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 Case No. 2015-25-01
15 November 2016, Riga

The Constitutional Court of the Republic of Latvia comprised of: chairman of the court sitting Aldis Laviņš, Justices Kaspars Balodis, Gunārs Kusiņš, Uldis Ķinis, Sanita Osipova, Daiga Rezevska, and Ineta Ziemele,

having regard to an application regarding initiation of a case submitted by twenty members of the 12th convocation of the Saeima: Gunārs Kūtris, Jānis Urbanovičs, Dainis Liepiņš, Inguna Sudraba, Silvija Šimfa, Arvīds Platpers, Aivars Meija, Mārtiņš Bondars, Inga Bite, Jānis Ruks, Sergejs Mirskis, Raimonds Rubiks, Sergejs Potapkins, Vitālijs Orlovs, Boriss Cilevičs, Igors Zujevs, Vladimirs Nikonovs, Jānis Ādamsons, Zenta Tretjaka, and Aleksandrs Jakimovs (hereinafter also – the Applicant),

on the basis of Article 85 of the *Satversme* of the Republic of Latvia, and Para 1 of Section 16, Para 3 of Section 17(1), as well as Section 28¹ of the Constitutional Court Law,

at a court sitting of 18 October 2016 examined in written procedure the case

"On Compliance of Section 60, Section 61 and Section 62 of the law "On Taxes and Duties" with the First Sentence of Article 91, Article 92 and Article 105 of the Satversme of the Republic of Latvia".

The Facts

1. On 2 February 1995 the *Saeima* of the Republic of Latvia (hereinafter – the *Saeima*) adopted the law "On Taxes and Duties" (hereinafter also – the Tax Law), which entered into force on 1 April 1995. It prescribes the types of taxes and duties and governs the procedure for determination of taxes and duties, collection and recovery thereof, the rights, duties and liability of the payers of taxes and duties, as well as the rights, duties and liability of tax and duty administration, the procedures for registering taxpayers, and the procedures for contesting and appealing of the decisions taken regarding tax and duty matters.

On 1 January 2015 amendments to the Tax Law entered into force. *Inter alia*, Chapter XI "Refunding of Late Tax Payments of a Legal Person" was added to this Law, which comprised Section 60, 61 and 62 (hereinafter jointly also – the contested norms) in the following wording:

"Section 60. Grounds for Refunding of Late Tax Payments and Initiation of Administrative Proceedings

(1) The State Revenue Service has the right to initiate proceedings regarding refunding of late tax payments of a legal person to the budget from a person who has been a member of the board of directors of such legal person at the time when the relevant late tax payments occurred (hereinafter – member of the board of directors), if all of the criteria referred to henceforth are met:

1) the amount of late tax payments exceeds the sum total of 50 minimum monthly wages determined in the Republic of Latvia;

2) the decision to recover late tax payments has been notified to the legal person;

3) it has been established that after occurrence of late tax payments the legal person has alienated assets for such person, which complies with the concept of an interested party within the meaning of the Insolvency Law in relation to the member of the board of directors;

4) an act regarding impossibility of recovery has been drawn up;

5) the legal person has not carried out the duty laid down in the Insolvency Law to submit an application for insolvency proceedings of a legal person.

(2) If the legal person has several members of the board of directors, they shall be solidarily responsible for the late tax payments of the legal person in accordance with Paragraph one of this Section.

Section 61. Decision to Refund Late Tax Payments

(1) If the criteria laid down in Section 60, Paragraph one of this Law have been established, the State Revenue Service shall, within three months from drawing up the act regarding impossibility of recovery, warn the legal person and the member of the board of directors, during term of office of which the late tax payments have occurred, in writing on the fact that proceedings regarding refunding of late tax payments of the legal person to the budget from the relevant member of the board of directors of the legal person are initiated. The time period, regarding which evidence must be submitted in accordance with Section 61, Paragraph three of this Law, shall be indicated in the warning.

(2) If the legal person or member of the board of directors, during term of office of which the late tax payments have occurred, within 15 days after notification of the written warning referred to in Paragraph one of this Section, submits an application regarding legal protection proceedings or insolvency proceedings, informing the State Revenue Service thereof in writing, or carries out payment of late tax payments, the State Revenue Service shall terminate the proceedings regarding refunding of late tax payments of the legal person to the budget from the member of the board of directors of the legal person after a court adjudication regarding initiation of legal protection proceedings or declaration of insolvency proceedings of the taxpayer has been rendered, or the State Revenue Service has established that payment of late tax payments has been performed in full amount, not later than 10 working days after establishment of the abovementioned facts.

(3) If there are objective reasons for non-submission of an application regarding insolvency proceedings to the court, and also evidence that after occurrence of late tax payments alienation of assets of the legal person for a person who should be recognised as the interested party in relation to the member of the board of directors within the meaning of the Insolvency Law, conforms to the economic nature, or there is evidence certifying that the member of the board of directors is not responsible for occurrence of late tax payments of the legal person and alienation of assets of the legal person (division of duties of members of the board of directors, justifying reasons, etc.), the member of the board of directors shall, within one month from the

day of receipt of the warning referred to in Paragraph one of this Section, inform the State Revenue Service, submitting the following documents regarding the time period from the day when the amount of late tax payments exceeds the sum total of 50 minimum monthly wages determined in the Republic of Latvia until the day of drawing up the act regarding impossibility of recovery, but not more than the time period of one year:

1) an explanation, in which objective reasons are indicated in detail why the member of the board of directors did not submit an application regarding insolvency proceedings to the court during his or her term of office;

2) printouts from the accounts opened and closed in credit institutions or any other legal persons, which are not credit institutions and commercial activity of which includes performance of non-cash payments, in which also information regarding the balance at the beginning and balance at the end of the accounting period in the bank account is indicated, and also an explanation and corroborative document regarding each payment made, the amount of which exceeds EUR 500, except an explanation regarding payments, which are tax payments into the State or local government budget;

3) an explanation, listing in detail assets of the legal person (intangible investments, fixed assets, investment properties, biological assets, long-term financial investments, stocks, long-term investments held for sale, debtors, short-term financial investments, money) and their value on the day when the amount of late tax payments exceeded the sum total of 50 minimum monthly wages determined in the Republic of Latvia, and on the day when the State Revenue Service drew up a deed regarding impossibility of recovery. In listing debtors, the given name, surname, personal identity number shall be indicated for a natural person, the name, registration number and amount of debtor liabilities – for a legal person;

4) an explanation, to which evidence has been appended that alienation of assets of a legal person from a person who should be recognised as the interested party in relation to the member of the board of directors within the meaning of the Insolvency Law, conforms to economic nature;

5) an explanation to which evidence is appended that the member of the board of directors is not responsible for occurrence of late tax payments of a legal person and alienation of assets of a legal person.

(4) If at the time of notifying the written warning referred to in Paragraph one of this Section the member of the board of directors during

whose term of office late tax payments have occurred does not have the right to access the documents of the legal person, the State Revenue Service shall, by itself, collect the necessary documents and other evidence related to the activity of the legal person.

(5) The State Revenue Service shall take a decision to refund late payments within two months after notification of the written warning referred to in Paragraph one of this Section, if any of the following circumstances is established:

1) the member of the board of directors has not submitted the documents laid down in Paragraph three of this Section to the State Revenue Service;

2) the member of the board of directors informs the State Revenue Service that he or she cannot provide evidence because the accounting documents are in such condition that it is impossible to get an overview on transactions and condition of property of the debtor in the time period from the day when the amount of late tax payments exceeds the sum total of 50 minimum monthly wages determined in the Republic of Latvia until the day of drawing up the act regarding impossibility of recovery.

(6) If the member of the board of directors has provided all the documents laid down in Paragraph three of this Section or if the State Revenue Service has fulfilled that laid down in Paragraph four of this Section, the State Revenue Service shall evaluate the documents at the disposal thereof and shall take a decision in accordance with the procedures laid down in the Administrative Procedure Law to refund the late tax payments or inform the member of the board of directors that proceedings regarding liability of members of the board of directors for refunding the late tax payments of the legal person to the budget are terminated.

(7) The State Revenue Service may contest the decision of the official to refund the late tax payments by submitting an application to the Director General of the State Revenue Service in accordance with the procedures laid down in the Administrative Procedure Law.

(8) The decision of the Director General of the State Revenue Service may be appealed to the court in accordance with the procedures laid down in the Administrative Procedure Law.

(9) After the decision to refund the late tax payments has become not subject to contesting or appeal, the addressee indicated in this decision – the

member of the board of directors shall be liable for the late tax liabilities of the legal person solidarily with the legal person.

(10) The regulation laid down in Paragraph one of this Section shall not apply to cases when the time period for payment of taxes has been extended, deferred, or divided.

(11) The State Revenue Service, on the basis of an application of the member of the board of directors, shall revoke the decision to refund the late tax payments in the case when the court renders an adjudication in relation to the legal person regarding initiation of legal protection proceedings or declaration of insolvency proceedings of the legal person. The regulation laid down in this Chapter shall not limit the rights of the State Revenue Service to exercise the possibilities laid down in the Insolvency Law to direct recovery towards the member of the board of directors.

(12) The State Revenue Service shall, within three working days from the day of initiating the proceedings regarding refunding of the late tax payments, publish the list of such legal persons on its website, in relation to which proceedings regarding refunding of late tax payments have been initiated.

Section 62. Execution of the Decision to Refund Late Tax Payments

(1) The member of the board of directors shall pay the late tax payments determined in the decision to refund the late tax payments into the budget within 30 days from the day of notification of the decision.

(2) If the payments determined in the decision to refund the late tax payments are not paid within the time period indicated in Paragraph one of this Section, the tax administration shall recover them in accordance with the procedures laid down in Section 26 of this Law.

(3) The application, in which the decision to refund the late tax payments is contested, shall suspend the operation of such decision from the day when the application is received at the institution until the day when the decision taken by the official of the State Revenue Service has become not subject to contesting or appeal."

2. The Applicant holds that the contested norms are incompatible with the first sentence of Article 91, as well as Article 92 and Article 105 of the *Satversme* of the Republic of Latvia (hereinafter – the *Satversme*).

The first sentence of Article 105 of the *Satversme* is said to comprise, *inter alia,* rights and interests that have economic value, as well as the right to engage in commercial activity. It is alleged that the contested norms restrict the rights of a legal person to engage in commercial activity in the form of a company that is liable for its commitments only with its property. The contested norms are said to be incompatible with the principle of separation of the liability and property of a capital company and its shareholders, which is one among the main principles of commercial law recognised in numerous countries around the world. The Applicant admits that in some case exceptions to this principle are admissible, envisaging direct liability of shareholders of the company or its management before creditors, however, in such exceptional cases liability for all commitments of the company is not envisaged.

With respect to the natural person – a member of the board of directors – the aforementioned restriction upon rights, established by the contested norms, is said to manifest itself as the obligation to pay the unpaid taxes of a legal person that has been imposed upon him. Allegedly, pursuant to the case law of the Constitutional Court, the obligation to pay taxes always means restriction upon the right to property.

The Applicant admits that the restriction upon the right to own property has been established by law and assumes that it has a legitimate aim_– protection of public welfare and other persons' interests.

