



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, 13 April 2011

Case No. 2010-59-01

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, Vineta Muižniece and Viktors Skudra,

having regard to a constitutional complaint of Ms. Lilija Ābika and Mr. Jānis Ābiks,

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

on 15 March 2011 in writing examined the case

“On Compliance of Section 16.¹ (3) of the Law “On Personal Income Tax” with Article 1 and Article 105 of the Satversme of the Republic of Latvia”.

The Facts

1. Before 1 January 2010, Section 9 (1) Indent 24 (this Section was included into the PIT Law by amendments of 22 November 2001 “Amendments to the Law “On Personal Income Tax”” that came into effect on 1 January 2002) of the Law “On Personal Income Tax” (hereinafter – the PIT Law) provided that the non-taxable minimum shall not contain income from contributions made to private pension funds and the latter shall not be taxed.

On 1 December 2009, in the framework of a body of draft laws, the Saeima adopted the Law “Amendments to the Law “On Personal Income Tax”” (hereinafter – the Amendments) that came into force on 1 January 2010.

Section 6 of the Amendments provides, among the rest, excluding Section 9 (1) Indent 24 from the PIT Law.

Meanwhile, the Amendments supplement the PITT Law with several norms that regulate taxation of the above mentioned incomes, including the norms of Section 8 (3) Indent 18 and Section 16.¹ (3).

Section 8 (3) Indent 18 provides that income from investment of contributions to private pension funds shall be regarded as the rest of the income of a natural person for which the tax must be paid.

Section 16.¹ (3) provides:

“The day when the beneficiary of a supplementary pension receives payment from a private pension fund shall be considered as the date of earning an income from investment of contributions to private pension funds.”

2. **The applicants Ms. Lilija Ābika and Mr. Jānis Ābiks** (hereinafter both together referred to as the Applicants) hold that Section 16.¹ (3) of the PIT Law

(hereinafter – the Contested Norm) infringe the right to own property as guaranteed in the Satversme and it contradicts the principle of legitimate expectations. Before the Contested Norm was adopted, no personal income tax was imposed on income from the contributions made to private pension funds; consequently, the regulatory framework providing imposition of the personal income tax at the amount of 10 percent has been retroactively applied to income from such contributions to private pension funds that have been made before the Contested Norm came into effect, namely, when such income was not taxed. However, when disbursing contributions made to a private pension fund by an employer, the personal income tax at the amount of 26 percent is applied; however the tax rate at the time when contributions were made constituted 23 percent. Consequently, the Contested Norm fails to comply with Article 1 and article 105 of the Satversme of the Republic of Latvia (hereinafter – the Satversme). The Applicants ask the Constitutional Court to recognize the Contested Norm as null and void as from the date of adopting thereof.

On 2 December 2009, the Applicant Ms. L. Ābika submitted an application to the joint-stock company “*SEB atklātais pensiju fonds*” regarding disbursement of the private pension capital. The disbursement was performed on 3 February 2010 by withdrawing the personal income tax at the amount of 26 percent of the sum of contributions made to the private pension fund by the employer of the Applicant, and that at the amount of 10 percent from income gained from contributions made to the private pension her (*see: Letter of 3 February 2010 by the joint-stock company “SEB atklātais pensiju fonds” No. 455916, case materials, Vol. 1, pp. 7).*

On 3 December 2009, the Applicant Mr. J. Ābiks submitted an application to the joint-stock company “*SEB atklātais pensiju fonds*” regarding disbursement of the private pension capital. The disbursement was performed on 3 February 2010 by withdrawing the personal income tax at the amount of 26 percent of the sum of contributions made to the private pension fund by the employer of the Applicant, and that at the amount of 10 percent from income gained from contributions made to the private pension her (*see: Letter of 3 February 2010 by the joint-stock company “SEB atklātais pensiju fonds” No. 455906, case materials, Vol. 1, pp. 6).*

The Applicants emphasize that, when engaging in pension funds, they could not know that income from contributions to the funds would be taxed. They have submitted the applications regarding disbursement of money before the Contested Norm came into force; in the applications they requested to disburse income earned before coming into force of the Contested Norm; however, the new regulatory framework was still applied to the particular sums. The tax law is a special field, wherein no retroactive force is permitted. Its inclusion into the Contested Norm contradicts the principle of legitimate expectations that follows from Article 1 of the Satversme. By adopting a less favourable legal norm, the legislator had the duty to provide for a lenient transition to a new regulatory framework; however, this was not done. Legitimate expectations in the field of tax law should be specially protected.

