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, 6 December 2010

Case No. 2010-25-01

The Constitutional Court of the Republic of Latvia, composed of the Chairman of the Court hearing Gunārs Kūtris, Justices Kaspars Balodis, Aija Branta, Kristīne Krūma, Vineta Muižniece and Viktors Skudra,

having regard to constitutional complaints to Mārtiņš Trautmanis and Mārtiņš Draudiņš,

according to Article 85 of the Satversme (Constitution) of the Republic of Latvia, Article 16 1st indent, Article 17 (1), 11th indent, Article 19.[2] and Article 28.[1] of the Constitutional Court Law,

on 3 November 2010 in writing examined the case

"On Compliance of Section 6 of the Law "Amendments to the Law on Personal Income Tax" of 1 December 2009 (Provision Envisaging Crossing out of Section 9 (1) (3) of the Law "On Personal Income Tax") and Section 8 (3) (13) and Section 16.1 (9) 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) (3) of the Law "On Personal Income Tax" (hereinafter – the PIT Law) provided that income from deposits in credit institutions and savings and loan associations registered in the Republic of Latvia and other Member States of the European Union or European Economic Area state, as well as income from mortgage bonds shall not be included in the annual taxable income and the tax shall not be imposed upon.

On 1 December 2009, in the frameworks of the package of draft laws, the Saeima adopted the Law "Amendments to the Law "On Personal Income Tax"" (hereinafter – the Amendments) that came into effect on 1 January 2010.

Section 6 of the Amendments provides, among the rest, crossing out of Section 9 (1) (3) of the PIT Law.

The Amendments also supplement the PIT Law by several norms that regulate withdrawal of the tax from the above mentioned incomes, including Section 8 (3) (13) and Section16.^{1} (9).

Section 8 (3) (13) provides that the rest of the income of a natural person for which the tax must be paid are interest income and incomes similar to it, as well as income related to interest income.

However, Section 16.^{1} (9) establishes the following:

"Within the meaning of this Law, the date of obtaining income and the day of disbursement of interest income shall be the date when a natural person is conferred the right to unrestrictedly use the respective income in accordance with a concluded agreement or law and when the respective income becomes available to the person according to the way and procedure established by the person."

2. The applicants Mārtiņš Trautmanis and Mārtiņš Draudiņš (hereinafter also referred to as the Applicants) hold that Section 6 of the Amendments (provision regarding crossing out of Section 9 (1) (3) of the PIT Law) and Section 8 (3) (13) and Section 16.^{1} (9) of the PIT Law (hereinafter – the Contested Norms) infringe their property right established in the Satversme and contradict the principle of legitimate expectations because the regulatory framework is retroactively applied to de[posits made

before coming into force of the above mentioned norms. Consequently, the Contested Norms do not 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 Norms as null and void as from the date of adopting them.

2.1. On 23 January 2009, **the Applicant M. Trautmanis** made a term deposit with capitalization for the term of 12 months. Pursuant to the Contested Norms, the personal income tax was deducted from the interest sum calculated on January 2010 (*see: statement of the joint stock company "Latvijas Hipotēku un zemes banka" on the term deposit of 8 March 2010 for the period from 1 January to 8 March 2010, case materials, Vol. 1, pp. 6*).

According to the Applicant, tax law is a special domain of law where retroactive force is not permissible. Retroactive effect of the Contested Norms contradicts the principle of legitimate expectations that follows from Article 1 of the Satversme. When adopting norms that are less favourable for depositors, the legislator had the duty to establish a lenient transition to a new legal regulatory framework; this, however, was not observed.

It has been indicated in the application that such regulatory framework in the field of taxes and fees that commits a person to making obligatory payments reduces value of property; consequently, the property right of a person is infringed. The restriction of the fundamental rights established in the Contested Norms has been established by law, it has a legitimate objective; however, no such restriction is necessary in a democratic society. It is also possible to reach the legitimate aim by applying more lenient measures, for instance, by providing that no tax shall be imposed on deposits made before coming into force of the Contested Norms. Moreover, the legislator has failed to observe proportionality. Detriment caused to a person by means of the Contested Norms is greater than the benefit gained by the society.

2.2. On 15 January 2009, **the Applicant M. Draudiņš** made a deposit for the term up to 15 January 2010. The personal income tax was deduced from the last percent income made on January 2010 as established in the Contested Norms (*see: Statement No. 10-002-160 of Riga affiliate of SEB banka of 13 March 2010, case materials, Vol. 2, pp. 8*).

