



THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

J U D G E M E N T

On Behalf of the Republic of Latvia

Riga, 20 May 2011

Case No. 2010-70-01

The Constitutional Court of the Republic of Latvia composed of the Chairman of the Court session Gunārs Kūtris, and justices Kaspars Balodis, Aija Branta, Kristīne Krūma, Uldis Kinis, Vineta Muižniece and Viktors Skudra,

having regard to a constitutional complaint of a limited liability company SIA “Kuldīgas RPB”,

according to Article 85 of the Satversme (Constitution) of the Republic of Latvia and Article 16 (1), Article 17 (1) Indent 11, and Article 19.² and Article 28.¹ of the Constitutional Court Law,

on 3 May 2011, in writing examined the case

“On Compliance of Section 14 (2) and (3) of the Law “On the Enterprise Income Tax” with Article 91 and 105 of the Satversme of the Republic of Latvia”.

The Facts

1. On 9 February 1995, the Saeima [Parliament] of the Republic of Latvia (hereinafter – the Saeima) adopted the Law “On the Enterprise Income Tax” (hereinafter – the Tax Law).

The Tax Law requires taxing income gained from economic activities, as well as establishes the procedure for calculation and payment of the enterprise income tax (hereinafter – the EIT).

Section 14 (2) and (3) of the Tax Law provides the following:

“(2)” If in a taxation period control of a commercial company or co-operative society is acquired by a person or a group of persons that previously did not control such commercial company or co-operative society, losses of pre-taxation periods of such commercial company or co-operative society shall not be covered in the taxation period or in subsequent taxation periods, if it is not specified otherwise in this Section.

(3) The provisions of Paragraph two of this Section are not applicable in cases where the commercial company or co-operative society in which a change of control has taken place maintains its previous type of ordinary activity, as conform to the ordinary activity of the commercial company or co-operative society for two taxation periods before the change in control, for five taxation periods after the change in control.”

2. The applicant – a limited liability company “Kuldīgas RPB” (hereinafter – the Applicant) holds that Section 14 (2) and (3) of the Tax Law (hereinafter – the Contested Norms) infringe the right to own property guaranteed in the Satversme of the Republic of Latvia (hereinafter – the Satversme) and contradicts the principle of legal equality.

In 2007, the control over the limited liability company SIA “Kuldīgas RPB” (hereinafter – SIA “Kuldīgas RPB”) was overtaken by a person who previously had no control over the company. Economic activities of SIA “Kuldīgas RPB” incurred losses; therefore in 2008 it changed its type of ordinary activity. Consequently, the Applicant lost its right to transfer, to the following taxation year, all losses incurred in the frameworks of the previous economic activity before the change in control and the type of ordinary activity.

According to the Applicant, the Contested Norms establish a different attitude towards those EIT payers that have been overtaken by a person previously not having had any control over them and that changed the type of ordinary activity. Such different attitude has no objective and reasonable grounds.

The Contested Norms are aimed at preserving the type of ordinary activity of a company registered before change in control. However, such restriction has no legitimate objective because profit of a company depends on the type of its ordinary activity. The company has to react rapidly to all changes in demand and production costs, and select such type of ordinary activity that permits gaining profit. Under the circumstances of economic crisis, certain fields of economic activities have undergone losses; therefore it was necessary to introduce rapid changes into the basic activity. If the company performs change in control and type of ordinary activity simultaneously, then, acting as a taxpayer, it loses the right to cover losses of previous taxation periods, which makes the EIT amount increase. Consequently, the Contested Norms hamper development of economic activities because it offers the following choice – either to preserve the loss-making type of ordinary activity as well as the right to cover losses of previous taxation periods, or to change the type of ordinary activity and to pay a higher EIT.

The duty to pay the EIT is a restriction of the property right. Along with the right to cover losses of previous taxation periods, this is the merchant rather than the owner of shares who loses money. Consequently, the Contested Norms do not facilitate welfare of the society.

3. The institution that issued the contested act, the Saeima holds that the Contested Norm does comply with legal norms of a higher legal force and asks the Constitutional Court to recognize them as compliant with Article 91 and Article 105 of the Satversme.

