# THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

**J U D G E M E N T**

**on Behalf of the Republic of Latvia**

**in Riga, 19 October 2017**

**in Case No. 2016-14-01**

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

on the basis of a constitutional complaint, which had been initiated with regard to applications by thirty seven natural persons (hereinafter – the Applicants) on the basis of Article 85 of the *Satversme* [the Constitution] of the Republic of Latvia and Para 1 of Section 16, Para 11 of Section 17 (1) as well as Section $19^2$ and Section $28^1$ of the Constitutional Court Law,

with the participation of the authorised representatives of the parties, who submitted the constitutional complaint, – sworn advocate Alisa Leškoviča and lawyer Kaspars Strazds,

as well as of the institution, which issued the contested act, – the *Saeima* [the Parliament], Ilze Tralmaka and Mārtiņš Brencis,

with Marija Paula Pēce as the secretary of the court hearing,

on 5, 6 and 19 September 2017, with the participation of the participants of the case at a court hearing examined the case "**On Compliance of Section 3, 5, 6, 7 and 9 of the law "On Solidarity Tax" with the First Sentence of Article 91 and Article 109 of the *Satversme* of the Republic of Latvia".**

## The Facts

**1.** On 30 November 2015, the *Saeima* adopted the law "On Solidarity Tax", which entered into force on 1 January 2016.

The Applicants contest several norms thereof:

1) Section 3 of the law, which provides that the tax object is the income, which has been defined in Section 14 and Section $20^2$ of the law "On State Social Insurance" and exceeds the maximum amount of the object of mandatory state social insurance contributions.

2) Section 5 of the law, which provides that taxpayers are employers, employees, domestic employees at a foreign employer, foreign employees at a foreign employer and self-employed persons, who are subject to state social insurance and whose income in the respective taxation year exceeds the maximum amount of the object of mandatory contributions as defined in the law "On State Social Insurance";

3) Section 6 of the law, which provides that the tax rate corresponds to the rate of mandatory contributions defined pursuant to Section 18 of the law "On State Social Insurance";

4) Section 7 of the law, which regulates calculation of the tax, providing that the State Social Insurance Agency (hereinafter – the Agency), on the basis of information provided by the State Revenue Service (hereinafter – SRS), aggregates the object of mandatory contributions of a socially insured person and the mandatory state social insurance contributions that have been made. The State Social Insurance Agency records the actually paid solidarity tax, after the maximum amount of the object of mandatory contributions, defined in the law On State Social Insurance, has been reached. The agency calculates the solidarity tax once a month;

5) Section 9 of the Law, which provides that the Agency transfers the actually paid tax for the reporting month into the account of the revenue of the state basic budget until the fifteenth date of the month following the reporting month.

To decide on the Applicants' request to restrict access to information included in the materials of the case under review, on 5 September 2016, Justice of the Constitutional Court Ineta Ziemele proposed convening an assignments meeting. The proposal was reviewed on 27 September and 4 October 2016 at an assignments meeting, and information about employees' remuneration, *inter alia*, also information about employment contracts and the terms thereof, statements on the contributions made, as well as information about the Applicants – names, surnames, personal identity codes, home address of the natural persons and the names and registration numbers of legal persons – was granted the status of restricted access information, which is in force until the Constitutional Court adopts the final ruling.

**2. The Applicants** – **thirty seven natural persons** – are employees, payers of the solidarity tax.

The Applicants hold that, essentially, the solidarity tax has been intended as mandatory state social insurance contributions (hereinafter also – insurance contributions). The terms used in the law "On Solidarity Tax" are said to correspond to the terms used in the law " On State Social Insurance", and the solidarity tax is administered in the procedure, in which insurance contributions are calculated and made. Allegedly, the only difference is that the insurance contributions are paid into the special budget, whereas the resources obtained from the solidarity tax – into the basic budget.

The contested norms of the law "On Solidarity Tax" are said to be incompatible with the principle of legal equality included in the first sentence of Article 91 of the *Satversme* in interconnection with the right to social security guaranteed in Article 109 of the *Satversme*. I.e., the contested norms prohibit the payers of the solidarity tax from receiving the social insurance services proportionally to the insurance contributions made. It is maintained that the aim of introducing the solidarity tax – increasing the state budget revenue for implementing measures aimed at decreasing social inequality cannot be

recognised as being legitimate since it is contrary to the principle of individual treatment that must be complied with in social insurance.

The Applicants express the opinion that the law "On Solidarity Tax" had been adopted in haste, without taking into consideration the opinions and proposals of social partners and experts. The impact of the solidarity tax on the national economic development had not been analysed sufficiently. Allegedly, the legislator did not examine the possible alternatives. The aim of the law could be reached by measures that are less restrictive on a person's rights.

The Applicants hold that the solidarity tax will cause development of schemes for tax optimisation and qualified, highly remunerated labour force leaving the country. Hence, the benefit that society gains from the contested norms is said to not outweigh the damage caused to the interests of the payers of the solidarity tax.

The Applicants hold that the incompatibility of the contested norms with the first sentence of Article 91 of the *Satversme* is manifested in several aspects.

Firstly, the contested norms cause, without reasonable grounds, unequal treatment of the employees who are payers of the solidarity tax compared to those employees who are not payers of the solidarity tax. I.e., if the insured social risk materialises, the insurance payments to the payers of the solidarity tax are said to be lower than the object of contribution (income), from which insurance contributions have been made. Whereas those employees, who are not payers of the solidarity tax, may receive insurance payments proportionally to the insurance contributions made.

Secondly, it is alleged that the contested norms cause, without reasonable grounds, equal treatment of groups of persons, which are in different circumstances. I.e., employees and self-employed persons, with respect to the obligation to pay the solidarity tax, are said to be in different circumstances. Employees have no choice with respect to determining the object of insurance contributions. A self-employed person, in turn, may choose the object of contributions (income), from which insurance contributions will be made, and also to change the object of contributions once in a quarter. Thus, it is possible to

control one's insurance contributions to avoid paying the solidarity tax. Thus, additional revenue is paid into the state budget, essentially, at the expense of employees because they, in difference to self-employed persons, have no possibility of choice with respect to paying the solidarity tax.

Thirdly, differential treatment of persons, who are in similar and comparable circumstances, is envisaged without grounds. I.e., the legislator has set different rates of the solidarity tax, depending on the types of social insurance that the respective payer of the solidarity tax has. The Applicants hold that all socially insured employees and self-employed persons, whose annual income exceeds 48 600 *euro*, are in similar circumstances but the legislator, without reasonable grounds, has envisaged differential treatment of various groups of payers of the solidarity. It is alleged than no objective grounds can be found for applying different tax rates depending upon a person's age and other circumstances and not only on the amount of income. The Applicants hold that the legislator, essentially, has not examined the validity of applying different rates.

In view of the above, the regulation established by the contested norms is said to disproportionate. The Applicants request recognising the contested norms as being incompatible with the first sentence of Article 91 and Article 109 of the *Satversme* and as being void since they entered into force, i.e., as of 1 January 2016.

**3. The institution, which issued the contested act,** – **the *Saeima*** – holds that the contested norms comply with the first sentence of Article 91 of the *Satversme* and do not infringe upon the Applicants' rights guaranteed in the first sentence of Article 109 of the *Satversme*.

The solidarity tax is said to be a specific labour tax. It is one among measures for decreasing inequality that were introduced in 2016. The solidarity tax has two interconnected aims – to decrease tax regressivity employees and ensure revenue in the state basic budget to finance the growing needs of the state's inhabitants for social protection and for decreasing inequalities. I.e., it is

maintained that the aim of the solidarity tax is to balance the burden of labour taxes and to ensure that the contributions by persons who receive high salaries for financing the measures to decrease social inequality would be proportionally equivalent to the contributions made by persons who receive low income from their salaries.

The *Saeima* holds that the solidarity tax reached the aim that was set; i.e., after this tax was introduced, the recipients of high salaries participated in covering the costs of measures for decreasing inequality in a fair amount, by assuming the same tax burden as the recipients of lower salaries. Concurrently with the introduction of the solidarity tax, other measures for decreasing inequality had been taken, for example, differentiated non-taxable minimum had been introduced and the minimum salary had been raised.

The State is said to have broad discretion in determining the taxation policy. The *Saeima* holds that the selection of both the tax rates and the circle of taxpayers, as well as the system of tax administration and deciding on the aim for which the revenue from the respective tax are to be spent fall within the State's discretion.

The *Saeima* does not uphold the Applicants' opinion that the solidarity tax, essentially, is an insurance contribution, which the legislator has chosen to call the solidarity tax. It is maintained that the contested norms do not affect the Applicants' rights that follow from the regulatory enactments that regulate social insurance. The contested norms, allegedly, do not affect the rights of the parties that make social insurance contributions that follow from participation in the social insurance system.

However, the *Saeima* admits that the solidarity tax is linked to insurance contributions in the way that the State has chosen to set for it the same rates and procedure of administration. The solidarity tax is administered by the Agency, which has at its disposal information on an employee's all income, which constitutes the object of insurance contributions.

The Agency is said to calculate the solidarity tax and transfer it into the account of the state basic budget. This procedure for administering the solidarity

tax is said to be simple, major state budget resources had not been required to implement it, and it does not create an administrative burden.

At the court hearing, the representatives of the *Saeima* expressed the opinion that the law "On Solidarity Tax" had not been adopted in haste and that all opinions had been heard and analysed. Likewise, possible alternative solutions had been analysed.

The representatives of the *Saeima*, during the court hearing, explained that the fact that different rates of the solidarity tax had been set for different groups of taxpayers followed from the need to provide special support to some groups of the payers of the solidarity tax, i.e., working pensioners and disabled persons.

**4. The summoned person – the Chancery of the President** – drew attention to the fact that the President had repeatedly informed the *Saeima* about his position with respect to drafting new legal regulation in the field of taxation and budget and, in particular, had proposed that a stricter parliamentary control over the process of creating the state budget should be ensured. A call had been made to implement a more systemic approach, required by targeted and effective use of the state budget resources. The government should constantly review the compliance of the expenditure and the functions of the state budget with the national development goals.

The President had turned to the *Saeima* and the Prime Minister, appealing to improve the quality of drafting the budget laws and, in general, to improve the legislative process, *inter alia*, eliminating potential incompatibility of the adopted laws with the *Satversme*. The President is of the opinion that the members of the *Saeima* should become involved in the drafting of the state budget as early as possible so that the submitted proposals would be examined and discussed in a timely manner. Allegedly, also the possibility for the society to receive information about the adopted laws and the reasoning and considerations of the legislator, which have been taken into account in deciding on the state budget and the matters related to the budget expenditure, should be improved.

The President had also noted that the failure to enforce decisions that had been adopted had a negative impact upon the inhabitants' trust in the state power and decreased the security and stability of the business environment. Allegedly, Latvia's economic growth requires a stable and predictable legal environment that would facilitate sustainable national development.

The president, turning to the Budget and Finance (Taxation) Committee of the *Saeima*, had underscored that the procedure for drafting the annual state budget law, defined in the law "On Budget and Financial Management", limited the possibility to examine validly and ensure that the basic expenditure of the state budget complied with the priority lines of the national development. Allegedly, the procedure for drafting the annual state budget did not ensure the possibility to conduct a comprehensive review of the state budget expenditure and, thus, to define precisely the fiscal space, within the framework of which the national priorities, defined in the national development plan and in other development planning documents, could be financed. A strategic assessment of the state budget revenue would give the possibility to ensure a systemic approach to re-allocation of the state budget resources and, respectively, purposefulness and effectiveness thereof.