The Applicant holds that the Contested Norms prevent him from enjoying a part of interests of his property and therefore they contradict Article 105 of the Satversme. The restriction established to his fundamental rights is not proportional because the State has chosen to tax deposits that the Applicant has accumulated during his lifetime; however, no progressive personal income tax is imposed on wages of employees of public institutions.

Moreover, the tax has been imposed without taking into account inflation in the State established by the State Central Statistical Bureau and without establishing respective reliefs. Losses caused by annual inflation are greater than incomes from a deposit in a bank.

According to the Applicant, the Contested Norms have a retroactive force, which is inadmissible pursuant to the principle of legitimate expectations. Cumbersome tax laws that revoke or restrict former regulatory framework cannot be applied to activities already executed, namely, to deposit agreements already concluded. The legislator had the duty to establish a transitional period to the new regulatory framework for depositors to have the possibility to choose whether to deposit their money in a bank or to keep it at home. The Applicant trusted in the fact that on January 2010 he would receive a particular sum; however, the Contested Norms have denied him such possibility.

In the opinion submitted by the Applicant after having got acquainted with case materials, he emphasizes that the possible legitimate objective could be reached by other more lenient measures, for instance, by prolonging transitional period up to adoption of the budget law of the following year or by providing that the Contested Norms would not be applied to deposit agreements already concluded. It is possible to tax only those deposits that were made provided that persons knew that the deposit interest income would be taxed.

3. **The institution that adopted the contested act, the Saeima** holds that the Contested Norms do comply with legal norms of a higher legal force and asks the Court to recognize them as compliant with Article 1 and Article 105 of the Satversme.

The Saeima does not deny that the Contested Norms do establish restriction to the rights of a person established in Article 105 of the Satversme. The State enjoys a

broad freedom of action in the field of tax policy when deciding what taxes to introduce, when to introduce them and what tax rate and application procedure to apply.

The Saeima indicates that obtaining income from capital has a profit-gaining character. A person may use this income as extra income or basic income. As to interest income, the previous regulatory framework provided a particularly favourable tax order if compared to income of other kinds. The aim of the regulatory framework was to facilitate formation of accumulation. However, during the economic recession, it was necessary to ensure a more even tax burden on incomes of all kinds. Therefore, the Amendments defined those kinds of capital assets, on income from which the tax on capital gains (15 percent tax rate) and other capital income tax, which is not capital gains, including the interest income (10 percent tax rate) would be imposed.

It has been emphasized in the reply that the personal income tax system is based on the principle of justice, pursuant to which the personal income tax depends on paying capacity of a taxpayer. Interest income is mainly characteristic to prosperous members of the society, whilst less prosperous persons have their wage as their main means of subsistence, upon which the personal income tax has always been imposed. Therefore the solution that envisages taxing of incomes of natural persons by applying a reduced rate shall be regarded as fair and proportional.

The reply also contains a reference to a feature that is characteristic to the tax system, namely, that income (profit) is taxed only after it is obtained (disbursed) without regard to time and efforts (investments, contributions) applied to obtain such income. For instance, if an enterprise gains profit only after it has invested great resources in its development during several years, the income is imposed such tax rate that is effective in the respective year rather the one that was effective during the period when investments were made. Consequently, in the case under review, it is not possible to establish that the Contested Norms would have a retroactive force because the tax is imposed at the time when income is gained.

The Saeima emphasizes that persons cannot have legitimate trust into the fact that the State would not introduce any tax or establish a special regime for application of it. Moreover, the intention of the government to impose the personal income tax on income from capital was made known already in the Declaration of 20 December 2007 regarding planned activities of the Cabinet of Ministers.

The Saeima denies the fact that provisions of Section 9 (1) (3) of the PIT Law, namely, the fact that the personal income tax shall not be imposed on incomes from deposits in a credit institution have remained unchanged for a long term disregarding some concretizing amendments. However, during economic recession in Latvia, legitimate expectations into the fact that the previous tax order would be preserved in regard to capital gains are not commensurable with the necessity to collect the tax as soon as possible with the purpose to ensure fair tax policy (especially provided that an increased personal income tax is applied to wages of employees) and prevent further reduction of funding for fulfilment of substantial public functions.