The Applicant holds that the contested norms are incompatible with all criteria of the proportionality principle. The measures selected by the legislator are said to be inappropriate for reaching the legitimate aim. The State is said to be unable to create an effective system for administering and collecting taxes and therefore has transferred this obligation upon other persons, in this particular case – upon board members. Moreover, it is contested, "whether the contested norms restrict the rights of those persons, whose rights the legislator, indeed, wanted to restrict". Namely, the legislator has the right to restrict only the rights of such persons, who have evaded paying of taxes in bad faith, thus, essentially, had engaged in fraudulent activities, whereas the criteria defined in Section 60(1) of the Tax Law comprise a broader circle of persons and could be applied also to persons, who did not commit unlawful actions intentionally.

The contested norms are said to be drafted on the basis of hypothetical assumptions that as the result of application thereof collection of taxes might improve; however, since the adoption of these norms no administrative

proceedings have been initiated in accordance with these norms. Allegedly, the contested norms do not ensure in a preventive way more responsible actions by board members. The Applicant holds that application of the contested norms is "easy to avoid".

Allegedly, the measures chosen by the legislator are not necessary for reaching the legitimate aim. A series of alternative measures is said to exist that would allow reaching the legitimate aim as effectively and the choice of which would be less restrictive upon a person's fundamental rights. The basic process, in the framework of which recovery of unpaid taxes should be achieved, is said to be insolvency proceedings in accordance with the Insolvency Law.

The Applicant holds that more effective measures for combatting fraudulent activities in the field of taxes would be Section 159 of the Latvian Administrative Violations Code (hereinafter – LAVC) and Section 218 of the Criminal Law. Moreover, the same effectiveness that is ensured in the framework of, for example, criminal proceedings is not ensured in the framework of administrative proceedings.

The Applicant holds that application of the contested norms causes such harm to a person's rights and unlawful interests that exceeds the benefit that society gains by application of these norms. Allegedly, the contested norms are going to restrict commercial activities instead of facilitating them, and this is said to be against public interests.

The Applicant holds that the contested norms are incompatible also with the principle of equality enshrined in the first sentence of Article 91 of the *Satversme*. Allegedly, the contested norms ungroundedly create equal treatment of two groups of persons that are in different circumstances, i.e., founders of a capital company (stockowners, shareholders), who are at the same time board members of these companies, and the founders of partnerships (members). These groups of persons are said to be in different circumstances. In difference to partnerships, the members of which exercise their right to engage in commercial activities in a form that requires assuming responsibility with all own property (general partnership) or one's property in accordance with the amount of one's investment (limited partnership), the founders of capital companies have chosen to engage in commercial activities by separating their own and the company's property.

Allegedly, equal treatment of the aforementioned groups lacks legitimate aim. Assuming hypothetically that the equal treatment, nevertheless,

has a legitimate aim, it would be necessary to recognise that the principle of proportionality had not been complied with. The legislator has not made due assessment of the consequences that the contested norms would cause to the founders of capital companies, who are also members of the company's board of directors. Moreover, the benefit that the contested norms would grant to society is said to be smaller than the harm inflicted upon the rights and lawful interests of founders of capital companies, who are also members of the board.

Allegedly, the contested norms allow, without grounds, different treatment of persons that are in comparable circumstances. I.e., the contested norms are said to be applicable to board members of capital companies, but are not applicable to other managing bodies of companies – the shareholders' meeting, the stockholders' meeting and members' meeting, as well as to managers and members of partnerships, although all these groups of persons are said to be in similar and comparable circumstances. All these groups of persons should be recognised as being representatives of the company, and they all have the right to assume commitments on behalf of the company and, in some cases, to adopt decisions that fall within the competence of a board. Allegedly, in this case the differential treatment lacks legitimate aim, since no objective reasons for differential treatment of board members can be discerned.

Incompatibility of the contested norms with the first sentence of Article 91 of the *Satversme*, allegedly, is manifested also by placing creditors of this capital company in an unequal situation with respect to the State Revenue Service (hereinafter also – SRS). Other creditors have to recover debts in general procedure, abiding by the regulation established by the Insolvency Law, whereas with respect to SRS the contested norms are said to establish a special procedure for debt recovery. Thus, SRS is placed in a more benevolent legal situation. This differential treatment is said to lack a legitimate aim.

The Applicant holds that the contested norms are incompatible also with the second sentence of Article 92 of the *Satversme*. Allegedly, the contested norms breach the principle of presumption of innocence. I.e., if the criteria defined in the contested norms are met, the guilt of the board member with respect to occurrence of tax debt of the capital company is presumed; moreover, the person is imposed the obligation to prove his own innocence.

The obligation imposed upon a board member to refund late tax payments of a legal person is said to have both preventive and punitive character typical of criminal law. This obligation, as to its nature, should be

regarded as being "a peculiar fine". The severity of penalty for this offence is said to prove also that the liability established by the contested norms can be equalled to a criminal sanction. Moreover, the contested norms do not envisage any mechanism that would ensure that the proportionality of the sanction would be assessed, or the possibility of SRS or the Court to decrease the amount of money to be recovered from the board member, if it were to be disproportionally large.

The Applicant admits that the restriction has been established by a law adopted in due procedure and assumes that the legitimate aim of the contested norms could be ensuring of public welfare, however, holds that the measures selected by the legislator are not appropriate for reaching the legitimate aim. I.e., the contested norms are said to be "an obviously irrational and inadmissible measure". Moreover, the contested norms allow deviation from the principle of impartial investigation that is typical of administrative procedure.

However, if it were established that the contested norms are appropriate for reaching the legitimate aim, they should be recognises as being disproportional due to being unnecessary for reaching the legitimate aim. The Applicant holds that there are alternative measures that would be less restrictive upon a person's rights and lawful interests and would reach the legitimate aim as effectively. Moreover, the benefit that society gains from the contested norms, allegedly, does not exceed the harm inflicted upon a board member's rights and lawful interests. Thus, the contested norms are said to be disproportionally restrictive.

3. The *Saeima*, the institution that issued the contested act, holds that the contested norms are compatible with the first sentence of Article 91 and Article 92 and Article 105 of the *Satvermse.*

The *Saeima's* opinion is based first and foremost upon statistical data; it notes that for a number of years capital companies have been the largest tax debtors. The board is the most important decision-taking body of a capital company, and its obligation is to manage the capital company in compliance with the provisions of legal acts.

The personal liability of a board member for failure to perform his duties or inappropriate performance thereof, allegedly, is not a new institution in the Latvian legal system. Before the contested norms were adopted, the

special role of a board member in managing a capital company had been recognised by establishing a board member's personal liability for various violations of regulatory enactments, *inter alia*, for tax evasion and failure to cooperate with officials of tax administration. The *Saeima* underscores that the contested norms provide for the liability of a board member for late tax payments of a legal person only in very specific cases, when failure to perform a number of obligations falling with the board's competence and defined in law has been simultaneously established.

The Applicant's opinion that the contested norms restrict the rights of a legal person included in Article 105 of the Satversme to engage in commercial activities in a form of a company that is liable for its commitments inly with its property is said to be unfounded. The contested norms, allegedly, do not have a negative impact upon the economic interests of a legal person to engage in commercial activities. Quite to the contrary – SRS's right to make a board member liable for late tax payments of a company has a positive impact upon a legal person's economic interests and serves as an incentive for board members to be more responsible in the performance of their duties.

The *Saeima* does not uphold the Applicant's opinion that the rights of a legal person to engage in commercial activities in a particular form, i.e., to choose independently and permanently retain its form follow from Article 105 of the *Satversme*. The existence and form of a legal person is said to depend upon its founders' will. The legal person itself does not have the right to change its form or, irrespectively of the founders' will, insist on retaining it. The *Saeima* also notes that the so-called principle of corporate veil pertains to separation of the legal persons' and the founders' property, not to the officials, authorised persons or employees of legal persons. It is contended that the contested norms do not affect this principle.

The *Saeima* admits that the contested norms envisage restrictions upon the right to own property of a board member as a natural person; however, this liability is envisaged only in a very specific situation, moreover, it is a joint liability of all members of the board.

The contested norms are said to include a mechanism that facilitates effectiveness of tax collection and promotes timely payment of taxes in good faith. Hence the restriction upon fundamental rights is said to be consistent with the legitimate aim defined in Article 116 of the *Satversme* – protection of public welfare.

The contested norms are said to be appropriate for reaching the legitimate aim. Considering the essential role that the board plays in managing a legal person, *inter alia*, obligation to submit application regarding insolvency proceedings and responsibility for accountancy, the circumstances, which in the contested norm have been indicated as pre-requisites for a board member's liability, should be recognised as being such that are under the board's control.

The *Saeima* draws attention to the fact that the Applicant has not indicated measures that would be as effective in facilitating performing in good faith board's statutory obligations, as well as in effective recovery of late tax payments. Allegedly, insolvency proceedings do not promote more responsible actions by the board members in maintaining the accountancy of a legal person, paying taxes and submitting application regarding insolvency proceedings in due time. Insolvency proceedings are said to be neither a faster, nor a more effective measure for recovering late tax payments. Similarly, administrative and criminal liability envisaged in other laws is not a measure appropriate for fast and effective recovery of late tax payments, because, essentially, it is not aimed at compensating for the unpaid taxes, but at punishing a person for actions that are harmful to society. Whereas collection of taxes is based upon performance of the fiscal function of the State, by ensuring revenue into the state budget. Moreover, criminal proceedings, in view of their impact and consequences, are not more lenient towards a person.

The *Saeima* holds that the legislator has ensured a reasonable balance between the interests of society and those of an individual and that the restriction established by the contested norms is proportional. Effective tax administration and due performance of the board member's duties is said to be in public interests. Whereas administrative proceedings, in which the liability of a board member is established, is said to ensure to a person not only full and appropriate possibilities to defend himself, but also protection guaranteed by the principle of impartial investigation.

With respect to possible incompatibility of the contested norms with the first sentence of Article 91 of the *Satversme*, the *Saeima* points out a number of aspects. The contested norms do not apply to the founders of a capital company, but to the board members, irrespectively of whether they are also founders of the capital company. If a person, upon establishing a capital company, has chosen also to have a position of a board member, then the rights and obligations that follow from his status as a shareholder or stockholder

should be examined separately from the rights and obligations that follow from the status of a board member.

The *Saeima* disagrees with the Applicants opinion that the contested norms create differential treatment of such groups of persons, the scope of whose rights, obligations and liability is to be equalled to the scope of a board member's rights, obligations and liability. It is contended that the board is not in similar and comparable circumstances with other managing bodies of a company, nor with members (managers) of a partnership. The scope of rights and obligations of other managing bodies of the company – shareholders' meeting or stockholders' meeting – cannot be equalled to the scope of board's rights and obligations. None of the bodies referred to above is responsible for keeping the accountancy of the company and for timely payment of taxes. The rights of other managing bodies to perform in some cases activities falling within the board's competence are said to be exceptional in nature. Moreover, usually the possibility of tax administration to recover late tax payments is said to depend upon actions by the board members of a capital company. Whereas members of a partnership (managers) usually are liable for its commitments with their whole assets, and thus the actual managers of the partnership are simultaneously responsible also for compensating for late tax payments. Therefore the *Saeima* holds that the principle of equal treatment has not been violated.