It has also been indicated in the application that such regulatory framework that commits to compulsory payment reduces value of property and therefore the right of a person to property is also infringed. The restriction of the fundamental rights established in the Contested Norm has been established by law and it has a legitimate objective; however, this restriction is not necessary in a democratic society. The legitimate objective can be reached by applying more lenient measures, for instance, by not imposing the personal income tax to those contributions to private pension funds that were made before coming into effect of the Contested Norm. It was also possible not to apply the new legal norm to cases when applications to disburse income from private pension funds were submitted before coming into force of the Contested Norm.

According to the Applicant, the principle of proportionality has not been observed because losses caused to a person by the Contested Norm are greater than the benefit to the society.

3. The institution that adopted 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 it as constitutional.

The Saeima indicates that up to 31 December 2009, incomes from contributions to private pension funds were not taxed. It was established in Section 9 (1) Indent 24. The aim of the particular regulatory framework was to facilitate savings; therefore incomes from contributions to private pension funds were ensured particularly favourable conditions if compared to other kinds of incomes. The amendments extended tax basis by introducing income from capital, which thus has permitted to impose tax on incomes from contributions made to private pension funds. Therefore, Section 9 (1) Indent 24 has been excluded; in addition to this, the date to be regarded as the date of earning income was concretized in the PIT Law. The Contested Norm is only technical concretization and it does not regulate the temporal aspect of a newly adopted legal norm. Exclusion of the Contested Norm from the law would not allow avoiding paying the tax.

According to the Saeima, the Applicants have contested the legal norm that, in fact, does not solve the situation described in the application. If the tax had not been withdrawn at the date when a person receives disbursement from the private pension fund, it would have to be paid according to resumed procedure by submitting an annual declaration on personal income tax. The Saeima asks the Constitutional Court to assess whether it is useful to continue proceedings in the present case.

It has been indicated in the reply that, in Latvia, a three-level pension system exists. This system ensures the possibility to form savings from obligatory social insurance contributions (the first and the second pension system), as well as voluntary additional contributions to private pension funds (the third pension system). Capital accumulated in private pension funds forms supplementary pension capital. No personal income tax is imposed on income transferred to contributions to pension funds for the year when respective contributions were made. Based on obligatory State social insurance contributions, a person is disbursed old age pension after teaching the age of retirement, whilst private pension funds ensure disbursement of supplementary pension. Pursuant to Section 8 (3) Indent 10 of the PIT Law, pensions irrespective of the source of payment thereof shall be regarded as the rest of the income of a natural person for which the tax must be paid. By imposing personal income tax on income earned from contributions made to private pension funds, it is ensured that the scheme of private pensions would conceptually differ from the general model, namely, imposition of the personal income

tax on pensions, which the Constitutional Court has already recognized as compliant with legal norms of a higher legal force (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01*).

In the reply, the Saeima refers to such peculiar feature of tax system that incomes are taxed only when they are obtained (disbursed). Consequently, it is not possible to establish any retroactive force in this case because incomes are taxed only when they are obtained. Person cannot have any legitimate expectations into the fact that the State would not introduce any other tax or that a special application regime would be ensured. Moreover, the intent of the government to impose capital tax on income has already been announced in 20 December 2007 Declaration on planned activities by the Cabinet of Ministers.

Under economic recession circumstances in Latvia, legitimate expectations regarding preservation of the already established tax system in respect to income and capital is not commensurate with the necessity to collect taxes as soon as possible, which would thus ensure fair tax policy (especially taking into account the fact that the personal income tax to be applied to labour force has been increased) and help avoid reducing funding for fulfilling substantial functions for the society.

It has been indicated in the reply that imposition of the personal income tax on income gained from the contributions made to private pension funds is aimed at reaching of the legitimate aim, which is ensuring of welfare of the society. The regulatory framework that envisages taxing the particular income does comply with the principle of justice and that of proportionality.