The Saeima does not deny that the Contested Norms establish restriction of the fundamental rights established in Article 105 of the Satversme. However, they are aimed at reaching of a legitimate aim, namely, welfare of the society.

The Contested Norms establish the procedure for paying the EIT and tax reliefs. The legislator enjoys a broad freedom of action when deciding, in the frameworks of the tax policy, on introduction of a particular tax, as well as a particular tax rate and taxation procedure.

In the field of taxes, such principle of legal equality restricts the freedom of action of the legislator at the minimum level because differences can mainly be assessed based on the political rather than formal legal viewpoint. The Saeima holds that a company that has simultaneously changed the type of ordinary activity and the control, does not and can not enjoy equal and comparable conditions if compared to companies taking no such actions.

The Contested Norms permit merchants reducing the taxable income for the following taxing period at the amount of losses of the previous years. Transfer of losses to the following taxation period is limited in time and the type of loss source, as well as in cases when control over a company is overtaken by another person and the type of economic activity is changed.

The Saeima indicates that the purpose of the Contested Norms is to ease tax burden; however, it prohibits applying such easement to evade taxation. Transfer of losses to the following taxation periods shall be regarded as a favourable legal regulatory framework for a tax payer who does not perform any change of the type of ordinary

activity. Neither natural, nor legal persons have been guaranteed any constitutional right to evade taxation or request easements of tax regime.

The term established in the Contested Norms is related to the fact that those are mainly long-term investments that cause losses to companies, namely, expenses for goods and services are registered when income is gained by means of particular goods and services.

The Saeima holds that, by preserving the type of ordinary activity of a company, economically grounded transactions would be made and the risk that the change in control could be used to artificially reduce taxable income and therefore the amount of the EIT. Moreover, preservation of the type of basic activity of a company for a considerable period after the change in control creates certain guarantees that working places in the respective field would be preserved.

The legitimate aim can not be reached by other measures because normative acts regulating taxes can not restrict change of type of ordinary activity or control of a company; however, it can restrict transfer of losses incurred. Section 14 of the Tax Law contains certain concretizations and addenda; consequently, the legislator has performed analysis of the Contested Norms on regular basis and has assessed them in conjunction with a particular economic situation.

The Contested Norms do not prohibit a company to change its type of basic activity in case of crisis or occurrence of extraordinary factors. Consequently, the Contested Norms restrict, in a reasonable manner, the property right of persons.

4. Summoned person, the Ministry of the Finance indicates that the legislator can relate the possibility to apply a more favourable financial regime, namely, the right to transfer losses of the previous year to the following taxation period, with certain prerequisites.

The restriction established in the Contested Norms is not applicable to everyday situations. Namely, for the consequences referred to in the Contested Norms to occur, it is necessary to execute change of shareholders of a company, as well as the type of basic activity. The prerequisite that a company preserves its basic activity for a certain period of time serves as guarantee for the fact that losses would not be used as means for artificial reduction of EIT amount.

The Ministry of the Finance indicates that in case of change of control of a company it is not possible to apply other more lenient instruments to cover losses. This is also testified by the uniform experience of foreign states in relation to the particular issue, namely, in the event of change of control of a company, several Member States of the European Union have established even stricter restrictions in respect to transfer of losses, or such transfer is prohibited (for instance, in Finland and Germany).

5. Summoned person, *Dr.iur. Aivars Lošmanis*, associate professor of the Faculty of Law of the University of Latvia [*Latvijas Universitāte*] indicates that choice of a merchant in favour of a certain type of economic activity depends on several conditions. In the tax law, meaning of the basic activity of a company differs from the one established in the commercial law. However, the Contested Norms do not restrict the choice of a merchant to change of the type of basic activity.

The term of change of control defined in the Tax Law is questionable. Pursuant to the Tax Law, if a person obtains more than 50 per cent of the value of equity capital, it shall be regarded that change of control has taken place in the company. However, in the light of commercial law, such holding of shares might not ensure full control over a company. The above mentioned situation shall be regarded as an issue of legal policy and it can not be considered in conjunction with the issue on restriction of the fundamental rights of a person.