Likewise, the *Saeima* does not uphold the Applicant's view that the contested norms envisage unfounded differential treatment of SRS and creditors of a legal person. This differential treatment is said to have objective and reasonable grounds. SRS acts on behalf of the whole society, not in its own interests. Moreover, SRS, in difference to creditors, whose claim has civil law grounds, has no access to measures for protecting itself against possible financial difficulties of the "business partner" and even cannot appraise the business risks or financial possibilities of business partners.

The *Saeima* holds that the contested norms do not envisage criminal law liability of board members and, thus, does not discern violation of the presumption of innocence included in the second sentence of Article 92 of the *Satversme*.

The joint liability of board members for a legal person's late tax payments has not been qualified in the Latvian legal system as a criminal offence or as an administrative violation. In the case, where the board

member’s liability envisaged in the contested norms sets in, such consequences that would usually be linked to punishing a person in criminal law procedure, as, for example, being entered in the Register of Criminal Records and having conviction registered, do not occur. The board member’s liability is compensatory, not punitive by nature, i.e., a board member participates in compensating for the unpaid taxes, the payment of which he had to ensure pursuant to his duties in managing a legal person.

However, if it were recognised that a board member’s liability established by the contested norms are to be recognised as such that falls within the scope of concepts “justification of the charges brought in a criminal case” and “indictment for a criminal offence”, the *Saeima* notes that the restriction included in the contested norms is proportional. The contested norms allow SRS to obtain sufficient evidence for establishing that criteria indicated in Section 60 of the Tax Law are met. Only in such a case it is presumed that the board member has not abided by legal requirements with respect to managing a legal person.

The *Saeima* notes that this presumption has been established to create an effective system for collecting taxes and, thus, is compatible with the legitimate aim defined in Article 116 of the Satversme – protecting public welfare. Allegedly, this presumption is not new in the Latvian legal system and, *inter alia*, had been enshrined in at least eighteen sections of LAVC. Moreover, other European states also allow such presumption in the area of tax law and it has been recognised as being justified by the European Court of Human Rights (hereinafter – ECHR). The *Saeima* underscores that the presumption follows from a board member’s status and duties in managing a legal person, i.e., it is assumed that a board member performs his obligations in good faith. Thus, the presumption is justified and necessary for reaching the legitimate aim. Moreover, the legislator has ensured an effective review of SRS’s decision within the framework of administrative procedure within the institution and in several court instances. Thus, a board member has the possibility to provide objective counter-arguments to the presumption included in the contested norm.

4. The summoned person – **the State Revenue Service** – holds that the contested norms comply with the first sentence of Article 91, Article 92 and Article 105 of the *Satversme*.

The contested norms are said to apply solely to board members and do not pertain to legal persons' right to property. The contested norms do not abolish the concept of separation of property of capital company and that of its founders.

The measures chosen by the legislator are appropriate for reaching the legitimate aim – ensuring public welfare.

The aim of the contested norms is said to be preventive, i.e., to provide incentives to board members to be aware of their importance in the daily management of the company's commercial activities and to take actions aimed at full and timely payment of taxes. LAVC Article 159 and Article 218 of the Criminal Law cannot be recognised as measures that would allow reaching the legitimate aim by imposing lees restrictions upon a person's rights and lawful interests. The aforementioned norms cannot be applied as an alternative measure in cases, when the pre-requisites for applying the contested norms have set it.

In assessing, whether the benefit gained by society exceeds harm caused to a person, it should be taken into consideration that the contested norms envisage a board member's liability only in exceptional cases, when all the pre-requisites envisaged in the contested norms have been met.

The benefit that society gains from the contested norms is said to exceed the harm caused to a person. All members of society are interested in the development of fair competition and business environment, since through this the state budget would receive bigger tax payments and the welfare of society as a whole would increase.

SRS admits that the obligation imposed a board member to compensate for a legal person's tax debts restricts the right of a board member as a natural person to own property. However, the restriction is said to be proportional. Considering the significance of a board in the management of a legal person, as well as the board's responsibility for accountancy, it must be recognised that the board has direct control over the circumstances that the contested norms envisage. Moreover, it is provided that the contested norms are applied in the framework of administrative procedure, where a person's rights are protected

on a high level, since the legality of decision is verified both by SRS and a court.

With respect to possible violation of Article 91 of the *Satversme*, SRS hols that a board is in different circumstances compared to other managing bodies of a company. No other managing body of company has as extensive range of statutory obligations as the board. Thus greater liability has been established for a board member, with good reason, compared to other persons, who are involved in managing or representing the company.

The board's liability for performance of its obligations is said to be consistent with internationally recognised practice. The board's liability specifically for tax debts is envisaged in Austria, Bulgaria, Cyprus, Finland, France, Ireland, Lithuania, Malta, the Netherlands, Slovenia, Spain, Sweden, and the United Kingdom. SRS holds that the aggregated statistics on the amount of total tax debt and the number of tax debtors is a justified reason allowing differential treatment of board members. According to the data of 2014, 2015 and 2016, capital companies constitute the majority of tax debtors (approximately 98%), and their total debt makes up 99 per cent of the total debt of subjects of the Commercial Register and the Register of Political Parties. The number of debtors – partnerships is said to be negligible, and their total debt constitutes approximately 0.3 per cent of the total debt of subjects of the Commercial Register and the Register of Political Parties.

A board member of a capital company is said to be in different circumstances also compared to a manager (member) of a partnership. In practice quite often such situations are encountered, where the tax administration's possibilities to recover late tax payments from a capital company directly and immediately depend upon a board member's actions. The consequences of unlawful actions by a manager (member) of a partnership are not as negative, since he has also personal liability for the partnership's commitments. Allegedly, this is proven also by the statistical data referred to above, where the total amount of tax debt incurred by partnerships is negligible compared to the total tax debt of capital companies.

There are objective reasons for the special legal regulation on SRS. In difference to creditors, whose claims have civil law grounds, SRS is not acting in its own interests, but on behalf of society as a whole. Tax revenue is needed to provide for society's needs and ensure its welfare.

SRS underscored that there are no grounds to perceive the regulation established by the contested norms as punitive action with features of criminal law sanction, and that the presumption of innocence cannot be applied to this regulation. A board member's obligation to compensate for late tax payments of a legal person is said to be preventive, not punitive by nature.

5. The summoned person – **the Ministry of Finance** – holds that the contested norms comply with the first sentence of Article 91, Article 92 and Article 105 of the *Satversme*.

The Ministry of Finance does not uphold the opinion expressed in the application that Article 105 of the *Satversme* guarantees the right to property, i.e., the right to engage in commercial activities in the form of a company that would be liable for its commitments only with the property of the capital company. The contested norms affect the right to property of neither the capital companies, nor founders of partnerships guaranteed in Article 105 of the *Satversme*. Neither no the contested norms abolish the concept of separation of assets of the capital companies and of the founders thereof. They pertain only to a board member, and the fact that a board member of a capital company is also a founder of this capital company, gives no grounds for assuming that also the founder's rights are restricted.

The Ministry of Finance admits that the contested norms restrict the rights of board members as natural persons to own property; however, this restriction should be recognised as being proportional. It has been established by law for a legitimate aim – for the protection of public welfare. The contested norms are aimed at aligning business activities and promoting competition, by limiting the possibility to avoid tax commitments.

The chosen measure is said to be appropriate for reaching the legitimate aim. Considering the board's role of a board in the management and representation of a legal person, as well as the board's responsibility for accountancy, it must be recognised that the board has direct control over the circumstances that the contested norms envisage. Analysis of the statistics on payment of late tax payments allows concluding that tax payers are more actively making use of the possibility to cooperate with SRS and make the late tax payments voluntarily. In 2015 SRS did not identify a single case, where it

would have been useful an proportional to impose the obligation upon a board member to compensate for the legal person's late tax payments.

The contested norms are said to have preventive nature. A board member, being aware of his liability for failing to perform his obligations defined in law, would act more responsibly. Moreover, the procedure that the contested norms establish give a board member the possibility to prevent adverse consequences by submitting an application regarding a legal person's insolvency or explaining the objective reasons, due to which in this particular case he is not responsible for the tax debts incurred by the legal person.

Bringing a civil law claim against a board member would not allow reaching the legitimate aim in the same quality as by the administrative procedure established in the contested norms. Moreover, in such a case the board member's rights would be even more restricted, because in this case the principle of impartial investigation would not be applicable. Likewise, Section 159 of LAVC and Section 218 of the Criminal Law cannot be recognised as being measures that would allow reaching the legitimate aim in the same quality and being less restrictive upon a person's rights and lawful interests.

The Ministry of Finance holds that the benefit that society gains through application of the contested norms exceed the harm inflicted upon a person. The contested norms comprise mechanisms for restricting a person's rights to the least extent possible. Whereas the public benefit, considering the impact upon the contested norms upon protection of public welfare, promoting voluntary payment of taxes and improving fair competition, should be recognised as being significant.

Board members are said to be in different circumstances compared to other members of managing bodies of legal persons, and, thus, differential treatment of board members is justified. Board members' liability for performance of their duties is also said to be consistent with the internationally generally recognised trend to provide more accurate and detailed regulation on board members' liability. The Ministry of Finance also draws attention to the statistics pointed out by SRS concerning the total amount of tax debt and the number and structure of tax debtors in Latvia in 2014, 2015, and 2016. This statistics proves that the majority of tax debtors are exactly capital companies.

The Ministry of Finance holds that the special legal regulation on SRS has objective reasons. Tax revenue is necessary to ensure that basic needs of society are met and its welfare ensured, thus, SRS acts on behalf of society as a whole.

The contested norms should not be recognised as being punitive, i.e., such that have features of a criminal law sanction. A board member's obligation to pay the legal person's late tax payments is said to be compensatory in nature. Even if the regulation established by the contested norms were to be recognised as criminal offence in the meaning of Article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter – the Convention), there would be no grounds to consider that the presumption of innocence had ben violated. Application of the contested norms and legality review is envisaged in the framework of administrative procedure in an institution and in court, where the principle of impartial investigation must be applied. In some cases, within the framework of administrative procedure, there is a well-founded need to request information or documents that are only at the disposal of a private person and known only to the taxpayer himself. The taxpayer should also be interested in submitting to tax administration relevant explanations. Thus, the contested norms protect the rights of a board member.

6. The summoned person – **the Ministry of Justice** – holds that compensation for a legal person's late tax payments to the State budget from the personal resources of a board member, essentially, is of criminal law nature.

The regulation established by the contested norms is said to have both punitive and preventive function, which is consistent with applying of a criminal sanction. Thus, in examining regulation included in the contested norms, the findings and principles of criminal law theory should be used, *inter alia*, the presumption of innocence should be applied.

The principle of impartial investigation is recognised in administrative proceedings; however, the person has the duty to participate. Not only in Latvia, but also in other countries tax administration to a large extent is based upon information provided by the taxpayer. Thus, a board member has the possibility to justify and prove that he is not liable for a company's late tax

payments. The Ministry of Justice holds that imposing this obligation upon a board member does not violate the presumption of innocence enshrined in the second sentence of Article 92 of the Satversme.

