THE CONSTITUTIONAL COURT
OF THE REPUBLIC OF LATVIA

JUDGMENT
ON THE BEHALF OF THE REPUBLIC OF LATVIA
Riga, June 8, 2007
in case No. 2007-01-01

The Republic of Latvia Constitutional Court, composed of the Chairman of the Court session Gunārs Kūtris as well as the Justices Kaspars Balodis, Aija Branta, Juris Jelāgins, Uldis Ķinis and Viktors Skudra,

having regard to the constitutional claim of Jānis Delis (hereinafter – submitter of the constitutional claim),

under Section 85 of the Constitution of the Republic of Latvia and Article 16 (Item 1), Article 17 (Item 11 of the first part), Article 19.[2] and Article 28.[1] of The Constitutional Court Law,

on January 21, 2006 at the Court session in writing examined the case

"On the Compliance of Words "up to 1 January 1996" of Part 2 of Section 13 and Part 3 of Section 13 of the Law "On Personal Income Tax" with Section 91 of the Constitution of the Republic of Latvia".

The Constitutional Court has established:

1. On May 11, 1993 the Supreme Council of the Republic of Latvia passed the Law "On Personal Income Tax" (hereinafter – the Law On Personal income Tax), and it came into force on January 1, 1994. The initial regulations provided that state pensions shall be considered as non-taxable income, i.e. no personal income tax shall be withheld from it.

On December 19, 1996 The Saeima of the Republic of Latvia (Parliament) (hereinafter – the Saeima) passed the Law "On Amendments to Law "On Personal Income Tax"". Item 10 of the third part of Article 8 establishes that pensions disregarding their distribution source shall be considered as a source of taxable annual earnings. However the wording of Item 2 of the first part of Section 13 of the Law On Personal Income Tax provides:

"for persons to whom a pension has been granted up to 1 January 1996 in conformity with the Law On State Pensions, the non-taxable minimum shall be in the amount of this pension."

On the other hand, the wording of Item 3 of the first part of Section 13 of the Law on personal Income Tax provides:

"for persons to whom a pension has been granted or calculated after 1 January 1996 in conformity with the Law On State Pensions or to whom a service pension or a special State pension has been granted or calculated in conformity with the regulatory enactments of the Republic of Latvia, the non-taxable minimum for these pensions shall be 1200 lats a year."

It was established in the Law of December 19, 1996 "On Amendments to the Law "On Personal Income Tax"" that it came into force on January 1, 1997.

On October 20, 2005 the Saeima passed the Law "On Amendments to the Law "On Personal Income Tax". Hence the wording of Item 3 of the first part of Section 13 of the Law On Personal Income Tax provides:

"for persons to whom a pension has been granted or recalculated after 1 January 1996 or specified a supplement to the pension for length of insurance standing, which has been accumulated up to December 31, 1995 in conformity with the Law On State Pensions or to whom a service pension or a special State pension has been granted or calculated in conformity with the regulatory enactments of the Republic of Latvia, the non-taxable minimum for such pensions (together with the supplement for accumulated length of insurance standing) shall be 1320 lats per year."

On June 8, 2006 the Saeima passed the Law "On Amendments to the Law "On Personal Income Tax"". Hence the wording of Item 3 of the first part of Section 13 of the Law On Personal Income Tax provides:

"for persons to whom a pension has been granted or recalculated after January 1, 1996 or specified a supplement to the pension for length of insurance standing, which has been accumulated up to December 31, 1995 in conformity with the Law On State Pensions or to whom a service pension or a special State pension has been granted or calculated in conformity with the regulatory enactments of the Republic of Latvia, the non-taxable minimum for such pensions (together with the supplement for accumulated length of insurance standing) shall be 1980 lats per year."

Amendments to Item 3 of the first part of Section 13 came into force on October 1, 2006.

2. The submitter of the constitutional claim holds that he was granted the old age pension on June 1, 2003, and its amount is 210.23 lats. Hence the personal income tax is withheld form the part of the pension that exceeds 165 lats. Hence words and figures "up to 1 January 1996" of Item 2 of the first part of Section 13 of the Law On Personal Income Tax and Item 3 of the first part of Section 13 (hereinafter – the contested regulations) are in conflict with Section 91 of the Constitution of the Republic of Latvia (hereinafter – the Satversme).