6. Summoned person, Dr. oec. Kārlis Ketners, professor of the Riga Technical University [*Rīgas Tehniskā universitāte*] holds that the period for transfer of losses established in the Contested Norms is related to the stipulated duty to preserve accounting documentation and the right of the tax administration to revise the amount of tax payments.

The right to transfer losses to the following taxation period can be regarded as a regulatory framework that is beneficial to a tax payer and it, disregarding the periodical nature of tax payments, permits exercising the principle of justice in respect to estimates of EIT during several taxation periods. The principle of continuity of activities of a company is regarded as an exception from the general prohibition to transfer losses in case of change of owners of a company. Consequently, the Contested Norms are regarded as an appropriate measure to restrict tax evasion.

The Contested Norms have been adopted because, as national economy grew, it was necessary to establish tax releases to companies that preserve their economic activities and working places even in case of change of shareholders.

When analysing experience of foreign states in respect to the rights of merchants to reduce taxable income by applying losses of the previous period, it is clear that, in the event of change of control of the company, covering of losses of previous taxation periods is considerably restricted by means of quantitative and qualitative criteria or is even prohibited.

7. Summoned person, Dr. oec. Arturs Kodoliņš indicates that the task of the Contested Norms is to ensure that, in a particular period, the EIT imposable income would comply with the economically substantiated profit of the same period.

The right to transfer such losses to the following taxation periods, that are not related to write off of long-term investments as expenses, shall be regarded as favourable legal regulatory framework in respect to a tax payer.

Purchase of shares of such companies, economic activity of which has caused losses, could be used to reduce the EIT amount. Therefore the Contested Norms envisage a restriction – prohibition to change the type of ordinary activity for a certain period of time.

The Contested Norms do hamper attraction of investors to companies suffering from insolvency risk; however, to reduce deficit of the State budget, it is necessary to apply restrictions that would not permit tax evasion.

The Findings

8. The Applicant asks the Constitutional Court to assess whether the prohibition to a company having executed change of control and that of type of ordinary activity to cover losses of previous taxation years complies with Article 91 and Article 105 of the Satversme.

It can be concluded from the legal substantiation of the constitutional complaint that, in the case under consideration, the Constitutional Court should assess compliance of the Contested Norms with the principle of equality established in the first sentence of Article 91 of the Satversme and the right to own property established in Article 105 of the Satversme.

The Contested Norms establish the procedure of assessment and payment of the EIT. It has been regulated based on two mutually related criteria – change of control of the company and that of the type of basic activity.

Consequently, in the frameworks of the case under consideration, the Contested Norms would be regarded as a single whole providing for the duty to pay tax from incomes from economic activities and establishing the procedure for calculation of the particular tax.

9. The Constitutional Court has already concluded in its case-law that, when establishing and implementing tax policy, the State enjoys a broad freedom of action. It includes the right to select tax rates to be applied and categories of persons they would be applied to, as well as the right to stipulate all details of respective regulatory framework. However, legal regulatory framework on taxes should be grounded by means of objective and rational considerations. Choice of the legislator in respect to a proportional and a necessary tax is an issue of policy and usefulness. Consequently, as to the procedure, according to which the amount of taxes is calculated, the scope of constitutional control is narrower (*see, e.g.: Judgment of 30 April 2008 by the Constitutional Court in the case No. 2007-23-01, Para 7 and 11*).

Likewise, the Constitutional Court has indicated the following: when assessing the conformity of the impugned norm with the first sentence of the Satversme Section 91, one shall take into consideration the fact that the rights, enshrined in Section 91 of the Satversme are “comparable”, namely, they may demand equal attitude but - just by themselves – they cannot reveal what the above attitude shall be, namely, favorable or unfavorable (*see: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 15.1*). Therefore other considerations should be applied, them exceeding the limits of legal equality.

The legal regulatory framework committing a person to paying taxes does pertain to the scope of the fundamental rights established in Article 105 of the Satversme. The duty of paying taxes always entails restrictions of property rights, as well as can be related to other restrictions established by law, which must be proportionate to the legitimate objective – protection of values of constitutional importance (*see: Judgment of 11 April 2007 by the Constitutional Court in the case No. 2006-28-01, Para 19.1, Judgment of 8 June 2007 in the case No. 2007-01-01, Para 19, and Judgment of 3 April 2008 in the case No. 2007-23-01, Para 6*).

