction on fundamental rights has been established by a law adopted in due procedure, it must be verified:

1) whether, in adopting the law, the procedure envisaged in regulatory enactments had been complied with;

2) whether the law has been promulgated and is publicly accessible in accordance with the requirements of regulatory enactments;

3) whether the law has been worded with sufficient clarity, allowing a person to understand the content of the rights and obligations following from it and to anticipate the consequences of application thereof, as well as whether the law ensures protection against arbitrary application thereof (*see, for example, Judgement of 8 April 2015 by the Constitutional Court in Case No. 2014-34-01, Para 14*).

The Applicant has not indicated such aspects in the adoption and promulgation or the clarity of the contested norms that would allow contesting the fact that the restriction on fundamental rights included in these norms had been established by law.

The contested norms were adopted by the law of 1 December 2009 “Amendments to the law “On Value Added Tax””. The respective draft law was examined in two readings as urgent, and the law was adopted and promulgated in the official journal “Latvijas Vēstnesis” in the procedure established in the *Satversme* and the *Saeima* Rules of Procedure. It follows from the case materials that, prior to each reading, the contested norms had been discussed at the sittings of the *Saeima* Budget and Finance (Taxation) Committee. The contested norms have been worded with sufficient clarity, and the consequences of application thereof can be anticipated.

**Hence, the restriction on fundamental rights included in the contested norms has been established by law.**

**18.** Any restriction on fundamental rights must be based on circumstances and arguments regarding its necessity; i.e., the restriction must be established for the sake of important interests – a legitimate aim. In the proceedings before the Constitutional Court, the institution, which has issued the contested act, first and foremost, has the obligation to indicate the legitimate aim of the restriction on fundamental rights (*compare, see, for example, Judgement of 15 November 2016 by the Constitutional Court in Case No. 2015-25-01, Para 11.2.*).

The participants of the case share the opinion that the legitimate aim of the restriction on fundamental rights established in the contested norms is the protection of public welfare, preventing the risk that State specified payments are not made and ensuring effective collection thereof. Several summoned persons hold that the legitimate aim of the restriction included in the contested norms is the economy of SRS’s administrative resources.

However, it does not follow from the law “On Value Added Tax” that the legitimate aim of the restriction on fundamental rights caused by the contested norms would be the prevention of the risk that the State specified payments are not made. The norms of Para 12<sup>2</sup> to 12<sup>11</sup> of Section 12 of the law “On Value Added Tax” are applied to a taxpayer only in the case where, because of the nature of his business activities, an over-payment of VAT has occurred. However, if an over-paid VAT has not occurred, the taxpayer remains outside the scope of this regulation. Thus, the contested norms do not establish a comprehensive measure for reducing the non-payment risk of the State specified payments but only define the State’s actions with the taxpayer’s financial resources that have come at the State’s disposal for reasons beyond his control. Hence, it can be concluded that the transfer of the over-paid VAT to the subsequent taxation periods creates the possibility to cover the taxpayer’s current VAT payments and possible debts of State specified payments at least in the amount of this over-paid VAT but does not eliminate the non-payment risk of the State specified payments. Consequently, the prevention of this risk with respect to particular taxpayers is the side effect of the contested norms rather than the legitimate aim of the restriction on fundamental rights established therein.

The procedure established in Para 12<sup>2</sup> to 12<sup>11</sup> of Section 12 of the law “On Value Added Tax” is aimed at economising the resources of the State. These norms achieve optimisation of work of the institutions of public administrations – the financial resources of a taxpayer, which are already at the State’s disposal, are used to cover his current VAT payments and debts of the State specified payments, and, thus, the state resources for administering these payments are saved. This procedure for transferring the over-paid VAT also allows SRS to save resources by refunding the over-paid VAT only at the end of the taxation year rather than several times per year. The saved resources, in turn, can be used to ensure other functions of the State and, as the result, the welfare of society in general is facilitated (*compare, see, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 9*). Thus, it can be concluded that the legitimate aim of the restriction on fundamental rights established in the contested norms is the protection of public welfare, which in the particular case manifests itself as economy of the State’s resources by making the procedure of administering the State specified payments more effective.