At the court hearing, J. Pleps, the representative of the President's Chancery, underscored that in the procedure of drafting and adopting the law "On Solidarity Tax", no violations could be discerned, the procedure, in which the draft law was adopted, had been well-considered and the opinions of the stakeholders had been heard.

**5. The summoned person** – **the Ministry of Finance** – holds that the contested norms comply with Article 91 of the *Satversme* in interconnection with the fundamental rights guaranteed in Article 109 of the *Satversme*.

The Ministry of Finance does not uphold the Applicants' view that the solidarity tax, as to its purpose and essence, conforms to the insurance contributions and has the nature of social insurance. Allegedly, the solidarity tax, as to the mechanism of paying it, is linked to insurance contributions; however, it

does not influence the social insurance services that a person is entitled to. A person cannot claim social insurance services, on the basis of having paid the solidarity tax.

The existing procedure for administering the solidarity tax had been introduced to avoid creating excessive administrative burden to the payers of the tax.

The legitimate aim of the solidarity tax is said to be promoting public welfare, and this conforms to the public interests. The measures chosen by the legislator for reaching this aim are said to be commensurate. I.e., by receiving the revenue from the solidarity tax into the state basic budget it is possible to finance a broad range of measures that are important for society, for example, to increase teachers' salaries and ensure measures of national defence.

The Ministry of Finance is of the opinion that an employee's tax commitments vis-à-vis the state, as to the amount thereof, should conform with the level of his revenue. The Ministry of Finance holds that that the assumption made by the Applicants regarding the losses that the individual incurs due to the hypothetical decrease of contributions made to the private pension funds lacks evidence.

The contribution to the state budget made by the payers of the solidarity tax is said to be considerable. In 2016, the revenue from the solidarity tax had exceeded the annual plan by 2.37 million euro or by 10.1 per cent, whereas in January 2017, the revenue paid into the state basic budget from the solidarity tax exceeded by 10.9 the revenue planned for January, in the amount 6.49 million euro.

To assess, whether the chosen aim could not be reached by other measures, less restrictive upon an individual's rights, an alternative had been examined during the period of drafting the law, i.e., a possibility of not introducing the solidarity tax. In such a case, the income inequality would be retained and the tax burden for the more prosperous employees would continue to be lower than that of employees with minimum and average income. Possible models for administrating the solidarity tax also had been examined, and the

conclusion had been to retain the existing mechanism for administering the insurance contributions, which is said to be the optimal solution both from the perspective of procedure of administration and of costs.

The draft law "On Solidarity Tax" had been prepared to perform the task defined in Para 4 of the minutes-decision (minutes decision No. 41 §430) of the meeting of the Cabinet on 25 August 2015 "On the Informative Report "On the Possibilities to Increase Revenue"". The draft law had been submitted to the Cabinet in accordance with the schedule for preparing the draft law "On the State Budget for 2016", Para 18 of which stipulated that the package of draft laws would be reviewed at the Cabinet's meetings on 8, 15 and 22 September. The draft law had been discussed also at meetings with the participation of representatives of the Ministry of Welfare and the Agency. Minutes of the meetings had been taken.

**6. The summoned person – the Ministry of Welfare** – holds that the contested norms do not infringe upon the right to social security ensured to the taxpayers by Article 109 of the *Satversme*.

The minimum amount of the object of insurance contributions had been defined in the framework of the state social insurance system already since 1997. This had been done with the aim to prevent that disproportionally large social insurance services are obtained, to protect the first pillar of pension system from excessive concentration of financial resources in demographically and economically favourable years, and to promote savings into private pension funds.

The state social insurance services are said to be calculated by taking into account a person's salary, which within the calendar year does not exceed the maximum amount of the object of social insurance contributions set for the particular year. Prior to the introduction of the solidarity tax, the insurance contributions from the object that exceed the maximum amount that had been set, had been reimbursed to the employer and the employee in accordance with the

Cabinet Regulation of 2 May 2000 No. 164 “Procedure for Calculating and Reimbursing the Overpaid State Social Insurance Contributions”.

Upon introducing the solidarity tax from 1 January 2016, Section $21^2$ had been added to the law “On State Social Insurance”, providing that the object of solidarity tax was the object of insurance contributions that exceed the maximum amount of insurance contributions defined in Section 14 (5) of this law. Thus, allegedly, it is not used in calculating the social insurance services accessible to a person. Also before the solidarity tax was introduced, the insurance contributions that had been made for an object above the maximum amount of the object of contributions set for the particular year had not been taken into consideration in granting social insurance services to a person.

S. Rucka, the representative of the Ministry of Welfare, at the court hearing stated that the difference solidarity tax rates were linked to the risks, against which a person was insured, and the scope of social insurance services that were, respectively, available to a person.

**7. The summoned person** – **the Ministry of Justice** – holds that the contested norms comply with the principle of a socially responsible state and do not restrict a person’s rights that follow from Article 109 of the *Satversme*.

The solidarity tax should not be considered as being insurance contributions because the revenue from this tax is not transferred into the special budget of social insurance and do not impact a person’s social insurance.

At the court hearing, L. Medina, the representative of the Ministry of Justice, expressed the opinion that the contested norms did not infringe upon a person’s right to social security that followed from Article 109 of the *Satversme*.

The Ministry of Justice holds that the legislator, in introducing the solidarity tax, had acted in accordance with its discretion in the field of taxation policy. The legislator had wished to supplement the sources of income for covering the cost of social nature from the state basic budget. The aim to decrease the social inequality among the inhabitants of the state was said to be of constitutional importance.

At the court hearing, L.Medina underscored that the procedure for drafting and adopting the law "On Solidarity Tax" had been well-considered and organised, involving social partners and representatives of Ministries in discussions.

**8. The summoned person** – **the State Revenue Service** – holds that the introduction of the solidarity tax ensured that the principle of equality was abided by with respect to all employees.

Pursuant to Sub-para 2.1., 2.3. and 2.4. of the Cabinet Regulation of 5 October 2010 No. 951 "Procedure, in which the State Revenue Services Provides Information to the State Social Insurance Agency Information on the State Social Insurance Mandatory Contributions", SRS provides information to the Agency on the insurance contributions from the employees' revenue from work. The Agency, on the basis of the information provided, aggregates the insurance contributions that have been made. Thus, the insured person, in accordance with the procedure defined in Section 21 of the law "On State Social Insurance", has the obligation to make contributions even after the object of contributions has reached the maximum amount, i.e., has the obligation to pay the solidarity tax.

SRS holds that the introduction of the solidarity tax has eliminated the inequality, which previously had manifested itself in the fact that persons with high income had been making significantly smaller tax contributions from their income from work compared to persons with lower level of income. Social inequality had increased because of this. The introduction of the solidarity tax had levelled out this tax burden, since the part of unpaid social contributions had been replaced by the solidarity tax. This is providing additional revenue to the state basic budget, which can be used for financing measures of public importance.

**9. The summoned person** – **the Ombudsman of the Republic of Latvia** (hereinafter – the Ombudsman) – recognises that the contested norms comply

with the principle of legal equality included in the first sentence of Article 91 of the *Satversme* and Article 109 of the *Satversme.*

In the field of social rights, the State is said to have discretion with respect to selecting mechanism for exercising these rights. Hence, the legislator, in examining the economic possibilities of the state and other circumstances, may exercise its discretion and create the system of social insurance, defining the rules for contributing, administering, managing and disbursing the resources.

The obligation of the State to establish a sustainable and balanced policy for ensuring public welfare and to set up an effective system of tax collection is said to follow from the principle of a socially responsible state. Allegedly, the solidarity tax ensures the necessary revenue into the state basic budget, which is used to decrease social inequality. The aim of the solidarity tax – protection of public welfare – is said to be legitimate. The Ombudsman holds that the contested norms do not restrict the rights of the payers of the solidarity tax to social security at least in the minimal amount, guaranteed in Article 109 of the *Satversme*.

**10. The summoned person** – **the Free Trade Union Confederation of Latvia** (hereinafter – LBAS) – holds that the contested norms comply with the first sentence of Article 91 and Article 109 of the *Satversme.*

Fairness is said to be one of the basic principles of taxation policy. In creating the taxation policy, both the horizontal fairness (similar tax rates for similar basis) and the vertical fairness (the tax contribution complies with the financial possibilities of the tax payer) must be examined. It is said to be important to ensure such relation between the horizontal and vertical fairness that would promote, to the extent possible, voluntary payment of taxes and would decrease shadow economy.

However, LBAS underscores that the decrease in inequality cannot be achieved solely by introducing the solidarity tax. The legislator, by attempting to balance the revenue as effectively as possible, should take complex measures to achieve progressivity of the taxation system because, quite frequently, the most

prosperous part of society does not receive the income in the form of salary from work but from dividends, interest payments, and capital.

Additionally, LBAS draws attention to the fact that the State should guarantee the universal accessibility of the social security system. The social security system should include also measures of social assistance that are envisaged for persons, who are unable to receive support from social insurance. Although the aim of the law "On Solidarity Tax" has been fairly defined, the legal mechanism that the State will use to ensure that the tax that has been paid is used for reaching the particular defined aim of the law is said to be unclear. Allegedly, the current legal regulation does not guarantee that the solidarity tax revenue will be used exactly for meeting the needs of increased social protection and decrease in inequality. A situation like this might weaken the already low public trust in the efficacy of tax use and would encourage searching for solutions that allow evading paying the tax. For example, the current regulation is said to allow the possibility to evade payment of the solidarity tax by transforming the revenue from a salary into return of capital. This could decrease the increase in the salaries of highly qualified labour force and, thus, in the long-term, have a negative impact upon the competitiveness of this labour force.

E. Baldzēns, the Chairman of LBAS, underscored at the court hearing that, in general, LBAS had supported the introduction of the solidarity tax and had been actively involved in the drafting of the respective law.

**11. The summoned person – the Professor of the Faculty of Law, the University of Latvia, *Dr.iur.* Jānis Lazdiņš** – holds that the regulation of the contested norms complies with the principle of justice and the right of the payers of the solidarity tax to the social guarantees established in Article 109 of the *Satversme* has not been restricted.

Allegedly, Latvia is a socially responsible state, and reciprocal solidarity is said to be one of the grounds for social cohesion. The aim of a socially responsible state is to level out most significant social differences and to ensure to all groups of inhabitants a living standard worthy of human dignity. Social

solidarity is said to be a mandatory element for the functioning of a democratic society. Its mandatory scope is regulated by the legislator, on the one hand, by defining the obligation to pay taxes and distributing the tax burden fairly, but, on the other hand, by granting the right to social benefits and other services of social nature. The distribution of social burden should be fair – more can be demanded from the one, who has more, and less be demanded from the one, who has less. The principle of a socially responsible state is said to mean also that the individual is linked to society and, thus, he also has certain responsibilities vis-à-vis society. Therefore an individual should accept the restrictions on his discretion that have been introduced in public interests.

The principle of solidarity is said to permeate the whole legal system. And this, in full extent and in particular, is applicable to the taxation law. Every taxpayer should participate, proportionally to his income, in satisfying the common needs of the state, which are financed through the mediation of the state budget. It is alleged that the law "On Solidarity Tax" does not introduce any innovations into the Latvian legal system but rather only highlights the solidarity duty in a democratic, socially responsible state governed by the rule of law. Essentially, it envisages imposing a progressive rate on income. Perhaps, if the legislator had established that progressive tax rate must be applied to income and had given up the solidarity tax, the society would have understood it better and it would have fairer.