However, the duty to pay taxes as such does not infringe the fundamental rights of a person guaranteed in the Satversme. Consequently, the fundamental rights established in

Article 105 of the Satversme cannot be assessed apart from the constitutional duty of a person to pay taxes prescribed according to a proper procedure (*see, e.g.: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 10*).

Consequently, when assessing compliance of the Contested Norms with the first sentence of Article 91 of the Satversme and Article 105 of the Satversme, it is necessary to establish in the case under review whether the limits of actions performed by the Saeima comply with what has been established in the Satversme, namely, whether, when establishing a differentiated procedure of EIT estimation, the legislator has restricted the fundamental rights of the Applicant in a non-proportional manner.

Consequently, the Court shall first assess compliance of the Contested Norms with Article 105 of the Satversme.

10. EIT payers are all performers of economic activity referred to in the Tax Law. Section 3 (1) of the Tax Law provides that the object upon which tax shall be imposed is taxable income obtained during a taxation period in Latvia and foreign countries. The income upon which the EIT is imposed is the amount of profit or loss indicated by the tax payer in the annual profit or loss calculations before the EIT is estimated, the first being increased or reduced by the sum of expenses or a part thereof established by the Tax Law.

Section 14 (1) of the Tax Law provides: if the result of adjustment of profit or losses of a taxation period of a taxpayer, made in accordance with this Law, is losses, they may be covered in chronological sequence from taxable income of the next eight taxation periods.

The Contested Norms provide that a tax payer, the control over which is obtained by a person or a group of persons not having yet controlled it and which fails to maintain its previous type of ordinary activity, as conform to the ordinary activity of the commercial company or co-operative society for two taxation periods before the change

in control, for five taxation periods after the change in control, shall not have the right to reduce taxable income by the amount of losses incurred during the previous taxation period.

The procedure of EIT calculation established in the Contested Norms does apply to the Applicant. Namely, the Applicant does not have the right to transfer losses of economic activities of the previous year to transfer to the following taxation period because the particular company has changed its type of ordinary activities and control. Consequently, the Applicant shall pay the EIT based on the entire sum of income.

In its reply, the Saeima regards the Contested Norms as a prohibition, namely, provisions restricting property right that are related with policy approaches enshrined in the Tax Law.

Consequently, the Contested Norms shall be regarded as a restriction to property right.

11. In order to assess constitutionality of the restriction of the fundamental rights established in Article 105 of the Satversme, it is necessary to establish:

- 1) whether the restriction is statutory;
- 2) whether the restriction has a legitimate aim;
- 3) whether the restriction is proportional with the legitimate aim.

Moreover, the contested regulatory framework has to be evaluated as the one that constitutes a considerable part of incomes into the State budget (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 22, and judgment of 6 December 2010 in the case No. 2010-25-01, Para 7*).

12. In the present case, there is no dispute whether the restriction of the property right is statutory. Materials of the court file testify that the Contested Norms have been adopted and proclaimed according to a due procedure.

Consequently, the restriction of the property right has been established by law.

13. The Constitutional Court has recognized that taxes generally fulfil the fiscal function, which ensures incomes in the national and municipal budget. This ensures the capacity of the State to fulfil its functions and duties in the field of protection of the fundamental rights. Taxes have been established to assure welfare of the society (*see, e.g.: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 9*).

Incomes into the State budget from EIT payments in 2010 were lower by 43.1 per cent if compared to 2009; however, they increased the prognosticated amount of incomes of the respective year by 112.2 million lats; however, during the first two months of 2011 22.3 million lats were already collected (*see: Ekonomikas ministrijas 2011. gada 18. aprīļa informatīvā ziņojuma par makroekonomisko situāciju valstī 38. lpp. <http://polsis.mk.gov.lv/>, consulted on 3 May 2011*).

The Saeima indicated that the Contested Norms also serve as a measure prohibiting exercising the right to reduce taxable income by the amount of losses of the previous period by evading EIT payment. The Ministry of the Finance is also of the viewpoint that losses can be used as an instrument for an artificial reduction of EIT amount.