**Thus, the restriction on fundamental rights established in the contested norms has a legitimate aim – protection of public welfare.**

**19.** Upon identifying the legitimate aim of the restriction on fundamental rights, the compliance of the restriction on fundamental rights with the proportionality principle must be reviewed. To assess the proportionality of the restriction on fundamental rights, it must be established: 1) whether the measures chosen by the legislator are appropriate for reaching the legitimate aim; 2) whether measures that are less restrictive on persons' fundamental rights (more lenient) do not exist; 3) whether the benefit gained by the society outweighs the damage caused to a person's rights and lawful interests (*see, for example, Judgement of 15 November 2016 by the Constitutional Court in Case No. 2015-25-01, Para 11.3.*).

**20.** The participants of the case share the opinion that the contested norms are appropriate for reaching the legitimate aim.

The contested norms allow SRS to transfer the over-paid VAT to cover the taxpayer's current VAT payments and the debts of State specified payments within the framework of the whole taxation year, reducing to the minimum the activities for administering these payments. SRS does not need to spend resources to verify the requested over-paid VAT after each taxation period and to refund the respective amounts from the State budget. SRS performs such verification only once within the taxation year – at the end of it. Moreover, at the end of the taxation year, SRS has access to information about the taxpayer's business activities throughout the taxation year. This information allows SRS to form a more comprehensive view of the transactions concluded by the taxpayer and verify more effectively, whether the taxpayer has paid VAT correctly within the taxation year. Thus, the procedure established in the contested norms allows saving the state resources by not only decreasing the number of activities for administering the State specified payments but also the frequency thereof, as well as allowing SRS to control VAT payments more effectively.

**Thus, the measures chosen by the legislator are appropriate for reaching the legitimate aim.**

**21.** In verifying, whether the legislator had more lenient measures at its disposal for reaching the legitimate aim, it must be taken into account that a more lenient measure is not just any other measure but only such that allows reaching the

legitimate aim in the same quality (*see, for example, Judgement of 15 November 2016 by the Constitutional Court in Case No. 2015-25-01, Para 11.3.2.*). Moreover, a measure that requires additional financial resources from the State cannot be considered as being a more lenient measure (*see Judgement of 8 March 2017 by the Constitutional Court in Case No. 2016-07-01, Para 24.1.*). The participants of the case share the opinion that there are no other alternative measures that would be less restrictive and, nevertheless, would allow reaching the legitimate aim in the same quality, i.e., to save the state resources in the same amount.

The contested norms exclude the necessity to refund the over-paid VAT as well as the need to conduct prior verification of the correctness of the taxpayer's VAT payments until the very end of the taxation year. Moreover, they allow reducing to the minimum the activities for administering a taxpayer's current VAT payments and the debts of State specified payments, insofar the amount of over-paid VAT is sufficient for covering these payments. The Constitutional Court recognises that there are no such more lenient measures that would ensure the saving of state resources in the same amount, which is ensured when the State has no need to take a significant part of administrative activities.

**Hence, there are no more lenient measures that would allow reaching the legitimate aim in the same quality.**

22. To examine, whether the public benefit from the restriction on fundamental rights established in the contested norms outweighs the damage caused to the taxpayer, the Constitutional Court, taking into account the findings from the CJEU's judicature regarding the content of the principle of VAT neutrality, must establish, whether the contested norms do not create a financial burden for the taxpayer. The Applicant holds that the restriction caused by the contested norms is incompatible with the principle of VAT neutrality since the over-paid VAT is not refunded to the taxpayer within a reasonable term and the refunding of it later than within a reasonable term is not compensated by interest payment. The *Saeima*, however, holds that the restriction is proportionate since the over-paid VAT is quickly and effectively channelled for covering a taxpayer's debts, which otherwise would have to be covered from the financial resources at his disposal. The *Saeima* and the Ministry of Finance underscore that the contested norms had been adopted in the conditions of economic crises, when it had been essential to ensure the State

budget revenue, preventing the non-payment risk of taxes and other State specified payments.