It has also been indicated in the reply that imposition of the personal income tax on income from capital gains is aimed at reaching of a legitimate objective, which is welfare of the society. It does comply with the principle of justice and that of proportionality because it establishes a reasonable tax amount in regard to incomes having a profit-gaining character.

The Constitutional Court has established:

4. 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 duty of the State to observe basic principles of a law-governed State, including that of legitimate expectations, follows from the notion of a democratic republic included in the above mentioned Article (*see, e.g.: Judgment of 19 June 2010 by the Constitutional Court in the case No. 2010-02-01, Para 4*). Pursuant to the principle of legitimate expectations, State institutions in their activities have to be consistent with regard to the passed normative acts, they have to observe the legitimate expectations, which might arise to persons in accordance with the specific legal norm (*see, e.g.: Judgment of 19 March 2002 by the Constitutional Court in the case No. 2001-12-01, Para 3.2*). However, the principle of legal security does not exclude the right of the State to amend the effective regulation. Otherwise this would lead to inability of the State to react to changing life. When amending legal regulation, however, the State has the duty to take into account the rights, in preservation and implementation of which people trusted. The

principle of legal security 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 (*see: Judgment of 15 March 2010 by the Constitutional Court in the case No. 2009-44-01, Para 15*).

When assessing the conformity of the impugned norm with legal principles that follow from constitutional values included in Section 1 of the Satversme, one shall take into consideration the fact that manifestation of these principles may differ in different domains of law. The nature of the impugned norm, its connection with other norms of the Satversme and their place in the system of fundamental rights, inevitably influence the scope of the control realized by the Constitutional Court. Namely, freedom of action of the legislator when regulating the particular issue may be a broad or a narrow one, and the Constitutional Court has the duty to assess whether the extent of freedom of action exercised by the Saeima complies with what has been established in the Satversme (*see: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 15.2 and 15.3*).

Consequently, in the case under review, compliance of the Contested Norms with Article 1 of the Satversme must be assessed in conjunction with Article 105 of the Satversme.

5. 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 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 rights (*see, e.g.: Judgment of 20 May 2002 by the Constitutional Court in the case No. 2002-01-03, the concluding part*).

The Constitutional Court, when assessing constitutionality of individual provisions of the Law On Personal Income Tax, *inter alia* has held that the liability to pay taxes always means restriction of property right (*see: Judgment of 11 April 2007 by*

the Constitutional Court 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, the regulatory framework of the Contested Norms, insofar as it commits a person to paying the tax, does pertain to the scope of the fundamental rights included in Article 105 of the Satversme.

6. Since three different norms are contested in the present case, it is necessary to assess whether the aim of all of the Contested Norms is to commit a person to paying a tax, namely, whether they establish any restriction to the fundamental rights established in Article 105 of the Satversme.

6.1. The duty of a person to pay the personal income tax from interest income follows from Section 6 of the Amendments insofar as it excludes Section 9 (1) (3) of the PIT Law, as well as from Section 8 (3) (13) of the PIT Law. Consequently, these norms establish restriction to the fundamental rights of a person enshrined in Article 105 of the Satversme.

6.2. However, the aim of Section16.[1] (9) of the PIT Law is to concretize details related with tax payment rather than to commit a person to pay the personal income tax from interest income. The Saeima indicates in the reply of 9 June 2010 that this particular Contested Norm "is of technical and concretizing nature; it does not regulate the issue regarding temporal validity of a legal norm to be adopted" (*case materials, Vol. 1, pp. 60*). 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.

The applications do not present legal justification why the regulatory framework of Section 16.[1] (9) of the PIT Law regarding the date to be regarded as the date of gaining interest income or that of disbursing interest income is unconstitutional, namely, that another date should be regarded as the date of obtaining interest income or that of disbursing it or that the particular tax should be paid according to a different procedure and in a different term.

However, it should be taken into account that the above mentioned Contested Norm is closely related with other Contested Norms. If those Contested Norms that

provide for paying the tax from interest income are recognized as unconstitutional and null and void, then 16.[1] (9) of the PIT Law shall also be recognized as null and void. Consequently, all three Contested Norms shall be assessed as a single regulatory framework that commits a person to paying the personal income tax from interest income (hereinafter – the Contested Restriction).

7. In order to assess constitutionality of the restriction, 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*).

8. In the case under review, the Applicants have contested the norms that were included into the PIT Law by the Amendments, as well as a norm of the Amendments that envisage crossing out of Section 9 (1) (3) of the PIT Law. In the present case, the fact whether the Amendments were adopted and proclaimed according to proper procedure; the case contains no evidence that would raise any doubt regarding the latter issue.