At the court hearing, J. Lazdiņš underscored the need to abide by the principle of justice in determining the tax burden. In his opinion, the solidarity tax, essentially, serves to reach social justice. Therefore no collision with the solidarity principle or the principle of a socially responsible state can be discerned in the legislator's action, i.e., establishing the obligation to pay the solidarity tax. However, J. Lazdiņš drew attention to the fact that the draft law "On Solidarity Tax" had been adopted in haste. Thus, the addressees of the law had not had sufficient time for understanding the nature of this tax.

**12. The summoned person – the Associate Professor of the University of Latvia *Dr.oec.* Ruta Šneidere** – holds that the law "On Solidarity Tax" complies with none of the basic principles of taxation policy – effectiveness, justice, simplicity, and timeliness.

Allegedly, the current taxation system with respect to labour taxes, *inter alia*, the solidarity tax, cannot be considered as being effective due to two reasons. Firstly, the tax system had been expanded by the introduction of the new regulation. Secondly, for the recipients of low salaries the total burden of labour tax, essentially, has not changed.

The solidarity tax cannot be considered as being just because the introduction of a new tax *per se* does not increase the motivation to pay taxes. Allegedly, society regards the taxation policy as dishonest and believes that the collected taxes are spent incorrectly. Increasing the tax rate for a small category of taxpayers with the purpose of finding a short-term solution to the problems in financing of expenditure items of the state basic budget cannot be regarded as being a fair taxation policy. Likewise, looking at it from the perspective of entrepreneurship, this taxation policy cannot be regarded as being just because the labour tax burden increases for companies and, thus, their competitiveness decreases.

R. Šneidere holds that taxation policy cannot be based on increasing separate taxes. She notes that complex methods should be used in developing taxation policy. The State should ensure the stability of taxation policy, amending the regulation less frequently, setting fair tax rates, as well as increasing the transparency in the use of taxes. The simplicity principle in the taxation policy is also said to be important, i.e., the taxation policy and regulatory enactments should be clear and comprehensible.

Neither can the principle of timeliness in taxation policy be applied to the process of drafting the law "On Solidarity Tax". The annotation to the draft law allows concluding that in the process of drafting the law "On Solidarity Tax", comprehensive discussions with social partners were not held.

**13. The summoned person – the Professor of the University of Latvia *Dr.oec.* Andris Deniņš** – holds that the contested norms are not economically substantiated and are incompatible with the first sentence of Article 91 of the *Satversme*.

A. Deniņš does not discern the economic substantiation for the provisions of Section 6 of the law "On Solidarity Tax", which provides that the solidarity tax rate complies with the rate of insurance contributions, which depends upon the risks that the particular person is insured against.

In general, the current level of Latvia's economic development is said not be appropriate for increasing the burden of labour tax as that significantly hinders the rate of business development, which is said to be slow as it is. Therefore no economic substantiation for introducing the solidarity tax can be found. A. Deniņš is of the opinion that the regulation of the law "On Solidarity Tax" should be revoked or amended in a way to make it appropriate for the economic situation in the state and to ensure that the principle of equality is complied with.

**14. The summoned person – the Minister for Finance Dana Reizniece-Ozola** – holds that the main arguments in favour of introducing the solidarity tax had been linked to the need to augment the state budget resources to provide support for such fields of public importance as, for example, the national defence, social benefits, and service pensions. At the particular moment, i.e., in circumstances of a limited budget, resources had been necessary.

D. Reizniece-Ozola expressed the opinion that the law "On Solidarity Tax" had not been sufficiently explained to society. Therefore, a negative response by entrepreneurs had been observed. However, the Minister for Finance holds that, in general, the solidarity tax had reached its aim because the state budget is "in principle, filling up".

Currently, in introducing the taxation policy reform, similarly as in introducing the solidarity tax, three main purposes are abided by: decreasing the inequality of various social groups, increasing the competitiveness of the state compared to neighbouring countries, as well as ensuring sufficient state budget

resources. In re-structuring the expenditure of solidarity tax revenue and amending the law "On Solidarity Tax", the sense of justice in society had to be reinforced; i.e., the understanding that the recipients of higher income pay a higher tax. Other complex solutions had been adopted in the framework of tax reform to make the general taxation system fairer, in view of the fact that the most prosperous persons are not always the payers of only the labour tax. Also the tax on the return on capital and the income tax to be paid from dividends had been reformed.

**15. The summoned person – the Minister for Welfare Jānis Reirs** – was the Minister for Finance at the time when the law "On Solidarity Tax" was adopted. At the court hearing, he emphasized that the idea of introducing the solidarity tax had not occurred suddenly but had been proposed already in 2011, when the state budget for 2012 had been discussed. However, at that time the draft law had not been proceeded with because it had been recognised that more extensive involvement of experts was required. In 2015, when the drafting of the law "On Solidarity Tax" began, the discussions had been held already in March but faster development had been achieved in August and September when the state budget was drafted.

The aims of adopting the law had followed from both the need to expand the fiscal space and the need to decrease the constantly growing inequality. Another consideration, which had been taken into account in introducing the solidarity tax, had been the need to decrease the regressivity of labour taxes.

With respect to administration of the solidarity tax, J. Reirs upholds the opinion expressed by the Ministry of Finance. I.e., this model for administering the solidarity tax had been chosen to not increase the administrative burden. J. Reirs explained the different rates of the solidarity tax by the need to promote the employment of retired and disabled persons.

In the process of drafting the law "On Solidarity Tax", discussions had been held, and matters related to the introduction of the solidarity tax had been discussed at the Tripartite Cooperation Council and the Council of Economy.

When considering the alternatives, increase of the personal income tax had been considered as one of the alternatives; however, this proposal had not gained support. The personal income tax is mainly transferred into the budgets of local governments but the financing of local governments in Latvia as such is already among the highest in the European Union. The budget revenue had been required mainly for decreasing the social gap in society, for example, to improve the accessibility of medical services.

**16. The summoned person – the Minister for Education Kārlis Šadurskis** – was head of the *Saeima* Budget and Finance (Taxation) Committee at the time, when the law "On Solidarity Tax" was drafted.

At the court hearing, K. Šadurskis underscored that the solidarity tax affected a small part of society. Allegedly, the law "On Solidarity Tax" is one among the tax laws that is the easiest to read and to comprehend. The solidarity tax had eliminated the regressivity of labour taxes and decreased inequality in the sector of high salaries.

In planning the state budget for 2016, resources had been required for strengthening the national security. Hence, expansion of the fiscal space had been an utmost necessity. Raising of the personal income tax would not have been as effective because 80 per cent of it are transferred into the budgets of local governments. Whereas abolishing the maximum amount of social contributions would subject the social budget to serious probable future risks. The possibility of increasing the value added tax had also been considered but had been rejected because, essentially, it would lead to increasing social inequality.

Allegedly, the law "On Solidarity Tax" had not been adopted in haste. Extensive discussions on the introduction of the tax had been held at the *Saeima* Budget and Finance (Taxation) Committee. Concerns had been voiced, *inter alia*, regarding the estimates of this tax; however, the actual revenue is said to exceed the estimates. The solidarity tax is said to be effective in reaching its aim. The tax revenue had been used to increase the national defence budget, disbursement of service pensions, as well as expanding the circle of free lunch recipients.

As regards the different solidarity tax rates for various groups of the payers thereof, K. Šadurskis underscored that the differences were minor; moreover, it was impossible to write an absolutely perfect law, so that "no exception ever would fall outside the frame". The linking of the solidarity tax to the social insurance system of the state and the arithmetic similarity of rates was said to be logical, as it made administration of the tax easier and "performance of all functions" to the payers thereof. When the draft law was discussed, lack of understanding of the different tax rates had not been expressed. K. Šadurskis said that the tax "simply coincided" with the social insurance contributions after the maximum amount of the object of social insurance contributions had been reached. Thus, the administration of the tax is very simple. Only the account into which the Agency transfers the tax revenue changes.

**17. The summoned person** – **the Bank of Latvia** – considers that the solidarity tax is a new type of income tax that has been introduced in Latvia, which is known in English as the *payroll tax*.

As to its economic nature, this tax, in assessing the tax burden, should be considered in interconnection with the personal income tax. The income tax cannot be aggregated with insurance contributions because their economic meaning differs. I.e., in insurance, with respect to the contributions, certain rights to social security are granted. Whereas the income tax in the budget can be used by the State for performance of its functions. At the court hearing, the representative of the Bank of Latvia E. Kušners expressed the opinion that, in the case of the solidarity tax, this had not been taken into consideration. The solidarity tax is not linked to the field of social security because it is not transferred into the social budget and the purposes for which it is spent are not linked to ensuring new social rights.

Allegedly, the solidarity tax regulation in the long-term will have a negative impact on the competitiveness of the Latvian employers. Although, in principle, the progressivity of taxation system should be supported, in the case of the solidarity tax it is said to create fiscal incentives for not taking a certain

action – to not pay higher salaries. Allegedly, Latvia has neither legal nor economic grounds to provide incentives to entrepreneurs not to pay higher salaries and, thus, not to create highly remunerated jobs. From the perspective of sustainable economic development, this situation is said to be very dangerous for the society as a whole, since the competitiveness of the state decreases. In implementing the principle of a socially responsible state in the field of taxation policy the State should take such measures that would be sustainable, balanced, fair, and proportionate.

E. Kušners underscored that the restriction on a person's fundamental rights caused by the regulation on the solidarity tax was not commensurate with the interests of the society as a whole.

## The Findings

**18.** The Applicants request the Constitutional Court to examine the compliance of the contested norms with the first sentence of Article 91 and Article 109 of the *Satversme*.

The Applicants hold that the contested norms of the law "On Solidarity Tax" are incompatible with the principle of equality in interconnection with the right to social security defined in Article 109 of the *Satversme*. It is noted in the applications that all employees, who make insurance contributions, are in similar and comparable circumstances; however, the payers of the solidarity tax cannot receive social insurance services corresponding to the insurance contributions that they have made proportionally to their salary.

It is of significance in the case under review that the right established in Article 109 of the *Satversme* is one of the types of social rights included in the *Satversme*. The Constitutional Court has noted repeatedly in its rulings that the State should be granted broad discretion in deciding on issues of social rights (*for example, Judgement by the Constitutional Court of 22 December 2005 in Case No. 2005-19-01, Para 9*).

Various opinions have been expressed in the case regarding the nature of the solidarity tax and the application thereof to the fundamental rights included in Article 109 of the *Satversme*. At the court hearing, the *Saeima* as well as a number of summoned persons – the Ombudsman, the Ministry of Justice, the Ministry of Welfare, and the Ministry of Finance – expressed the opinion that the contested norms did not infringe upon the applicants' right to social security envisaged in Article 109 of the *Satversme*.

**Hence, the Constitutional Court must first and foremost establish whether the contested norms are applicable to such rights of the Applicants that fall within the scope of the right to social security included in Article 109 of the *Satversme*.**

**19.** Article 109 of the *Satversme* provides that everyone has the right to social security in old age, for work disability, for unemployment and in other cases provided by law.

The Constitutional Court has recognised that the ensuring the fundamental rights included in Article 109 of the *Satversme* can be examined in a number of aspects, i.e., verifying, whether a person's fundamental rights envisaged in Article 109 of the *Satversme* have been restricted, or else, verifying, whether the State has fulfilled its duty (*see, for example, Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 15.1*). Those instances, where the core of the right to social security has been affected, need a different assessment, i.e., the set of basic obligation in the field of social security that the State has no right to deviate from even in circumstances of economic recession (*see, for example, Judgement of 21 December 2009 by the Constitutional Court in Case No. 2009-43-01, Para 31. and 31.2.*).

