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. 2014–11–0103

25 March 2015, Riga

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

with the participation of the applicants'– Ltd. "DOBELES HES", Ltd. "PALSMANES ŪDENSDZIRNAVU HES" and limited liability company "SL PLUS" – authorised representative sworn attorney at law Jānis Vaits, the authorised representative of the joint stock company "LATGALES ENERĢĒTIKA" Uģis Grauds, as well as the owner of the applicant – farm "Dzirnavas" of Dobele region Bērze rural municipality – Orvils Heniņš,

the representative of the institution, which adopted the contested act, – the Saeima – Mārtiņš Brencis, and

the representative of the institution, which adopted the contested act, – the Cabinet of Ministers, – Rudīte Vesere,

with the secretaries of the court sitting Elīna Kursiša and Alla Spale,

on the basis of Article 85 of the Satversme of the Republic of Latvia and Para 1 and Para 3 of Section 16, Para 11 of Section 17(1), as well as Section 19^2 and Section 28 of the Constitutional Court Law,

on 17 February and 25 February 2015 in Riga examined at an open court sitting the case

"On the Compliance of Subparagraph "f" of Para 1 of Section 3(1), Section 19^1 of Natural Resources Tax Law, the Cabinet of Ministers Regulation of 14 January 2014 No. 27 "Amendments to the Cabinet of Ministers Regulation of 19 June 2007 No. 404 "Procedures for the Calculation and Payment of Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources"" with Article 105 of the Satversme of the Republic of Latvia."

The Facts

1. On 15 December 2005 the Saeima adopted Natural Resources Tax Law (hereinafter – NRTL), which entered into force on 1 January 2006.

The law of 6 November 2013 "Amendments to Natural Resources Tax Law" (hereinafter – Amendments to NRTL grozījumi), *inter alia*, added a number of legal provisions to NRTL, establishing the obligation to pay the natural resources tax also to persons using water resources for producing electricity in a hydroelectric power station with the total installed capacity of hydroelectric generation stations was below 2 MW (hereinafter also – the small-scale HPS).

Subparagraph "f" of NRTL Section 3(1) provides that a taxpayer of the natural resources tax is a person who has received or in accordance with the laws and regulations regarding environmental protection or use of subterranean depths had a duty to receive a permit, a licence or a C category polluting activity certificate laid down in the laws and regulations regarding environmental pollution and who in the territory of the Republic of Latvia, continental shelf of exclusive economic zones uses water resources for production of electricity in a

small HPS. Whereas NRTL Section 19^1 provides: “The tax rate for the use of water resources for production of electricity in a hydroelectric power plant, the total capacity of the hydroelectric station installed of which is less than 2 megawatts, shall be 0.00853 euros per 100 cubic metres of the water that has flown through the hydrotechnical structure. The Cabinet shall determine the procedures by which the water flown through the hydrotechnical structure shall be calculated on the basis of the quantity of electricity produced and the efficiency coefficient of the operation of the hydroelectric station.”

The procedure for calculating and paying natural resources tax was established by the 19 June 2007 Regulation of the Cabinet of Ministers No. 404 “Procedures for the Calculation and Payment of Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources” (hereinafter also – Regulation No. 404). On 14 January 2014 the Cabinet of Ministers adopted Regulation No. 27 “Amendments to the Cabinet of Ministers Regulation of 19 June 2007 No. 404 “Procedures for the Calculation and Payment of Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources”” (hereinafter – the amendments to Regulation No. 404). The amendments to Regulation No. 404 provide for the following:

“1. Introduce the following amendments in Regulation of 19 June 2007 by the Cabinet of Ministers No. 404 “Procedures for the Calculation and Payment of Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources” (Latvijas Vēstnesis, 2007, 100. nr.; 2009, 90. nr.; 2010, 67. nr.; 2013, 189. nr.):

1.1. to replace in the reference to the law, on the basis of which the regulation has been adopted, the number and word “Section 17” with the number and word “Section19^1”;

1.2. to replace in the text of the Regulation the words “Ministry of Environment” (in appropriate case) with the words “Ministry of Environmental Protection and Regional Development” (in appropriate case);

1.3. to add to the regulation Subparagraph 1.20, worded as follows:

"1.20. the procedure for calculating the water flown through the hydrotechnical structure on the basis of the quantity of electricity produced and the efficiency coefficient of the operation of the hydroelectric station.";

1.4. to add Para 21^1, 21^2, 21^3, 21^4 and 21^5 to the Regulation, worded as follows:

"$21.^1$ The quantity of water used for production of electricity shall be calculated in accordance with the following formula:

$$W_{HES} = \frac{E_{HES}}{0{,}002725 \times H_{HES} \times \eta_{HES}}$$, where

W_{HES} – the quantity of water used for the production of electricity in the hydroelectric station, m^3;

E_{HES} – the quantity of produced electricity, kWh;

H_{HES} – water drop (difference between levels), m;

η_{HES} – the average or benchmark efficiency coefficient (comprises the efficiency coefficients of the turbine, transmission and generator);

0.002725 – coefficient, which characterises the average water consumption for producing 1 kWh of electricity ($kWh/m^3 \times m$).

21. ^{2} The total sum of natural resources payment in *euro* shall be calculated in accordance with the following formula:

$$\sum_{DRN} = W_{HES} \times 0{,}01 \times 0{,}00853$$

$21.^3$ The efficiency coefficient of a hydropower unit is indicated in their certificates. If the efficiency coefficient of hydropower units cannot be based upon the certificate of the hydropower unit or the permit to use water resources, then the average benchmark efficiency coefficient of 0.75 shall be used.

$21.^4$ If several hydropower units have been installed at a hydroelectric power station, then the quantity of water that has flown through shall be first calculated for each hydropower unit separately and the results shall be added up.

$21.^5$ The taxpayer shall calculate the tax for the actual quantity of water that has flown through the hydrotechnical structure on the basis of the indicator defined in the appropriate permit to use water resources or the recorded data that are entered into the log. If the record-keeping documents indicate any of the indicators within a certain interval, then the highest limit of the interval shall be used for calculating the quantity of water that has flown through the hydrotechnical structure and tax."

2. Subparagraphs 1.3 and 1.4 shall be applicable as of 1 January 2014."

Since 4 June 2014 Regulation No. 404 has the following title: "Procedures for the Calculation and Payment of Natural Resources Tax, Procedures for the Issuance of Permits for Use of Natural Resources and Auditing the Management Systems."

2. Two cases were initiated at the Constitutional Court with regard to the compliance of Subparagraph "f" of NRTL of Para 1 of Section 3(1), NRTL Section 19^1 and amendments to Regulation No. 404 (hereinafter together – the contested norms) with Article 105 of the Satversme of the Republic of Latvia (hereinafter – the Satversme). On 5 August 2014 a decision was adopted to combine cases No. 2014–11–0103 and No. 2014–30–0103 in one case. The combined case No. 2014–11–0103 retained its former name **"**On the Compliance of Subparagraph "f" of Para 1 of Section 3(1), Section 19^1 of Natural Resources Tax Law, the Cabinet of Ministers Regulation of 14 January 2014 No. 27 "Amendments to the Cabinet of Ministers Regulation of 19 June 2007 No. 404 "Procedures for the Calculation and Payment of Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources"" with Article 105 of the Satversme of the Republic of Latvia".

3. **The applicant** – Ltd. **"**DOBELES HES", Ltd. "PALSMANES ŪDENSDZIRNAVU HES", joint stock company "LATGALES ENERĢĒTIKA", limited liability company "SL PLUS", as well as farm "DZIRNAVAS" from Dobele region Bērze rural municipality, "Dzirnavas" from Tukums region Sēme rural municipality, farm "Zariņi" from Liepāja region Kalēti rural municipality, farm "OZOLKALNI", "EZERSPĪĶI" from Saldus region Šķēde rural municipality, J.Rudzītis' farm "STIEBRIŅI" from Kalsnava rural municipality, farm "GRANTIŅI" from Saldus region Nīgrande rural municipality, farm "SKUĶĪŠU DZIRNAVAS" from Rīga region Garkalne rural municipality, farm "DZIRNAVAS" from Saldus region Brocēni town, G.Grīgs' farm "Bišpēteri" from Tukums regions Irlava rural municipality, farm "ZAĶĪŠI" from Saldus region Zirņi rural municipality, farm "AVOTI" from Saldus region Pampāļi rural municipality, Sanita Ozoliņa–Šmite's farm "RAUZAS