Essentially, the contested norms envisage board members' personal liability vis-à-vis one specific creditor – SRS, by restricting a natural person's right to property and imposing the obligation to pay a legal person's tax debt in concrete cases. The Ministry of Justice already provided an opinion No. 1-9.1/1549 at the time when the law was drafted, to be more precise, on 26 November 2016, pointing out that the contested norms did not fit into the legal system as a whole and were incompatible with the *Satversme*.

It is not questioned that the restriction has been established by law. However, the Ministry of Justice upholds the statement made by the *Saeima* Legal Bureau in its opinion of 11 December 2014 No. 111.13/1-30-12/14 that in a state governed by the rule of law a situation was inadmissible, where the State, being unable to achieve effective performance of a legal person's obligation to pay taxes, transferred this obligation to another person. Thus, there were doubts as to whether the restriction upon rights included in the contested norms had a legitimate aim. The Ministry of Justice holds that the contested norms are also incompatible with the proportionality principle, as there are alternative measures that would be less restrictive upon a person's rights, for example, insolvency proceedings of a legal person.

Moreover, the Ministry of Justice holds that the contested norms place other creditors of a legal person in an unequal situation, because they create unjustified advantages for SRS.

7. The summoned person – sworn advocate **Jānis Taukačs** – expresses the opinion that the main idea of the contested norms should be supported, i.e., the State may collect tax debts of companies from dishonest board members. Quite often, when a company has received a SRS' decision on tax surcharges, the board considers the possibility of abandoning the respective company and establishing a new one. Reckless attitude towards the obligation to pay taxes is inadmissible.

In Latvia indicators of uncollected value added tax are among the worst in the whole European Union, and the VAT gap has been large for many years. This gap has developed mainly due to such reasons as value added tax fraud, errors in administration, structuring and insolvency cases. Moreover, capital

companies quite often recklessly enter into purchasing transactions with dishonest sellers, holding that it is not the buyer's responsibility. However, this opinion is incompatible with the finding by the Court of Justice of the European Union that a buyer's liability may set in in those cases, where he knew or should have known about value added tax fraud.

The institute of board members' liability could deter companies from entering into risky transactions and, thus, also partially deal with the major problem of the state budget. Proportional and particularly preventive measures are envisaged for eliminating such cases. Moreover, the Organisation for Economic Co-operation and Development) (hereinafter – OECD) already in July 2009 underscored in its report on corporate management and tax risk management that those states, where corporate management in general is poor, should consider the possibility to establish by law additional liability to company boards and senior managers for tax payment.

J. Taukačs underscores that liability of a legal person for its tax debts, without liability of a relevant natural person, is not effective. Moreover, the established joint liability and the scope of possible sanctions proves that the contested norms have not only a preventive aim (to deter a board from actions leading to tax debts), but also fiscal (to collect into the state budget the amount of company's unpaid taxes).

The Commercial Law already now envisages that creditors may demand liability from the board in a case, where it has been impossible to satisfy their claims from the company and it is possible to prove that a board member by his actions had caused losses to the company. Likewise, the Insolvency Law envisages a certain succession of creditors and procedure for recovery. SRS may demand the board's liability for a company's tax debts. However, abandoning tax debts is so widespread in Latvia that this procedure for recovering tax debts might turn out to be ineffective both with regard to fiscal interests and prevention.

A form of a board's liability that is similar to the one established by the contested norms has been accepted in approximately half of the European Union Member States; however, usually liability is limited to particular types of taxes or transactions, or it sets in in the case, where board members knew or they should have known that the company that they represent substantially violated provisions of tax law. It is also important, what exactly the norms on a board's liability are like, as well as the general culture of tax payments, and

also the procedure of tax recovery and system of dispute resolution in the particular state. Serious foreign investors do not consider the possibility of abandoning a capital company with tax debts, moreover, in other countries board members have appropriate insurance policy.

The liability of board members is said not to be incompatible with the presumption of innocence. The current critical situation, i.e., too many cases, where the State is defrauded of value added tax and other taxes, as well as the fiscal scope of such fraudulent activities prove that introduction of special preventive measures is proportional and in general compatible with the interests of the State.

8. The summoned person – Associate Professor at the Stockholm School of Economic in Riga *Ph.D.* **Anete Pajuste** – agrees to the arguments included in the application that the contested norms might violate the presumption of innocence principle. It is "automatically" assumed that alienation of any assets is done in bad faith and causes losses to the company, not that it complies with the economic nature of the company.

Some countries, for example, Canada envisages recovery of tax debt from a board member, if it is impossible to recover the debt from the company and if the board member has not acted as an honest and careful manager. A. Pajuste underscores that prior to adoption of the contested norms a similar mechanism had been established also in Latvia, for example, in Section 170 of the Commercial Law, allowing creditor to bring claims against officials of a capital company, who had caused losses to the company and had not compensated for these.

The contested norms should be examined in the context of the practice of applying laws in the particular state. If society is certain that in all instances of applying law the presumption of innocence principle is respected and that the party applying the law is not financially interested in applying the sanction, it relies upon adequate application of legal provisions. In Latvian society, as well as in societies of several other countries there is a perception that tax administration services apply to tax payers "presumption of guilt", moreover, act in accordance with a definite plan for fees to be collected for filling the budget. In this context the risk of a board member's personal liability is disproportionally large. In many countries it is possible to insure a board

member's liability; however, in Latvia, the insurance premium, due to the aforementioned reasons, could be disproportionally high.

Establishing the liability of a board member should be left within the competence of a court. If the contested norms remain in force, SRS should invest serious effort in improving its reputation to convince society that it perceives taxpayers as clients, not as culpable persons. Otherwise the contested norms will have a negative impact upon business environment.

The Findings

9. Compliance of three norms with the first sentence of Article 91, Article 92 and Article 105 of the *Satversme* is contested in the application.

Section 60 of the Law on Taxes sets out provisions for initiating procedure of administrative proceedings regarding repayment of late tax payments of a legal person into the State budget by a person, who has been a member of the board of this legal person during the period, when the respective late tax payments occured. Section 61 of the Law on Taxes establishes the procedure, in which SRS adopts a decision on repayment of the late tax payments of a legal person into the state budget. Whereas Section 62 of the Law on Taxes establishes the procedure, in which the decision by the State Revenue Service on repayment of late tax payments of a legal person is to be enforced.

The Applicant contests the compatibility of the liability of a board member for repaying the late tax payments of a legal person into the state budget with the *Satversme*. It is stated in the application that the contested norms place a disproportional restriction upon the right to own property of capital companies, founders and board members thereof. The Applicant holds that the contested norms also violate the presumption of innocence principle and the principle of equality.

The arguments provided in the written response by the *Saeima* and opinions by the summoned persons mainly examine compliance of the contested norms as a uniform legal regulation with the *Satversme* in respect to capital companies and board members thereof.

The contested norms constitute a uniform legal regulation, because they as a whole establish liability for repaying into the state budget the late tax payments and the procedure for repayment. Thus, the contested norms influence the scope and content of one another.

The aim of applications submitted to the Constitutional Court by the subjects of abstract review of legal norms, *inter alia*, members of the *Saeima*, is to protect public interests. An application of this kind is to be regarded as an important tool for the protection of important national and public interests. Abstract review of legal norms is a measure for aligning the legal system. Thus, the Constitutional Court must examine compliance of the contested norms with norms of higher legal force with respect to the whole range of those persons, to whom this particular legislation has been applied by the legislator (*compare: Judgement of 15 June 2006 by the Constitutional Court in Case No. 2005-13-0106, Para 20.2*). However, the Constitutional Court can review the contested norms insofar legal grounds have been provided in the application and considering its reasonable link to the scope of the contested norms. The grounds included in the application pertain to the situation of capital companies, founders and board members thereof. Thus, in reviewing the compliance of the contested norms with the *Satversme*, the arguments provided by the Applicant must be taken into consideration.

Therefore the Constitutional Court shall examine the contested norms as a united legal regulation, first and foremost reviewing their compatibility with Article 105 of the *Satversme*, and then with Article 92 and the first sentence of Article 91 of the *Satversme*.

10. The Applicant holds that the contested norms are incompatible with Article 105 of the *Satversme*.

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

Article 105 of the *Satversme* provides a comprehensive guarantee for rights of material nature, understanding by "property rights" all rights of material nature that a person may use for his own benefit and that he can handle according to his own will (*see, for example, Judgement of 27 October*

2010 by the Constitutional Court in Case No. 2010-12-03, Para 7, and Judgement of 3 November 2011 in Case No. 2011-05-01, Para 15.2).

The finding has been consolidated in the case law of the Constitutional Court that in those cases, where compliance of a legal norm with the whole Article 105 of the *Satversme* is contested, the exact sentence of the Article, the compliance with which should be be reviewed, must be identified (*see, for example, Judgement of 13 October 2015 by the Constitutional Court in Case No. 2014-36-01, Para 15.1.*).

10.1. It follows from the opinions of participants in the case and the summoned persons that the contested norms should be examined in connection with the fourth sentence of Article 105 of the *Satversme*. The fourth sentence of Article 4 of the *Satversme* provides that expropriation of property for public purposes is allowed only in exceptional cases on the basis of a specific law and in return for fair compensation. The Constitutional Court has recognised that this sentence does not regulate a situation that occurs in connection with enforcement of a coercive measure established by the State (*see Judgement of 8 April 2015 by the Constitutional Court in Case No. 2014-34-01, Para 12.3*).

The contested norms do not establish expropriation of property for public purposes in return for a fair compensation, but affect a person's right to freely use his property, when SRS initiates the procedure for recovering late tax payments. Thus, the restriction upon fundamental rights envisaged by the contested norms does not fall within the scope of the fourth sentence of Article 105 of the *Satversme*.

Thus, the contested norms must be examined within the scope of the first three sentences of Article 105 of the *Satversme*.

10.2. The first sentence of Article 105 of the *Satversme* protects a person's lawfully acquired property, whereas the second and the third sentence allow the State to restrict the property right by law in public interests. Firstly, the property right comprises also the owner's social obligation before society – property may not be used contrary to public interests. Secondly, the property right may be restricted in accordance with law. Thus, the property right may be restricted, if only restrictions are established by law, have a legitimate aim and are proportional to this aim (*see, for example, Judgement of 26 April 2007 by the Constitutional Court in Case No. 2006-38-03, Para 12, and Judgement of 10 October 2014 in Case No. 2014-04-03, Para 7.2*).

The Applicant holds that the restricted norms place disproportional restrictions upon the property right of a number of persons. The contested norms are said to restrict the rights of a legal person to engage in business activities in the form of a company that is liable for its commitments only with its property, i.e., in the form of a capital company. The contested norms are said to restrict at the same time also the right of company's founders (shareholders and stockholders) to engage in business activities in the form of a capital company.

The *Saeima*, SRS and the Ministry of Finance do not uphold this opinion held by the Applicant and hold that the contested norms restrict neither the property right of legal persons, nor those of their founders.