The case under review does not comprise a dispute on whether the State has fulfilled its obligation to guarantee the right to social security at least on the minimal level. Hence, in examining, whether the contested norms are applicable to such rights of the Applicants that fall within the scope of the right to social security, the Constitutional Court must examine, whether the contested norms

apply to fulfilment of the State's obligation defined in Article 109 of the *Satversme* or cause a restriction on the Applicant's fundamental rights.

**19.1.** The Constitutional Court already has noted that Article 109 of the *Satversme* defines the right to a stable and predictable, as well as effective, just and sustainable system of social protection and security, which guarantees proportionate social security (*see, for example, Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 15.2.*). The legislator, by adopting the law "On Social Security", has defined the principles for establishing the system of social security and the principles of its operation, as well as the main social rights of persons. These, *inter alia*, include the right to such social insurance, which requires compulsory contributions from the employees, employers, and, in some cases, from the State *(see, for example, Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 15.2.*).

Thus, social insurance is a part of the state social security system. The general principles and the financial and organisational structure of the state social insurance are defined by the law "On State Social Insurance". Pursuant to this law, social insurance is a set of measures organised by the State to ensure the risk of a person or persons in his care to lose income from work due to the insured person's illness, disability, maternity, unemployment, old age, accident at work or having an occupational disease, caring for a sick child, as well as additional expenditure in connection with the death of the socially insured person or persons in his care (*Section 3(1) of The law "On State Social Insurance"*). The range of social insurance services is individual and depends upon the prior insurance contributions made by the person. Section 7 of the law "On State Social Insurance" provides that the social insurance services are financed from the special social insurance budget (hereinafter – the special budget).

The law "On Social Security" provides for a person's right to social assistance in case if he is unable to provide for himself or to overcome particular difficulties in life. In such cases, the State provides social assistance to a person

by granting a social benefit in cash or in kind, or in the form of other services (*see Section 13(1) of the law "On Social Security"*). The state social benefits are financed from the state basic budget. These envisage providing support irrespectively of the insurance contributions made by a person.

**Thus, the contested norms do not pertain to the State's obligation to establish and to maintain a social security system that guarantees the social security of every person.**

**19.2.** The scope of rights included in Section 109 of the *Satversme* has been specified in laws. The legislator has defined the rights of a person to social security provided for in Article 109 of the *Satversme, inter alia,* in the form of social insurance.

The legal relationship of social insurance is established on the basis of law, simultaneously with establishing legal employment relationship. Section 20 of the law "On State Social Insurance" provides that an employee makes the insurance contributions with the mediation of the employer, i.e., the employer calculates and transfers into the special budget both the part of the employer's and the employee's social contributions. Moreover, the legislator has provided that the insurance contribution is a tax (*see Para 9 of Section 8 of the law "On Taxes and Fees").*

Each of the Applicants is making social contributions and, if a particular insurance case sets it, he can apply for social insurance services. The Constitutional Court has already noted: "If an employee is insured for a type of obligatory insurance, then, when the case of insurance sets in, he/she has the right to appropriate security" (*see Judgement of 26 March 2004 by the Constitutional Court in Case No. 2003-22-01, Para 11*).

Examination of the basic principles of the social insurance established in Latvia leads to the conclusion that they, *inter alia*, include a person's own social responsibility for his future and the scope of his social security. Insurance contributions are a person's long-term investment, which guarantees to him social security in the future. Moreover, social security is characterised also by the fact that the person in co-participating in it throughout his period of employment.

Thus, a person can exercise the rights envisaged in Article 109 of the *Satversme* in full, if he has co-participated in the insurance system. In such a case, the scope of social insurance services is proportional to the insurance contributions that have been made (*compare to Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 16.2.*).

**19.3.** The Applicants hold that if an insurance case occurs, the social insurance service to a person, who is the payer of the solidarity tax, is smaller than the object of contributions, from which actually the insurance contributions have been made. In this respect, the constitutional complaint is based on the Applicants' assumption that the solidarity tax is insurance contributions that the legislator has decided to call a solidarity tax and channel for financing measures from the state basic budget rather than disburse to a person in the form of insurance service.

Section 12 (1) of the law "On State Social Insurance" provides that the object of contributions by the employer and the employee is all income calculated in salaried work, from which personal income tax must be withheld, without deducting the non-taxable minimum, tax concessions and eligible expenses, for which the tax payer has the right to decrease the taxable income, Thus, all socially insured persons, including the Applicants, make social insurance contributions from a particular object.

Section 12(5) of the law "On State Social Insurance" provides that a maximum amount is set for the object of insurance contributions. The procedure for setting it is defined by the Cabinet. In accordance with Para 5 of the Cabinet Regulation No. 1478 "Regulation on the Minimum and Maximum Amount of the State Social Insurance Mandatory and Voluntary Contributions" (hereinafter – Regulation No. 1478), in 2016 the maximum amount of insurance contributions was 48 600 *euro*, whereas in 2017 – 52 400 *euro*. Thus, this is the maximum amount up to which, when an insurance case occurs, the social insurance services are calculated and disbursed, proportionally to insurance contributions.

In Latvia, the maximum amount of social insurance was introduced in 1997, but in 2009 it was revoked until 31 December 2013 to increase the revenue

of the special budget. This measure, at the same time, opened the possibility for the recipients of high salaries to obtain benefits and pensions in large amounts (*see Transcript of the Court Hearing of the Constitutional Court of 5 September 2017, Case Materials, Vol. 10, p. 77*).

Until 1 January 2016, the Agency recalculated the overpaid insurance contributions of a person, whose insurance contributions exceeded the maximum amount, and reimbursed it in the procedure defined by the Cabinet. Thus, if a person's insurance contributions exceeded the set maximum amount, the overpaid part of contributions was reimbursed to the person.

The Constitutional Court has recognised that it is admissible to set the maximum amount of the object of insurance contributions; moreover, balancing the special budget can be considered as the basis for guaranteeing the sustainability of this budget. Therefore it is essential to prevent development of deficit in the special budget and also to guarantee that disbursement of social insurance benefits would be possible also in the future (*see Judgement of 11 November 2005 by the Constitutional Court in Case No. 2005-08-01, Para 8*). In view of the fact that the right to social security is based on the State's obligation to establish a sustainable social security system, the legislator must balance the financial possibilities of the special budget not only with a person's rights in the social field but also with the need to ensure the welfare of society as a whole. The responsibility for balancing the special budget and reasonable use of the budget resources lies upon the State. Therefore the logics of the state revenue and expenditure allow setting the maximum limit for insurance services (*see Judgement of 11 November 2005 by the Constitutional Court in Case No. 2005-08-01, Para 6.3.*). The legislator has chosen to balance the special budget by introducing the solidarity tax, which would allow financing some measures of the social security system from the basic budget. I.e., the aim of the solidarity tax is, *inter alia*, to ensure revenue into the state basic budget to finance the growing needs for social protection of inhabitants and decreasing the inequality (*see Section 2 (1) of the law "On Solidarity Tax"*).

When the solidarity tax was introduced, it was defined that the object thereof was the income that exceeded the maximum amount of the object of insurance contributions set for the respective calendar year (*see Section 3 of the law "On Solidarity Tax").* Thus, the legislator has changed the previous system, in accordance with which the overpaid insurance contributions were reimbursed to the person, and has channelled this part into the basic budget in the form of the solidarity tax. Hence, the solidarity tax is a new tax, which must be calculated from the tax object referred to in Section 3 of the law "On Solidarity Tax" – the income that has been defined in Section 14 and Section $20^2$ of the law "On State Social Insurance" and exceeds the maximum amount of the object of mandatory social insurance contributions defined for the state for the respective calendar year. The fact that the legislator had wanted to introduce a new, discrete tax is proven also by Para 16 of Section 8 of the law "On Taxes and Fees", in which this tax is defined as a separate type of tax.

Thus, the solidarity tax is, essentially, a new type of income tax. This also means that the solidarity tax is not an insurance contribution and cannot be attributed to the receipt of social insurance services in any aspect.

**Thus, the contested norms do not cause a restriction on the fundamental rights included in Article 109 of the *Satversme*.**

**19.4.** The Constitutional Court has noted already before that the regulation, insofar it envisages a person's obligation to pay a tax, falls within the scope of the first and the third sentence of Article 105 of the *Satversme* and should be assessed as a restriction on the right to property (*see, for example, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 19*). However, within the framework of the case under review, the compliance of the contested norms with Article 105 of the *Satversme* is not examined (*see Decisions by the 2nd Panel of the Constitutional Court of 21 July 2016 on Initiating a Case, Case Materials, Vol. 3, pp. 132 –137 and Vol. 5, pp. 32 –38*).

The legislator, in adopting the contested norms, has not restricted a person's fundamental rights to social security in cases provided for by law

because any person, including the Applicants, have the right to social insurance proportional to the scope, in which the person has co-participated in accumulating the social insurance capital, as well as the right to other social security measures guaranteed by the State.

In view of the fact that the contested norms do not pertain to the Applicants' fundamental rights envisaged in Article 109 of the *Satversme* to social security, the Constitutional Court will not examine the compatibility of the contested norms with Article 109 of the *Satversme*. Therefore, in accordance with Para 6 of Section 29 (1) of the Constitutional Court Law, the legal proceedings in this part of the case must be terminated because continuation thereof is impossible.

**Hence, the legal proceedings in the part regarding the compliance of the contested norms with Article 109 of the *Satversme* must be terminated.**

**20.** The first sentence of Article 91 of the *Satversme* provides that all people in Latvia are equal before the law and the court. The Constitutional Court has recognised that the legislator, in adopting legal norms, must take into consideration the equality principle that is included in the aforementioned norm of the *Satversme* (*see, for example, Judgement of 3 April 2001 by the Constitutional Court in Case No. 2000-07-0409, Para 1 of the Findings*). The principle of equality prohibits the state institutions from issuing such norms that, without reasonable grounds, allow differential treatment of persons who are in similar and comparable circumstances (*see, for example, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 11*). Its objective is to ensure that the requirement of a state governed by the rule of law regarding a comprehensive impact of the law upon all persons is complied with and that the law would be applied without any privileges (*see, for example, Judgement of 13 February 2013 by the Constitutional Court in Case No. 2012-12-01, Para 14.1.*). However, the principle of equality allows and even requires differential treatment of persons who are in different circumstances, as well as allows differential treatment of persons, who are in similar circumstances if there are

objective and reasonable grounds for it (*see, for example, Judgement of 3 April 2001 by the Constitutional Court in Case No. 2000-07-0409, Para 1 of the Findings)*.

The Applicants have requested examining the compliance of a number of norms of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme*; these are norms that define the tax object, the taxpayers, the tax rates, the procedure for calculating the tax and channelling the tax revenue into the state basic budget.

**Therefore, it should be established, first and foremost, which of the contested norms should be examined in the framework of the first sentence of Article 91 of the *Satversme*.**

**21.** Pursuant to Section 3 of the law "On Solidarity Tax", the tax object is the income that has been defined in Section14 and 202 of the law "On State Social Insurance" and exceeds the maximum amount of the object of insurance contributions defined for the respective calendar year. Section 5 of the law "On Solidarity Tax", in turn, provides that taxpayers are the employers, employees, domestic employees with the employer – a foreigner, foreign employees with the employer – a foreigner – and self-employed persons subjected to the state social insurance and whose income during the taxation period exceeds the maximum amount of the object of mandatory contributions defined in accordance with the law "On State Social Insurance". Thus, the payers of the solidarity tax are all employees and self-employed persons, who are subjected to the state social insurance and whose income within a calendar year exceeds the amount defined in law. All Applicants are employees therefore, in view of the facts of the case under examination and limits of the claim, the possible restriction on the fundamental rights of employers as the payers of the solidarity tax will not be examined in this case.