Consequently, the Contested Restriction has been established by law.

9. 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*).

Tax is a precondition of a nationally organized society and an indispensible part of the State policy (*see: Lazdiņš J. Ievads nodokļu tiesībās. Jurista Vārds, No. 40, 10 October 2006)*. Implementation of the fundamental principle of State financial life is regulated by Article 66 of the Satversme that provides that, before the beginning of each accounting year, the Saeima adopts the State budget of incomes and expenditures. Budget is an economic plan of the State, wherein incomes and expenditures of the State for a

definite accounting period are planned based on effective laws, tax laws included (*see: Dišlers K. Ievads Latvijas valststiesību zinātnē. Rīga, A. Gulbis, 1930, pp. 141).* 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. The fact that a person working in Latvia has the duty to pay taxes established by the legislator indirectly follows from Article 73 of the Satversme.

The Constitutional Court has already concluded in its case-law that collection of the personal income tax has been established in the interests of the society. Namely, the basic function of the personal income tax as a direct tax is the fiscal function, which ensures incomes in the national budget and municipal budgets. With the help of these incomes it is possible to fund prior social and economic activities, as well as to decrease inequality of the level of persons' incomes and welfare. Hence the national tax policy is used for achieving the objectives of the social policy. Therefore the State tax policy is also implemented to reach aims of its social policy. The greatest part of municipal budget incomes is ensured, and these incomes *inter alia* are shifted to realization of municipal social programmes (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 23*).

Consequently, the Contested Restriction does have a legitimate aim – protection of welfare of the society.

10. Having established 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 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 reasonable 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 Court 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*).

Nonetheless, the duty to pay taxes is inseparably related to establishing the resources ensuring implementation of this duty, namely, the State not only obligates the tax payers to pay taxes of a certain amount, but also provides for order of calculating and withholding taxes, and procedure of payment thereof, as well as the liability for failing to fulfil this duty (*see: Judgment of 11 April 2007 by the Constitutional Court in the case No. 2006-28-01, Para 13*).

Constitutional courts of other states have also drawn attention to the fact that, when establishing and implementing tax policy, a state enjoys a broad freedom of action. For instance, the Constitutional Court of the Republic of Latvia has emphasized that establishment of taxes is the exceptional constitutional competence of the legislator (Articles 67 and 127 of the Constitution). The taxed objects may be very different. The legislator, who has the duties arising from the Constitution to establish what is taxed, also has discretion to decide on exceptions (*see: Judgment of 22 December 2006 by the Constitutional Court of the Republic of Lithuania in the case No. 47/03, http://www.lrkt.lt/dokumentai/2006/r061222.htm).*

The Belgium Constitutional Court has indicated that 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 (*see: Judgment of 22 June 2005 by the Belgium Constitutional Court in the case No. 107/2005 B, Para 13.1, http://www.const-court.be).*

The German Federal Constitutional Court has established in its case-law that Article 14 (1) of the Basic Law for the German Federal Republic that establishes 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 does not have any substantial effect on his or her financial position (*see, e.g.: Judgment of 5 February 2002 by the Second Senate of the German Federal Constitutional Court in cases No. 2 BvR 305, 348/93, BVerfGE 105, 16<32>).*

When assessing limits of the freedom of action of the legislator regarding imposition of any tax on a particular object, it should be taken into account that the Satversme *expressis verbis* authorize the legislator to adopt the State budget, consequently, to establish State incomes and expenses. Consequently, the Satversme grants the legislator the authority to implement such fiscal policy that would ensure necessary income for the State. 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.

10.1. Taxes paid for income of persons almost in every state is a relevant source of incomes for the state. Income from capital, including interest income is also regarded as taxable income. In European States at present interest income are also taxed, although application procedure of such tax differ. For instance, in the German Federal Republic, such tax that considerably exceeds the tax established in the Contested Norms is imposed on capital income of a certain minimum amount (*see, e.g.: http://www.n-heydorn.de/abgeltungssteuer.html)*. In Austria *(see: http://www.gv.ris.bka.gv.at)* and in Great Britain *(see: Saeima's reply, case materials, Vol. 2, pp. 22*), the personal income tax is imposed on such income, the income being constituted of other income of a person, too. However, in Cyprus, tax rate for interest income depends on the type of the institution that disburses interest income (*see: Saeima's reply, case materials, Vol. 2, pp. 22*).