The Constitutional Court has recognised that a person's economic interest to engage in business activities falls within the scope of the first sentence of Article 105 of the *Satversme* (*see Judgement of 12 December 2014 by the Constitutional Court in Case No. 2013-21-03, Para 10.1*). Consequently, a limitation of such an interest should manifest itself as concrete impact upon business activities, for example, decrease in profit caused by application of the contested norms. I.e., causality between the restriction upon the property right and the contested norms must be established.

The contested norms apply to a legal person's board member as a natural person. It is noted in the annotation to the draft law that by implementing regulation established by the contested norms a mechanism would be created that would give SRS the right to demand that a board member covers the liabilities of late tax payments by a legal person [*see Para 2 in report on initial impact assessment (annotation) of the draft law No.98/Lp12 submitted to the* Saeima *on 10 December 2014 "Amendments to Law "On Taxes and Duties*]. The contested norms make no reference to other subjects. No arguments have been presented in the case with respect to applicability of the contested norms to other subjects. Thus, no causality can be established between the contested norms and economic interests of legal persons or founders thereof.

Thus, the contested norms do not restrict the property rights defined in Article 105 of the *Satversme* of legal person or founders thereof.

10.3. The Applicant holds that the contested norms place disproportional restrictions also upon the property right of a legal person's board member as a natural person.

The contested norms establish a procedure for repaying into the state budget the late tax payments of a legal person by a person who has been a board member of this legal person at the time, when the respective late tax payments occurred. The contested norms provide that when certain pre-requisites are met, the obligation to repay a legal person's late tax payments is transferred to a board member as a natural person. A board member must repay the late tax payments of a legal person into the state budget within 30 days from the receipt of SRS notification. If he fails to do so, upon entering into force of the decision these payments are recovered in non-contentious procedure from the board member, by using the resources from the respective person's account at a credit institution and his property (moveable and immoveable property, as well as assets held by third parties).

Thus, the contested norms restrict the property right of a legal person's board member as a natural person.

11. To review the constitutionality of the restriction upon fundamental rights defined by Article 105 of the *Satversme* that the contested norms comprise, it must be determined, whether it has been established by law, whether it has a legitimate aim and whether it complies with the proportionality principle (*see, for example, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007-01-01, Para 22*).

11.1. To assess, whether the restriction upon the right to property has been established by law adopted in due procedure, the Constitutional Court must verify, whether the contested norms have been adopted in compliance with the procedure established by regulatory enactments (*see, for example, Judgement of 8 April 2015 by the Constitutional Court in Case No. 2014-34-01, Para 14*).

The Applicant holds that in the course of adopting the contested norms the opinion of a number of *Saeima* members had been ignored, the opinion provided by the *Saeima* Legal Bureau, pointing to possible violations of Article 91, 92 and 105 of the *Satversme*, as well as the views expressed by some representatives of the sector had not been taken into consideration.

Pursuant to Article 21 of the *Satversme*, to establish its internal operations and procedure, the *Saeima* draws up its Rules of Procedure. Article 24 of the *Satversme*, in turn, provides that the *Saeima* adopts decisions with the absolute majority vote of its members that are present.

It follows from the materials pertaining to discussions regarding the draft law that comprises the contested norms that the draft law had been examined at the *Saeima* Budget and Finance (Taxation) Committee by appraising all proposals that had been submitted and listening to the representatives of the sector. Following discussions, the *Saeima* Budget and Finance (Taxation) Committee had submitted it for reviewing at the sitting of the *Saeima.* The *Saeima* has examined in the procedure established by the *Saeima* Rules of Procedure all proposals submitted in due procedure. The draft law was adopted by 56 members of the *Saeima* voting "for" it, and 33 – "against".

The Constitutional Court has already recognised that in the course of adopting decisions at the *Saeima* it would be advisable to hear and to analyse the opinion of national authorities and other stakeholders involved in the process of preparing a draft regulatory enactment; however, neither the *Satversme*, nor the *Saeima* Rules of Procedure provide that abiding by any of the opinions expressed is a mandatory pre-requisite for adopting legal norms, if it is rejected in a democratic legislative process. Participation of stakeholders in the process of reviewing a draft regulatory enactment may facilitate adoption of an objective decision and balancing of various interests; however, an opinion held by a particular group of persons is not binding upon the legislator (*see, for example, Judgement of 25 March 2015 by the Constitutional Court in Case No. 2014-11-0103, Para 18.1*). Therefore there are no grounds to recognise that in adoption of the contested norms the procedure established in the *Satversme* and the *Saeima* Rules of Procedure had not been complied with.

The case does not contain any other dispute with respect to aspects in adopting or promulgating the contested norms.

Thus, the restriction upon fundamental rights included in the contested norms has been established by law.

11.2. All restrictions upon fundamental rights should be based upon circumstances and arguments that make them necessary, i.e., the restriction must be established due to important interests – a legitimate aim (*see, for example, Judgement of 22 December 2005 by the Constitutional Court in Case No. 2005-19-01, Para 9*). The Constitutional Court has recognised that in legal proceedings before the Constitutional Court the obligation to identify the legitimate aim first and foremost lies upon the institution that has issued the

contested act (*see, for example, Judgement of 25 October 2011 by the Constitutional Court in Case No. 2011-01-01, Para 13.2*).

The *Saeima* notes in its written response that the restriction upon the right to property included in the contested norms has been established to create an effective tax collection system, and, thus, complies with the legitimate aim defined in Article 116 of the Satversme – protection of public welfare. The contested norms comprise a special mechanism with respect to board members to promote tax payment in good faith and to facilitate effectiveness of tax collection. Essentially, this opinion is not contested by the Applicant or by the persons summoned in the case.

The Constitutional Court recognizes that timely payment of taxes is in the interests of society as a whole. The contested norms are aimed at effective recovery of tax payments that a legal person has not made timely, and thus have been adopted in the interests of public welfare.

Thus, the legitimate aim of the restriction upon fundamental rights included in the contested norms is protection of public welfare.

11.3. Upon establishing the legitimate aim of a restriction upon fundamental rights, its compliance with the proportionality principle must be examined. To asses proportionality of the restriction upon fundamental rights it must be established whether: 1) the chosen measures are appropriate for reaching the legitimate aim; 2) whether no other measures, less restrictive (lenient) upon persons' fundamental rights exist; 3) whether the benefit gained by society exceeds the harm inflicted upon a person's rights and lawful interests (*see, for example, Judgement of 30 March 2011 by the Constitutional Court in Case No. 2010-60-01, Para 23*).

11.3.1. The Constitutional Court has recognised that the measures chosen by the legislator are appropriate for reaching the legitimate aim, if this aim can be reached by the respective legal norms (*see, for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 15*).

The Applicant holds that the measures chosen by the legislator are not appropriate for reaching the legitimate aim.

The *Saeima* does not uphold this opinion and notes that the contested norms are appropriate for reaching the legitimate aim. This opinion is supported by persons summoned in the Case – SRS, the Ministry of Finance, and J. Taukačs.

It is noted in the annotation to the draft law that a board member is liable for tax debts of a legal person, if a tax debt of a certain amount has accrued and it is impossible to recover this debt from the legal person itself, if alienation of assets to an interested party has been established, and, moreover, the statutory obligation to submit an application regarding insolvency of the legal person has not been submitted.

The board is an important decision-taking body of a capital company, and it has a special role in managing a legal person. The board is an executive institution, which also exercises legal capacity of the legal person. It performs two functions in a capital company: management and representation of the company. Management of a company is internal implementation of all those measures aimed at ensuring operations of the company, i.e., economic and organisational management of the company (*see Decision of 8 November 2010 by the Constitutional Court on terminating legal proceedings in Case No. 2012-04-03, Para 14*). In view of the board's special role in managing the legal person and organising its work, the Constitutional Court recognises that the pre-requisites for joint liability of board members included in the contested norm are under direct control of the board.

A board member's liability for late tax payments of a legal person is envisaged also in legal systems of other states, for example, in Austria, Bulgaria, Cyprus, Finland, France, Germany, Ireland, Lithuania, Malta, the Netherlands, Slovenia, Sweden, and the United Kingdom.

Thus, the Constitutional Court recognises that in the circumstances of the case under review the liability of a board member, which is manifested as a restriction upon the right to property, is an appropriate measure for improving effectiveness of tax collection. The existence of regulation included in the contested norms makes a board member aware of the consequences that follow from the fact that the statutory obligation to manage with sufficient care everyday operations of a capital company are not fulfilled and will act more responsibly. Thus, presumably, in the long-term both effectiveness of tax collection and business environment will improve.

Consequently, the measure envisaged by the contested norms is appropriate for reaching the legitimate aim.

11.3.2. To establish, whether the legislator had at its disposal less restrictive measures, the Constitutional Court must examine, if the legislator had considered alternatives to the contested norms (*see, for example,*

Judgement of 21 December 2009 by the Constitutional Court in Case No. 2009-43-01, Para 30.2). Moreover, in assessing, whether the legitimate aim could be reached by other means, it should be taken into consideration that a more lenient measure is not just any other measure, but only such that allows reaching the legitimate aim in the same quality (*see, for example, Judgement of 20 May 2011 of the Constitutional Court in Case No. 2010-70-01, Para 16.1.*).

The Applicant holds that alternative measures could be insolvency proceedings pursuant to regulation of the Insolvency Law, as well as regulation provided by LAVC Section 159 and Section 218 of the Criminal Law.

The Ministry of Finance and SRS underscore that the contested norms together with the regulation that has been adopted previously with respect to board members' liability for violations in the field of tax law constitute a united legal mechanism and urge, in particular, board members to act more responsibly and avoid a situation, where SRS has the grounds for applying the contested norms.

The necessity of the contested norms is justified also in the letter of No. 20-02/7163 of 15 December 2014 by the Ministry of Finance addressed to the *Saeima* Budget and Finance (Taxation) Committee. It is underscored in the letter that, *inter alia*, by bringing a civil claim against a natural person (board member) the legitimate aim could not be reached in the same quality as by applying the contested norms. Moreover, this measure would be even more restrictive upon a person's rights than the contested norms, since the principle of impartial investigation, typical of administrative procedure, would not be applicable.

The Constitutional Court recognises the arguments presented by the Ministry of Finance and SRS as being substantiated. The legal situation, to which the contested norms apply, differs from the one to which regulation on insolvency proceedings apply. I.e., the contested norms are applied only in the case, if insolvency proceedings of a legal person have not been initiated. The procedure established by the contested norms cannot take place concurrently with insolvency proceedings. If the procedure defined in the contested norms has been instigated, but later insolvency proceedings of a legal person are initiated, SRS terminates the proceedings regarding recovery of a legal person's late tax payments from its board members. Thus, initiation of insolvency proceedings cannot be recognised as being a more lenient measure.

The *Saeima* has provided substantiated arguments on why LAVC Section 159 and Section 218 of the Criminal Law cannot be regarded as being more lenient measures allowing reaching the legitimate aim in the same quality, but in a way that is less restrictive upon a person's rights. I.e., the characteristics that must be established to apply the contested norms differ from those that characterise a criminal offence – evasion of tax payments. Pursuant to the definition included in the tax law, evasion of tax or duty payments is deliberate provision of false information in tax declarations, failure to submit tax declarations, informative declarations or requested information for the administration and control of taxes, unlawful application of tax deductions, advantages, and rebates or any other deliberate act or omission leading to non-payment of taxes or duties in full amount or in part.