The Contested Norms apply to the field of taxes; however, in fact, they restrict the right to reduce taxable income by the amount of losses of the previous period. Such regulatory framework shall be regarded as beneficial to tax payers because the tax is withheld only from profit of a tax payer. Moreover, to calculate the EIT amount based on

profit gained by a tax payer during a taxation period, the legislator has restricted, in certain cases, the possibility to deduce losses incurred before a particular taxation period from the income upon which the EIT is imposed.

On the one hand, the legislator has the right to establish such regulatory framework for ensuring welfare of the society that it regards as necessary. On the other one, the legislator is also committed to establishing an appropriate mechanism to assure observance of such regulatory framework.

The Contested Norms are aimed at restricting ungrounded reduction of the income upon which the EIT is imposed, which is in the interest of welfare of the society.

The European Court of Human Rights has also recognized that a state has the right to adopt all necessary laws to assure payment of taxes; therefore regulatory framework aimed at preventing of tax evasion has a legitimate objective (*see: Hentrich v. France, judgment of 22 September 1994, Series A, no. 296-A, pp. 19 – 20, para. 39; Gasus Dossier- und Fördertechnik GmbH v. the Netherlands, judgment of 23 February 1995, Series A, no. 306-B, para. 59; Mamidakis c. Greece, arrêt du 11 janvier 2007, No. 35533/04, Para. 48*).

Consequently, the Contested Norms do have a legitimate aim, which is protection of welfare of the society.

14. Having established the legitimate aim of the restriction, it is necessary to assess compliance thereof with the principle of proportionality. To assess whether the restriction is proportional, the following shall be investigated:

1) whether measures selected are appropriate for reaching of the legitimate objective;

2) whether the objective can be reached by other measures restricting the rights and legal interests of a person at a lesser extent;

3) whether the benefit gained by the society is greater than detriment caused to a person.

15. Measures selected by the legislator are regarded as appropriate for reaching of the legitimate aim if the Contested Norms ensure reaching of the aim.

The legislator has established that a company having performed change in control shall not have the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period. However, the legislator has also provided an exception from the general regulatory framework, namely, a company shall have the right to reduce the income upon which the EIT is imposed by the amount of losses incurred the previous taxation period in case if it preserves the type of ordinary activity for the period of five years after the change in control as it was before the change in control.

If, after the change in control, the company preserves its type of ordinary activity for a certain time, then, when estimating the EIT, the fact of such change is of no importance.

Section 14 (5) of the Tax Law provides: “Within the meaning of this Section it shall be considered that a person controls another person, if the first referred to person directly or by way of participation in one company or in several companies owns more than 50 per cent of all the shares or capital shares issued by the other person and they have more than 50 per cent of all the votes of shareholders (owners of shares), as may be counted in any voting.”

The Saeima indicates that the precondition to preserve the type of ordinary activity of the previous taxation periods serves for a company to obtain the right to reduce the income upon which the EIT is imposed at the amount of losses incurred during the previous taxation period has been included into the Contested Norms with the purpose to prevent companies use the change in control as a measure to reduce the taxable income

and the amount of impossible EIT. The summoned person Mr. A. Kodoliņš also indicates that purchase of shares of such companies, economic activity of which has caused losses, could be used for ungrounded reduction of EIT amount.

The Contested Norms establish several mutually related criteria serving as prerequisites for the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period. Criteria included therein are applied to make EIT estimates; consequently, the contested norms neither restrict the change in control of a company, nor that in the type of ordinary activity.

Consequently, it can be concluded that by restricting, based on certain criteria, the right to reduce the income upon which the EIT is imposed by the amount of losses incurred the previous taxation period it is possible to prevent ungrounded reduction of EIT amount.

The Contested Norms are appropriate for reaching of the legitimate objective.

16. When analysing whether there exist more lenient measures to reach the legitimate aim, in the present case the Constitutional Court shall take into account the limits of the restriction established by the nature of the tax law.

As to the field of tax based on the viewpoint of the fundamental rights, the Constitutional Court can assess the fact whether a particular tax is an proportional burden to an addressee and whether normative regulatory framework on taxes has been adopted in accordance with the Satversme (*to compare, see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 24*).