When evaluating constitutionality of the contested regulations, one has to take into account the fact that all persons to whom these regulations refer are receivers of the state pension. The only difference is the period when the pension is granted. Hence it is possible to establish that persons who receive old age pensions enjoy equal and comparable conditions.

Since the personal income tax is withdrew only from those pensions that were granted after January 1, 1996, one has to conclude that the contested regulations provide for different treatment of the receivers of the state pension.

The submitter of the constitutional claim, by referring to the jurisprudence of the Constitutional Court, holds that the above different treatment has no reasonable grounds. Namely, capital of the pension depends directly on the amount of state social

insurance payments under the Law "On State Social Insurance". A person as a performer of social insurance payments pays taxes and thus builds his/her own capital. But when the person becomes a recipient of social insurance services, the personal income tax is imposed on expenses from this capital if the amount of these expenses exceeds 1980 lats per year. The submitter of the claim holds that the personal income tax is imposed on incomes that have already been taxed.

The submitter of the claim holds that it follows from the basic principle of social insurance that social insurance funds can not be used otherwise than established; e.g., for social payments. The above funds can be used only for provision of social insurance services.

Taking into consideration the aforesaid, the submitter of the claim requests the Constitutional Court to declare the contested norms as being in conflict with Section 91 of the Satversme and to invalidate them from the moment when they came into force, i.e. since January 1, 1997.

3. The institution that passed the contested provisions – the Saeima – holds that the claim is ungrounded and the contested norms comply with the Satversme. In order to asses the compliance of the contested provisions with the principle of legal equality provided for in the first sentence of Section 91 of the Satversme, first of all it is necessary to establish what persons are in equal or, in accordance with particular criteria, comparable conditions and whether the contested provisions provide for different treatment of these groups, rights of which should be equal.

The Saeima recognizes as an important condition the fact that there are several pensions mentioned in the Item 2 of the first part of Section 13 of the Law on Persona Income Tax (old-age pension, special pension and service pension); these pensions are both, the ones that are formed from state social insurance payments and disbursed from the national social budget and the ones that are funded from the basic national budget (long service pension and special pension) and are not formed in the framework of the social insurance system, but are calculated and disbursed at the amount and in the order established in special laws.

When assessing the pensions that are formed out of state social insurance payments, one has to take into consideration two important conditions; first, personal expenses for social insurance payments are not liable to the personal income tax; and secondly, the principle of solidarity is observed in the state social insurance system.

Hence the Saeima holds that, when making state social insurance payments and disbursing a pension as accumulation of this sum form the special budget of the State, no double taxation of incomes takes place. The incomes are taxed only once, which is – when disbursing a pension if it exceeds 165 lats.

The Saeima also holds that the pension system, under Section 91 of the Satversme, does not provide people for protected rights to request a recognizable share, but it allows hoping that the persons shall receive material support that would depend on circumstances at the moment when a person is granted a pension. A possibility for a person to request a recognizable share can be used in cases when an old age pension is granted to a person who became employed or started making social insurance payments after January 1, 1996. Hence one can conclude that the contested provisions do not provide for double taxation of person's incomes with the personal income tax because the personal income tax is imposed on the pension that is formed not in the result of personal payments but in accordance with the principle of solidarity.

The opinion of the submitter of the claim that under the contested provisions all persons who receive pensions are in equal and comparable conditions also is ungrounded. This means that only those persons who receive a pension in the framework of the social insurance system enjoy equal and comparable conditions.

The contested provisions provide for a different treatment of different groups of people, but such treatment may not serve as grounds for restriction of certain basic rights of people. The case concerns observation of the principle of legal equality, rather than consideration of the above principle together with some other rights (e.g., right to own property or right to social security).