The two afore-mentioned provisions, essentially, define restrictions upon a person's rights that are characteristic of criminal proceedings and envisage sanctions for offences that are harmful to society. The contested norms, however, are primarily aimed at repayment of late tax payments into the state budget. Moreover, it should be taken into consideration that the sanctions envisaged in the Criminal Law as to its impact upon a person's rights is ultimately restrictive compared to other types of sanctions, even if they have some features are typical of the field of criminal law.

The Constitutional Court has recognised that its task is to examine compatibility of contested norms with the fundamental rights established in the *Satversme*, not to replace the legislator's discretion by its opinion on the most rational solution (*see Judgement of 30 March 2010 by the Constitutional Court in Case No. 2009-85-01, Para 19*). It follows from the case materials that the legislator has considered alternatives to the contested norms and selected the most lenient measure for reaching the legitimate aim.

Thus, there are no more lenient measures that would allow reaching the legitimate aim of the restriction upon the right to property in the same quality.

11.3.3. To appraise proportionality of the contested norms, it must be verified, whether the adverse consequences that a person incurs as the result of restriction upon fundamental rights do not exceed the benefit that society gains from this restriction (*see, for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010-70-01, Para 17*). Thus, the

Constitutional Court must establish, which interests are to be balanced in this case, and decide, which of these interests should be granted priority.

The Applicant holds that application of the contested norms causes harm to a person's rights and lawful interests that exceeds the benefit that society gains from application of these norms, and that society, most probably, will have no benefit from the contested norms.

Whereas the *Saeima*, the Ministry of Finance and SRS hold that the benefit that society gains from application of the contested norms exceeds the harm inflicted upon a person. Allegedly, it is in public interests to facilitate voluntary payment of taxes, avoid late tax payments, as well as to promote fair competition. The restriction upon a person's fundamental rights is said to be proportional, since a board member is required only to address the adverse consequences caused to the state budget due to such circumstances that were under his control and with respect to which he had objective possibilities and the obligation to prevent these. Moreover, the contested norms envisage a full mechanism for protecting a person's rights in accordance with principles of administrative procedure.

The Constitutional Court has noted that taxes basically perform the fiscal function, which ensures revenue to the state budget. By using the budget revenue the State is able to perform its functions and obligations, *inter alia*, in the field of ensuring fundamental rights (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, 9*). ECHR also has recognised that effective tax collection is an important financial interest of the State (*see ECHR Judgement of 23 July 2002 in Case "Janosevic v. Sweden", Application No. 34619/97, Para 103–104*). Thus, taking into consideration the impact of the contested norms upon facilitation of voluntary tax payments and increasing fair competition, the Constitutional Court recognises that public greatly benefits from the contested norms.

A board member must repay a legal person's late tax payments (tax debt), which, pursuant to Section 26 of the Tax Law, comprise not only the amount of basic debt, but also penalties and late payment charges, only in the case, if all criteria cumulatively are met. Moreover, board members have joint liability. This decreases even more the impact that the contested norms have upon a person.

In assessing, whether the benefit gained by society exceeds the harm caused to an individual, it should be also taken into consideration that the

contested norms comprise a special mechanism for restricting a board member's rights to the least extent possible (for example, possibility to terminate the procedure for recovering legal person's late tax payments if an application regarding insolvency proceedings has been submitted; suspending enforcement of the decision, if the decision has been appealed in court).

Thus, the legislator, in adopting the contested norms, has ensured a balance between the interests of society and those of a person, and the restriction established by the contested norms is proportional.

Thus, the contested norms are compatible with the first three sentences of Article 105 of the *Satversme.*

12. The Applicant holds that the contested norms violate the presumption of innocence principle that follows from the second sentence of Article 92 of the *Satversme.* The Panel of the Constitutional Court has initiated the case regarding possible incompatibility of the contested norms with Article 92 of the *Satversme* in its entirety. It provides that everyone has the right to defend his or her rights and lawful interests in a fair court, that everyone must be presumed innocent until his or her guilt has been established in accordance with law, that everyone, where his or her rights are violate without basis, has a right to commensurate compensation, and that everyone has a right to the assistance of counsel.

Article 92 of the *Satversme* provides a laconic definition of the right to a fair court. The second and the fourth sentence of this Article highlight, in particular, two principles that follow from the right to a fair court – presumption of innocence and the right to the assistance of counsel.

It follows from the application that the Applicant, in essence, requests assessment of compatibility of the contested norms with the second sentence of Article 92 of the *Satversme*. Arguments presented by the *Saeima* and persons summoned in the case also pertain to compatibility of the contested norms with the second sentence of Article 92 of the *Satversme*. In view of the fact that the second sentence of Article 92 of the *Satversme* identifies separately presumption of innocence as an element of the right to a fair court, the Constitutional Court shall examine compatibility of the contested norms with the second sentence of this Article.

13. The Constitutional Court has noted that presumption of innocence enshrined in the second sentence of Article 92 of the *Satversme* is one of the fundamental principles of a state governed by the rule of law (*see, for example, Judgement of 23 February 2006 by the Constitutional Court in Case No. 2005-22-01, Para 4*).

Presumption of innocence is an element of fair criminal proceedings. In accordance with presumption of innocence, a person's innocence is presumed in criminal proceedings. I.e., presumption of innocence protects a person, against whom an assumption or statement has been made with respect to, possibly, committed criminal offence, against being recognised as being guilty before the guilt of this person has been proven in procedure established by law and by a ruling in a criminal case that has entered into force (*see, for example, Judgement of 23 February 2006 by the Constitutional Court in Case No. 2005-22-01, Para 4, and Judgement of 5 November 2008 in Case No. 2008-04-01, Para 10.3*).

Until now the Constitutional Court has examined presumption of innocence as an element of the right to a fair court in criminal cases and cases of administrative violations and has already noted that Article 92 of the Satversme must be examined in interconnection with Article 6 of the Convention (*see, for example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 12*).

ECHR recognises that the concepts of Article 6 of the Convention "justification of the charges brought in a criminal case" and "indictment for a criminal offence" in concrete national legal acts in the context of fundamental rights are to be interpreted autonomously and the outcome of such interpretation in particular cases may differ. By using this approach, the essence of the case, not the qualification it has been given in the national law is decisive (*see, for example, Judgement of 20 June 2002 by the Constitutional Court in Case No. 2001-17-0106, Para 6.1 of the Findings*). The Constitutional Court has used the notion of autonomy of these concepts in its case law (*see, for example, Judgement of 18 October 2012 by the Constitutional Court in Case No. 2012-02-0106, Para 13*).

Pursuant to ECHR case law, presumption of innocence, although it directly pertains to the field of criminal law, in general also forms the content of the right to a fair trial in broader understanding of it. I.e., this principle falls within the scope of Para 1 of Article 6 of the Convention. This paragraph

provides that in the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgement must be pronounced publicly, but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

ECHR, in explaining the concepts "justification of the charges brought in a criminal case" and "indictment for a criminal offence", has applied Para 1 of Article 6 of the Convention in its criminal law aspect also to the field of tax, customs and competition law (*see, for example, ECHR Judgement of 24 February 1994 in Case "Bendenoun v. France", Application No. 12547/86; Judgement of 7 October 1988 in Case "Salabiaku v. France", Application No. 10519/83, and Judgement of 11 February 2003 in Case "Ringvold v. Norway", Application No. 34964/97*). Pursuant to the case law of ECHR, disputes regarding failure to perform obligation to pay taxes have been examined neither in the criminal law aspect, nor civil law aspect of Para 1 of Article 6 of the Convention, since tax administration has been recognised as being a special function of the State, in the performance of which the State enjoys substantial discretion (*see, for example, ECHR Judgement of 12 July 2001 in Case "Ferrazzini v. Italy", Application No. 44759/98, Para 27–29*). However, tax disputes linked to calculation and recovery of fees and late payment charges have been examined in the case law of ECHR in the criminal law aspect of Article 6 of the Convention (*see ECHR Judgement of 23 November 2006 in Case "Jussila v. Finland", Application No. 73053/01, Para 38).*

In Case "*Engel and Others v. the Netherlands*" ECHR recognised: to establish, whether the particular case must be examined in the criminal law aspect of Article 6 of the Convention, it must be reviewed in accordance with three criteria, i.e., qualification of the particular offence in the national legal acts, the nature and severity thereof, as well as the severity of the penalty that the person risks incurring (*see ECHR Judgement of 8 June 1976 in Case "Engel and Others v. the Netherlands", Applications No. 5100/71; Nr. 5101/71; Nr. 5102/71; Nr. 5354/72; Nr. 5370/72, Para 82*).

For Article 6 of the Convention to be applicable in its criminal law aspect, it is sufficient to establish compliance with at least one of these criteria (*see ECHR Judgement of 11 February 2003. in Case "Ringvold v. Norway", Application No. 34964/97, Para 36–42, and Judgement of 8 June 1976 in Case "Engel and Others v. the Netherlands", Applications No. 5100/71; Nr. 5101/71; Nr. 5102/71; Nr. 5354/72; Nr. 5370/72, Para 82*). Thus, if the criminal law nature of the offence were recognised or the concrete person risked incurring such sanctions that as to their nature and severity would belong to the field of criminal law, Para 1 of Article 6 of the Convention would be applicable in its criminal law aspect. The second and the third criteria are alternative. If examination of each criterion separately does not lead to a clear conclusion, then cumulative approach to the test of these criteria is admissible (*see ECHR Judgement of 31 July 2007 in Case "Zaicevs v. Latvia", Application No. 65022/01, Para 31*).

Thus, to examine compliance of the contested norms with the presumption of innocence principle included in the second sentence of Article 92 of the *Satversme*, the Constitutional Court must first and foremost establish, whether the contested norms regulate such field of law to which presumption of innocence is applicable.

14. Thus, the Constitutional Court shall examine:

1) qualification of the particular offence, linking it to criminal law;

2) nature and severity of the offence;

3) severity of penalty that the relevant person risk incurring for the offence (*see, for example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 13.1*).

The Applicant holds that administrative cases regarding recovery of a legal person's late tax payments from a board member should be equalled to criminal cases in the meaning of Article 6 of the Convention and, thus, all principles of criminal procedure are applicable in these cases, *inter alia*, the presumption of innocence principle.

The Ministry of Justice upholds the Applicant's opinion that the regulation established by the contested norms, in essence, is of criminal law nature. I.e., it is said to be both punitive and preventive.

However, *Saeima*, the Ministry of Finance and SRS do not support this opinion, underscoring that recovery of a legal person's late tax payments from

board members established by the contested norms has compensatory, rather than punitive nature and that it is primarily aimed at ensuring collection of revenues into the state budget.

15. In examining compliance of the contested norms with the criteria referred to above, first and foremost the qualification of the particular offence in the national legal acts must be reviewed.