The Findings

4. The Applicants hold that the Contested Norm fails to comply with the right to property established in Article 105 of the Satversme; it neither complies with the principle of legitimate expectations that follows from Article 1 of the Satversme.

Article 1 of the Satversme provides that Latvia is an independent democratic republic. It has been established in the case-law of the Constitutional Court that the principle of legitimate expectations requires that the State, when amending normative regulation, would observe a reasonable balance between trust of persons and the interests that should be ensured by amending regulatory framework. Manifestation of these principles in different fields of law may differ. If compliance of regulatory framework in the field of tax with Article 105 of the Satversme and with the principle of legitimate expectations has been contested, then compliance of the Contested Norm with Article 1 of the Satversme shall be assessed in conjunction with Article 105 of the Satversme (*see: Judgment of 6 December 2010 in the case No. 2010-25-01, Para 4, and Judgment of 19 June 2010 in the case No. 2010-02-01, Para 4*).

Consequently, compliance of the Contested Norm with Article 1 of the Satversme shall be assessed in conjunction with Article 105 of the Satversme.

5. Article 105 of the Satversme: “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 Constitutional Court has already concluded in its case-law that Article 105 of the Satversme determines both the right to enjoyment of the property and the right of the state to restrict the property right (*see: Judgment of 6 December 2010 by the Constitutional Court in the case NO. 2010-25-01, Para 1, Judgment of 11 April 2007 in the case No. 2006-28-01, Para 19.1, and Judgment of 8 June 2007 in the case No. 2007-01-01, Para 19*).

Consequently, it is necessary to assess whether the Contested Norm commits a person to paying tax, namely, whether it establishes any restriction of rights established in Article 105 of the Satversme.

According to the Saeima, the Contested Norm only has a technically concretizing character. Its inclusion from the Law would not, in fact, change the principle that the Applicants would have to pay the tax. Namely, if the tax would not be withdrawn at the moment when a person receives disbursement from a private pension fund, the person would still have the duty to pay it according to recapitulate procedure when submitting annual declaration of personal income tax.

5.1. The Constitutional Court has already assessed another norm similar to the one reviewed in the present case, namely, Section 16.¹ (9) of the PIT Law “Date of Earning the Income” that provides: “The day of earning interest income and accordingly also the day of disbursement of interest income within the meaning of this Law shall be considered as the date when a natural person is given the right to act without restriction with the respective income in accordance with the contract entered into or the law and the relevant income becomes accessible to such person in the manner and according to the procedures indicated thereby.”

The Constitutional Court has indicated that the aim of this norm is to concretize details related with tax payment rather than to commit a person to pay the personal income tax from interest income. If this particular norm taken separately would be recognized as null and void, the person would still have the duty to pay the personal income tax from interest income, including such interest income that is obtained from deposit made before coming into force of the Amendments (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 6.2*).

In the present case, too, the Contested Norm does not commit a person to paying the personal income tax from payments that a recipient of supplementary pension receives from a private pension fund.

5.2. In the Case No. 2010-25-01, not only Section 16.¹ (9), but also those norms that established paying the personal income tax from interest profit. The Constitutional Court concluded that the contested norm included in Section 16.¹ (9) of the PIT Law is closely related with other contested norm referred to in the above mentioned case. Consequently, the contested norms were assessed as a single regulatory framework (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 6.2*).

Although, in the present case, no other norm apart from Section 16.¹ (3) of the PIT Law has been contested, the Applicants, in fact, hold that this is the fact of lack of favourable regulation rather than the text of the Contested Norm that fails to comply with the Satversme. The Constitutional Court has concluded that the Saeima enjoys a broad freedom of action regarding issues related with procedures of legislation, including issues regarding wording of transitional periods and the choice regarding introduction thereof into the text of a law, transitional provisions of a law, or establishing a particular date of coming into force of a law (*see: Judgment of 19 June 2010 by the Constitutional Court in the case No. 2010-02-01, Para 9.4.2*).