The Saeima holds that the necessity of the contested provision results from economic considerations, i.e. one of the main considerations when resolving taxation

of pensions depending on the year when the pension was granted was the small amount of a pension. Up to January 1, 1996 the amount of granted pensions was considerably lower than non-taxable minimum established for pensions (at that period the non-taxable minimum per month was 100 lats, but in the first quarter of 1997 the average amount of the above pensions was 40.56 lats), which is why Item 2 of the first part of Section 13 is included in the Law On Personal Income Tax.

Moreover, this item has only of a concretizing nature because none of the pensions that were granted before January 1, 1996 and was not recalculated after the above date, exceeds the non-taxable minimum provided for in Item 3 of the first part of Section 13. Whereas, if the pension granted before January 1, 1996 was recalculated due to additional social insurance payments, then Item 3 of the first part of Section 13 can be applicable to this pension.

The Seaima informs that in December 2006 only 22 328 out of 575 928 pensioners, which is about 4%, received a pension that exceeded 165 lats.

The Saeima indicates that the question concerning personal incomes that should be taxed is the issue of national tax policy, i.e. it is an exclusive competence of the legislator. No person has subjective public right not to pay taxes, and no provision is included in the Satversme, which would provide that tax payment on its own is restriction of basic rights.

Hence the Saeima concludes that different attitude defined by the contested provisions has an objective and a reasonable basis, and it requests the Constitutional Court to declare the constitutional claim as ungrounded, and the contested provisions – as being in compliance with the first sentence of Section 91 of the Satversme.

4. Law Enforcement Institution of the Republic of Latvia (hereinafter – the Law Enforcement Institution) indicates that the contested provisions regulate allowances for payers of the personal income tax and it should be regarded in the context of Item 10 of the third part of Section 8 of the Law On Personal Income Tax. Hence one can consider that the submitter of the claim in fact contests Item 10 of the third part of Section 8 of the above Law that includes pensions into the list of incomes that personal income tax shall be imposed upon.

When assessing the compliance of the contested provisions with the first sentence of Section 91 of the Satversme, the Law Enforcement Institution expresses opinion, - that different treatment when defining taxes from pensions has no objective and reasonable grounds. However this does not give an answer to the question whether taxation of pensions complies with the basic rights established in the Satversme. In order to find it out, the particular provision should be assessed in relation to those rights established in the Satversme that could be limited by the regulation, namely, right to own property guaranteed by Section 105 of the Satversme and right to social security guaranteed in Section 109 of the Satversme.

In accordance with the jurisprudence of European Court of Human Rights (ECHR), it can be concluded that the pensions defined by the contested provisions are to be considered a property. Hence the above rights enjoy protection of property. Unlike what has been mentioned in the answer of the Saeima, the fact whether the particular payment is based on payments made by the recipient play no significant role.

Personal income tax as restriction of rights to own property is statutory. Its direct objective is creation of the national budget, and it can be acknowledged as a significant prerequisite of fulfilment of state functions. Hence one achieves the legitimate objective of restriction of the basic rights included in Section 116 of the Satversme – rights of welfare, rights of other people and public safety. Taking into consideration the aforesaid, one can conclude that under the Law On Personal Income Tax the tax rate of 25%, which is applied after subtracting the non-taxable minimum – 165 lats per month, do not violate the "core" of the rights to own property. This amount of the tax can be considered as a proportionate restriction of rights to own property that is admissible in order to ensure formation of the national budget and reach the above legitimate objectives.

Hence the Law Enforcement Institution expresses the opinion that the contested regulation that provides for taxation of pensions does not violate the rights to own property. This opinion can be regarded as a proportionate restriction of rights to own property established in the framework of freedom of action of the State that can be justified by the necessity to form the national budget in order to reach legitimate

objectives – welfare of the society, provision of rights of other people and guaranteeing public safety.

When assessing the compliance of the contested provisions with Section 109 of the Satversme, the Law Enforcement Institution holds that social security – a pension – is guaranteed by the Law "On State Pensions", as well as other special laws. Whereas Law On Personal Income Tax restricts the guaranteed social security by decreasing its amount due to the withheld tax. When assessing restricting of such rights and social security, one can conclude that it is statutory and it is justified by the necessity to form the national budget in order to reach legitimate objective - welfare of the society, provision of rights of other people and guaranteeing public safety.