The contested norms define a procedure for establishing a board member's liability for repayment of a legal person's late tax payments into the state budget. In the Latvian legal system it has not been qualified as a criminal offence subject to criminal sanction, nor as an administrative violation, envisaging an administrative sanction.

Liability for evasion to pay taxes and payments equalled thereof is envisaged in Section 218 of the Criminal Law and LAVC Section 159, covering offences that have other elements of crime. The Constitutional Court has already recognised that the criteria included in the contested norms that serve as the grounds for initiating procedure to recover late tax payments from a board member are not identical to pre-requisites for initiating criminal proceedings or record-keeping with respect to an administrative violation (*see Para 11.3.2 of this Judgement*).

Thus, the particular crime has not been qualified as criminal law offence in the Latvian legal system.

Hence, the contested norms do not apply to an offence that is envisaged in criminal law related regulatory enactments.

16. ECHR has recognised that with respect to the second criteria, in appraising the nature and severity of the offence, its nature and the nature of sanction envisaged for it should be taken into consideration. If the norm is general in nature and the sanction has both preventive and punitive aim, then it should be recognised that the particular offence must be equalled to the autonomous concept of "criminal offence" in the meaning of Article 6 of the Convention (*see, for example, ECHR Judgement of 21 February 1984 in Case "Ozturk v. Germany", Application No. 8544/79, Para 53*). The Constitutional Court has also used this approach in its case law, recognising an administrative violation in cases, where a monetary fine is envisaged as a sanction, as being "criminal offence" in the meaning of Article 6 of the Convention (*see, for*

example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 13.2.2.).

The contested norms are generally binding as to their nature; they apply to all members of a board. The contested norms have been adopted so that the State could ensure one of its basic functions – to execute the state budget, and is aimed at effective recovery of late tax payments of all legal persons. This aim of the contested norms is consistent with public interests (*see also Para 11.2. of this Judgement*).

It follows from the annotation to draft law "Amendments to the Law "On Taxes and Duties"" that the contested norms have a preventive aim, i.e., to make a board member of a legal person more aware of his responsibility for making the payments of a legal person's taxes and other mandatory payments in time, as well as performing his other statutory duties [*see Para 2 in report on initial impact assessment (annotation) of the draft law No.98/Lp12 submitted to the* Saeima *on 10 December 2014 "Amendments to Law "On Taxes and Duties*]. The *Saeima* points to the preventive aim of the contested norms in its written response, and, essentially, it is recognised by all persons summoned in the case. The Constitutional Court recognises that a preventive aim of the contested norms can be established.

As the outcome of administrative proceedings the contested norms allow imposing upon a board member the obligation to repay from his personal resources into the state budget the late tax payments (tax debt) of a legal person, which, pursuant to Section 26 of the Tax Law, includes not only the amount of the basic debt, but also penalty fees and late payment fees. To impose this obligation upon a board member, in accordance with pre-requisites included in the contested norm, causality between a board member's actions or failure to act and negative consequences thereof – occurrence of tax debt, must be established. I.e., SRS must prove within the framework of administrative proceedings that the board member has not duly performed his statutory duties, as the result of which respective negative consequences have set in. Hence, the obligation to repay a legal person's tax debt, *inter alia*, with respect to a board member, has also an individual punitive function. Thus, in essence, it is recognised that it is an inducing and coercive measure, which is applied to a person, who has committed a punishable infringement of law (*see, for example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 15*).

Thus, the contested norms are applied for an offence for which, in view of its nature, penalty is applied.

17. The Constitutional Court has recognised in its case law: if the penalty as to its nature and essence complies with the second criterion, then the severity thereof does not need to reach the degree envisaged in the third criterion (*see, for example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 3.2.2*). Thus, in the case under review examining compliance of the contested norms with the third criterion is not necessary.

Hence, the contested norms pertain to the scope of the second sentence of Article 92 of the *Satversme* and their compatibility with the presumption of innocence principle must be examined.

18. Pursuant to regulation established in the contested norms, upon initiating a procedure for recovering a legal person's late tax payments into the state budget from a board member, SRS must establish the fact and the amount of late tax payment and must prove that the legal person has been notified thereof, that assets have been alienated to an interested party, recovery is impossible, and that the obligation to submit an application regarding a legal person's insolvency procedure has not been fulfilled. Upon establishing that these criteria defined in Section 60 of the Tax Law are met and by taking into consideration the obligations of a board member defined in the Commercial Law and in other regulatory enactments, it is assumed that a board member has not performed in good faith legal requirements regarding management of a legal person, and in the circumstances of the case under review it is to be equalled to "offence" in the meaning of Article 6 of the Convention.

Thus, this assumption restricts the right to presumption of innocence established in the second sentence of Article 92 of the *Satversme*.

19. The Constitutional Court has established that presumption of innocence is constituted by three elements:

1) it protects a person, so that he would not be recognised as being guilty before his guilt has been proven in accordance with law;

2) a person must not prove his innocence. The burden of proving guilt lies upon the official in charge of proceedings – the investigator or the prosecutor;

3) all reasonable doubt regarding guilt that cannot be removed, must be interpreted in favour of the accused person. Unexonerative ruling (as well as convicting sentence) must be based on evidence established in procedure defined in law (*see Judgement of 23 February 2006 by the Constitutional Court in Case No. 2005-22-01, Para 4*).

It follows from the application that, in essence, compliance of the contested norms with the first and the second element is challenged; i.e., SRS already upon initiating the procedure defined in the contested norms is said to presume a board member's guilt for the occurrence of a legal person's tax debt, and the contested norms, allegedly, do no abide by the principle that a person must not prove his own innocence.

Although pursuant to presumption of innocence, the accused does not have the obligation to prove his innocence, but the person bringing the charges has the obligation to provide sufficient evidence of the person's guilt in the particular offence; however, this does not mean that it would be inadmissible to include in law a rebuttable presumption if actual circumstances point to the guilt of a concrete person or a group of persons. The special importance of presumption of innocence is undeniable; however, the assumption that it is absolute would collide with the principle of the unity of the *Satversme* and fundamental rights of other persons enshrined in the *Satversme*, as well as other provisions of the *Satversme* (*see Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para15.1*). Thus, presumption of innocence does not prohibit from imposing restrictions upon a person, if such are necessary for reaching the legitimate aim and proportionality is abided by (*see Judgement of 23 February 2006 by the Constitutional Court in Case No. 2005-22-01, Para 5.1.*).

Thereby the Constitutional Court has recognised that in certain cases presumption of innocence allows the legislator to provide for legal presumption of a fact in such legal relationship to which this fundamental right applies (*see Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 15.1).* The Convention does not, in principle, prohibit legal presumption of a fact, but allows it only upon the condition that the states party to the Convention apply this presumption reasonably, taking into consideration

the risks in application thereof and retaining a person's right to defence (*see ECHR Judgement of 7 October 1988 in Case "Salabiaku v. France", Application No. 10519/83, Para 28*).

To examine whether in the circumstances of the case under review legal presumption of a fact is admissible, it must be established whether:

1) legal presumption of a fact has been established in law in due procedure and is being unequivocally applied to precisely defined, specific situations. I.e., it must be established, whether this presumption has been envisaged in law *expressis verbis* and whether it is intended to apply it to a limited range of situations;

2) legal presumption of a fact has been established for reaching a legitimate aim. I.e., it must be verified, whether such presumption has been established for the protection of significant interests of the State, society or private persons;

3) a person's interests are balanced. I.e., whether to the person, to whom legal presumption of a fact is applied, at the same time the possibility is ensured to rebut this presumption by using evidence that is at his disposal or can be easily obtained and, thus, to prove his innocence (*see, for example, Judgement of 28 March 2013 by the Constitutional Court in Case No. 2012-15-01, Para 15.1. and 15.2.*).

Therefore compliance of the contested norms with all these criteria must be examined.

19.1. The Constitutional Court has already recognised that board members' liability for a legal person's late tax payments is directly established in the contested norms, that they are clearly worded and no violations have been established in the procedure of adopting thereof (*see Para 11.1 of this Judgement*).

Board member's liability for a legal person's late tax payments is envisaged only in those cases, where the specific criteria that are precisely defined in the first part of Section 60 of the Tax Law are met.

Thus, legal presumption of a fact has been established by law in due procedure and is unequivocally applied to precisely defined specific situations.

19.2. The *Saeima* notes that legal presumption of a fact that is included in the contested norms has been established with the aim of creating an effective system of tax collection and, thus, complies with the legitimate aim

defined in Article 116 of the *Satversme* – for protection of public welfare. This aim has been recognised as being legitimate also by ECHR (*see, for example, ECHR Judgement of 23 July 2002 in Case "Västberga Taxi Aktiebolag and Vulic v. Sweden", Application No. 36985/97, Para 116*). ECHR has also underscored the importance of public interest, since taxes is the main source of the State's revenue (*see ECHR Judgement of 23 July 200 2in Case "Janosevic v. Sweden", Application No. 34619/97, Para 103*). States have the right to establish their own fiscal policy and system, ensuring that taxes are paid, and it is in public interests (*see ECHR Judgement of 22 September 1994 in Case "Hentrich v. France", Application No. 13616/88, Para 39*). The Constitutional Court has also found that legal norms that envisage liability for violating tax laws or pre-requisites for releasing from this liability have bee set in the interests of public welfare (*see Judgement of 15 April 2013 by the Constitutional Court in Case No. 2012-18-01, Para 15*).

Thus, legal presumption of a fact has been established to protect public welfare.

19.3. ECHR has recognised that in the field of criminal law states must abide by certain limits in applying presumption, i.e., it must be taken into consideration what is being presumed and verified whether the presumption is rebuttable (*see ECHR Judgement of 7 October 1988 in Case "Salabiaku v. France", Application No. 10519/83, Para 26–28*).

It follows from the case materials that application of the contested norms and judicial review are envisaged within the framework of administrative procedure, which ensures a high level of protection for a private person's rights and lawful interests by applying the principle of impartial investigation. However, notwithstanding application of the principle of impartial investigation, the participants of administrative procedure have the obligation to participate. Section 59(4) of the Administrative Procedure Law provides that participants in the administrative procedure have the obligation to submit evidence at their disposal and to inform institutions about facts that are known to them and could be of importance in the particular case. Section 150(3) of the Administrative Procedure Law, in turn, provides that an applicant, according to his or her capacity, must participate in collecting evidence. Whereas Section 38 of the Tax Law provides: if the taxpayer disagrees to the amount of the tax payment assessed by the tax administration, it must provide evidence regarding the amount of tax liabilities. This approach

to participation has been enshrined also in ECHR judicature on tax cases, recognising that the tax system to a large extent is based upon information provided by the taxpayer (*see, for example, ECHR Judgement of 23 July 2002 in Case "Janosevic v. Sweden", Application No. 34619/97, Para 103*). Moreover, the contested norms provide that if the board member no longer has access to evidence needed for his defence, it is the obligation of SRS to obtain it.

Thus, in some cases within the framework of administrative procedure there are grounds to request information and documents that are solely at the disposal of a private person (in this case – a board member). However, if the person objectively has no access to the evidence, then the person has the right to expect application of the principle of impartial investigation.