DZIRNAVAS" from Smiltene district Palsmane rural municipality, farm "CELMIŅI–1" from Ogre region Lēdmane rural municipality, Andra Cibuļska's farm "Jaunkraukļi" from Ādaži rural municipality, Ltd. "BILLES HES", limited liability company "EGLĪTIS UN BIEDRI", Ltd. "RANKA HIDRO", limited liability company "HYDROENERGY LATVIA", limited liability company "Rubīns GG", Ltd. "KRĀCE", limited liability company "OGRES HES", limited liability company "GREV", limited liability company "ZILUPES HES", limited liability company "Vecogre", „KRĒSLIŅI" Ltd., limited liability company "Mazdambji", limited liability company "VADAKSTES HES", limited liability company "ANNENIEKU ŪDENS DZIRNAVAS", Ltd. "MEŽROZĪTE HES", Ltd. "MEGATE", limited liability company "SASPĒLE", limited liability company "SANKAĻI", Ltd. "BRASLAS HES", limited liability company "Tovtra", limited liability company "NAGĻU HES", Ltd. "GAUJAS HIDROELEKTROSTACIJA", limited liability company "ĀŽU HES", limited liability company "GM", limited liability company "Mazā Jugla Hidro", limited liability company "KRĪGAĻU DZIRNAVAS", limited liability company "Vēžu Krāces", limited liability company "GRĪVAIŠU HES", limited liability company "SPRIDZĒNU HES", "IU CEĻŠ" Ltd., Ltd. "CIRĪŠU HES", limited liability company "GALGAUSKAS DZIRNAVU HES", Company "JANOVSKIS" Ltd., limited liability company "GA 21", limited liability company "AG 21", Ltd. "KORNA DZIRNAVU HES", limited liability company "PILSKALNA HES", limited liability company "NOVATORS", Ltd. "Labdeves", Ltd. "FIRMA–GABRO", Ltd. "IEVULĪČI", limited liability company "NERETAS DZIRNAVAS", Ltd. Raunas dzirnavu HES", limited liability company "SUDA", limited liability company "EDVIHES", Ltd. "ENERGO 2000", limited liability company "GRIENVALDE", limited liability company Dzirnavu HES "KALNA KĀRKLI", limited liability company of the city of Valka "KALNDZIRNAVAS", limited liability company "DZELDAS HES", Ltd. "ĒRBERĢES HES", limited liability company "GAISMA–97", limited liability company "VN ŪDENS–DZIRNAVAS", limited liability company "DZIRNAVAS–K", Ltd. "HS BĒNE", Ltd. "PATINA", limited liability

company “Lūkins & Lūkins”, Ltd. “BRANDEĻU HES”, limited liability company “Oserviss”, limited liability company “Spēkstacija PR”, Norvaitis’ one–man company “KARĪNA”, one–man company “BITMETA DZIRNAVAS” (hereinafter all together – the Applicants) – holds that the contested norms are incompatible with Article 105 of the Satversme.

It is noted in the applications that the Applicants produce electricity in small HPS. The contested norms had established an obligation for the Applicants to pay natural resources tax for using water resources in the production of electricity. It is contended that the obligation to pay the tax is a restriction upon the right to own property; therefore the compliance of the contested norms with Article 105 of the Satversme should be examined.

It is alleged that the restriction upon the Applicants’ right to own property had been established by law; however, no consultations with the representatives of the respective field had been held during while the norms were drafted and adopted, amendments to NRTL had been submitted to the Saeima for hearing in the package of draft budget laws; however, it is doubted whether a draft law that envisages establishing a new tax should be heard in urgent procedure together with other draft laws that influence the budget.

The restriction upon the right to own property is said to have no legitimate aim, since the aim that follows from the contested norms – to reduce the damaged inflicted upon natural resources – is simulative. Water, which is used in producing electricity, is not irreversibly consumed, polluted or transformed. The legislator had substantiated the imposition of natural resource tax upon the small-scale HPS by the damage inflicted upon fish resources and legal inequality between the three largest hydroelectric power stations in Latvia and the small HPS. However, the contested norms are said not to be targeting the legitimate aim, since the small-scale HPS every year compensate for the damage inflicted upon fish resources in accordance with Section 26(3) of Fishery Law. The reference to legal inequality, in its turn, is said to be unfounded.

Even if it were established that the restriction upon the right to own property had a legitimate aim, the restriction would not comply with the principle

of proportionality. The measures used by the legislator are said to be inappropriate for reaching the legitimate aim, since by applying a tax to the small-scale HPS the damage caused to natural resources could not be decreased and a more rational use of resources could not be achieved. It is contended that the calculation of the natural resource tax allows concluding that hydroelectric power stations with the largest water drop must pay the lowest tax. Thus, a more rational use of water resources could be made by increasing the water drop. However, legal acts prohibit from increasing the water level to increase the drop.

The small HPS could be divided into three groups: 1) small HPS that sell all electricity they produce on the free market; 2) small HPS that sell all electricity they produce in the framework of mandatory electricity procurement; 3) small HPS that sell part of the electricity they produce on the free electricity market, but part of it – within the framework of the mandatory electricity procurement. The natural resource tax is said to be an excessive burden upon those persons, whose HPS sell part of or all electricity that they produce on the free market. The calculation of natural resource tax show that in general the Applicants must pay a tax in the amount of 15 to 50 per cent of their gross revenue, and this is said to be disproportional. At the same time a number of Applicants have been imposed the obligation to pay also subsidised electricity tax, and both types of tax must be paid from the revenue, i.e., irrespective of whether the company operates with profit or loss.

It is contended that the legislator had not considered, whether the legitimate aim of the restriction could not be reached by other measures, less restrictive upon an individual's rights. Likewise, the benefit that the society gains from the restriction upon the right to own property is said not to exceed the losses caused to the Applicants. Society is said to benefit from the operations of the small-scale HPS, whereas, if the production of energy from renewable energy resources decreased, then the share of fossil electricity and dependence from the energy resources of other countries would increase.

At the court sitting the Applicants' authorised representative sworn attorney–at–law J.Vaits noted additionally that, in assessing the proportionality

of the obligation to pay the tax, it must be considered, whether after paying the tax the person still had an economic interest to continue the respective business activity. Whereas in assessing the compliance of the amendments to Regulation No. 404 with the Satversme, the same arguments provided by the Applicants that applied to the compatibility of the contested norms in the amendments to NRTL with the Satversme should be taken into consideration.

4. **The institution, which adopted the contested act, – the Saeima** – holds that Subparagraph "f" of Para 1 in Section 3(1) of NRTL and NRTL Section 19^1 (hereinafter – the contested NRTL norms) comply with Article 105 of the Satversme.

The Constitutional Court should assess the compatibility of the contested NRTL norms with the first sentence of Article 105 of the Satversme. Article 105 of the Satversme is said to provide both for unhindered exercise of the right to own property and the rights of the State to restrict the right to own property in public interests.

The restriction upon the Applicants' fundamental right has been established by law, which had been adopted in due procedure. Allegedly, neither the Satversme, nor the Saeima Rules of Procedure define consultations with the possible addressees of legal norms as a mandatory pre–requisite for adopting such norms. The Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy (hereinafter – the Water Framework Directive) requires the users of water to cover the costs of water management services. Latvia must create a mechanism that would ensure that water users would cover all expenses related to the use of this resource, not only the damages caused to fish resources as the result of economic activities. Hence, the restriction upon the fundamental rights is said to have a legitimate aim – to ensure the other persons' rights and welfare of society.

The measures used by the legislator are said to be appropriate for reaching the legitimate aim of the rights restriction. Natural resources tax is said to be an

appropriate and legitimate mechanism for such measures to ensure financing that have the aim of reducing the impact upon environment. Moreover, it should be examined in interconnection with Article 115 of the Satversme. It is alleged that there are no other measures, more lenient towards an individual's rights, but the chosen legal regulation is said to balance the interests of society and those of an individual in the field of environment protection.

The Saeima does not uphold the Applicants' opinion that the amount of natural resource tax in the particular situation is not proportional. Initially the draft amendments to NRTL had planned applying the tax rate of 0.018 euro/kWh to the small-scale HPS. However, taking into consideration also the planned subsidised electricity tax, the rate of the natural resource tax was made dependent upon the quantity of water flowing through a hydrotechnical structure. The procedure for calculating the said quantity of water is established by the Cabinet of Ministers, on the basis of quantity of electricity that is produced and the efficiency coefficient of the hydroelectric station. Such calculation is allegedly more complex; however, it is more proper with regard to the taxpayer, since only that quantity of water that is used to produce electricity must be paid for.

During the court sitting M.Brencis, the representative of the Saeima, noted in addition that the legislator had broad discretion in establishing taxes. The contested NRTL norms were said to be an incentive for persons to use water resources in a more rational way. The calculation of the natural resources tax had been based upon the idea – the more efficient use of water, the lower the natural resource tax payments.

5. The institution, which adopted the contested act, – the Cabinet of Ministers – holds that the contested norms comply with Article 105 of the Satversme.