The legislator has introduced the Contested Norms by adopting, on 13 March 1997, the Law “Amendments to the Law “On Enterprise Income Tax””, and, on 25 November 1999, the Law “Amendments to the Law “On Enterprise Income Tax””.

It follows from case materials that the Contested Norms have been elaborated and adopted with the purpose to establish tax reliefs for a company that preserve their former type of basic activity and working places after the change in control (*see: Case materials, pp. 33*).

Consequently, the conclusion that the regulatory framework based on the principle of continuity of company's activity shall be regarded as a beneficial in respect to a tax payer, unlike the general prohibition to reduce the income upon which the EIT is imposed by the amount of losses incurred the previous year in case of change in control of the company.

The Saeima indicates that, when selecting the most appropriate measure for reaching of the legitimate objective, the legislator guided itself by the consideration that a more lenient regulatory framework on tax collection should be applied to such tax payers who continue their former activity and therefore preserve working places in a particular domain (*see: Case materials, pp. 37*).

It can also be concluded from the case materials that the legislator has performed analysis of Section 14 of the Tax Law on regular basis, namely, amendments and addenda to the above mentioned section have been made 11 times. Consequently, it can be concluded that the legislator has assessed the Contested Norm also in conjunction with the economic situation and recognized them as appropriate for the present needs of the society.

The Constitutional Court has no reason to question the fact whether the Contested Norms are aimed at reaching of the legitimate aim, namely, welfare of the society.

The legislator enjoys a broad freedom of action when establishing what kind of tax releases and what group of persons would be granted.

16.1. The restriction established in the Contested Norms is admissible if necessary; moreover, no other measures exist that would be as effective and would restrict the fundamental rights at a lesser extent.

When investigating whether the legitimate aim could be reached otherwise, the Constitutional Court emphasizes that a more lenient means are not any means, but only such by which the aim may be reached in the same quality (*see: Judgment of 13 May 2005 by the Constitutional Court in the case No. 2004–18–0106, Para 19 of the Findings*).

When analysing legal regulatory framework on EIT calculation in the Netherlands, Portugal and Italy the Applicant indicated that the legislator could select direct or indirect transfer of shares to another person as a criterion for loss of the right to cover losses incurred during the previous taxation period.

It follows from Section 14 (5) of the Tax Law that the legislator related the notion of change in control of a company with the fact that owner of the majority of shares has a considerable impact on further strategy of a company.

The summoned person Mr. A. Lošmanis indicates that holding of shares established in the Tax Law does not always assure a full control over a company; however, nuances of the above mentioned legal regulatory framework is an issue of law policy, which falls in the jurisdiction of the legislator.

Freedom of action enjoyed by the legislator also includes the right to establish legal regulatory framework on taxes in detail and to concretize content of terms used in normative acts. Consequently, in the frameworks of the matter under consideration, it is of no importance whether the meaning of the term “change in control of a company” differs from the one accepted in the commercial law.

The term “change in control of a company” should be considered in conjunction with other criteria of the Contested Norms because the Contested Norms is a single regulatory framework. It can be concluded from the Contested Norms that, when deciding on the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period, the decisive role is played by the

fact whether the company has also changed the type of its ordinary activity along with the change in control, rather than the fact that the change in control has taken place.

As to the alternative solution mentioned by the Applicant, the Saeima indicated that a tax payer could take advantage of such legal regulatory framework to evade taxes, namely, former owner of a company would alienate, for an acceptable price in favour of another owner of shares, non-profitable shares, where the latter would consolidate losses incurred with profit of the company, which would give the opportunity to the new owner to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period without great investments or expenses (*see: Case materials, pp. 34*).

The Constitutional Court has reiterated in its case-law that legal regulation of other states, when solving separate issues of the Latvian legal system, can not be directly applied, apart from the cases established by law. In the analysis of comparative rights, one has to take into account the different legal, social, political, historical and systematic context (*see, e.g.: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 24.1 and judgment of 3 June 2009 in the case No. 2008-43-0106, Para 10.6*).