Thereby a board member has been ensured the possibility to substantiate and to prove that he is not liable for the occurrence of a legal person's late tax payments and that he has acted as an honest and careful manager. This substantiation and evidence, in turn, helps SRS to perform its statutory obligations and to assess the situation impartially.

ECHR has recognised that member states may grant to their institutions of tax administration the right to impose even large-scale sanctions for failure to pay taxes – but only insofar the taxpayers are given the possibility to appeal against the respective decision in court. The court should have the right to examine the dispute on its merits, *inter alia*, a right to revoke the decision in full on the basis of both facts of the case and legal considerations (*see ECHR Judgement of 17 April 2012 in Case "Steininger v. Austria", Application No. 21539/07, Para 55*).

Pursuant to Section 61 of the Tax Law, a board member has been ensured the possibility, by submitting evidence and explanations, to appeal at the institution and in court both his liability for formation of tax debts and the scope of liability.

Firstly, it is possible by turning to the State Revenue Service and the Director General of SRS. Secondly, pursuant to Section 61(8), the decision is subject to appeal at the Administrative District Court, which has the right to review both the facts of the case and legal considerations. Moreover, the Administrative District Court collects evidence upon its own initiative (*see Section 107(4) of the Administrative Procedure Law*). Judgement of the Administrative District Court may be appealed at the Administrative Regional

Court, the judgement of which, in turn, may be appealed in cassation procedure at the Department of Administrative Cases of the Supreme Court.

Thus, a board member is ensured the possibilities to rebut the presumption that the contested norms comprise. Therefore the liability of a board member for repaying a legal person's late tax payments into the state budget that is established by the contested norms complies with the principle of the right to a fair trial and guarantees conformity with presumption of innocence.

Thereby the contested norms are not incompatible with the presumption of innocence principle and comply with the second sentence of Article 92 of the *Satversme*.

20. The Constitutional Court must also verify compliance of the contested norms with the equality principle, which is included in the first sentence of Article 91 of the *Satversme*.

The first sentence of Article 91 of the *Satversme* provides: "All human beings in Latvia shall be equal before the law and the courts."

The Constitutional Court has repeatedly recognised that the objective of the equality principle enshrined in the first sentence of Article 91 of the *Satversme* is to ensure that such requirement set for a state governed by the rule of law as comprehensive impact of law upon all person and application of law without any privileges whatsoever is met (*see, for example, Judgement of 2 February 2010 by the Constitutional Court in Case No. 2009-46-01, Para 7*). However, this does not mean levelling, but requires equal treatment of those persons, who are, indeed, in similar and comparable circumstances. I.e., the equality principle 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 that (*see, for example, Judgement of 23 November 2015 by the Constitutional Court in Case No. 2015-10-01, Para15).*

To examine, whether the contested norms comply with the equality principle, it must be established:

1) whether and which persons (groups of persons) are in similar and according to concrete criteria comparable circumstances;

2) whether the contested norms envisage equal or differential treatment of these persons;

3) whether this 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 23 November 2015 in Case No. 2015-10-01, Para 16*).

21. In assessing compliance with the equality principle, first and foremost it must be established, whether and which persons (groups of persons) are in similar and according to concrete criteria comparable circumstances. To establish this, the main common feature of the comparable group must be identified.

Since the Applicant has provided arguments regarding the possible incompatibility of the contested norms with the equality principle in a number of aspects, the Constitutional Court must examine all these aspects of the contested norms.

21.1. The Applicant holds that the contested norms create without grounds equal treatment of two groups of persons that are in different circumstances, i.e., founders of capital companies (stockholders, shareholders), who are also board members, and founders of partnerships (members).

The Constitutional Court already established that the contested norms do not apply to founders of capital companies (stockholders, shareholders), but apply to board members of capital companies (*see Para 10.2 of this Judgement*). If a person, who is a stockholder or a shareholder of a capital company, concurrently holds also the position of a board member, in this status he is comparable to members of a partnership. I.e., Section 94(1) of the Commercial law provides that members of a partnership are personally liable for the obligations of the partnership with all of their property as joint debtors. The contested norms establish personal liability of board members of capital companies for repaying tax debts to the state budget (*see Para 10.3. of this Judgement*). Thus, insofar the contested norms envisage personal liability of board members of capital companies for repaying tax debts into the state budget they are in comparable situation with members of a partnership.

The Applicant holds that the envisaged equal treatment is unfounded, because members of a partnership have chosen already at the moment of establishing a partnership to engage in business activities without separating their own and the company's assets, i.e., they have assumed personal liability

for meeting the partnership's obligations, whereas in a situation of board members of capital companies such choice has not been made.

The *Saeima* does not discern in this a violation of the equality principle.

The Constitutional Court holds that, assessing in this aspect, whether the equal treatment of comparable groups established by the legislator is substantiated, the decisive factor is the general nature of the obligation to pay taxes. Pursuant to Para 4 of Section 1 of the Tax Law, taxpayers are all natural or legal persons of the Republic of Latvia or foreign countries and groups of such persons or their representatives formed on the basis of contracts or agreements, who are in engaged in performance of taxable activities. When engaging in any of the forms of commercial activities envisaged in the Commercial Law, the persons must act so as to, *inter alia*, perform the obligation established in the Tax Law to pay taxes in the interests of society as a whole (*see also Para 11.2 of this Judgement*).

In a partnership each member has statutory obligation and rights to participate in the management of the partnership (*see Section 83(1) of the Commercial Law*). Member's actions in good faith in managing the company and representing the company directly influences compliance of commercial activity with law, *inter alia*, also making timely payments of taxes defined in the Tax Law.

In a capital company, the board, pursuant to Section 221 of the Commercial Law, is the only executive body of it that manages and represents the company. Thus, the board of a company, similarly to members of a partnership, has the obligation to act responsibly and in good faith, ensuring that commercial activities of the company comply with law, *inter alia*, making timely payments of taxes established by the Tax Law. No participant of the case has presented arguments as to special circumstances existing in the case of a capital company that would objectively prohibit members of the board to perform their obligations responsibly and in good faith, ensuring that the commercial activities of the company comply with law.

The Constitutional Court recognises: to reach the legitimate aim – ensure protection of public welfare, personal liability of board members of capital companies may be equalled to the liability of partnership's members.

Thus, in this aspect establishing of equal treatment is justified.

21.2. The Applicant holds that the equality principle has been violated also by applying the contested norms to the board of a capital company as one of the managing bodies of a capital company, but not applying them to other managing bodies of a capital company, as well as to managers and members of partnerships, who manage and represent partnerships. All managing bodies of companies are said to be in equal and comparable circumstances.

The *Saeima* does not uphold the opinion that the contested norms have created differential treatment of other managing bodies of companies, the scope of whose rights, obligations and responsibility should be equalled to the scope of the board's rights, obligations and responsibility. The Ministry of Finance and SRS also recognise the special role of the board in managing a company.

A partnership is not a legal person in the meaning of the Commercial Law. The Constitutional Court already established in Para 21.1 of this Judgement that all members of a partnership have the right and obligation to participate in managing the partnership, by performing managers' functions in accordance with the provisions of partnership agreement. Thus, members of a partnership are also managers, who manage operations of the partnership, each personally representing the partnership in relations with third persons and as joint debtors are liable for all obligations of the partnership with their property.

Whereas capital companies (limited liability company or a joint stock company) have the status of a legal person (*see Section 134 and Section 135 of the Commercial Law*).

The law establishes the following administrative bodies of a limited liability company – the meeting of shareholders, the board, as well as the council (if the articles of association provide for such) (*see Section 209 of the Commercial Law*). Whereas the administrative bodies of a joint stock company is the meeting of stockholders, the council and the board of directors (*see Section 266 of the Commercial Law*).

The Commercial Law defines the board as the only executive body, which manages and represents a capital company (*see Section 221(1) and Section 301(1) of the Commercial Law*. Thus, the competence of the board as an executive body cannot be compared to administrative bodies of a capital company that perform other functions.

Thus, the board is not in similar and comparable circumstances with other administrative bodies of capital company.

Thereby, the differential treatment established by the contested norms is justified.

21.3. The Applicant holds that incompatibility of the contested norms with the first sentence of Article 91 of the *Satversme* manifests itself also by placing SRS and creditors of a capital company in an unequal situation. I.e., the contested norms are said to envisage a special regulation on SRS for recovering tax debts. The *Saeima*, as well as the Ministry of Finance and SRS do not uphold this opinion and believe that the differential treatment of SRS is justified.

Pursuant to Section 1 of the law "On the State Revenue Service", SRS is a direct administration authority under the supervision of the Minister for Finance, which ensures the accounting of tax payments and taxpayers, the collection of State taxes, fees and other mandatory payments determined by the State in the territory of the Republic of Latvia, as well as collects taxes, fees and other mandatory payments for the budget of the European Union, implements the customs policy and organises customs matters. SRS's obligations in the field of tax administration are defined in Section 18 of the Tax Law, providing that the obligations of tax administration are aimed at ensuring full compliance with rules of the Tax Law and other laws on taxes (duties) both on part of taxpayers and in the operations of tax administration.

The Constitutional Court has already recognised that the State needs tax revenue to ensure public welfare (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010-25-01, Para 9*). SRS as tax administration acts in the interests of society as a whole, *inter alia*, controlling outstanding payments of taxes and other payments determined by the State and recovering on uncontested basis taxes not paid within the set term (*see Section 18 of the Tax Law*). Thus, tax administration, in difference to creditors, who may choose, whether to engage in a transaction by considering such factors as solvency, reputation and by assessing the risks of commercial activities, has the obligation in performing the State functions placed in it competence to cooperation with all subjects, who, pursuant to law, must pay taxes administered by SRS. Only tax administration turns against the debtor by submitting a tax claim (claim to payment of taxes, duties, and other payments established by the State). Another valid regulation also proves that SRS performs the functions of the State as tax administrator, pursuant to which SRS

exercises its rights in administrative procedure, adopting its own decisions on recovering late tax payments (*see Section 26 of the Tax Law*).

The special status of SRS as tax administration is manifested also in the framework of insolvency proceedings (*see, for example, Section 38(5), Section 40(2), Section 53 (3), and Section 118(4) of the Insolvency Law*). Moreover, in the framework of insolvency proceedings the regular tax payments must be made as a matter of priority (*see Para 3 of Section 64(1) of the Insolvency Law*) and a number of payments made in the interests of tax administration have been granted priority compared to other payments. Thus, SRS as the State's tax administration also in the framework of insolvency proceedings is in different circumstances compared to creditors of a capital company, and the differential treatment established by the contested norms with respect to this aspect is justified.

Hence, the contested norms are compatible with the first sentence of Article 91 of the *Satversme*.

The Substantive Part

On the basis of Section 30-32 of the Constitutional Court Law the Constitutional Court

held:

to recognise Section 60, Section 61 and Section 62 of the law "On Taxes and Duties" as being compatible with the first sentence of Article 91, Article 92 and Article 105 of the *Satversme* of the Republic of Latvia.

The Judgement is final and not subject to appeal.

The Judgement shall enter into force in the day it is published.

Chairman of the court sitting A. Laviņš