However, in case if the Saeima has failed to provide a proper transitional regulatory framework, a person submitting a constitutional complaint shall have the right to choose, which of the norms of the law that establishes regulatory framework restricting his or her rights to contest.

The Contested Norm is closely related with Section 8 (3) Indent 18, Section 15 (1) and (3).¹, as well as the norm of the Amendments that provides excluding of Section 9 (1) Indent 24 from the PIT Law. Together with the above mentioned norms, the Contested Norm forms a single legal regulatory framework in respect to imposition of the personal income tax on supplementary pensions (hereinafter – the Contested Regulatory Framework). Consequently, in the present case, Section 16.¹ (3) of the PIT Law has been contested insofar that it fails to provide that the date before coming into effect of the new regulatory framework shall be regarded as the date of earning income in respect to disbursements from private pension funds, wherein contributions were made before coming into force of the Contested Regulatory Framework. In the frameworks of the present case, the Contested Norm shall be assessed as a part of a single regulatory framework imposing the personal income tax on supplementary pensions and deals with issues related with payment of the particular tax.

5.3. In 1995, the Saeima accepted the Pension Reform Concept and planned to introduce pension system of three levels that would include an adolescent solidarity pension scheme, a funded pension scheme, and private pension funds. The legislator was planning to elaborate such pension system that could preserve stability irrespective of

economic changes. Fundamental principles of pension system, circle of insured persons and the procedure for accumulating resources were established in the Law “On State Pensions”. The legislator also elaborated regulatory framework that gave possibility to persons to accumulate resources in private pension funds by making contributions in their own favour and thus ensuring supplementary pension capital (*see: Judgment of 1 December 2010 by the Constitutional Court in the case No. 2010-21-01, Para 17*).

The private pension scheme functions since 1 July 1998, and the aim of the scheme is to make persons, by mediation of private pension funds, accumulate and invest monetary contributions made by them on voluntary basis, which would thus ensure them supplementary capital at the old age. In the frameworks of the private pension scheme, as on 31 December 2009, six private pension funds functioned in Latvia, namely, five open and one closed private pension fund, which altogether offered 19 pension plans engaging 189.5 thousand members, which is 16.3 percent of economically active inhabitants. Net capital of private pension plans at the end of 2009 reached 0.72 percent of the GDP. IN 2009, profitability of the third pension level was 10.5 percent, whilst in 2008 – 10.1 percent (*see: Order No. 674 of 17 November 2010 by the Cabinet of Ministers “Conception on Stability of Social Insurance System in the Long Term” [“Konceptijas par sociālās apdrošināšanas sistēmas stabilitāti ilgtermiņā”], pp. 18, http://www.lm.gov.lv/upload/aktualitates/koncepcija_24052010.pdf*).

Pursuant to Section 1 of the Law “On Private Pension Funds”, supplementary pension capital shall be supplementary pension capital accrued pursuant to a particular payment plan or payments and services established in favour of recipients of supplementary pension pursuant to a particular disbursement plan. Payments can be established as payments of supplementary pension during the lifetime of a recipient or a payment in a certain time period, or as a single disbursement. Depending on accumulation of the supplementary pension capital in respect to different parts thereof, different tax regime is established:

- 1) when disbursing supplementary pension capital accumulated from individual contributions (in the particular case, the particular capital was accrued only by one

Applicant), the personal income tax was not withdrawn; it is neither withdrawn after coming into force of the Amendments;

2) when disbursing supplementary pension capital accrued by contributions of an employer, the personal income tax has been withdrawn before and after coming into force of the Amendments. This is only the tax rate established in Section 15 (2) of the PIT Law that has changed. Before 2009, the tax rate was 25 percent, in 2009 – 23 percent, and in 2010 – 26 percent;

3) when disbursing profit earned in the result of pension plan resource management (the difference between accumulation at the end of the term and contributions made), the particular tax was not withdrawn. After coming into force of the Amendments and pursuant to Section 11.⁹ (11) Indent 3 of the PIT Law, this profit constitutes income from capital which is not capital gains. Pursuant to Section 15 (3.¹) of the PIT Law, the tax rate for profit from capital shall be 10 percent.