Taxation of income from money capital ensured incomes into the Latvian State budget already at the pre-occupational period, starting from 1918 (*see: Latviešu konversācijas vārdnīca, Vol. 15, Rīga, Grāmatu apgādniecība A. Gulbis, 1937, pp. 29113.-29114)*.

When discussing about the PIT draft law at the plenary session of 6 April 1993 of the Supreme Council of the Republic of Latvia, a representative of the Ministry of Economic Reforms, Deputy Head of the Tax Policy Department V. Bļinovs supported the concept that the personal income tax should be imposed on all incomes, including income from deposits in credit institutions. In his speech, he also referred to the regulatory framework of Section 455 of the Law "On Income Tax" that was effective at the pre-occupational period, namely, that the tax from capital income shall be deducted from: 2) dividends paid by stock companies to shareholders; 2) income from all kinds of securities

of State, local government and private institutions; 3) rent for different kinds of capital deposits in banks, bank accounts, and mutual credit banks. However, a member of the Saeima, a Chairman of the Economic Committee of the Supreme Council O. Kehris drew attention to the fact that this proposition of the Ministry of Economic Reforms should be assessed based on the economic situation in general, and it is also necessary to establish what is of greatest importance – to develop financial market and to facilitate accumulations or to favour consumption (*see: Transcript of the plenary session of 6 April 1993 of the Supreme Council, http://www.saeima.lv/steno/AP_steno/1993/st_930406v.htm).*

The Supreme Council of the Republic of Latvia adopted the PIT Law on May 1993, and it came into effect on 1 January 1994. Section 1 of this Law provided that the personal income tax is a tax imposed on income of a natural person. However, Section 9 thereof established exceptions from the general regulatory framework, i.e. types of untaxed income. Para 3 of this Section provided that the provisions of this Section would not apply to income from deposits in credit institutions.

Consequently, as to interest income, the legislator had established a more favourable tax order with the purpose to reach a particular aim of economic policy – to facilitate accumulation of money and development of financial market.

Already in December 2007 Para 5.70 of the Declaration on planned activities of the Cabinet of Ministers lead by I. Godmanis provided that it is necessary to elaborate a modern law on the personal income tax by establishing a well-considered and fair taxation of capital income (*see: http://www.mk.gov.lv/mk/vesture/godmana-valdiba-2).*

It cannot be denied that the regulation established in Section 9 (3) of the PIT Law was effective for a long time, and therefore persons could have obtained legitimate trust in constancy of the particular regulation. However, 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.

10.2. The Applicants hold that the legitimate aim could be reached even if the Contested Norms would be applied only to interest income from such deposits that were 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*). By applying the alternative measure referred to by the Applicants, the legitimate aim could not be reached at the same quality. The case contains no materials that would indicate any other alternative measures, by means of which the legitimate aim would be reached at the same quality.

Moreover, interest income has been established a lenient order, namely, considerably lower tax rate is applied to it if compared, for instance, with incomes from wage labour.

10.3. 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 (*see: Judgment of 19 June 2010 in the case No. 2010-02-01, Para 9.4.2*).

In the case-law of constitutional courts, 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, e.g.: Judgment of 18 May 2009 by Constitutional Court of the Republic of Spain in the case No. 116/2009, summary http://www.codices.coe.int).*

In the present case, it cannot be established that the Contested Norms would be applied to any of the Applicants with the so-called authentic retroactive force so that the tax would be applied to such income that a person has gained before coming into force of the Amendments.

The general principle of the PIT Law is that tax that is in force on the date of obtaining income is applied to incomes of a person. To illustrate, income of a person from a wage labour are taxed in accordance with the regulatory framework that is effective on the date of disbursing of the wage rather than on the date when a labour agreement is concluded. Income of a person from creative work are taxed pursuant to the

regulatory framework that is effective on the date of obtaining royalties rather than on the date when a person started executing a particular work. Income obtained by a person from fruits shall be taxed in accordance with the regulatory framework that is effective on the date of selling them rather than on the date of planning a tree.

Pursuant to this general principle, the personal income tax is also imposed on interest income of a person in accordance with the regulatory framework that is effective on the date of obtaining income rather than on the date when a person made a deposit.