The case had been initiated at the Constitutional Court regarding the compatibility of the contested norms with Article 105 of the Satversme as a whole; however, essentially, their compliance with only the first three sentences of Article 105 of the Satversme should be examined. The Cabinet of Ministers

agrees that the obligation to pay taxes is a restriction upon the right to own property. However, the State has great discretion in the field of taxes, and the right of the State to establish an obligation to pay taxes *per se* does not infringe upon a person's fundamental rights.

It should be taken into consideration that the natural resources tax, in difference to other taxes, should not be assessed as a fiscal instrument; it is said to have other concrete objectives. The application of this tax is said to be based upon principles that are used internationally and have been embedded also in the national legal acts – the principle "polluter pays" and the principle of producer's responsibility. Until the amendments to NRTL were adopted, the small-scale HPS had not paid anything for using water resources and, thus, had lacked incentives for more careful use of natural resources. Moreover, Latvia is obliged to take into consideration the requirements that follow from the Water Framework Directive, *inter alia*, the requirement to ensure such price policy that would serve as an incentive for the users of water resources to use this resource efficiently.

The restriction upon the Applicants' right to own property has been established by law, and it has a legitimate aim. The State has intended the contested norms for balancing the society's interest in living in beneficial environment with the facilitation of economic development. The natural resources tax must ensure that all costs linked to the use of water resources are covered in full. Allegedly, no more lenient measures exist, neither is it possible to establish another natural resources tax rate, since the contested norms balance the interests of society and those of an individual in the field of environment protection.

The initial wording of the draft amendments to NRTL, with the intention to simplify the tax calculations, envisaged establishing the tax rate as a fixed per cent of the existing electricity purchasing price. However, in the course of examining the draft law, a more commensurate approach to the tax calculation had been identified; i.e., a formula, according to which every small-scale HPS could calculate the tax payment individually. The formula had been developed in

cooperation with the faculty members of the Latvia University of Agriculture, Faculty of Rural Engineering and is aimed at efficient use of natural resources and introduction of environmentally friendly technologies. The natural resources tax is said to be unconnected to the prices of mandatory procurement and with whether the electricity that is produced is sold in the framework of mandatory procurement or is used to meet the needs of the small-scale HPS themselves.

In the additional explanations that were provided, the Cabinet of Ministers expressed the opinion that the scope of damage to environment caused by the small HPS was indirectly linked to the height of the water drop of the hydroelectric power station, since as the result of their operations the oxygen regime and temperature changed, sedimentation process occurred in the water basin, as well as erosion of the water–bed in the rapids sections.

During the court hearing the representative of the Cabinet of Ministers R.Vesere noted in addition that the Applicants' objections regarding inconsiderate introduction of the tax were unfounded. Since 2010, when the management plans for river basins were elaborated, discussions had taken place regarding the need to introduce natural resources tax for using water at the small-scale HPS. Whereas in 2013 the particular regulation was drafted.

6. The summoned person – the Ombudsman of the Republic of Latvia (hereinafter – the Ombudsman) – holds that the contested norms are incompatible with Article 105 of the Satversme.

The obligation that the contested norms impose upon the Applicants to pay the natural resources tax is to be recognised as a restriction upon their right to own property. However, the case under review contains no dispute on whether the aforementioned restriction has been adopted in due procedure, i.e., by law. The aim of the natural resources tax defined in NRTL – to ensure financing of measures for environment protections – should be recognised as being legitimate. The proportionality of the contested norms should be examined, *inter alia*, also in interconnection with the criteria included in Section 17(2) of Water

Management Law that should be taken into consideration in establishing the natural resources tax.

The burden of natural resources tax, referred to by the Applicants, which in some cases can exceed 50 per cent of the gross revenue of a small-scale HPS, is said to be disproportional. The Ombudsman has doubts, whether the amount of the natural resources tax to be paid and the social, ecologic and economic consequences of its application have been examined in accordance with Para 4 of Section 17(2) of Water Management Law. Moreover, in this particular case the efficiency of using the natural resource tax revenue could also be questioned.

At the court hearing, the authorised representative of the Ombudsman Inga Peimane additionally noted that the incompatibility of the restriction upon fundamental rights established by the contested norms with the principle of proportionality mainly manifested itself in the fact that the resources gained from the payment of natural resources tax did not enter the budgets of the local governments, on the territory of which the damage to environment occurred.

7. The summoned person – the Small Scale Hydropower Association of Latvia (hereinafter – SSHA) – holds that the contested norms are incompatible with Article 105 of the Satversme.

Allegedly, the aims, indicated by the Cabinet of Ministers, in which the natural resource tax was established, have not been not met. SSHA does not uphold the statement that the small-scale HPS were inflicting damage upon environment. The production of electricity at hydroelectric power stations has been globally recognised as one of the most environmentally friendly types of electricity production. Moreover, the operation of the small-scale HPS is said to ensure that pollutants are collected and utilised (these products accumulate at the power stations), as well as enriching water with oxygen. The legislator, in adopting the contested norms, has not examined their social, ecologic and economic consequences, as well as the geographic and climatic conditions of the affected regions. At the time, when the amendments to NRTL were drafted, the Cabinet of Ministers is said to have violated the principle of equality, since only

the opinion expressed by the Latvian Anglers Association had been heard, but the opinion of the affected sector, SSHA including, had not been heard.

The reference to the Water Framework Directive made by the Saeima and the Cabinet of Ministers is said to be unfounded, since the regulation that it comprises pertains only the quality of water and pollution, but not to such use of water resources that does not change the state of water. Contrary to the statement made by the Cabinet of Ministers, there are no proof that the water used for producing electricity returns to nature in a changed form. Moreover, even if the Water Framework Directive were applicable, there were no such expenses related to water use that were not already covered by the small-scale HPS. A number of legal acts also impose upon the small-scale HPS the obligations to maintain the hydrotechnical structures, to enforce riverbanks, to cover the costs of using water basins.

SSHA holds that the formula that must be used to calculate the quantity of water used for producing electricity does not facilitate introduction of more efficient technologies, since a reduction in the payment of the natural resources tax can be achieved by increasing the water drop, which is prohibited by legal acts.

At the court sitting the authorised representative of SSHA Jānis Irbe noted in addition that in the case under review, in examining the compatibility of the contested norms with the Satversme, there were no grounds to analyse state support that was available to the small-scale HPS sector. Any state support had a fixed term, and the entitlement to it could be taken away, whereas the natural resources tax had to be paid by every small-scale HPS, and it did not have a fixed term. Thus, the proportionality of the tax payment can be examined only in interconnection with the price of electricity sold on the free market.

8. The summoned person – the Latvian Anglers Association (hereinafter – the Anglers Association) – holds that the contested norm complies with Article 105 of the Satversme.

Allegedly, the adoption of the norms had been well–founded and conformed to the State's interests, it had received the support of the Environment Advisory Council. The majority of studies conducted in Latvia and in the world point to the negative impact upon environment left by the small-scale HPS, for example, insufficient quantity of water in rivers, changed ecological balance of water, flooding of the rapids stages in rivers, destruction of the biotopes of ecologically sensitive fish species.

Solutions are being searched for in the world to decrease the damage to environment caused by the operations of small-scale hydroelectric power stations. However, no legal act in Latvia envisages assessment of the damage caused by the operations of the small-scale HPS, prevention of this damage and compensation for it. Information provided by the State Environmental Service shows that at least 80 per cent of all small-scale HPS operate in the regime of storing water. I.e., only a part of the stored amount of water is used to operate turbines, but the rest is kept as reserve. The small-scale HPS are said to be paying the tax only for the water used to operate turbines, but not for the quantity of stored water. Allegedly, the State has the right to apply the tax also to the quantity of stored water, because both in the case when water is used and when it is stored, the water level in the river fluctuates and these fluctuations leave a negative impact upon environment.

At the court hearing the chairman of the board of Anglers Association Alvis Birkovs noted in addition that the operations of the small-scale HPS left an impact not only upon the river upon which the hydroelectric power stations had been built, but the whole ecosystem and the catchment basin of the river. The payment of natural resources tax allegedly makes the small-scale HPS interested in decreasing the negative environmental impact of their business activities.

9. The summoned person – the World Wildlife Fund (hereinafter – the Fund) – holds that the contested norms comply with Article 105 of the Satversme.

Allegedly, from the perspective of environment protection, the adoption of the contested norms is well–founded, since the small-scale HPS leave a negative impact upon environment, i.e., the operations of the small-scale HPS are said to be incompatible with Article 115 of the Satversme. Moreover, the consequences caused by the operation of small-scale HPS could hinder the implementation of requirements set by the Water Framework Directive in Latvia and threaten the reaching of targets defined in the Water Management Law.