The above mentioned norms and the Contested Norm as a single regulatory framework require withdrawing the tax from a part of the supplementary pension (disbursement of supplementary pension capital that was formed by contributions of an employer, and capital gains). Consequently, this norm establishes restriction of the basic rights established in Article 105 of the Satversme of the Republic of Latvia (hereinafter – the Contested Restriction).

6. In order to assess constitutionality of the restriction of the basic rights established in Article 105 of the Satversme, it is to be investigated whether it is statutory, whether it is provided for protection of a legitimate objective and whether it complies with the principle of proportionality. Moreover, the contested provision has to be evaluated not as restriction of a person for owing property but as restriction that is provided in legal relations of taxis in order to ensure creation of the national budget and municipal budgets (*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*).

Namely, it is necessary to take into account the freedom of action granted to the legislator in the field of tax.

7. In the present case, the regulatory framework that has been included into the PIT Law by adopting the Amendments, as well as the norm of the Amendments that establishes excluding Section 9 (1) Indent 24 of the PIT Law is contested. In the frameworks of the present case, the fact whether Amendments would have been adopted and proclaimed according to a proper procedure has not been contested; there are no facts raising such doubt.

Consequently, the Contested Restriction has been established by law.

8. Circumstances and arguments why it is needed shall be the basis for any restriction of fundamental rights, namely, the restriction is determined because of significant interests – the legitimate aim (*see: Judgment of 22 December 2005 by the Constitutional Court in the case No. 2005-19-01, Para 9*).

The Constitutional Court has already established that tax is a precondition of a nationally organized society and an indispensable part of the State policy. Tax income form a substantial part of the State budget incomes, which ensures the capacity of the State to fulfil its functions and duties in the field of protection of the fundamental rights. Collection of the personal income tax has been established in the interests of the society (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 9*).

Consequently, the Contested Restriction has a legitimate aim, which is protection of welfare of the society.

9. When stating the legitimate objective, it is necessary to assess the compliance of the restriction to the principle of proportionality. In order to investigate whether the

respective restriction is proportionate, the Constitutional Court has established in its case-law: first of all, if the means, used by the legislator are suitable for achieving the legitimate objective; secondly, if such activity is required, i.e., if it is not possible to attain the objective by other means, which would less limit the rights and legal interests of an individual; thirdly, if the activity of the legislator is proportionate or adequate, i.e., if the benefit, obtained by the society, is greater than the loss incurred to the rights and lawful interests of an individual. However it has to be taken into account that, in the field of tax rights, it would not be sensible for the legislator to set the same conditions as for, the field of e.g. protection and provision of civil and political rights. The specific character of the corresponding field also establishes the boundaries of political control; from the viewpoint of restriction of basic rights, the Constitutional can mainly assess whether tax payments prove to be a disproportionate burden for an addressee and whether the legal regulation of taxes comply with the general principles of law (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 24*).

When establishing and implementing the tax policy, the State enjoys a broad freedom of action. The right to determine tax rates to be applied to certain categories of persons, as well as the right to establish details of a particular regulation pertain to the scope of freedom of action of the legislator. The fundamental right of a person to own property shall not be infringed if the State commits a person to a public duty to make payments that are not an undue encumbrance for him or her and that do not have any substantial effect on his or her financial position. 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: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 10*).

9.1. The Contested Regulatory Framework can be regarded from two aspects. On the one hand, it establishes payment of the personal income tax from capital gains and it is similar to the regulatory framework regarding interest income from capital. On the other hand, the Contested Regulatory Framework deals with the pension system, namely, it requires taxation of supplementary pension. Each of the aspects shall be assessed independently, especially in the light of legitimate expectations.

When reporting on the draft law “On Private Pension Funds” on behalf of the responsible committee, at a Saeima meeting of 27 February 1997, a member of the Parliament Mr. Pēteris Keišs indicated the following: “It is necessary to launch private pension funds in the State due to two aspects. First, private saving in such funds ensure more accurate compliance of pension with contributions made during employment periods, and it stimulates having private savings for retirement age in order to increase living standard of persons. Second, in the market economy financial system, such funds might serve as an important investment source” (*see: Transcript of the Saeima meeting of 27 February 1997: http://www.saeima.lv/steno/st_97/st2702.html*).