The Constitutional Court has already established that, pursuant to the principle of VAT neutrality, the over-paid VAT should be refunded to the taxpayer within a reasonable term, i.e., by not causing a financial burden. However, if in the refunding of the over-paid VAT the reasonable term is exceeded, the State has the obligation to compensate to the taxpayer for the financial loss caused by the inaccessibility of the respective amount of money, by paying to him late payment interest. Hence, the Constitutional Court must verify, whether:

1) the contested norms ensure that the over-paid VAT is refunded to the taxpayer within a reasonable term;

2) if the contested norms fail to ensure this – whether the financial burden caused by this to the taxpayer is compensated for by late payment interest.

CJEU has repeatedly examined, whether the term for refunding of the over-paid VAT set in the Member States' national norms is reasonable. Upon examining the actual and legal circumstances of the respective cases, CJEU has recognised that three months is a reasonable term for refunding the over-paid VAT (*see CJEU Judgement of 12 May 2011 in Case No. C-107/10, Para 49*). The summoned persons L. Leitāne and S. Novicka also have referred to three months as a reasonable term, typical of commercial law, within which the debtor settles accounts with the creditor. CJEU has recognised the term of six months as being unreasonable and incompatible with the principle of VAT neutrality (*see CJEU Judgement of 10 July 2008 in Case No. C-25/07, Para 27, and Judgement of 21 October 2015 in Case No. C-120/15, Para 25 and Para 26*). Accordingly, CJEU has recognised the term of eight months as also being unreasonable (*see CJEU Judgement of 12 May 2011 in Case No. C-107/10, Para 55 to 58*), as well as a term that might reach and exceed one year (*see CJEU Judgement of 18 October 2012 in Case No. C-525/11 Para 26 – 27*).

Pursuant to Section 12(12<sup>3</sup>) of the law “On Value Added Tax”, VAT confirms the over-paid VAT within 30 days after the VAT declaration for the respective taxation period has been received. In accordance with the first and the second part of Section 11 of the Law, the VAT declaration, depending on the form of its submission, must be submitted within 15 or 20 days after the taxation period expires. Following each taxation period, which does not happen to be at the end of the taxation year and in which over-paid VAT has occurred, SRS confirms within 30

days the amount of over-paid VAT and uses it to cover the taxpayer's debts of the State specified payments. If the amount of taxpayer's debts is equal to or exceeds the over-paid VAT then all refunded sum is refunded to the taxpayer in the form of saving the resources at his disposal, within these 30 days.

However, if the amount of over-paid VAT exceeds the amount of a taxpayer's debts then it must be refunded to the taxpayer within these 30 days only if any of the conditions defined in Section 12 (12<sup>7</sup>) of the law "On Value Added Tax" has been met, also in the case if the amount of over-paid VAT reaches the defined limit. However, if the amount of over-paid VAT exceeds the amount of the taxpayer's debts but none of the conditions defined in Section 12 (12<sup>7</sup>) sets in, after covering the taxpayer's debts the remaining amount of the over-paid VAT is transferred to the subsequent taxation period, in which it will be fully or partially used to cover the taxpayer's current VAT payment and the debts of State specified payments.