The impact of the operations of small-scale HPS upon environment was said not to be appropriately assessed; therefore it was difficult to grasp the scale of the damage caused by them. However, it has been concluded that operations of the small-scale HPS lead to degrading and destruction of different plants, living organisms and fish spawning areas. A river valley covering several kilometres is degraded and destroyed, and the natural landscape is transformed. The natural movement of water in the watercourse basin is interfered with, thus worsening the sanitary conditions of water and the quality of water, as well as causing changes to ground waters. Due to operation of the small-scale HPS water level fluctuates, and these fluctuations cause artificial processes of erosion and landslides on the riverbanks.

Thus far the contribution of small-scale HPS to Latvia's economy and the total amount of electricity produced, allegedly, did not compensate for the damage caused by their operations. The benefits to society from watercourse resources and services of river ecosystems are said to exceed the benefit ensured by operations of the small-scale HPS.

At the court sitting the authorised representative of the Fund – Ingus Purgalis – noted in addition that the small-scale HPS perhaps did strengthen independence from fossil energy resources, however, this fact did not decrease the negative environmental impact caused in the territory where small-scale HPS operated.

10. The summoned person – Riga Technical University, Faculty of Engineering Economics and Management, professor at the Department of

Customs and Taxes *Dr. oec.* Kārlis Ketners – holds that the contested norms are incompatible with Article 105 of the Satversme.

Allegedly, the contested norms do not ensure proportional and well-founded tax regulation. If the contested norms have been adopted with the aim to compensate for the environmental damage caused by the operations of small-scale HPS, then it cannot be considered as being the legitimate aim, since this damage could be compensated for by other measures. Moreover, neither the Water Framework Directive, nor the Water Management Law contains direct references to the need to adopt the contested norms, since the regulatory enactments mentioned above provide for other legal measures to create a water management system. References to legal inequality between the hydroelectric power stations managed by the joint stock company "Latvenergo" and the small-scale HPS is said to be unfounded.

The fact that natural resources tax belongs to environmental taxes should be taken into consideration. Environmental taxes should be linked to market deficiencies and applied to the polluter or polluting activities. The object of an environmental tax should be linked to the environmental damage, but the tax rate should be appropriate for the damage inflicted. Such taxation regime should be predictable and reliable to promote measures for environmental protection. However, technically the contested norms cannot promote measures for environmental protection.

At the court sitting K.Ketners added that the State had unlimited discretion in establishing taxes. This meant that the legislator could establish also a very high tax as a fiscal barrier. A tax could influence behaviour, i.e., the State could facilitate or restrict particular activities by a tax. However, a tax should not be turned into divesting of the property.

11. The summoned person – Riga Technical University, Faculty of Engineering Economics and Management, docent at the Department of Customs and Taxes, certified tax consultant *Dr. oec.* Māris Jurušs – holds

that in the case under examination it should be assessed whether the amount of natural resource tax is commensurate with the expenses that must be covered to eliminate the damage inflicted upon natural resources by the operations of the small-scale HPS.

The restriction upon the right to own property had been established by law. The restriction upon the right to own property is said to have a legitimate aim – protection of natural resources. The legislator, in adopting the contested norms, did not indicate in what way the legitimate aim of the restriction would be reached. The contested norms do not give taxpayers an option of choice, which is given in the case of some other objects of the natural resources tax. I.e., – no option of choosing is envisaged – to pay the tax or to implement all measures that are necessary to eliminate the damage caused by one's actions. Thus, the fact, whether the legitimate aim of the restriction is met, depends only upon the way the State uses the revenue from natural resource tax on the particular taxation object.

Allegedly, it follows from the contested norms that the amount of the natural resources tax for each taxpayer is formed differently. However, the considerable tax burden that one individual bears cannot be the grounds for revoking or not applying this tax. Moreover, the revenue from business activities depends upon various factors, *inter alia*, each individual's ability to organise his or her business activities in such a way as not to suffer losses.

At the court sitting M. Jurušs added that the law, definitely, should not mandatorily envisage an option of choice for the taxpayer – to pay the tax or to eliminate the harmful consequences of one's activities.

12. The summoned person – Latvia University of Agriculture, Faculty of Rural Engineering, visiting docent at the Department of Architecture and Construction *Mg. sc. ing.* Kārlis Siļķe – holds that the contested norms are incompatible with Article 105 of the Satversme.

Allegedly, the formula for calculating the quantity of water used by hydrotechnical structure for production of electricity is not proper *vis–à–vis* the

taxpayer, since the most important variable in this formula is the water drop (difference between levels). The water drop in the small-scale HPS is said to be very diverse – within the range from 1.5 to 15 meters. This meant that in the case of two small-scale HPS, which produced the same amount of electricity, the one with the water drop of 1.5 metres would have to pay for the water used in production of electricity a ten times larger amount of tax than the other hydroelectric power station, which had the water drop of 15 metres.

During the court sitting K.Siļķe noted in addition that the formula included in the amendments to Regulation No. 404 was correct, however, the coefficient included in it 0.002725 was incorrectly described (explained). To achieve a fairer result, the formula should be supplemented with a coefficient that would level out the differences in water drops or levels of the small-scale HPS.

13. The summoned person – the author of the book "Mazo HES ierīkošanas iespējas Latvijā" [Possibilities of Building Small Scale HPS in Latvia] ***Mg. sc. ing.*** **Leons Magelis** – holds that calculating the payment of natural resources tax on the basis of water that has flown through the hydrotechical structure is not valid.

Allegedly, it has not been proven that the water quality becomes poorer or damage is inflicted upon environment as the outcome of the small-scale HPS' operations. If such statement were proven, then the amount of natural resources tax should be calculated on the basis of the actual quantity of water that flows through. The contested norms are said to create a situation, where two small-scale HPS, which operate close to one another and on the same river, but differ as to the difference in levels, the quantity of water that flows through the structure can be the same, however, the quantity of electricity that is produced can differ even more than two and a half times. This means that the hydroelectric power station with the smallest difference in levels will receive smaller gross revenue, but will pay a larger natural resources tax.

At the court sitting L. Magelis added that it would be fairer to pay the natural resources tax for the actual quantity of water that has flown through,

which does not comprise sanitary flowrate that is not used for producing electricity.

14. The summoned person – the former special adviser on energy issues at the European Commission Juris Ozoliņš – holds that it would be fairer to establish for the small-scale HPS a rate of natural resources tax that would be proportional to the amount of electricity produced; however, then the natural resources tax system would have the same reporting system as the subsidized electricity tax.

Allegedly, there are not many types of economic activities that would not leave an impact upon environment. The small-scale HPS belong to sustainable ways for acquiring electricity, but they also leave an impact upon environment. However, the issue of the exact way, in which small-scale HPS influence environment by their operations, is still contestable. The legislator should choose, whether to support energy security and sustainable development or decrease impact upon environment, or support the interests of some social groups. Harmonisation of the energy, environment and entrepreneurship sustainability is envisaged by legal acts that pertain to renewable energy. Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC is one of the most important regulatory enactments in this field.

In the case under review the process, in which the obligation to pay the natural resources tax for using water resources for producing electricity in small-scale HPS was introduced, is said to be of greater importance. In the particular case the legislator's arguments regarding the necessity of the natural resources tax are said to be inaccurate and illogical. The legislator has unfoundedly referred to the Water Framework Directive, since the environmental impact of the small-scale HPS should not be linked to the protection of water basins and the principles for ensuring the quality of drinking water. In the small-scale HPS, similarly to solar and wind power stations, the resources are not used or amassed,

water is not even moved. Whereas the formula used for calculating the quantity of water used in the production of electricity is said to be disproportional to the revenue that the small-scale HPS gain from the electricity transferred to the grid.

At the court sitting J. Ozoliņš added that in this particular case the object of production, i.e., electricity should be taxed. The quantity of water that has flown through the station is not calculated precisely; therefore it is not appropriate to use it as the basis for payments of natural resources tax.

The Findings

15. 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."

The Applicants request the Constitutional Court to examine the compatibility of the contested norms with Article 105 of the Satversme. At the court sitting J. Vaits, the Applicants' authorised representative, noted that the contested norms were incompatible with the first and the third sentence in Article 105 of the Satversme. The Constitutional Court has found that Article 105 of the Satversme provides both for unhindered exercise of the right to own property and the rights of the State to restrict the exercise of the right to own property in the interests of the public (*see, for example, Judgement of 20 May 2002 by the Constitutional Court in Case No. 2002–01–03, the Findings*). The Constitutional Court has also noted that the obligation to pay a tax always means a restriction upon the right to own property (*see, for example, Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007–01–01, Para 19*). It follows from the above that the regulation established by the contested norms, insofar it envisages a person's obligation to pay the natural resources tax, falls within the scope of the first and the third sentence in Article 105 of the Satversme.

Hence, the Constitutional Court will examine the compliance of the contested norms with the first and the third sentence in Article 105 of the Satversme.

16. In the case under review several norms of NRTL and of the Cabinet of Ministers Regulation are being contested. Therefore it must be examined, whether all contested norms establish a person's obligation to pay a tax, i.e., whether all contested norms restrict a person's right to own property.