9.2. The Supreme Council of the Republic of Latvia adopted the PIT Law in May 1993, and it came into effect on 1 January 1994. At that time, private pension funds did not exist in Latvia. Initially, the PIT Law provided that neither pensions, nor interest payments shall be taxed. Such regulatory framework was effective when the Saeima was discussing pension concept and adopted laws related thereto, including the Law “On Private Pension Funds”. Pursuant to the above mentioned regulatory framework, the Saeima incorporated Section 9 (1) Indent 24 into the PIT Law. The above mentioned section provided that no personal income tax shall be imposed on income from contributions made to private pensions funds. State pensions, income gained from contributions to private pension funds and interest income, in fact, is regarded as income, whereto the PIT Law applies. Tax relief established in Section 9 (24) of the PIT Law was effective for a considerable period of time, and persons could legally trust into the fact that the particular regulatory framework would not change.

9.3. The Constitutional Court has already concluded that legitimate expectations of a person into the fact that tax relief would remain effective even if economic priorities would change cannot be protected at the same extent as legitimate expectations of a person in other cases when the right to own property is restricted (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 10.1*).

The Constitutional Court has concluded that imposition of the personal income tax on interest profit, as well as introduction of such regulatory framework without establishing transitional period in respect to income gained from deposits made before

coming into force of the new regulatory framework do comply with Article 105 of the Satversme (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01*). Insofar as the Contested Regulatory Framework is similar to the regulatory framework regarding income from capital, it is not necessary to re-assess its compliance with Article 105 of the Satversme.

9.4. The purpose of pensions is to ensure income for a person at an old age, namely, in the period when a person is presumed to be incapable. As it has been already mentioned above, to ensure resources for this purpose, the State has elaborated a three-level pension system. The Contested Norm applies only to supplementary pensions, namely, the third pension level, which establishes voluntary participation of a person. Consequently, it is necessary to establish whether it is permissible to impose tax on supplementary pension.

In the judgment of 8 June 2007 in the case No. 2007-01-01, the Constitutional Court has already concluded that the legislator is entitled to acknowledge pensions as an object of the personal income tax. Such action of the legislator does not violate the assigned freedom of action established in Section 105 of the Satversme (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 24.1*). In the above mentioned judgment, the Constitutional Court assessed, inter alia, principles of pension formation and the fact that State social insurance contributions are exempted from the personal income tax.

Also incomes into private pension funds in case if they do not exceed certain amount are not taxed. Pursuant to Section 10 (1) Indent 5 of the PIT Law, the contributions made to the private pension funds established in accordance with the Law on Private Pension Funds, or other private pension funds registered in other Member States of the European Union or European Economic Area states, which do not exceed certain amount of the annual taxable income of a person.

When imposing tax on capital accumulated in a private pension fund at the moment when the person is disbursed the income, no double taxation takes place.

Especially taking into account the fact that basic pension that are granted from 1995, in case if they do not exceed certain minimum amount, are not taxed, it can be concluded that taxation of capital disbursed from private pension funds as such cannot be regarded as non-compliant with Article 105 of the Satversme. However, when elaborating the particular regulatory framework, the legislator has to take into account the fact that it is in the interest of the society to stimulate persons to accumulate savings in private pension funds for their retirement age, namely, to participate in the third pension level.

9.5. When assessing compliance of the Contested Regulatory Framework with the principle of legitimate expectations, it should be taken into account that before coming into force of the Amendments, the personal income tax was imposed only on that part of supplementary pension that was formed by capital disbursement paid into the private pension fund by an employer. This is only the tax rate that has changed. Before 2009, it was 25 percent, in 2009 – 23 percent, and in 2010 – 26 percent. Consequently, the Applicants could not legally trust into the fact that the tax rate would remain unchanged.

Change of the tax rate at the amount of some percents does not deter a person from participating in the third pension level. It should be taken into account that a person who makes contributions to private pension funds is ensured a more beneficial legal status if compared to the one who voluntarily save money for their old age in any other way. Person's capital in a private pension fund is formed also by that part of person's income that should be paid as the personal income tax in case if the person would not get involved in the third pension level. This part also constitutes capital gains. Whilst this capital is not disbursed to a person, it is not taxed and therefore constitutes savings.