If the amount of over-paid VAT is so large that is not used also in the subsequent taxation periods until the very end of the taxation year then the term, within which it will be refunded to the taxpayer, depends on a number of conditions. Pursuant to Section 12 (12<sup>6</sup>) of the law "On Value Added Tax", if the taxation period happens to be at the end of the taxation year, the over-paid VAT is refunded to the taxpayer within 10 days following the date of its confirmation (in the wording of this norm that was in force until 31 December 2010 – within 30 days following the receipt of the tax return for the last taxation period of the pre-taxation year). However, in accordance with Section 12 (12<sup>11</sup>), SRS may extend the term of 30 days defined in Part 12<sup>3</sup> if any of the conditions defined in paragraphs of Part 12<sup>11</sup> have been met. Pursuant to Para 1 to 2 of Part 12<sup>11</sup>, this term may be extended until the day when the taxpayer corrects the deducted input tax or SRS takes certain actions – completes the tax audit or verification of the data compliance or verifies the validity of applying the 0 per cent VAT rate. Para 5 of Part 12<sup>11</sup>, in turn, provides that SRS has the right to extend the term of 30 days referred to above if it requests, within this term, the taxpayer to provide additional information that is needed to approve the amount of over-paid VAT. In such a case, the additional information must be provided within 15 days, whereas SRS must adopt a decision on the validity of the request to refund the over-paid VAR no later than within 75 days after the receipt of the VAT return of the respective taxation period

Pursuant to Part 1 –1<sup>2</sup> of Section 9 of the law “On Value Added Tax”, a taxpayer’s taxation period can be one month, three months or half of the taxation year. Thus, assuming that the taxpayer submits the VAT declaration immediately after the taxation period ends, the shortest period for refunding the over-paid VAT, which has not been used to cover his debts and current VAT payment, allowed by the norms of Parts 12<sup>3</sup>–12<sup>11</sup> of Section 12 of the law “On Value Added Tax” is 40 days following the end of the taxation period. The over-paid VAT should be refunded within this period in the case, if the taxation period, in which it has occurred, happens to be at the end of the taxation year and SRS does not need to receive additional information or conduct an in-depth check.

However, if the amount of over-paid VAT, which has not been used to cover the current VAT payments and the debts of State specified payments, has occurred in the first taxation period of the taxation year, assuming that the taxpayer submits the VAT declaration immediately after the last taxation period of the taxation year has ended, it would be refunded to the taxpayer:

- 1) if the taxation period is one month long – approximately within one year (11 months long remaining taxation periods + 40 days);
- 2) if the taxation period is three months long – approximately within 10 months (9 months long remaining taxation periods + 40 days);
- 3) if the taxation period is six months long – approximately within 7 months (one 6 months long remaining taxation periods + 40 days).

These terms may be even longer if SRS needs additional information or has to scrutinize the taxpayer. SRS has indicated to the Constitutional Court that in the norms of the Value Added Tax law, which is in force at the time of reviewing this case, the same procedure for refunding the over-paid VAT has been established, in accordance with which it is possible that the over-paid VAT is refunded to the taxpayer later than within a year *see Case Materials, Vol. 2, pp. 3 –6*).

The legislator’s obligation in the field of tax policy is to create such a taxation system that is aimed at sustainable national development. Only a sustainable taxation system is able to ensure public welfare (*compare, see Judgement of 19 October 2017 by the Constitutional Court in Case No. 2016-14-01, Para 26*). This, in particular, applies to those taxes that are applicable to business activities because, in the conditions of a free market economy, the business activities performed by private persons is one of the pillars of the national economy and its main source of income. If the VAT system causes for the business operators such

financial burden that hinders the performance of business activities, this can have an impact also on the development of the national economy.

The *Saeima* and the Ministry of Finance note that the contested norms had been adopted in conditions of crisis when the protection of the State budget against non-payment of taxes and tax fraud had been of particular importance.

Conditions of crisis leave a negative impact on the financial conditions of not only the State but also each person. They create a particularly negative impact on taxpayers, who are engaged in business activities and who must adjust, on the one hand, to the purchasing power of their clients, and, on the second hand, the measures taken by the state to stabilise the economic situations. In such conditions, an amount, which is comparatively small at the background of the national economy, may significantly impact a taxpayer's business activities, for example, his ability to settle accounts with creditors, to purchase new raw materials, to disburse salaries to his employees, etc. The contested norms had been applied to the applicant in the administrative case also during the economic crisis.