Subparagraph "f" of Para 1 of NRTL Section 3(1) defines, which person should be considered as a taxpayer paying the natural resources tax. Whereas NRTL Section 19[1], *inter alia*, defines the rate of the tax to be paid for using water resources to produce electricity in small-scale HPS. A person's obligation to pay natural resources tax for using water resources to produce electricity in a small-scale HPS follows from the contested norms. Hence, these norms restrict a person's right to own property.

Whereas the amendments to Regulation No. 404 do not envisage the obligation to pay the natural resources tax, but, in accordance with the authorisation granted by the legislator, establish the procedure for calculating the quantity of water that has flown through a hydrotechnical structure, on the basis of the quantity of electricity that has been produced and the efficiency coefficient of the hydrotechnical station. However, not all norms of the amendments to Regulation No. 404 are linked to the procedure for calculating the quantity of water that has flown through. For example, Subparagraph 1.2 of this Regulation specifies the wording with regard to the name of the branch ministry used throughout the text of Regulation No.404, and this in no way pertains to the procedure for calculating the quantity of water that has flown through. The Applicant's authorised representative J.Vaits also specified at the court sitting that the only those norms of the amendments to Regulation No. 404 that pertained to the procedure for calculating the quantity of water that had flown through the station restricted the Applicants' fundamental rights. Therefore in the framework of the case under examination the Constitutional Court will examine

the compatibility of the amendments to Regulation No. 404 with the Satversme only insofar they establish the procedure for calculating the quantity of water that has flown through a hydrotechnical structure.

The amendments to Regulation No. 404, insofar they establish the procedure for calculating the quantity of water that has flown through a hydrotechnical structure, *per se* do not impose an obligation upon a person to pay the natural resources tax. I.e., if the amendments to Regulation No. 404 were recognised as being invalid, a person, nevertheless, would retain the obligation to pay the natural resources tax, established in NRTL. However, the norms of the amendments to Regulation No. 404 comprise the procedure for establishing the amount of the natural resources tax that a person has to pay. Thus, the amendments to Regulation No. 404 are closely linked to the contested NRTL norms. Moreover, it follows from the applications and the explanations provided by the Applicants at the court sitting that the same legal arguments that are applied to the incompatibility of the contested NRTL norms with the Satversme are also applied to the possible incompatibility of the amendments to Regulation No. 404 with the Satversme.

Hence, both the contested NRTL norms and the amendments to Regulation No.4040, insofar they establish the procedure for calculating the quantity of water that has flown through a hydrotechnical structure, are to be examined as a uniform regulation that establishes a person's obligation to pay a certain amount of natural resources tax for using water resources to produce electricity at small-scale HPS.

17. The Constitutional Court has recognised that the right to own property can be restricted, if the restriction is justifiable. To establish, whether the restriction upon rights is justifiable, the Constitutional Court must examine:

1) whether the restriction upon fundamental rights has been established by law;

2) whether the restriction has a legitimate aim;

3) whether the restriction is proportional to its aim (*see, for example, Judgement of 20 May 2002 by the Constitutional Court in Case No. 2002–01–03, the Findings*).

18. Even though the contested NRTL norms and the amendments to Regulation No. 404 are to examined as a uniform regulation, the Constitutional Court, nevertheless, must verify, whether each of the norms referred to above has been adopted in due procedure.

Prior to examining, whether the restriction upon fundamental rights has been established by law, the subject, which in the field of tax law is to be considered as the legislator, must be identified. Pursuant to Article 64 of the Satversme two subjects have the right to legislate – the Saeima and the people in procedure and scope established in the Satversme. Whereas Article 73 of the Satversme points out those issues that cannot be put for a national referendum. It follows from the above, that the Satversme restricts the actions of the people as the legislator in the field of taxes and, insofar the actions by the State with regard to taxes fall within the scope of Article 73 of the Satversme, the Saeima is to be considered as the sole legislator in this field.

18.1. Divergent opinions have been expressed in the case as to whether the NRTL norms were adopted in due procedure.

The Applicants call into question, whether the legislator has the right to include a draft law that envisages introduction of a new tax into the package of draft budget laws. I.e., they doubt, whether a draft law that envisages introduction of a new tax could be recognised as being a draft law that amends the State budget. The Applicants hold that such procedure for establishing new taxes is incompatible with the meaning and purpose of Article 87^1 of the Saeima Rules of Procedure. The representative of the Saeima noted at the court hearing that the issue, whether a draft law that envisaged introduction of a new tax should be submitted for hearing as part of the package of drat budget laws was political and depended upon the legislator's will.

The contested norms were included in the draft amendments to NRTL, which the Cabinet of Ministers on 1 October 2013 submitted to the Saeima together with other draft laws of the State budget package. On 17 October 2013 the Saeima adopted the amendments to NRTL in the first reading, but on 6 November 2013 – in the second, final reading. The amendments to NRTL were promulgated on 27 November 2013 and entered into force on 1 January 2014.

Pursuant to Article 21 of the Satversme the Saeima provides for its internal operations and order. Article 87^1 of the Saeima Rules of Procedure provides that the package of draft budget laws consists of a draft law on the annual State budget or draft laws governing or amending the state budget, or budget–related draft laws. The procedure, established in the Saeima Rules of Procedure, in which the draft annual State budget law and draft laws governing or amending the State budget are heard, differs from the procedure of reading other draft laws.

Since the planning of the State financial resources are based upon the calculations of the State revenue and expenditure, the legislator has the right and, at the same time, also an obligation to include into the State budget law and the accompanying package of laws only such issues, which pertain to the particular financial year and are closely related to the use of the State financial resources (*see Judgement of 19 December 2011 by the Constitutional Court in Case No. 2011–03–01, Para 18*).

In view of the special procedure established for hearing the package of draft budget laws, the Saeima must examine, whether all draft laws of the state budget package, submitted by the Cabinet of Ministers, comply with the criteria set out in Article 87^1 of the Saeima Rules of Procedure. If a draft law does not comply with these criteria, the Saeima must exclude it from the package of draft budget laws. Moreover, the Saeima has acted like this in reading the package of 2014 draft State budget laws. For example, at the sitting of 17 October 2013 the Saeima excluded form the package of draft budget laws the draft law "Amendments to the Law "On National Referendum, Legislative Initiative and European Citizens' Initiative"" (No. 925/Lp11) (*see transcript of the 17 October*

2013 sitting of the 11th Saeima, available: http://www.saeima.lv/lv/transcripts/view/196, accessed on 25.02.2015.).

The amendments to NRTL entered into force on 1 January 2014. As of 1 January 2014, the contested norms provided for the obligation to pay the natural resources tax. Thus, the amendments pertained to the particular fiscal year, and the Saeima has abided by the requirements of Article 87^1 of the Saeima Rules of Procedure.

The Applicants hold that during the course of adopting the amendments to NRTL their interests had been ignored and no discussions with the representatives of the sector had been held (*see Application in Case Materials, Vol. 2, p. 13).*

It follows from the case materials that a representative of the sector participated in the sittings of the Budget and Finance (Taxation) Committee that examined the draft amendments of NRTL (*see Case Materials, Vol. 3, pp. 3, 14, 16).* The participation of stakeholders in the process of hearing a draft regulatory enactment may facilitate adoption of an unbiased decision and balancing of various interests; however, the opinion of a particular group of persons is not binding upon the legislator (*see also Judgement of 26 November 2009 by the Constitutional Court in Case No. 2009–08–01, Para 17.2*). Even though it would be advisable to hear the opinion of the addressees of the norms, neither the Satversme, nor the Saeima Rules of Procedure establish such hearing as a mandatory pre–requisite for adopting legal norms. The opinion of the addressees of these draft norms cannot prohibit the Saeima from adopting decisions. Thus, there are no grounds to recognise that the contested amendments to NRTL had been adopted by ignoring the provisions of the Satversme and the Saeima Rules of Procedure. The case does not contain a dispute regarding other aspects in adopting or promulgating the amendments to NRTL.

Thus, it can be concluded that the amendments to NRTL have been adopted and promulgated in accordance with the procedure set out in the Satversme and the Saeima Rules of Procedure.

18.2. Pursuant to Section 3 of Law on Taxes and Fees, the taxable objects to which State taxes are applied and the tax rates are determined by the Saeima. NRTL Section 19[1] determines the taxable object and the rate, as well as authorises the Cabinet of Ministers to establish the procedures by which the water that has flown through the hydrotechnical structure shall be calculated on the basis of the quantity of electricity produced and the efficiency coefficient of the operation of the hydroelectric station. Thus, the legislator has defined two criteria that the Cabinet of Ministers must abide by in elaborating the procedure referred to above. In accordance with the authorisation granted in NRTL, the Cabinet of Ministers had the task to elaborate a procedure that would be based upon the two criteria indicated by the legislator, would comply with the Satversme and laws and would be aimed at reaching the aims defined in NRTL Section 3.