Thus, the obligation to pay the solidarity tax has been envisaged for a certain circle of socially insured persons, the defining feature of which is the tax object. The rates of the solidarity tax differ for persons depending upon the

insurance contribution rate that is applied to the particular person. Hence, it follows from the contested norms that the payers of the solidarity tax are identified according to the tax object and are divided into groups according to the tax rate.

Therefore the Constitutional Court must verify, whether the legislator, in defining the circle of persons who have the obligation to pay the solidarity tax, as well as the object and the rates of this tax, has not allowed a restriction on the Applicants' fundamental rights without grounds.

The addresses of Section 7 of the law "On Solidarity Tax" are the Agency and SRS. This section defines the competence of public administration in calculating the solidarity tax. Section 9 of the law, likewise, pertains to the competence of public administration, i.e., sets the Agency's obligation to transfer the tax revenue into the state basic budget. A regulation like this does not grant subjective rights to a person. Therefore the compliance of Section 7 and Section 9 of the law "On Solidarity Tax" with the *Satversme* will not be examined.

Thus, on the basis of Para 6 of Section 29 (1) of the Constitutional Court Law, the Constitutional Court will not continue legal proceedings regarding this part of the claim.

**Hence, the legal proceedings in the case regarding compliance of Section 7 and Section 9 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* shall be terminated.**

**22.** In continuing the legal proceedings, the Constitutional Court will examine the compliance of Section 3, Section 5 and Section 6 of the law "On Solidarity Tax" (hereinafter jointly also – the contested regulation) with the principle of legal equality included in the first sentence of Article 91 of the *Satversme*.

In assessing the compliance of the contested regulation with the principle of equality, it must be established:

1) which persons or groups of persons are in similar and comparable circumstances;

2) whether the contested norms envisage differential treatment;

3) whether the differential treatment has objective and reasonable grounds; i.e., whether it has a legitimate aim and whether the principle of proportionality has been complied with (*see, for example, Judgement of 2 February 2010 by the Constitutional Court in Case No. 2009-46-01, Para 7*).

Consequently, first and foremost, it must be established, whether and which persons (groups of persons), with respect to the obligation to pay the solidarity tax, are in similar and according to specific criteria comparable circumstances.

**22.1.** The Applicants hold that the possible inequality is manifested in a number of respects.

Allegedly, the contested regulation created, without reasonable grounds, unequal treatment of employees who pay the solidarity tax, compared to those employees who do not pay the solidarity tax. I.e., in this respect the constitutional complaint is based on the Applicants' opinion that the solidarity tax is an insurance contribution.

The Constitutional Court notes that, upon introduction of a new tax, changes in regulation *per se* establish two groups of persons, at the same time envisaging differential treatment of then, i.e.; persons who are taxpayers and persons who do not have to pay the tax. However, the fact that in the framework of the new tax regulation the rights of these two groups are regulated, essentially, differently, is not *per se* a violation of the equality principle.

In the case under review, it should be taken into consideration that the feature, by which the groups of persons indicated by the Applicants are identified, is the object of the solidarity tax; i.e., the amount of income to which the solidarity tax is applied. Those employees, whose income within a year does not reach the limit, upon which the obligation to pay the solidarity tax occurs, do not have this feature and, thus, in the circumstances of the case under review,

essentially, cannot be compared to those employees, whose income exceeds this limit and who, accordingly, have the obligation to pay the solidarity tax.

The Constitutional Court has already noted that the solidarity tax is not an insurance contribution. Hence, from the perspective of the equality principle, there is no need to examine the argument regarding the scope of social insurance services, since it has been recognised already that each person who makes the insurance contributions receives these services proportionally to the contributions made (*see Para 19.2. of this Judgement*).

**Hence, the employees, who are payers of the solidarity tax, and the employees, who are not payers of the solidarity tax, as regards the obligation to pay this tax are not in comparable circumstances.**

**22.2.** The Applicants holds that the contested norms of the Solidarity have established similar treatment of groups of persons who are in different circumstances; i.e., employees and self-employed persons, who have been imposed the obligation to pay the solidarity tax.

Allegedly, employees cannot choose to not pay the solidarity tax because it is paid by the employer, together with the insurance contributions. Whereas self-employed persons may define (declare) themselves the object of contributions from which the solidarity tax must be paid. It is maintained that self-employed persons have the possibility to declare such amount of income as to not pay the solidarity tax. In defining the regulation on the solidarity tax, the specifics of declaring income and expenditure of self-employed persons had not been taken into account. Hence, with the contested norms, the legislator has allowed a situation, in which one group of persons with the annual income exceeding 48 600 *euro* – the employees – have no choice with respect to paying the solidarity tax, whereas self-employed persons with the same income are said to have this choice. Therefore, the similar treatment in this situation is said to be unjustifiable.

Pursuant to Section 14 (1) of the law "On State Social Insurance", the object of mandatory contributions of an employer and employee are all calculated income from work from which personal income tax must be deducted

without deduction of the non-taxable minimum, tax concessions and eligible expenses. The income tax for the income that an employee gains in the form of a salary is calculated and paid by the employer, in the procedure established in the law "On the Personal Income Tax". The insurance contributions are calculated and paid in the procedure defined in the first and the second part of Section 20 of the law "On State Social Insurance". I.e., also the insurance contributions of the employee are paid by the employer, paying into the special budget account the contributions to be made both by the employer and the employee.

A self-employed person calculates and pays the personal income tax into the budget in two procedures – as an advance payment and in summary procedures of calculation, – by submitting the annual tax return *(see Section 18 and Section 19 of the law "On Personal Income Tax"*).

The object of insurance contributions of a self-employed person, pursuant to Section 14(2) of the law "On State Social Insurance", is the freely selected income (or revenue of the payers of fixed personal income tax) from the production of goods, performance of work, provision of services, creative and professional activity and other income from economic activity, except for the income that is obtained by a natural person, who has been referred to in Section 6, Paragraph seven, eleven or thirteen of the law "On State Social Insurance", from agricultural (fish) farming, his or her immovable property, self-produced production in an individual subsidiary farm or household farm, copyright and related rights. A self-employed person may make the choice of the income from which to make insurance contributions once in a reporting quarter, however, a self-employed person must make it at least from the minimum a amount of the insurance object defined in Para 2 of the Cabinet Regulation No. 1478, which is 12 minimum monthly salaries defined by the Cabinet.

The record-keeping of a self-employed person's income and the procedure for making social insurance contributions differ from the procedure, in which employees pay their salary tax and make social insurance contributions. Accordingly, a self-employed person decides himself on how to secure oneself against cases of various social risks. If a self-employed person does not make

social insurance contributions he is not entitled to the respective social insurance services. Thus, in such a case a person must assume individual responsibility for his social security.

However, every self-employed person who is subjected to the state social insurance, just like an employee, has the obligation to pay the solidarity tax if his income in the taxation period exceeds the maximum amount of the object of mandatory contributions set in the law "On State Social Insurance". The feature that allows comparing both groups is the object of the solidarity tax; i.e., the defined amount of income. The fact that these two groups of persons have different procedures for keeping the record of income and for paying taxes does not prohibit from comparing these groups with respect to the obligation to pay the solidarity tax.

**Thus, from the perspective of the obligation to pay the solidarity tax, employees and self-employed persons, who have the obligation to pay this tax, are in comparable circumstances.**

**22.3.** The Applicants also note that the legislator has envisaged different rates of the solidarity tax for various groups of taxpayers, depending on the types of social insurance that the respective groups of persons have. The differential treatment is said to be unsubstantiated because, with respect to the obligation to pay the solidarity tax, these groups of persons are in similar and comparable circumstances; i.e. all these persons receive a certain amount of income.

To determine, whether and which groups of persons are in similar and comparable circumstances, the feature that these groups share must be found (*see Judgement of 4 December 2003 by the Constitutional Court in Case No. 2003-14-01, Para 12*).

Section 3 of the law "On Solidarity Tax" provides that the tax object is linked to the object of insurance contributions. Hence, all employees and self-employed persons who must be socially insured and whose annual income exceeds the maximum amount of the amount of the object of insurance contributions pay the solidarity tax. The uniting feature is the object of the

solidarity tax because it defines the circle of persons, to whom the obligation to pay the solidarity tax applies.

**Hence, all employees and self-employed persons, who must be socially insured and whose annual income exceeds the maximum amount of the amount of the object of insurance contributions, are in comparable circumstances.**

**23.** By the introduction of the solidarity tax, the legislator has specified the range of subjects and has defined the object of the tax. The Constitutional Court has recognised that the in the field of tax law the legislator has the right to select the object of taxes and the circle of taxpayers (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 10*). In examining the limits of the legislator's discretion in establishing a tax for a certain object, it should be taken into consideration that introduction of a new tax is a matter of political decision linked to the priorities of the national development. The legislator's decision on what tax would be necessary is an issue of expedience (*see, for example, Judgement of 30 April 2008 by the Constitutional Court in Case No. 2007-23-01, Para 7 and Para 11*). The obligation to pay taxes, *per se*, does not infringe upon a person's fundamental rights defined in the *Satversme*. Thus, a person's fundamental rights established in Article 91 of the *Satversme* cannot be examined in isolation from a person's constitutional duty to pay taxes that have been established in due procedure (*compare to, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 10*).

In the circumstances of the case under review, the subject and the object of the tax *per se* do not cause a violation of the equality principle, i.e., in the case under review the differential treatment of comparable groups follows from the tax rates that have been set. Hence, Section 3 and Section 5 of the law "On Solidarity Tax" are not to be examined in the framework of the first sentence of Article 91 of the *Satversme* since they do not cause a restriction on the fundamental rights. Hence, on the basis of Para 6 of Section 29 (1) of the

Constitutional Court Law, the Constitutional Court will not continue legal proceedings regarding this part of the claim.

**Hence, the legal proceedings in the part regarding possible incompatibility of Section 3 and Section 5 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* shall be terminated.**

**24.** In examining the compliance of Section 6 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme*, the Constitutional Court must verify, whether this section of the law "On Solidarity Tax" envisages differential treatment of payers of solidarity tax who are in comparable circumstances.

Section 6 of the law "On Solidarity Tax" provides that the rate of the solidarity tax complies with the rate of insurance contributions established by Section 18 of the law "On State Social Insurance". The first part of this section provides that the rate of mandatory contributions, if the employee is insured for all types of social insurance, shall be 34.09 per cent. The rate of insurance contributions for other groups of persons that must have social insurance is set by the Cabinet.

Until 2017, the Cabinet issued regulation on the distribution of the state social insurance contribution rates according to the types of state social insurance for the respective year. Hence, every year the distribution of insurance contribution rates according to the types of social insurance could change for a number of taxpayers' groups, i.e., the rates could increase or decrease. On 1 January 2017, the Cabinet Regulation No. 759 "Regulation Regarding the Distribution of State Social Insurance Contribution Rate by State Social Insurance Types", in which the term for the application of rates is not fixed, entered into force.