Pursuant to the contested norms, the term, within which the over-paid VAT can be refunded to the taxpayer, may vary from approximately one month to one year, and even longer. This means that, pursuant to the contested norms, the over-paid VAT can be refunded to the taxpayer also within a term that cannot be deemed as being reasonable. However, this procedure for transferring the over-paid VAT could be recognised as being compatible with the principle of VAT neutrality if the regulatory enactments would envisage compensation to the taxpayer for this financial by late payment interest. However, the law "On Value Added Tax" does not envisage compensation by late payment interest for the financial burden caused by the transfer of the over-paid VAT. Thus, the contested norms cause a financial burden for the taxpayer, which is not compensated for. This, in turn, means that the contested norms are incompatible with the principle of VAT neutrality.

**Hence, the restriction on fundamental rights established in the contested norms is not proportional and the contested norms are to be recognised as being incompatible with Article 105 of the *Satversme*.**

**23.** Pursuant to Section 32 (3) of the Constitutional Court Law, a legal norm (act), which has been recognised by the Constitutional Court as being incompatible with a legal norm of higher legal force, is to be recognised as being void as of the date when the Constitutional Court's judgement is published, unless the

Constitutional Court has provided otherwise. In setting the date, as of which the contested norms should be recognised as being void, it must be taken into account that recognising them as being void should not create a substantive infringement on the rights and interests of the State, society and individual persons (*compare, see, for example, Judgement of 3 April 2008 by the Constitutional Court in Case No. 2007-23-01, Para 20, and Judgement of 27 January 2011 in Case No. 2010-22-01, Para 15*).

The contested norms have already become void as of 1 January 2013, when the Added Value Tax Law entered into force. However, they still are being applied in administrative legal proceedings that have been initiated and have not been completed, assessing the legality of decisions adopted by SRS on the basis of them. In deciding on the date, as of which the contested norms become void, it should be taken account that the task of the Constitutional Court is to prevent, to the extent possible, infringements on persons' fundamental rights caused by them (*compare, see, for example, Judgement of 15 June 2017 by the Constitutional Court in Case No. 2016-11-01, Para 22*). In such administrative proceedings, including the administrative proceedings, in the framework of which the Applicant decided to turn to the Constitutional Court, the probable infringement of the applicant's fundamental rights can be prevented only by recognising the contested norms as being void as of the moment when they entered into force. Therefore, with respect to all persons, to whom the contested norms had been applied and who have started defending their rights in the procedure established in the Administrative Procedure Law and with regard to whom the administrative proceedings have not been completed yet, the contested norms, insofar they do not ensure refunding of the over-paid VAT to the taxpayer within a reasonable term, must be recognised as being void as of the date they entered into force.

### **The Substantive Part**

On the basis of Section 30 to 32 of the Constitutional Court Law, the Constitutional Court

**held:**

**1. To recognise Part 12<sup>3</sup> and Part 12<sup>5</sup> of Section 12 of the Law “On Value Added Tax” (in the wording that was in force from 1 January 2010 until 31 December 2012), insofar as they restrict the right to have tax over-payment refunded within a reasonable term, as being incompatible with Article 105 of the *Satversme* of the Republic of Latvia.**

**2. With respect to persons, to whom the contested norms had been applied and who have started to defend their rights in the procedure defined in the Administrative Procedure Law and with respect to whom the administrative proceedings have not been completed yet, to recognise Part 12<sup>3</sup> and Part 12<sup>5</sup> of Section 12 of the Law “On Value Added Tax” (in the wording that was in force from 1 January 2010 until 31 December 2012), insofar as they restrict the right to have tax over-payment refunded within a reasonable term, as being incompatible with Article 105 of the *Satversme* of the Republic of Latvia and void as of the date they entered into force.**

The judgement is final and not subject to appeal.

The judgement shall enter into force on the date of its publication.

Chairperson of the court hearing

I. Ziemele