The participants of the case have not contested the right of the Cabinet of Ministers to establish the procedure by which the water flown through the hydrotechnical structure is calculated. Neither has it been established in the course of hearing the case that the Cabinet of Ministers breached the authorisation granted to it by the legislator. It can be concluded from the above that the Cabinet of Ministers, in adopting the amendments to Regulation No. 404 has complied with the auhtorisation granted by the legislator. The case does not contain a dispute with regard to other aspects in adopting or promulgating the amendments to Regulation No. 404. Thus, the amendments to Regulation No. 404 have been adopted and promulgated in accordance with the procedure established in the Satversme.

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

19. Any restriction upon the fundamental rights must be based upon circumstances and arguments regarding its necessity, i.e., the restriction must be established for the sake of 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 the legal proceedings before the Constitutional Court the duty to identify the legitimate aim falls upon the institution, which has adopted the contested act (*see Judgement of 25 October 2011 by the Constitutional Court in Case No. 2011–01–01, Para 13.2*).

The Saeima states that the restriction upon the fundamental rights has been established to balance the public interest to live in a benevolent environment with economic development. I.e., the legitimate aim of the restriction upon the fundamental rights is said to be ensuring other persons' rights and public welfare. The Cabinet of Ministers in its written reply upholds the Saeima's opinion with regard to the legitimate aim of the restriction upon the fundamental rights (*see written reply by the Cabinet of Ministers, Case Materials, Vol. 1, p. 99*).

To identify the legitimate aim of the restriction upon the fundamental rights in the case under review, the reason why in the particular case the legislator has established a person's obligation to pay the natural resources tax must be identified. Pursuant to NRTL Section 2, the purpose of the natural resources tax is to promote economically efficient use of natural resources, restrict pollution of the environment, reduce manufacturing and sale of environment polluting substances, promote implementation of new, environment-friendly technology, support sustainable development in the economy, as well as to ensure environmental protection measures financially. The representative of the Saeima noted at the court hearing that in the case under review the natural resources tax has been established, basically, for using water as resource. I.e., the obligation to pay this tax has been established so that persons would pay for using water as significant resource and use this resource as efficiently as possible. Whereas the summoned persons K. Ketners and M. Jurušs at the court hearing expressed the opinion that in general the tax has been established both for using water as resource, but also in connection with the fact that after flowing through hydrotechnical stations of the small-scale HPS its properties had changed, and also in view of the impact that operations of small-scale HPS left upon environment.

A number of the European Union and international documents have foregrounded the importance of water as resource. The Constitutional Court has recognised that the regulatory enactments of the European Union, insofar the fundamental principles of the Satversme are not affected, must be taken into consideration in the interpretation of the national regulatory enactments (*see, for example, Judgement of 2 May 2012 by the Constitutional Court in Case No. 2011–17–03, Para 13.3*). The 1st recital in the Preamble to the Water Framework Directive notes that water should be treated as heritage and should be protected. Moreover, a requirement to the member states of the European Union to provide incentives to use water resources efficiently follows from Article 9 of the Water Framework Directive.

Whereas Para 19 in the final report the United Nations 2012 Conference on Sustainable Development recognizes the critical importance of water as resource in ensuring sustainable development (*see: Report of the United Nations Conference on Sustainable Development. Rio de Janeiro, Brazil, 20 – 22 June 2012. United Nations: New York, 2012, p. 23, available: http://www.uncsd2012.org/content/documents/814UNCSD%20REPORT%20final%20revs.pdf, accessed on 25.02.2015.*). Even though the document referred to above is not binding as to its legal status, nevertheless, the findings that it comprises should be recognised as being sufficiently authoritative (*to compare see Judgement of 14 September 2005 by the Constitutional Court in Case No. 2005–02–0106, Para 16*). It follows from the above that a tax to be paid for using such important resource as water can serve the purpose of protecting public welfare.

Moreover, it should be taken into consideration that the natural resources tax should be recognised as being the so-called environmental tax (*see, for example, Dr. oec. K. Ketners' opinion in Case Materials, Vol. 4, p. 28*). The system of environmental taxes is used to adjust prices in such a way as to ensure that taxpayers' actions are environment-friendly (*see: Milne J. E., Andersen M. S. [editors]. Handbook of Research on Environmental Taxation. [N.p.]: Edward Elgar Publishing, 2012, p. 15*). Thus, the legislator's general aim in

establishing the obligation to pay natural resources tax for using water as resource important for society in business activities is to ensure more efficient and responsible use of natural resources.

The environmental taxes do not have pronounced fiscal functions as, for example, taxes on revenue; however, the resources obtained from the payments of natural resources tax can be used for financing projects and measures of public importance. It has also been recognised in the case law of the Constitutional Court that the regulation that envisages payment of a tax should be assessed as a restriction that has been established in taxation legal relationships to ensure the formation of the State and local government budget (*see Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007–01–01, Para 22*). Taxes are established to ensure public welfare (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010–25–01, Para 9*). The contested norms are aimed not only at more efficient and responsible use of natural resources, but also at ensuring revenue in the State budget, and this revenue may be used, *inter alia*, to finance measures for improving the environment condition. Thus, the restriction upon the fundamental rights that the contested norms comprise is aimed at protecting public welfare.

Thus, the restriction upon the fundamental rights has a legitimate aim – the protection of public welfare.

20. Upon establishing the legitimate aim of the restriction upon the fundamental rights, its compliance with the principle of proportionality must be examined. Since in the case under review the compatibility of a restriction upon the right to own property, which follows from the obligation to pay a tax, with the Satversme is being examined, the Constitutional Court must establish, whether the specificity of the tax law influences the scope of constitutional review.

The Constitutional Court has recognised that in the field of tax law the legislator cannot be set the same requirements as, for example, in the field of ensuring and protecting civic or political rights (*see, for example, Judgement of*

13 April 2011 by the Constitutional Court in Case No. 2010–59–01, Para 9). The State, in establishing and implementing its taxation policy, enjoys broad discretion (*see, for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010–70–01, Para 9*). It comprises the right to choose tax rates and the categories of persons that the taxes apply to, as well as the right to provide details of the respective regulation. In examining the limits of the legislator's discretion with regard to establishing a tax for a specific object. it must be taken into consideration that the Satversme *expressis verbis* authorizes the legislator to adopt the State budget, i.e., to determine the revenue and expenditure of the State. The Satversme authorises the legislator to implement such fiscal policy that would ensure the revenue necessary for the State (*see Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010–25–01, Para 10*).

Thus, the State must provide for its sustainable development, *inter alia*, also in a way to ensure that the State budget would always have the resources necessary for performing the functions of the State. Moreover, the Constitutional Court has already noted that a person's right to own property cannot be examined in insolation from a person's constitutional duty to pay taxes established in due procedure (*see, for example, Judgement of 13 April 2011 by the Constitutional Court in Case No. 2010–59–01, Para 9*).

The finding that the rights that follow from Article 105 of the Satversme should be interpreted in interconnection with Article 1 of Protocol No. 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms (*see, for example, Judgement of 28 May 2009 by the Constitutional Court in Case No. 2008–47–01, Para 7.1*) has become embedded in the case law of the Constitutional Court. It follows from the case law of the European Court of Human Rights (hereinafter – ECHR) that the cases related to the establishment of the obligation to pay taxes are predominantly examined in the context of control over the use of property (*see, for example: Sermet L. The European Convention on Human Rights and property rights. Human rights files, No. 11 rev. Strasbourg: Council of Europe Publishing, 1999, p. 25*). It has also been

recognised in the case law of ECHR that a tax, as to its nature, must not be confiscatory (*see, for example, ECHR Judgement of 25 July 2013 in Case "Khodorkovskiy and Lebedev v. Russia", Applications No. 11082/06 and 13772/05, Para 870*). Whereas the Constitutional Court has recognised that in reviewing the legality of restricting fundamental rights, it could chiefly examine, whether the payment of the tax was not an excessive burden for the addressee and whether the legal regulation on taxes complied with the general principles of law (*see Judgement of 8 June 2007 by the Constitutional Court in Case No. 2007–01–01, Para 24*). Thus, in assessing, whether the payment of a tax is not an excessive burden for the addressee, it must be considered, *inter alia*, whether the applied tax as to its nature is not confiscatory.

Thus, the specificity of the tax law influences the scope of constitutional review.

21. In addition to this, in the case under review it is important that the contested norms do not introduce a totally new obligation to pay a natural resources tax, but revoke an exemption from the obligation to pay the natural resources tax that had been in force for a rather long period.