9.6. The Applicants hold that the legitimate aim could be reached also if the Contested Norm would not be applied to incomes from contributions to private pension funds that are made after coming into force of the Amendments.

However, “when assessing whether the legitimate aim may be reached in a more lenient way, the Constitutional Court takes into consideration 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*).

It should be taken into account that private pension funds are aimed at long-term functioning. If the legislator would introduce such regulatory framework that would establish procedure for imposing tax on capital gains in private pension funds depending on the year of making contributions, this would complicate administration system and raise the costs thereof, which would lead to negative impact on profitability of private pension funds. However, the State budget would receive considerably less income and therefore it could not ensure implementation of the above mentioned aims.

Consequently, the alternative measure mentioned by the Applicants could not reach the legitimate aim at the same quality. The case contains no materials that would refer to other alternative measures that would ensure reaching of the legitimate aim at the same quality.

9.7. When assessing whether imposing of the personal income tax on capital gains in private pension funds prevents a person to get involved in the third pension level, it should be taken into account that the above mentioned incomes are established a rather lenient procedure, namely, tax rate that is smaller than that applied to basic pension that does not exceed the untaxed minimum is applied thereto.

9.8. It cannot be denied though that, in a democratic and law-governed State, cases when the law is granted with a retroactive force shall be regarded as an exception. The regulatory framework in the field of taxes is characterized by special requirements. However, this does not mean that, in the field of taxes, a law cannot be granted a retroactive force in separate cases. In the field of tax, they distinguish between the so-called authentic retroactive force and pseudo retroactive force. Authentic retroactive force applies to legal norms that have become ineffective prior to coming into force of a particular legal norm, whilst pseudo retroactive force applies to ongoing legal relations (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 10.3*).

In the present case, it cannot be established that the Applicant would have been applied the Contested Norm by applying the authentic retroactive force and the tax would have been collected for supplementary pension that was disbursed to the persons before coming into force of the Contested Norm.

The general principle of the PIT Law provides that the tax that is in force at the date of gaining income is imposed on incomes of a person. According to the aforesaid, basic pensions are imposed tax that is effective on the date of disbursing funds rather than the one that was effective when the person was employed. Supplementary pension is also taxed by applying the tax that is effective on the date of disbursing funds rather than a person made savings or requested disbursement of supplementary pension.

The Constitutional Court has already concluded the following: “Persons had to take into consideration the fact that in case of State economic situation and needs would change, tax rates and tax relief might change. Consequently, when concluding agreements on deposit for a certain term that exceeds one accounting year, persons had no objective reason to count on the fact that the effective legal regulation regarding tax relief would remain unchanged during the entire period of the agreement.” (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-59-01, Para 10.3*).

Persons who made contributions to private pension funds had to count with the fact that in case if economic situation of the State as well as its needs would change, tax rates may also change.

9.9. The Constitutional Court also takes into account what has been indicated in the Saeima reply, namely, that the Contested Norm regulates disbursements of third level pension and it does not affect the basic pension.

The Constitutional Court has already concluded that, when adopting the Contested Regulatory Framework, Latvia underwent economic recession (*see, e.g.: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01*). Under such circumstances, different measures to ensure State budget income were inevitable. They concerned more or less taxpayers. If the State would choose solving the situation by other solutions rather than by increasing State budget incomes, which would lead to, for instance, inflation, consequences to the Applicants and other persons involved in the third pension level would be even less beneficial because supplementary pensions and the value of pension capital would decrease in the result of inflation.

The benefit that the society has generally gained from the Contested Regulatory Framework as a part of measures to ensure budget incomes is greater than the restriction of the fundamental rights and legitimate expectations established to the Applicants.

Consequently, the Contested Regulatory Framework does comply with the principle of proportionality and therefore the Contested Norm does comply with Article 1 and Article 105 of the Satversme of the Republic of Latvia.

The Constitutional Court

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

h o l d s :

Section 16.¹ (3) of the Law “On Personal Income Tax” does comply with Article 1 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