Section 70 of the Credit Institutions Law provides that the interest shall be paid each year on 31 December and upon the complete repayment of a credit or a deposit. However, pursuant to Section 69 of the Credit Institutions Law, the amount of the interest rate and the procedures for the payment of interest shall be specified in the contract upon mutual agreement of the bank and the client. Consequently, depending on provisions of a particular agreement, different situations are possible in relation to the length of the period for obtaining capital interest by a person after coming into effect of the Amendments.

The general principle prevailing in the field of tax provides that taxation period shall be one year that corresponds to a calendar year. Section 7 of the PIT Law provides that "the annual income of the payer shall consist of the aggregate of money, natural values and services received within the whole taxation period (calendar year)". Also pursuant to Section 4 of the Law on Budget and Financial Management, "a financial year shall begin on 1 January and end on 31 December".

Persons had to take into consideration the fact that in case of State economic situation and needs would change, tax rates and tax reliefs 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 reliefs would remain unchanged during the entire period of the agreement.

Situations similar to the one considered in the present case have formed in case-law of constitutional courts of other states. For instance, the German Federal Constitutional Court has adopted a judgment in the case regarding revoking of tax reliefs in relation to income from certain fixed income securities, i.e. social mortgage bonds. The Court concluded that revoking of tax relief in relation to interest obtained from the

above mentioned securities does comply with constitutional requirements. The revocation had a retroactive effect because State interests and welfare of the society were of greater importance than personal interest of the applicant into preserving the previous order (*see: Judgment of 5 February 2002 by the German Federal Constitutional Court in the case No. 2 BvR 305, 348/93, BVerfGE 105, 16<32>).*

10.4. The Applicant M. Draudiņš also draws attention to a non-proportional restriction of the property right because, by imposing the personal income tax upon interest income, reduction of deposit value due to inflation has not been taken into consideration.

Unfortunately the Applicant did not take into account the fact that the invested capital is not taxed. Interest income only, a part of which must be paid as tax in accordance with a particular tax rate, is taxed. Since only interest income is taxed and only a small part of this income is paid as tax, it cannot be stated that the owner is denied the possibility to duly use his or her capital investments because they are taxed. Reduction in capital value due to inflation is not related with taxation of interest income. Statement of the Applicant is aimed at compensation for the reduction of money property value caused by inflation rather than to infringement of the fundamental rights caused by taxation. There is no such constitutional legal requirement that would commit the State, when directly refusing from taxation, should compensate reduction of money value caused by inflation.

The German Federal Constitutional Court neither established any infringement of the property right in the case initiated based on constitutional complaints regarding the fact that interest from deposits in credit institutions in 1971, 1973 and 1974 were taxed insofar as it did not exceed reduction of capital value at each particular year (*see: Judgment of 19 December 1978 by the German Federal Constitutional Court in the case No. 1 BvR 335, 427, 816/76, BVerfGE, 50, 57).*

10.5. When assessing proportionality of the Contested Restriction, the Constitutional Court takes into consideration what has been reported in the Saeima's reply, namely, that interest income is mainly characteristic to prosperous members of the society (*see: case materials, Vol. 2, pp. 20*). The Contested Norms are not aimed at income of those social groups that would need special protection by the State.

The Constitutional Court has already concluded that, when adopting the Contested Norms, Latvia underwent unprecedented economic recession (*see, e.g.: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01)*. Under such circumstances, measures to ensure incomes into the State budget were inevitable. They were generally applied to the majority of tax payers. If the State would not have taken measures to increase budget incomes but, instead, would have selected other solutions, in the result of which, for instance, inflation would increase, consequences to the Applicants and other persons having deposits in credit institutions would be more advantageous because, inflation would result in reduction of value of interest and deposits as well.

The benefit gained by the society from the Contested Norms as a part of body of measures aimed at ensuring budget incomes is greater than restriction of the fundamental rights and legitimate expectations of the Applicants.

Consequently, the Contested Restriction does comply with the principle of proportionality, and therefore the Contested Norms do comply with Article 1 and Article 105 of the Satversme.

The Constitutional Court

Based on Article 30 – 32 of the Constitutional Court Law

h o l d s :

1. Section 6 of the Law "Amendments to the Law on Personal Income Tax" of 1 December 2009 (Provision Envisaging Crossing out of Section 9 (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.

2. Section 8 (3) (13) and Section 16.1 (9) 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.

The Presiding Judge G. Kūtris

Translated by Egija Labanovka, translator of the Constitutional Court