It should also be mentioned that legal regulatory regulation on tax in the Netherlands is based on 23 July 1990 Council Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (hereinafter – Directive 90/434/EEC). The legislator of the Netherlands had stipulated that regulatory framework on taxes established in the Directive 90/434/EEC shall be applied to situation at the national level [*see: Law of 1969 of the Kingdom of the Netherlands on Enterprise Income Tax (Wet op de vennootschapsbelasting), Section 14*].

Pursuant to Article 11 (1) sub-clause “a” of the Directive 90/434/EEC, a Member State may refuse to apply or withdraw the benefit of all or any part of the provisions where it appears that the merger, division, transfer of assets or exchange of

shares has as its principal objective or as one of its principal objectives tax evasion or tax avoidance, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation.

When interpreting Article 11 (1) sub-clause “a” of the Directive 90/434/EEC, the European Court of Justice has concluded the following: in order to determine whether the planned operation has such an objective, the competent national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. According to established case-law, such an examination must be open to judicial review (*see: Judgment of 17 July 1997 in the case C-28/95 Leur-Bloem, Recueil, ECR I-4, pp. 161, clause 41*).

Legal regulatory frameworks on taxes in Portugal and Italy provide that, when performing individual assessment, competent authorities shall investigate whether a particular company has or has not executed such change in legal and factual conditions that could influence the amount of the income upon which the EIT is imposed. Taking into account individual aspects of a particular case, competent authorities of the above mentioned states have the right to provide for an exception from the general prohibition to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period.

The Directive 90/434/EEC does not establish methods and measures to be applied to implement its purpose, namely, it is up to Member States of the European Union to decide on the way of reaching the aims set.

It is possible to agree with the statement of the Applicant that other methods could also be applied when estimating EIT. However, assessment of each separate case of share alienation would require considerable investments to strengthen capacity of the tax administration. Consequently, it can be concluded that it would be impossible to introduce the alternative solution suggested by the Applicant in the field of control and supervision without financial investments.

Consequently, by applying the alternative solution suggested by the Applicant, the legitimate aim could not be reached at the same quality.

16.2. It follows from case materials that even stricter restrictions have been established in several EU Member States in respect to transfer of losses in case of change in control of a company. In the majority of cases, transfer of losses to reduce tax payments is restricted if at least one criterion is present, namely, change in control of a company (*see: Case materials, pp. 177*).

The Contested Norms contain an additional criterion; therefore it can be regarded as a favourable regulatory framework for tax payers.

Consequently, the opinion of the Saeima expressed in its reply, namely, that the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period constitute a more favourable regulatory framework in respect to tax payers and that the legislator does not any constitutional duty to establish tax release of a certain kind or amount, it having only the right to do so, is grounded.

When selecting on out of several ways of facilitating welfare of the society, the legislator has to assure that tax payments are not a non-proportional burden and all reliefs are grounded, as well as to ensure a reasonable balance between interests of the society and the right of a person to own property.

It can be concluded that possible alternative solutions would mean adoption of a less favourable regulatory framework. Taking into account the aforesaid, the Constitutional Court has no reason to recognize that no other more lenient measures exist that would ensure reaching of the legitimate aim at the same quality.

Consequently, the legitimate aim could not be reached at the same quality by applying less restrictive measures.

17. When assessing compliance of the restriction of the fundamental rights with the legitimate aim, it is necessary to investigate whether the unfavourable consequences caused to a person occur as a result of the restriction of the fundamental rights are or are not greater than the benefit gained from the restriction by the society in general

The Contested Norms are in force for several years already. They include two cumulative criteria, namely, if both criteria are met simultaneously, then the company does not have the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period.

Consequently, it can be concluded that the Applicant had the possibility to consider and evaluate its further action. Change in control of a company, like conclusion of any other transaction, is related with certain risk. Economic activity, too, is related with initiative and courage to work under constant threat and economic risks, namely, it is related with many difficulties and unforeseen situations that may occur as a result of actions of the merchant and external conditions.

Economic activity can not be abased only on tax releases established by the State (*see, e.g.: Judgment of 27 October 2010 by the Constitutional Court in the case No. 2010-12-03, Para 18.3*).