The Cabinet of Ministers notes in its written reply that historically regulatory enactments envisaged an exemption from paying the natural resources tax for using water resources in hydroelectric power stations as an initial support to the small-scale HPS that would allow them to commence their operations (*see written reply by the Cabinet of Ministers in Case Materials, Vol. 1, p. 88).*

Para 2 of Section 17^1 of 14 September 1995 law "On the Natural Resources Tax" (in the wording of 20 December 2011) provided: "The tax shall not be calculated for: [..] 2) the use of water (flow) in hydrotechnical and fisheries facilities, in water reservoirs, fish farms and pond farms, except for the quantity of water that in the permit for water use have been defined as consumption for production, maintenance and household needs." This exemption was retained in NRTL by providing in Para 2 of Section 5 (in the wording of the law of 15 December 2005) that the tax should not be paid for using water (flow) in

hydrotechnical and fisheries facilities, also in hydroelectric power stations. This regulation was in force until the amendments to NRTL entered into force. Likewise, Section 17(1) of the Water Management Law, from the date of its adoption – 12 September 2002 until 6 November 2013, when the amendments came into force, provided that natural and legal persons used water flow free of charge for producing hydroelectric power.

It cannot be concluded neither from the legal norms referred to above, nor the discussions that were held at the time when these norms were read at the Saeima sittings that the exemption from the natural resources case in the particular case had been intended as an initial support to small-scale HPS. Nevertheless, by including such exemption into legal norms the legislator with regard to the use of water for production of hydroelectric power had established a more favourable tax regime for the small-scale HPS.

Two concepts are known in the tax law – tax relief and exemption from tax. Compared to tax relief, an exemption from tax is a more favourable tax regime for a person, since the legal acts define precisely those cases, where persons do not have to pay the tax at all. For example, Chapter 2 of NRTL provides detailed regulation regarding the kinds of operations (types of operations) or the kinds of persons to which the natural resources tax is not applied. All operations (or kinds of operations) that are referred to in this chapter are related to the use of natural resources or goods that are harmful to the environment or causing certain pollution. Thus, essentially, any activity, which is not currently taxable, is such that could envisage for the person conducting it the obligation to pay the natural resources tax. However, the legislator, by exercising its discretion, in these cases has established an exemption from the tax.

With regard to tax exemptions, it has been recognised in the case law of the Constitutional Court that a person's legal certainty that a tax exemption would not be revoked even if priorities of economic policy were to change is not protected to the same extent as a person's legal certainty in other cases, when restrictions are placed upon the right to own property (*see, for example, Judgement of 6 December 2010 by the Constitutional Court in Case No. 2010–*

25–01, Para 10.1). Whereas in those cases, where regulatory acts had exempted persons from the obligation to pay a tax for a long period of time, they do not have the right to expect that such regulation would remain unchanged and that they would never have to pay the respective tax, – exactly as in the case, where the legislator establishes an obligation to pay a new tax.

22. The Applicants noted that the restriction on the right to own property was not proportional, since those Applicants that sold the produced electricity in the framework of mandatory procurement also had the duty to pay the subsidized electricity tax (*see, for example, Application in Case Materials, Vol. 1, p. 24*). However, the Applicants have not advanced such arguments that would allow concluding that the natural resources tax, as to its nature, was confiscatory. Neither do the case materials provide confirmation to the fact that in the case under review the natural resources tax could be recognised as being confiscatory.

In assessing, whether the payment of a tax is not an excessive burden for the addressee, it must be taken into consideration that each tax is an element in the taxation policy implemented by the legislator and that usually each person has the obligation to pay a number of taxes. Each tax has different aims, objects, rates, the procedure for calculating and applying it. Likewise, each Applicant also simultaneously pays a number of taxes. Moreover, the obligation to pay various taxes and the financial impact caused by it differs depending upon the Applicants' legal status (for example, one–man company, a farm or a share company), types of activities, contractual commitments and other circumstances.

The Applicants have requested the Constitutional Court to examine the compatibility of only one particular tax with the Satversme. J. Vaits, the Applicants' authorised representative, noted at the court hearing that the Applicants were under different circumstances. Some of the Applicants sell all electricity that they produce in the framework of mandatory procurement, others – on the free market, or sell part of the produced electricity on the free market and part – in the framework of mandatory procurement. Thus, in the case under

review, the Constitutional Court must not examine the proportionality of the whole tax burden applied to the Applicants, since that would mean reassessment of the taxation policy in various sectors, and it is not the task of the Constitutional Court.

Hence, the Constitutional Court shall examine only the compatibility of the natural resources tax related to the use of water resources for producing electricity at small-scale HPS with the Satversme, without dealing with the restriction upon the right to own property caused by the obligation to pay other taxes.

23. It follows from the facts of the case and the legal substantiation submitted by the Applicants that in the case under review, in examining the compatibility of the contested norms with the general principles of law, the Constitutional Court must verify, whether the principle of proportionality has been complied with. To establish, whether the restriction upon fundamental rights complies with the principle of proportionality, the Constitutional Court usually examines, whether the measures applied are appropriate for reaching the legitimate aim; whether the legitimate aim cannot be reached by other measures, less restrictive upon a person's rights and legal interests; whether the benefit gained by society exceeds the losses caused to a person (*see, for example, Judgement of 22 December 2008 by the Constitutional Court in Case No. 2008–11–01, Para 13*).

24. The Applicants and some of the summoned persons have expressed doubts, whether the restriction upon the fundamental rights that the contested norms comprise is appropriate for reaching its legitimate aim.

24.1. The Constitutional Court upholds the finding express in literature on the tax law that the taxation legal norms should be not only legally impeccable, but also economically substantiated (*see: Lazdiņš J. Ievads nodokļu tiesībās. Jurista Vārds, 2006. gada 10. oktobris, Nr. 40, 2. lpp.*). Moreover, regulation on taxes must be founded upon unbiased and rational considerations

(*see Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010–70–01, Para 9*).

The Constitutional Court cannot verify, whether the measures used by the legislator comply with the finding of economics. However, to conclude, whether the restriction upon fundamental rights caused by the obligation to pay the tax is appropriate for reaching its legitimate aim, the Constitutional Court must verify, whether the measures used by the legislator have reasonable explanation, based upon unbiased and rational considerations. I.e., whether the taxpayers, the taxable object and the principle for calculating the tax have not been determined arbitrarily and whether the procedure for calculating the tax allows determining mathematically the payable tax.

Pursuant to the contested norms, the natural resources tax applies to all small-scale HPS and it must be paid for using water resources to produce electricity. The procedure for calculating the quantity of water that has flown through the facility, included in Regulation No. 404, abiding by the authorisation granted by the legislator, has been determined on the basis of the quantity of electricity that has been produced and the efficiency coefficient of the hydrotechnical station. This means that the criteria used for calculation pertain to the process of production that takes place in small-scale HPS. Thus, the selected principle for calculating the tax has a reasonable explanation.

The written opinions submitted to the Constitutional Court by the summoned persons K. Siļķe and L. Magelis call into question the correctness of the formula developed by the Cabinet of Ministers and its suitability for calculating the natural resources tax (*see the opinions of the summoned persons, Case Materials, Vol. 4, pp. 1, 31 – 33*). K. Siļķe also noted that the Cabinet of Ministers had made an error in explaining the coefficient 0.002725 of the formula. However, at the court hearing K.Siļķe admitted that the inaccuracy referred to above did not essentially influence the calculation of the quantity of the water that had flown through. The formula introduced by Regulation No. 404 was said to be a generally known formula of hydraulics and hydrotechnics. Thus,

it is possible to use this formula to make mathematically correct calculations of the quantity of water that has flown through a hydrotechnical structure.

It must be noted additionally that both the particular object of the natural resources tax and the formula for calculating the quantity of water that has flown through have been chosen with the aim to create incentives for more efficient use of water resources. The Cabinet of Ministers in its additional explanations to the Constitutional Court has noted that hydroelectric power stations with small water drops are less efficient, since they use more water for producing one kilowatt-hour of electricity compared to hydroelectric power stations with larger water drops (*see additional explanations by the Cabinet of Ministers, Case Materials, Vol. 4, p. 71*). It follows from the above that a person, whose small-scale HPS has larger water drops or efficiency coefficient of hydroelectric station, must pay smaller natural resources tax.

Thus, in the particular case the measures chosen for reaching the legitimate aim of the restriction upon the fundamental rights has a reasonable explanation, based upon unbiased and rational considerations.

24.2. Pursuant to NRTL Section 28 (4), the payment of taxes for using water resources to produce electricity in small-scale HPS are paid into the basic State budget.