As to proportionality of the restriction, the Law Enforcement Institution indicates that the Legislator has determined the non-taxable minimum – 1980 lats per year or 165 lats per month. Such non-taxable minimum considerably decreases the restriction caused for persons. Hence one can conclude that by imposing the personal income tax on pensions, the legislator has not exceeded the commissioned freedom of action by ensuring an efficient fulfilment of rights to pension.

The Law Enforcement Institution considers that the amount that is liable to the personal income tax should be regarded taking into consideration the existing inflation and ongoing pension indexation. First of all, inflation has an impact on the fact that pension that is disbursed to a person gradually looses its purchasing capacity while the pension remains the same. Secondly, pension indexation influences the fact that if a pension initially is not taxed, it can reach the threshold of non-taxable minimum and it can be submitted to taxation. In this case, increase of pensions that emerges in the result of indexation is not reflected in the amount of disbursed pension. This circumstance would, in fact, also decrease purchasing capacity of the received pension and the amount of social security provided for a person, as well.

The Law Enforcement Institution holds: for performance of the duty to gradually increase the amount of offered social security, the state has to regularly reconsider the non-taxable minimum related to the personal income tax.

In accordance with the aforesaid, the Law Enforcement Institution holds that the provision under which the part of the pension that exceeds the amount of 165 lats per months is liable to the personal income tax is not in conflict with the rights to own property established in Section 105 of the Satversme, nor with rights to social security established in Section 109 of the Satversme. Hence consideration of the contested provisions together with eventually related basic rights still does not give an answer to the question – what should be the attitude of the legislator towards mutually comparable groups of recipients of pensions. Hence the questions about whether the pensions of recipients of a pension should or should not be charged with personal income tax is to be solved by the Legislator for it falls within the scope of freedom of action of the Legislator.

In the present wording of the Law, legal equality of mutually comparable groups is established, but the question about the ways how to balance the attitude of the state falls within the scope of the Legislator. Hence the Law Enforcement Institution requires to the Constitutional Court to determine the date after which the contested norms would become invalid if the Legislator will not have been passed regulations that would correspond to the equality principle.

5. The Ministry of Finance of the Republic of Latvia indicates that the basic function of a tax is a fiscal function, which ensures regular incomes into the budget. Moreover, the greatest part of the personal income tax is transferred into the budget of the local government thus ensuring funding of social service measures for socially unprotected people living in the particular territory.

The Ministry of Finance indicates that there exists a general principle, according to which all incomes of a natural person shall be charged with the personal income tax. The object of the personal income tax is all incomes of a natural person disregarding the source or its acquisition. However, taking into account considerations of expedience, the State can exempt definite kinds of incomes from taxation (for instance, scholarships, inheritance or compensations) or incomes of particular categories of persons.

When evaluating the compliance of the provisions of the Law On Personal Income Tax with the basic rights established in Section 105 and Section 109 of the

Satversme, the Ministry indicates that the objective of Section 109 of the Satversme is to guarantee subsistence for a person by providing rights to social security in old age but without changing the particular scheme of calculation of a pension or other issues related to social security. Taking into account economic potentialities of Latvia, the contested provisions guarantee this social security. Hence the contested provisions do not violate realization of rights guaranteed by Section 91 and Section 109 of the Satversme. Whereas Section 105 of the Satversme guarantees rights to own property, and provisions of this Section may not restrict rights of the State to pass laws that the State considers as being necessary for conmtrolling utilization of property in accordance with common interests or in order to ensure reception of taxes or fines.

The Ministry of Finance admits that one of the main reasons why the Law On Personal Income Tax provides for different treatment when taxing pensions depending of the year of granting the pension is amount of a pension. Amounts of pensions granted before 1996 were considerably lower than the non taxable minimum of that period, and the granted pensions were not recalculated.

These pensions were recalculated on November 1, 1993, and their amount was defined depending on the length of service of insurance and average wage of persons who were employed in the national economy at the particular period of time. The Ministry holds that the non-taxable minimum provided for in Article 13 of the Law On Personal Income Tax differs depending of the year when the pension was granted (recalculated). In fact this can be regarded as violation of the principle of equality because pensions that were granted before 1996 and that were not recalculated after the above date or that are not provided for additional payment for the length of service of insurance that was accumulated till December 31, 1996 (i.e. pensions that are never taxed) do not reach the taxable minimum in their amount.