The Contested Norms are aimed at ensuring incomes into the State budget and reduction of tax burden to those companies that have preserved the type of their ordinary activity and working places after change in control.

Benefit gained by the society from reaching of the aims of the Contested Norms is greater than the restriction established by the Contested Norms to tax payers; moreover, under certain circumstances, tax payers have the opportunity to assess potential implications, namely, gains and losses, of their actions.

Consequently, the Contested Norms do comply with the principle of proportionality and therefore with Article 105 of the Satversme.

18. When interpreting Article 91 of the Satversme, the Constitutional Court has recognized that the principle of equality forbids to the State institutions passing such norms, which without a reasonable ground permit a differentiated attitude to persons, who are in equal and under certain criteria comparable circumstances. The principle of equality permits and even requires a differentiated attitude towards persons, who are in different circumstances as well as permits a differentiated attitude towards persons, who are in equal circumstances, if there is an objective and reasonable basis for it (*see, e.g.: Judgment of 3 April 2001 by the Constitutional Court in the case No. 2000-07-0409, Para 1 of the Concluding Part, and Judgment of 29 December 2008 in the case No. 2008-37-03, Para 7*). A differentiated attitude is discriminating, if it does not have an objective and well-grounded reason, i.e. – a legitimate aim or if the chosen means and the advanced objectives are not proportionate (*see: Judgment of 23 December 2002 by the Constitutional Court in the case No. 2002-15-01, Para 3 of the Findings*).

18.1. In order to assess whether the Contested Norms comply with the principle of equality included into the first sentence of Article 91 of the Satversme, the following shall be investigated:

- 1) whether and what persons (groups of person) enjoy equal and, according to certain criteria, comparable conditions;
- 2) whether the Contested Norms establish an equal or a different attitude towards these persons;
- 3) whether such attitude has an objective and reasonable grounds, namely, whether it has a legitimate aim and whether the principle of proportionality has been observed.

18.2. The Constitutional Court has already concluded that, when deciding on the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period, the decisive role is played by the fact that the company has also changed the type of its ordinary activity after the change in control.

Consequently, all those tax payers (respectively – companies) having performed change in control enjoy equal and, according to certain criteria, comparable conditions.

The Contested Norms establish a different attitude to persons who enjoy equal and comparable conditions. Namely, a company having executed change in control shall not have the right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period; however, a company that preserves the type of its ordinary activities for a certain time after the change in control shall have the right to deduct losses incurred during the previous taxation period.

However, such different attitude has an objective and reasonable grounds. The right to reduce the income upon which the EIT is imposed by the amount of losses incurred during the previous taxation period shall be granted only to such company that has preserved the type of its ordinary activity. A company insures losses mainly in the frameworks of long-term activities. Therefore a direct link exists between the two elements for EIT estimation, them being long-term activity and losses. If a causal relations exist between a constant long-term functioning of a company or the type of basic activity and losses, then deduction of losses incurred during the previous taxation periods from the incomes upon which the EIT is imposed is a logical prerequisite for reduction of the EIT amount.

Consequently, the Contested Norms do not cause any infringement of the principle of equality and do comply with Article 91 of the Satversme.

19. The Constitutional Court concludes that the legislator had the reason to establish a different procedure for EIT calculation by applying the criterion of preservation of the type of economic activity of a company as it was before the change in control. When assessing all conditions of the particular field (branch), the legislator has the right to establish regulation that would not ensure an absolute individualization of legal regulation and is equally applicable to comparable, however different cases (*see:*

Judgment of 3 April 2008 by the Constitutional Court in the case No. 2007-23-01, Para 16.3).

Consequently, there is no reason to consider that, when establishing a different procedure for EIT calculation, the legislator has exceeded its freedom of action established in the Satversme.

The Ruling

Based on Article 30 – 32 of the Constitutional Court Law, the Constitutional Court

h o l d s :

Section 14 (2) and (3) of the Law “On Enterprise Income Tax” does comply with Article 91 and Article 105 of the Satversme of the Republic of Latvia.

The judgment is final and not subject to appeal.

The Judgment shall come into force on the date of publishing it.

Presiding Judge

G. Kūtris