The distribution of the rates of insurance contributions in accordance with the types of social insurance, is as follows:

1) in 2016, the compulsory contribution rate for an employee who has reached the age giving the right to receive a state old-age pension or who has

been granted a state old-pension (including before term) was 28.75 % of the object of compulsory contributions. Whereas in 2017 this rate is 29.73 %;

2) In 2016, the compulsory contribution rate if an employee is a recipient of a service pension or a disabled person – recipient of state special pension was 31.08 % of the object of compulsory contributions. Whereas in 2017 this rate is 31.57 %;

3) In 2016, the compulsory contribution rate for a person who is employed by an employer – a foreign taxpayer, if the permanent place of residence of such person is not in the Republic of Latvia and he or she stays for 183 days or more in the Republic of Latvia in any 12-month time period which begins or ends in a taxation year, was 31.47 % of the object of compulsory contributions. Whereas in 2017 this rate is 31.71 %;

4) In 2016, the compulsory contribution rate for a person who is employed by an employer – a foreigner, if the employee is a recipient of a service pension or a disabled person – recipient of State special pension was 31.08 % of the object of compulsory contributions Whereas in 2017 this rate is 31.57 %;

5) In 2016, the compulsory contribution rate for a person who is employed by an employer – a foreigner, if the employee has reached the age giving the right to receive a State old-age pension or has been granted a State old-pension (including before term) was 28.75 % of the object of compulsory contributions. Whereas in 2017 this rate is 29.73 %;

6) In 2016, the compulsory contribution rate for a person who is employed in the Republic of Latvia by an employer – a foreign taxpayer, if the permanent place of residence of such person is in the Republic of Latvia, and a person who is employed by an employer from another European Economic Area Member State or Swiss Confederation to whom in accordance with Articles 11, 12, 13, 14, 15 and 16 of Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, laws and regulations of the Republic of Latvia (hereinafter – domestic employee at a foreign employer) are applicable, was 34.09 % of the object of compulsory contributions. Also in 2017 this rate is 34.09 %;

7) In 2016, the compulsory contribution rate for a self-employed person was 30.58 %. Whereas in 2017, this rate is 31.13 %.

Thus, the different rates have been set for the payers of the solidarity tax, by taking into account the risks, against which the person is insured. Hence, this leads to the differential treatment of the payers of the solidarity tax; i.e., different tax rates have been set for them.

**Section 6 of the law "On Solidarity Tax" causes differential treatment of comparable groups of persons.**

**25.** Upon establishing that a legal norm causes differential treatment, the Constitutional Court must examine, whether the differential treatment has been established by a legal norm adopted in the procedure set out in the *Satversme*; i.e., whether it can be recognised as being a law adopted in due procedure (*see, for example, Judgement of 2 March 2016 by the Constitutional Court in Case No. 2015-11-03, Para 20, and Judgment of 15 June 2017 in Case No. 2016-11-01, Para 17.2*).

Hence, the Constitutional Court must examine Section 6 of the law "On Solidarity Tax", which causes differential treatment of comparable groups of persons.

To assess, whether the tax regulation has been established by a law adopted in due procedure, it must be verified:

1) whether the law had been adopted in compliance with the procedure envisaged in regulatory enactments;

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

3) whether the law has been worded with sufficient clarity, so that a person would be able to understand the content of the rights and obligations that follow from it and forecast the consequences of application thereof, as well as whether the law ensures protection against arbitrary application thereof (*see, for example, Judgement of 3 July 2015 by the Constitutional Court in Case No. 2014-12-01, Para 16*).

**25.1.** A finding has been enshrined in the case law of the Constitutional Court that the fact, whether a law has been adopted in due procedure, must be examined in accordance with Article 21 of the *Satversme*. It includes the principle that the *Saeima* defines its procedure of work itself (*see Judgement of 22 February 2001 by the Constitutional Court in Case No. 2001-06-03, Para 5 of the Findings, and Judgement of 16 December 2008 in Case No. 2008-09-0106, Para 6.1.*).

On 30 November 2015, the *Saeima* adopted the contested norms in the framework of the annual draft budget laws. The contested norms were included in the draft law "On Solidarity Tax", which was submitted, together with the other draft laws of the state budget package by the Cabinet on 30 September 2015.

In the initial impact assessment report of the submitted draft law (hereinafter – the annotation), the Cabinet has explained the aim of the solidarity tax, described the problems in the current situation, included detailed calculations, and provided consideration regarding the constitutionality of the regulation and possible alternative solutions. The public involvement in the drafting of the respective regulation is also reflected in the annotation, and the opinion of the social partners on the respective tax is noted.

The Constitutional Court has noted that the procedure established in the *Saeima* Rules of Procedure, in which the annual draft state budget law and the draft laws that determine or amend the state budget are examined, differs from the procedure, in which other draft laws are examined. Article $87^1$ of the *Saeima* Rules of Procedure provides that the package of draft budget laws contains the draft law on the annual state budget and draft laws that set forth or amend the state budget, or budget-related draft laws. The legislator has the right and, at the same time, an obligation to include into the state budget law and the package of accompanying laws only such matters, which pertain to the respective fiscal year and are closely linked to the use of the state budget resources (*see Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 18*). In view of the special procedure that has been established for

examining the package of the draft state budget laws, the *Saeima* must also examine, whether the draft laws of the state budget package submitted by the Cabinet comply with the criteria defined in Article $87^1$ of the *Saeima* Rules of Procedure. If a draft law does not comply with these criteria, the *Saeima* must exclude it from the package of draft budget laws (*see, for example, Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 18.1.*).

The solidarity tax was introduced with the aim of ensuring state budget revenue for financing the growing needs of social security and decreasing inequality. It is also underscored in the annotation to the draft law that additional resources are necessary to finance the social payments from the state budget. M. Brencis, the representative of the *Saeima*, also underscored at the court hearing that the resources had been necessary to finance social security measures (*see Transcript of the Court Hearing of the Constitutional Court of 5 September 2017, Case Materials, Vol. 10, p. 55*).

The Constitutional Court has recognised that the tax revenue constitutes an essential and indispensable part of the annual state budget revenue, ensuring the State's ability to perform its functions and also its basic obligations in ensuring the fundamental rights (*see, for example, Judgement of 6z December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 9*). The law "On Solidarity Tax" introduced a new tax, which ensures revenue in the state budget. Hence, this law was applicable to the particular fiscal year, ensured the state budget revenue and could be included into the package of the annual draft budget laws. Thus, the *Saeima* has complied with the requirements of Article 21 of the *Satversme*.

**25.2.** In examining the compliance of the legislative procedure with the *Satversme*, it must be taken into account that the adoption of the state budget is an important function of the *Saeima*, which it performs as an institution, which is directly responsible before the people of Latvia. The Constitutional Court has noted that the budget is an important matter for the life of the state and society, because it should be considered as the tool for ensuring the public welfare (*see*

*Judgement of 3 February 2010 by the Constitutional Court in Case No. 2011-11-01, Para 10 and Para 17.3.*).

The *Satversme* sets requirements with respect to every decision, which pertains to important matters in the life of the state and society that ensure that the decisions are adopted in compliance with the principle of a democratic state governed by the rule of law. Hence, the *Saeima,* in exercising its right to legislate and to set the budget, enjoys discretion insofar the general principles of law and the norms of the *Satversme* are not violated.

It can be assessed, whether the legislator has abided by the general principles of law and the norms of the *Satversme,* by examining the case on its merits; i.e., by establishing, whether violations of the Applicants' fundamental rights cannot be found.

The Applicants have expressed the opinion that the law "On Solidarity Tax" had been drafted and adopted in haste, without examining its impact on groups of taxpayers but the expansion of the fiscal space and provision of as large state budget revenue as possible had been set as its primary aim. The Applicants' objections are mainly related to the fact that the social partners and experts had not been sufficiently heard during the drafting of the law.

Pursuant to Article 75 of the *Satversme* and Article 92 of the *Saeima* Rules of Procedure, the legislator has the right to make its own considerations regarding the usefulness of examining a certain draft law in urgent procedure. Whereas the term that the *Saeima* sets for submitting proposals regarding the urgent draft law must be such as to allow a member of the parliament, who wants to submit proposals, to present them in accordance with the requirements set in the *Saeima* Rules of Procedure (*See Judgement of 26 November 2009 by the Constitutional Court in Case No. 2009-08-01, Para 17.1*). Thus, the legislator must ensure such procedure for drafting regulatory enactments that would provide sufficient time for submitting and examining proposals, including alternative proposals. The discussion of proposals allows examining, whether alternatives to the regulation exist (*compare to Judgement of 7 July 2014 by the Constitutional Court in Case No. 2013-17-01, Para 28.1*).

At the sitting of 3 November 2015, the *Saeima* recognised by a majority vote that the draft law "On Solidarity Tax" had to be recognised as being urgent and adopted it in the first reading. A term was set for submitting proposals for the second reading – by 17:00, 6 November 2015.

Thus, the members of the *Saeima* were given the possibility to submit proposals, and time for preparing the proposals was allocated. As the tables that summarise the proposals prepared for the second reading show, the term that was set was sufficient to allow the persons, who had the right to submit proposals, to word them appropriately and submit them. Several proposals regarding the draft law were submitted.

It follows from the case materials, that representatives of ministries, the representatives of the *Saeima* Legal Bureau, as well as experts, social partners and representatives of the sector had participated in the sittings of the *Saeima* Budget and Finance (Taxation) Committee, during which the draft law "On Solidarity Tax" was discussed (*see Audio Recording of the Sitting of 22 October, 28 October and 17 November of 2015 of the* Saeima *Budget and Finance (Taxation) Committee, Case Materials, Vol. 10, p. 138*).

Likewise, the preparatory materials for the draft law allow concluding that the *Saeima* Legal Bureau, in providing its opinion on the draft law, had suggested specifying the aim and the terms of the law, as well as to assess the validity of applying differential tax rates. The minutes and the audio recordings of the sittings of the *Saeima* Budget and Finance (Taxation) Committee prove that the proposals submitted by the *Saeima* Legal Bureau were examined and that also considerations regarding the tax rates made by the Ministry of Finance were heard. The materials of the Committee's sittings prove that all proposals that had been submitted within the set term were discussed and examined (*see the Audio Recording of the Sitting of 22 October, 28 October and 17 November 2015 of the* Saeima *Budget and Finance (Taxation) Committee, Case Materials, Vol. 10. p. 138*).

Likewise, the objections and proposals made by the social partners were repeatedly heard at the sittings of the *Saeima* Budget and Finance (Taxation)

Committee. It follows from the opinion provided by J. Reirs at the court hearing that several social partners had been already heard while the law had been drafted, for example, the Latvian Chamber of Commerce and Industry, the Association of Latvian Commercial Banks, the Employers' Confederation of Latvia, the Latvian Taxpayers' Rights Association, and their written opinions had been examined. The proposals had been collected and examined during the sittings of the Cabinet and the *Saeima* Budget and Finance (Taxation) Committee, as well as during the sittings of the *Saeima*. K. Šadurskis, who was the Chairman of the Budget and Finance (Taxation) Committee of the 12th *Saeima* of the Republic of Latvia, also stated at the court hearing that the draft law "On Social Tax" had been discussed in detail (*see Transcript of the Court Hearing of 6 September 2017 of the Constitutional Court, Case Materials, Vol. 11, p. 30).*

Whereas E. Kušners, the representative of the Bank of Latvia, drew attention to the fact that since the draft law had ben swiftly progressed with, the Bank of Latvia had not had sufficient time to participate in the discussions thereof. E. Baldzēns, the Chairman of the Free Trade Union Confederation of Latvia, at the court hearing expressed the opinion that social partners had participated in the drafting of the law and, in discussing possible solutions for decreasing the regressivity of taxation system, had proposed examination of such alternatives that would comprise complex solutions rather than targeting only one group of employees; however, there had been no time for introducing complex changes to the taxation system (*see Transcript of the Court Hearing of the Constitutional Court on 6 September 2017, Case Materials, Vol. 11, pp. 67 and 101).*

However, the Constitutional Court has obtained confirmation that the legislator had ensured the involvement of social partners and stakeholders and hearing of their opinion in the procedure of examining the draft law "On Solidarity Tax". The fact that the legislator did not take into account all proposals that were made cannot be the grounds for recognising that the *Satversme* had not been complied with because the opinion of a particular group of persons is not

binding upon the legislator. Moreover, the opinion of the addressees of the legal norms on the draft of these norms cannot prohibit the *Saeima* from adopting decisions (*see, for example, Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 18.1.*). It is important, whether the legislator examined the submitted proposals and considered the possible alternatives. The procedure for drafting the law "On Solidarity Tax" and the state budget of 2016 in general proves that the legislator has examined various possibilities to ensure the public welfare.