Hence the Ministry of Finance holds a view that all pensioners – those who were granted a pension before January 1, 1996 and those who were granted a pension or the pension was recalculated after the above date, in fact find themselves in an equal situation. Taking into account amounts of pensions of these pensioners, as well as the fact that these pensioners are mainly old-aged people and disabled persons, one has also taken into consideration the principle of proportionality.

6. The Ministry of Welfare of the Republic of Latvia holds that one of the considerations why in January 1, 1997 the legal provision that provides that pensions shall be considered a kind of incomes of natural persons that shall be taxed into the Law on Personal Income Tax is changes in the order of recalculation of state pensions. This means that the initial capital of an old-age pension (i.e. capital of a pension for the time period till January 1, 1996, when personalized accounting of social insurance payments was introduced) in 1996 was calculated basing on average social insurance payment in the State in 1995. Whereas, since 1997 the basis of the calculation of a pension was the average wage, from which social insurance payments were made in the time period from January 1, 1996 to December 32, 1999 (depending on the year of demanding a pension). Thus changes in the amount of pensions could be foreseen.

The Ministry of Welfare holds that pensions are not the object of state social mandatory payments since no sate social mandatory payments have to be made from pensions. The above opinion is justified by Section 14 of the Law "On State Social Insurance" which establishes that state pensions shall not be the object of state social insurance mandatory contributions.

7. The Institute of Economy of the Latvian Academy of Sciences does not find justification for the fact why the contested provisions divide pensioners into two groups due to the time when pensions were granted. Whereas one should recognize as correct the arguments of the submitter of the claim that this division does not comply with the principle of equality established by Section 91 of the Satversme.

It was also indicated that the Institute of Economy of the Latvian Academy of Science has no information at its disposition regarding possible reduction of the budget in the case if the regulation that provides that personal income tax should be withheld form pensions would be cancelled. If this sum is insignificant, one of the solutions could be ascription of this tax to all kinds of pensions disregarding the time of their granting and, correspondingly, increase of the non-taxable minimum of a pension.

8. The director of the Institute of Accounting of the Faculty of Economics and Management of the University of Latvia, professor Dr.oec. Inta Brūna holds that imposing the personal income tax on a pension disregarding its amount means double taxation of incomes of the same origin.

Similarly, looking from the point of ethical considerations, imposition of the personal income tax on pensions does not manifest care of the society for improvement of living conditions of old-age people.

At the same time I. Brūna holds: Item 24 of the first part of Artice 9 of the Law On Personal Income Tax establishes that the personal income tax shall not be imposed upon income from the investment of payments in private pension funds. In this case one can clearly see that requirements of the Law are not balanced.

9. The professor of the Institute of Finances of the University of Latvia Dr.oec. Lūcija Kavale indicates that in accordance with the Law On Personal Income Tax, social insurance mandatory payments, when acquiring the form of a pension, are submitted to taxation. This means unequal attitude towards different kinds of personal incomes – a wage and a pension, and this is not fair.

L. Kavale also holds that only about 4 percents form pensioners receive a pensions that constitutes more than 1980 lats per year, which is why impact of incomes that the State would receive after imposing the personal income tax on pensions, is insignificant.

The Constitutional Court holds that:

10. The case is initiated on the on the Compliance of words "up to 1 January 1996" of Part 2 of Section 13 "Relief for a Payer" and Part 3 of Section 13 of the Law "On Personal Income Tax" with Section 91 of the Satversme of the Republic of Latvia. Item 2 of the first par of Section 14 of the Law provides relief for those groups of pensioners who were granted a pensions in accordance with the Law "On State Pensions" of November 29, 1990 (hereinafter – Pension Law of 1990). But relief provided for in Item 3 of the first part of Section 13 of the Law is referable to pensioners that were granted a pension under the Law "On State Pensions" of November 2, 1995 (hereinafter – Pension Law of 1995), as well as to the groups of pensioners who were granted a pensions due to some special laws (long service pension and special state pension).