The Ombudsman holds that the efficiency of using revenue from the natural resources tax could be called into question, since it is not paid into the budgets of those local governments, on the territories of which small-scale HPS operate and is not used to eliminate the environmental impact caused in the particular territory (*see the Ombudsman's opinion, Case Materials, Vol. 4, p. 68*). Whereas the Cabinet of Ministers has noted that Latvia has accumulated experience in managing revenue from the natural resources tax over many years. Subsidies are allocated from the State budget for the program "Latvian Environmental Protection Fund", and part of this subsidy is channelled for assessing the operations of small-scale HPS, increasing efficiency and reducing negative environmental impact (*see additional explanations by the Cabinet of Ministers, Case Materials, Vol. 4, p. 75*).

Certainly, the natural resources tax ensures the State budget revenue. It has been recognised in the case law of the Constitutional Court that the legislators duty to cover from the revenue of a particular tax expenditure only in particular fields does not follow from the Satversme (*see Judgement of 3 February 2012 by the Constitutional Court in Case No. 2011–11–01, Para 13*). In the instance under review, the revenue from the natural resources tax can be used to finance various social and economic measures aimed at protecting the public welfare, *inter alia,* also projects to be implemented in the field of environment protection.

Thus, it can be concluded that the measures used by the legislator are appropriate for reaching the legitimate aim of the restriction upon the fundamental rights.

25. It follows from the explanations provided by the participants in the case and summoned persons during the court hearing that in the particular case a lower tax rate, another principle for calculating the tax or such formula for calculating the quantity of water that has flown through the facility that would contain a coefficient that would level out the differences in water drops of small-scale HPS could be considered to be more lenient measures.

25.1. In establishing, whether the legislator had more lenient measures at its disposal, the Constitutional Court must examine, whether the legislator has 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*).

It follows from the case materials that the Saeima in the first reading approved the initially submitted wording of the amendments to NRTL. For the second reading, the proposals by the Saeima members U. Augulis and J.Tutins were submitted – to retain the exemption from paying the tax for using water recourses, as well as a proposal by the Cabinet of Ministers offering another procedure for calculating the payment of tax and another, lowered tax rate (*see Case Materials, Vol. 3, pp. 156, 163*). In the second reading, the Saeima, in separate voting, rejected the proposal to retain the exemption and supported the

proposal submitted by the Cabinet of Ministers (*see the Transcript of the extraordinary sitting of the 11th Saeima on 6 November 2013, available: http://www.saeima.lv/lv/transcripts/view/202, accessed on 25.02.2015.*). Thus, the legislator has examined the possibility to retain the exemption and the necessity to revoke it. Hence, the legislator has considered both the validity of the restriction upon the fundamental rights that the contested norms of NRTL comprise, as well as alternatives to the contested NRTL norms.

25.2. The Constitutional Court underscores that in assessing, whether the legitimate aim can be reached by other means, it must be taken into consideration that a more lenient measure is not just any other measure, but such that would allow reaching the legitimate aim in at least the same quality (*see, for example, Judgement of 13 May 2005 by the Constitutional Court in Case No. 2004–18–0106, Para 19 of the Findings*). Moreover, in particular, in assessing, whether more lenient measures for reaching the legitimate aim exist, the Constitutional Court must abide by the limits of review that follow from the nature of the tax law (*see, for example, Judgement of 20 May 2011 by the Constitutional Court in Case No. 2010–70–01, Para 16*).

As noted above, the natural resources tax should be considered an environmental tax. The Constitutional Court has recognised that tax laws perform also a regulatory function, i.e., balance the interests of the State and those of taxpayers, as well as influence taxpayers' behaviour (*see Judgement of 3 April 2008 by the Constitutional Court in Case No. 2007–23–01, Para 15*). Thus, the legislator, in exercising its discretion in establishing taxation policy, has the right to support or restrict, through the natural resources tax, the use of particular economic activity, technology or natural resource, thus providing for sustainable development of the State. I.e., the legislator has the right to select such measures for reaching the defined legitimate aim that can influence a person's interest to take up particular types of commercial activities or employ particular technologies in his or her commercial activities. *Inter alia*, the legislator can, by using the tax, also increase the costs of the respective commercial activity and,

thus, decrease the amount of income that the person had planned to gain from the respective activity.

Thus, if the legislator, by exercising its discretion, has decided to introduce a tax with a regulatory function, the absence of such a tax cannot be recognised as being a more lenient measure. In such a case, similarly to the case under review, the legislator wishes to reach two purposes by the restriction upon the fundamental rights – to leave a particular impact upon a person's behaviour and to ensure revenue for the State budget. This means that the absence of an obligation to pay the natural resources tax would not allow reaching the legitimate aim of the restriction upon the fundamental rights in at least the same quality.

If the Constitutional Court has established that the principle for calculating the tax, which the legislator has chosen, has a reasonable explanation, based upon unbiased and rational considerations, then the Constitutional Court has no right to provide that the legislator should select another tax rate, another principle for calculating the tax or should include other elements in the formula for calculating the tax. Likewise, ECHR, in examining case with regard to restrictions upon human rights in connection with the obligation to pay tax, does not assess the choices made by states in the field of taxes, unless such choice lacks reasonable grounds (*see, for example, ECHR Judgement of 4 July 2013 in Case "R.Sz. v. Hungary", Application No. 41838/11, Para 48*). It has been established in the case under review that the legislator considered alternatives to the contested norms, and certainty has been gained that the principle for calculating the tax has a reasonable explanation, which is based upon unbiased and rational considerations.

Thus, there are no more lenient means that would allow reaching the legitimate aim of the restriction upon the fundamental rights in at least the same quality.

26. The Applicants contend that the burden created by the natural resources tax is not proportional and that the public benefit does not exceed the damage inflicted upon their rights and legal interests.

The Applicants, in turning to the Constitutional Court, also forecasted that due to the amendments to NRTL the majority of companies operating in the particular field would become insolvent by the end of 2014 (*see the Application, Case Materials, Vol. 2, pp. 29–30*). And yet, during the court hearing, the Applicants' representatives noted that they had no knowledge of cases, where the insolvency proceedings of a company operating in the respective field had been initiated due to the obligation to pay the natural resources tax or where a company had ceased to produce electricity in a small-scale HPS. The authorised representative of SSHA noted at the court hearing that the actual impact of this tax upon particular companies operating in the sector significantly differed, since it depended upon various factors.

In the case under review, in assessing the benefit that the society gains form the contested norms, the gains from the operations of small-scale HPS should be taken into consideration. The summoned person J.Ozoliņš noted that in 2013 in Latvia 146 small-scale HPS operated, from which 59 million kilowatt-hours of electricity were procured. The contribution by the small-scale HPS to the balance of consumption in the State complies with their technical possibilities (*see J.Ozoliņš' opinion, Case Materials, Vol. 4, p. 59*). The authorised representative of SSHA noted during the court hearing that the contribution by the small-scale HPS to the national electricity supply made up approximately 1 to 1.5 per cent. The Constitutional Court recognises that small-scale HPS contribute to the national electricity supply and strengthening of the self–sufficiency in energy. Moreover, the small-scale HPS produce electricity from renewable resources, which should be counted as environmentally friendly energy resources.

The State, in establishing the obligation to pay natural resources tax for using water resources in producing electricity, has attempted to make the operations of small-scale HPS more efficient and environment-friendly; i.e., to the extent possible, promote introduction of more modern technologies in the

operations of small-scale HPS, as well as to identify the environmental impact of the small-scale HPS. This means that society, in addition to the benefit it gains from the production of electricity in the small-scale HPS, also benefits from more efficient operations of the small-scale HPS and, thus, in general the public welfare is being promoted.

As established above, in this particular case the natural resources tax also has a regulatory function. Thus, a person – the taxpayer – has the possibility to adjust his or her actions in such a way as to decrease the possible negative consequences caused by the obligation to pay the tax.

Moreover, the contested norms are aimed at ensuring revenue into the State budget. This means that the public benefit – *vis–à–vis* restrictions upon the rights of some taxpayers – is not only more efficient operations of the small-scale HPS, but also the State budget resources to be used for the protection of public welfare.

Hence, the benefit that the society gains from the contested norms exceeds the damage inflicted upon a person's rights and legal interests, and the contested norms comply with the principle of proportionality.

The Substantive Part

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

h e l d :

1. To recognise Subparagraph "f" of Para 1 of Section 3(1) and Section 19[1] of Natural Resources Tax Law as being compatible with Article 105 of the Satversme of the Republic of Latvia.

2. To recognise the Cabinet of Ministers Regulation of 14 January 2014 No. 27 "Amendments to the Cabinet of Ministers Regulation of 19 June 2007 No. 404 "Procedures for the Calculation and Payment of

Natural Resources Tax and Procedures for the Issuance of Permits for Use of Natural Resources”” as being compatible with Article 105 of the Satversme of the Republic of Latvia.

The Judgement is final and not subject to appeal.

The Judgement has been pronounced in Riga on 25 March 2015.

The Judgement shall come into force as of the moment of its pronouncement.

Chairman of the court sitting A. Laviņš