On 30 November 2015, the *Saeima* adopted the law "On Solidarity Tax" in the second, the final, reading. The President of the State promulgated the law "On Solidarity Tax" on 18 December 2015, and the law entered into force on 1 January 2016 and was published in the official journal "Latvijas Vēstnesis" No. 248 on 18 December 2015.

Hence, the contested regulation was adopted and has been promulgated in the procedure established in the *Satversme*.

**25.3.** In establishing, whether the particular legal norm is sufficiently clear, the Constitutional Court must analyse the content of the principle of legal certainty and Article 90 of the *Satversme*.

Article 90 of the *Satversme,* in interconnection with the principle of legal certainty, provides that the legal norms adopted by the legislator must be sufficiently predictable and clear, as well as sufficiently stable and unchanging so that a person could take not only short-term decisions but also make long-term future plans (*see, for example, Judgement of 25 October 2004 by the Constitutional Court in Case No. 2004-03-01, Para 9.2.*). Thus, on the one hand, the principle of legal certainty imposes the obligation upon the legislator to adopt such legal norms that are sufficiently clear. On the other hand, the principle of justice requires ensuring that a party applying the legal norms is able to resolve any case in life with the help of the legal norms (*see Decision of 19 December 2012 by the Constitutional Court on Terminating Legal proceedings in Case No. 2012-03-01, Para 18.1*).

The Constitutional Court has recognised the predictability of the consequences of a legal norm as an essential criterion that proves that the legal norm has been clearly worded; i.e., the norm should be worded in such a way as to allow a person to clearly forecast the field of its application and its significance (*see Judgement of 30 March 2011 by the Constitutional Court in Case No. 2010-60-01, Para 15.2., and the Decision of 19 December 2012 on Terminating Legal Proceedings in Case No. 2012-03-01, Para 18.3.*). The Constitutional Court had already noted before that a tax law that was so complicated that a person would be unable to comprehend it would be incompatible with the constitutional norms (*see Judgement of 19 June 2010 by the Constitutional Court in Case No. 2010-02-01, Para 9.4.2.*).

The law "On Solidarity Tax" refers to the meaning of the terms used in the law, the purpose of the law, the taxpayers and the object, the rates and the taxation period have been indicated, and the procedure for calculating and administering the tax is regulated. The legislator has provided that the terms used in the law "On Solidarity Tax" comply with the terms used in the law "On State Social Insurance" and in other related regulatory enactments. Also the tax rates that are established are the same as the ones included in the law "On State Social Insurance". Thus the legislator has defined that the regulation on the solidarity tax is to be established by using, *inter alia*, such method for interpreting legal norms as the method of systemic interpretation.

The right to define the details of the regulation in the field of taxation and to specify the content of the terms used in regulatory enactments falls with the scope of the legislator's discretion (*see Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 16.1.*). The *Saeima* also enjoys broad discretion in matters related to the legislative technique (*see Judgement of 19 June 2010 by the Constitutional Court in Case No. 2010-02-01, Para 9.4.2.*). Thus, the legislator's constitutional obligation to set sufficiently clear regulation does not mean that all details should be defined exactly in the particular regulatory enactment, in this case – in the law "On Solidarity Tax". Therefore the fact that the content of the solidarity tax must be established in

interconnection with other legal norms *per se* cannot be recognised as being incompatible with the *Satversme*.

The question, how great effort and how much time of the taxpayer is required to gain understanding of his rights and obligations that follow from the new regulation, is an aspect that must be taken into consideration in assessing, whether a legal norm is sufficiently clear.

The obligation to pay the respective tax, which is binding upon certain groups of persons, clearly follows from the law "On Solidarity Tax". The Agency calculates the solidarity tax and transfers it into the state budget. Thus, any reasonable taxpayer could verify, whether his income exceeded the maximum amount of the object of insurance contributions. Moreover, a person, if necessary, seeking appropriate advice, could establish the content and nuances of the regulation on the solidarity tax. The field of taxation *per se* is to be considered as such, where a person might need the advice from the experts of this field and from lawyers.

The law "On Solidarity Tax" has been worded with sufficient clarity to allow a person to understand the content of the rights and obligations that follow from it and to forecast the consequences of application thereof; moreover, the law clearly defines the field of application thereof and the competence of the public administration, thus ensuring protection against arbitrary application of this law.

**Thus, the solidarity tax has been established by a law adopted in due procedure.**

**26.** The legislator may adopt a legal regulation that causes differential treatment of comparable groups of persons only if such action has objective and reasonable grounds, i.e., a legitimate aim.

In examining, whether the setting of different solidarity tax rates for comparable groups of taxpayers has a legitimate aim, it must be taken into consideration that the obligation to pay the solidarity tax has been established within the framework of the national taxation policy.

Before the solidarity tax was introduced, when the maximum amount of the object of insurance contributions was reached, the person no longer participated in social insurance with respect to that part of his income received within the particular calendar year that exceeded this maximum amount. I.e., the overpaid insurance contributions were reimbursed to the employee. Hence, the total burden of labour tax for those employees, whose salaries exceeded the maximum amount of the object of insurance contributions, gradually decreased.

Pursuant to Section 2 of the law "On Solidarity Tax", by introducing this law, the legislator wanted to achieve that all employees and self-employed persons, whose annual income was to be considered high, according to a criterion chosen by the legislator – the maximum amount of the object of insurance contributions, would pay the solidarity tax. In this way the legislator wanted to decrease the tax regressivity for employees and, at the same time, collect additional state budget revenue to finance the growing needs of the state's inhabitants for social security and decreasing inequality.

The Minister for Finance D. Reizniece-Ozola also pointed to the legislator's aim to achieve that all persons with high income paid the solidarity tax, participating in a solidary way in increasing the revenue of the state basic budget. At the court hearing, she underscored that the solidarity tax was introduced to reinforce the sense of justice in society; i.e., that the recipients of high salaries would pay a larger tax. At the court hearing this opinion was upheld also by J. Reirs, K. Šadurskis, and the representatives of the *Saeima*. In view of the opinions expressed at the court hearing, the solidarity tax should be paid by all employees and self-employed persons with high income; i.e., the legislator has envisaged as the only criterion for imposing the obligation to pay the solidarity tax a certain amount of income (*see Transcript of the Court Hearing of the Constitutional Court on 6 September 2017, Case Materials, Vol. 11, pp. 13-40*).

The Constitutional Court has recognised that the State, in the implementation of taxation policy, enjoys broad discretion (*see Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 20*).

Thus, the legislator has the right also to choose a solution for ensuring revenue into the state basic budget that is required to provide for the inhabitants' growing needs for social security and decreasing of inequality. However, in the implementation of taxation policy, the legislator's actions must comply with the general legal principles and the norms of the *Satversme*. It follows from the basic norm and the principle of a socially responsible state that is included in the Preamble to the *Satversme*. Likewise, in exercising its discretion in the field of taxation policy, the legislator must comply with the principles of effectiveness justice, solidarity, and timeliness.

The Preamble to the *Satversme* provides that everyone should take care not only of himself and ones next of kin but also of the general public good. This means that an individual and society have a relationship of reciprocal solidarity (*see: Latvijas Republikas Satversmes komentāri. Ievads. I nodaļa. Vispārējie noteikumi. Autoru kolektīvs prof. R. Baloža zinātniskajā vadībā. Rīga: Latvijas Vēstnesis, 2014, 222. lpp.*). Any tax, in fact, is a solidarity payment because it allows supplementing the state budget with resources that are used to finance measures that are important for the society as a whole. Hence, the performance of the obligation to pay any tax is a manifestation of the solidarity principle. I.e., within the framework of the taxation systems, individuals, in accordance with their income, specifics of consumption, the value of property in their ownership or other socioeconomic criteria pay certain taxes, thus embodying reciprocal solidarity in society. Paying of taxes is the way, in which persons assume shared responsibility for meeting the needs of society and for maintaining the Latvian state.

Whereas the legislator's obligation in the field of taxation is to establish a solidary and fair – based upon certain criteria – mechanism for levelling out socioeconomic difference, aimed at sustainable national development; moreover, not only in the formal meaning of it but also by ensuring an effective functioning of this mechanism, as well as to introduce the necessary changes to the taxation policy in a well-considered and timely manner. Implementation of a taxation policy like this ensures the public welfare.

**Thus, the State's obligation to implement a fair, solidary, effective and timely taxation policy to ensure the public welfare follows from the principle of a socially responsible state.**

**27.** When establishing a new tax, the State must verify, whether the principle of equality and other principles of taxation policy that follow from the *Satversme* have been complied with, by balancing the rights of a person with the need to ensure the welfare of the society as a whole and creating such taxation regulation that would be aimed at embodying these principles and implementing them substantially.

When a restriction on fundamental rights is established, in the legal proceedings before the Constitutional Court, the obligation to present and to substantiate the legitimate aim of the established restrictions first and foremost lies upon the institution, which has issued the contested act (*see, for example, Judgement of 13 June 2014 by the Constitutional Court in Case No. 2014-02-01, Para 13*).

**27.1.** At the court hearing, D. Reizniece-Ozola, in substantiating the considerations upon which the establishment of the solidarity tax rate had been based, expressed the opinion that the different tax rates had been established with the aim of providing special support to some groups of the payers of solidarity tax, for example, working pensioners and disabled persons. At the court hearing, this opinion was upheld also by the summoned persons J. Reirs and K. Šadurskis (*see, Transcript of the Court Hearing of the Constitutional Court of 6 September 2017, Case Materials, Vol. 11, pp. 13–40*). The representative of the Ministry of Finance D. Robežniece at the court hearing expressed the opinion that the differential solidarity tax rates should not be linked to supporting special groups of payers of solidarity tax and, for example, with respect to working pensioners she noted that this was their free choice – to remain in the labour market or to receive the pension and be outside the labour market (*see Transcript of the Court Hearing of the Constitutional Court of 5 September 2017, Case Materials, Vol. 10, p. 82*).

Pursuant to Section 6 of the law "On State Social Insurance", employees must be socially insured and, accordingly, they make social insurance contributions appropriate for their employment, age and health status for those risks, the occurrence of which for the respective groups of persons is real. Hence, the social insurance rates follow from the risks that the person is subject to and, respectively, the types of social insurance for which the person is ensured.

By the law "On Solidarity Tax", the different insurance rates set for various groups of persons in social insurance are applied to comparable groups of persons. However, in the meaning of the law "On Solidarity Tax", the persons covered by the law "On State Social Insurance" are payers of the solidarity tax on the basis of another criterion, which, essentially, is not linked to the social insurance, i.e., – on the basis of a certain amount of income. The Constitutional Court has already recognised that, in adopting the contested norms, the Applicants' rights to social security have not been affected (*see Para 19. 4. of this Judgement*). In view of the considerations expressed at the court hearing regarding the legislator's aim to support special groups of payers of solidarity tax by applying differential rates, the differences in rates should have been objectively substantiated in the process of adopting the law "On Solidarity Tax" in the meaning of a particular support mechanism linked to the obligation to pay the solidarity tax. Decreasing of social differences, by facilitating the employment of retirement-age persons, is an important task of the State; however, it should be performed by implementing measures aimed at creating special or exceptional conditions for the particular group of persons. If the legislator envisages such special regulation aimed at reaching a particular goal, must provide special substantiation on the way, in which the particular group of persons is in a different situation compared to other persons.

**27.2.** The *Saeima* has noted in its written reply that the establishment of different tax rates was linked to the fact that the solidarity tax would be administered exactly like the insurance contributions, therefore simple collection of this tax had been ensured and additional administrative burden had not been created for the taxpayers. Likewise, this solution had not required large

additional expenditure, which the development of a new system for administering the tax would have required.

At the court hearing, the Constitutional Court obtained confirmation of the fact that, in setting the solidarity tax rates, the rates of insurance contributions already applied in social insurance had to be used for the sake of simplicity of administration. The simplicity of administering the solidarity tax is manifested in two aspects. Firstly, the taxpayers do not have to take any actions linked to calculation of the tax, since this is taken care of by the Agency. Secondly, linking of the tax administration to an already established management mechanism allows decreasing the State's expenditure, which would increase in the case of introducing a new system. Therefore the rates of the solidarity tax are identical with the social insurance rates and differ only depending on the types of social insurance that the particular person is insured for. Allegedly, this mechanism of administering the tax is aimed at ensuring the welfare of society as a whole, which, in the *Saeima*'s opinion, is to be considered the legitimate aim of the restriction on fundamental rights – the differential treatment. Essentially, at the court hearing this was admitted by the representatives of the Ministry of Finance and the Ministry of Welfare, D. Reizniece-Ozola, J. Reirs, and K. Šadurskis *(see Transcript of the Court Hearing of the Constitutional Court of 6 September 2017, Case Materials, Vol. 11,m pp. 11 – 40).* This legitimate aim is indicted also in the annotation to the draft law "On Solidarity Tax".

The Constitutional Court finds that the solidarity tax is administered solely on the level of public administration, without involving the person. I.e., the employee's solidarity tax is paid, in fact, by the employer, simultaneously with the disbursement of the monthly salary, transferring into the state special budget the insurance contributions (as a single payment). SRS keeps the records of all taxes paid by an employee or a self-employed person, *inter alia*, also if a person is employed by several employers. Whereas the Agency, on the basis of information provided by SRS, aggregates the person's object of insurance contributions and the paid insurance contributions. The Agency records the contributions for the sum, which exceeds the annual maximum amount of the

object of insurance contributions, as the solidarity tax. The Agency transfers solidarity tax, which has been actually paid, into the state basic budget from the revenue of each social insurance special budget, in accordance with the share of each special budget in accordance with the law on the state budget for the respective year, as defined by Para $20^5$ of the Cabinet Regulation of 2 May 2000 "Procedure in which the Overpaid State Social Insurance Contributions are Calculated and Reimbursed and in which the Solidarity Tax is Calculated and Reimbursed".

Thus, the administration of the solidarity tax does not increase the administrative burden for persons because the tax is calculated by state institutions. Thus, in this respect, the argument provided by the legislator regarding the simplicity of administration cannot be considered as being the grounds for establishing differential treatment of the payers of the solidarity tax.

One of the issues that the legislator must consider to determine, whether the respective tax will be effective, is the cost of administering the tax. However, the costs of administering the tax cannot be the grounds for establishing unequal division of tax rates among taxpayers who are in comparable circumstances.

The Constitutional Court notes that simplicity of administration, which in the case under review manifests itself as adoption of the rates established in social insurance, is not an objective reasoning for the choice of particular solidarity tax rates substantively, in establishing the obligation to pay a new tax within the framework of the existing regulation. I.e., the simplicity of administration *per se* does not substantiate the existence of an objective criterion that would require differential treatment of the payers of solidarity tax by differentiating the tax rate. If the obligation to pay the tax has been established for a concrete circle of taxpayers and is based on a particular tax object then application of differential tax rates should be substantiated by objective differences between the subjects in connection with the tax object chosen by the legislator.

**Thus, the simplicity of administration may not be the only objective substantiation for establishing differential treatment of reciprocally solidary groups of payers of solidarity tax.**

**27.3.** At the court hearing, the representatives of the *Saeima* and the Ministry of Finance, as well as K. Šadurskis and D. Reizniece-Ozola, explaining the considerations that had been the basis for choosing the solidarity tax rates, mentioned the argument that the differences between the tax rates were minor and applied only to a small number of taxpayers (*see Transcript of the Court Hearing of the Constitutional Court on 6 September 2017, Case Materials, Vol. 11, pp. 13 –40*). The *Saeima* also holds that differences between the tax rates are minor (*see Transcript of the Court Hearing of the Constitutional Court on 19 September 2017, Case Materials, Vol. 11, p. 164*). The fact that the solidarity tax had reached the planned fiscal aim was said to be much more significant (*see Transcript of the Court Hearing of the Constitutional Court on 19 September 2017, Case Materials, Vol. 11, p. 162*). K. Šadurskis underscored that it was impossible to write an absolutely perfect law, "where no exception ever would fall outside the frame" (*see Transcript of the Court Hearing of the Constitutional Court on 6 September 2017, Case Materials, Vol. 11, p. 36*).

The fact that the number of persons who pay the solidarity tax is small *per se* cannot substantiate the differential treatment; i.e., differentiation of the tax rates on the basis of criteria that are not aimed at the purpose of the particular tax. It is impossible to regulate in the law the situation of each particular person; however, the law should ensure a sufficiently differential treatment so that the particular norm in a different legal and actual situation would not cause incompatibility with the principle of equality included in the first sentence of Article 91 of the *Satversme*. In this case, all payers of the solidarity tax are in comparable circumstances. Hence, these persons should be treated equally. The legislator may envisage differential treatment of a particular group of payers of the solidarity tax only if this treatment has a legitimate aim. In this case, a legitimate aim would be a set of considerations that would substantiate the

existence of such differences between the payers of the solidarity tax that would require establishment of different tax rates.

The Constitutional Court also noted that the amount of revenue collected into the state budget from the solidarity tax could not be recognised as the legitimate aim of the differential treatment, i.e., the restriction on fundamental rights. A significant amount of budget revenue (the fiscal effect of the tax) *per se* cannot be used to justify a restriction of fundamental rights in the meaning of the first sentence of Article 91 of the *Satversme*.

The Constitutional Court has recognised that, basically, taxes are used for performing the fiscal function of the State, ensuring revenue into the state budget. With the help of this revenue, the State is able to perform its functions and obligations, *inter alia*, in the field of ensuring the fundamental rights (*see Para 25.1. of this Judgement*). Uncontestably, the contribution made by the social tax into the state budget allows financing measures that are important for society.

However, the legislator, in ensuring sufficient revenue in the state budget, has the obligation to develop such tax regulation that would ensure fair and solidary re-distribution of income in society by implementing an effective and timely taxation policy. In the case under review, this means establishing such solidarity tax rates that would have objective and reasonable grounds.

**The differential treatment of the groups of payers of solidarity tax, which has been established by Section 6 of the law "On Solidarity Tax", lacks a legitimate aim therefore this contested norm is incompatible with the first sentence of Article 91 of the *Satversme*.**

**28.** Pursuant to Section 32 (3) of the Constitutional Court Law, a legal norm, which has been recognised by the Constitutional Court as being incompatible with a legal norm of higher legal force, is to be held as being void as of the day when the judgement of the Constitutional Court is published, unless the Constitutional Court has provided otherwise.

The Applicants have requested the Constitutional Court to recognise the contested norm of the law "On Solidarity Tax" as being incompatible as of the date of its adoption. However, in deciding on the date as of which the contested norms become void, the rights and interests of other persons, not only those of the Applicants, must be taken into consideration. Moreover, recognition of the contested norm as being void may not cause new infringements upon fundamental rights defined in the *Satversme* (*see, for example, Judgement of 16 December 2005 by the Constitutional Court in Case No. 2005-12-0103, Para 25, and Judgement of 19 October 2011 in Case No. 2010-71-01, Para 26*).

In the case under review, the Constitutional Court must take into consideration the fact that the right enshrined in Article 91 of the *Satversme* is "relative"; i.e., it may require equal treatment but as such cannot reveal what this treatment should be like, i.e., favourable or unfavourable (*see Judgement of 8 November 2006 by the Constitutional Court in Case No. 2006-04-01, Para 15.1.*). Thus, in deciding on the date, as of which the contested norm should be recognised as being void, the scope of the equality principle in the particular field should be taken into consideration.

The Constitutional Court found that all payers of solidarity tax were in comparable circumstances and that the differential treatment established by the legislator lacked a legitimate aim. The legislator must examine the rates established for the payers of solidarity tax and consider how to comply with the equality principle. The Constitutional Court may not define, which tax rates should be considered as being appropriate and proportionate because pursuant to Article 66 of the *Satversme* only the *Saeima* has the right to decide on the state budget and, *inter alia*, also taxes.

The Constitutional Court has repeatedly underscored that, in deciding on the date, as of which the judgement enters into force, it should be also taken into consideration that the field of the state budget and tax law is an important field of the State's activities (*see, for example, Judgement of 21 December 2009 by the Constitutional Court in Case No. 2009-43-01, Para 34, and Judgement of 15 April 2013 in Case No. 2012-18-01, Para 22*). The state budget affects a broad

range of persons and it has a significant impact upon the economy in general, therefore granting retroactive force to the ruling would jeopardise the principle of legal certainty. In view of the considerations regarding compliance with the equality principle in the field of taxation policy as well as to ensure the stability of the state budget, the judgement of the Constitutional Court in the case under review may not be granted retroactive force. In addition to that, immediate revoking of the solidarity tax before a new legal regulation has entered into force is impossible, since attainment of the planned tax revenue is closely linked to the State's possibilities to perform its functions. This would jeopardise the public welfare and security.

Hence, in the case under review, it is necessary and admissible to leave the norm that is incompatible with the *Satversme* in force for a certain period of time to give the legislator the possibility to adopt a new legal regulation that would abide by the equality principle.

In view of the fact that the legislator needs a reasonable time period to adopt a new legal regulation and that the respective changes must be aligned with the general taxation policy and that the stability of the state budget must be ensured, Section 6 of the law "On Solidarity Tax" shall be recognised as being void as of 1 January 2019.

**The Substantive Part**

On the basis of Article 30-32 of the Constitutional Court Law, the Constitutional Court

**held:**

**1) to terminate legal proceedings in the part regarding the compliance of Section 3, 5, 6, 7 and 9 of the law "On Solidarity Tax" with Article 109 of the *Satversme* of the Republic of Latvia;**

**2) to terminate legal proceedings in the part regarding the compliance of Section 3, 5, 7 and 9 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* of the Republic of Latvia;**

**3) to recognise Section 6 of the law "On Solidarity Tax" as being incompatible with the first sentence of Article 91 of the *Satversme* of the Republic of Latvia and void as of 1 January 2019.**

The judgement is final and not subject to appeal.

The Judgement enters into force at the moment it is pronounced.

Chairperson of the Court Hearing S. Osipova