It follows from the constitutional claim that the old age pension was granted to the submitter of the claim in 2003 under the Pension Law of 1995. But in the contested Item 3 of the first par of Section 13 of the Personal Income Law, several kinds of pensions are mentioned – old age pensions, long service pension and special state pension. Hence one can conclude that the submitter of the claim does not contest the entire Item 3 of the first part of Section 13 of the Law On Personal Income Tax, but its words *"for persons to whom a pension has been granted or recalculated after January 1, 1996 or specified a supplement to the pension for length of insurance standing, which has been accumulated up to December 31, 1995 in conformity with the Law On State Pensions […], the non-taxable minimum for such pensions (together with the supplement for accumulated length of insurance standing) shall be 1980 lats per year".* This means that relieves that, by this provision, are provided for those groups of pensioners who are granted a pension under other legal acts do not violate rights of the submitter of the claim.

Hence the legal interests of the submitter of the claim concern only the provision of Item 3 of the first part of Section 13 of the Law On Personal Income Tax which is applicable to the group of pensioners who are granted an old age pension.

11. The submitter of the claim indicates that the contested provisions provide for different treatment of those persons who are granted a pension before January 1, 1996 and persons who were granted a pension after the above date. The different treatment manifests itself in a way that the non-taxable minimum of the first group is equal to the amount of the pensions, but that of the second group – 1980 lats per year or 165 lats per month.

Section 91 of the Satversme provides:

"All human beings in Latvia shall be equal before the law and the courts. Human rights shall be realised without discrimination of any kind."

It follows from the constitutional claim that it is necessary to asses the compliance of the contested provisions only with the first sentence of Section 91 of the Satversme, which guarantees equality of persons. Therefore, in the frameworks of this

case, the contested provisions will be analysed not in the context of principle of prohibition of discrimination but that of equality.

The Constitutional Court has reiterated that the principle of equality prohibits the state institutions to pass provisions that provide for different treatment of persons who enjoy equal conditions without reasonable basis *(see, e.g.: Judgment of the Constitutional Court in the case No. 2001-07-0103, December 5, 2001, Para 3 of the Concluding Part).*

The principle of equality should guarantee existence of a common legal procedure. This means that its task is to ensure that such requirement of a judicial state as comprehensive influence of a law on each persons and application of a law without any privilege is realized. This guarantees a complete influence of a law, objectiveness and impassiveness of its application, as well as that everyone shall observe the instruction of the law (*see: Judgment of the Constitutional Court in the Case No. 2005-02-0106, September 5, 2005, Para 9.1).* However unity of legal procedure does not mean levelling since "Equality allows a differentiated approach, if it can be justified in a democratic society" (*judgment of the Constitutional Court in the case No. 2001-02-0106, June 26, 2001, Para 4).*

Hereby the principle of equality admits and even requires different treatment of persons who enjoy different conditions, as well as it permits different treatment of persons who enjoy equal conditions if this has objective and reasonable grounds *(see: Judgment of the Constitutional Court in the case No. 2000-07-0409, April 3, 2001, Para 1 of the Concluding Part).*

Different treatment has no objective and justified grounds if it has no legitimate objective or there are no proportionate relations between means selected and objectives defined (*see: Judgment of the Constitutional Court in the case No. 2002-15-01, December 23, 2002, Para 3 of the Concluding Part).*

Hence, when assessing the compliance of the contested provisions with Section 91 of the Satversme, it is necessary to investigate whether:

1) persons (groups of persons) enjoy equal or comparable conditions;

2) the contested provisions provide for different treatment;

3) different treatment has an objective and reasonable grounds, i.e. whether this is a legitimate objective and whether the principle of proportionality is observed.

12. In order to find out which persons (groups of persons) enjoy equal and, according to definite criteria, comparable conditions, it is necessary to define the common characteristic trait of these persons (groups of persons).

The subjects of the contested norms are persons who receive an age pension or social budget payment of social security guaranteed by the State. Hereby it is possible to conclude that both, those persons who were granted a pension under the Pension Law of 1990 and those who were granted a pension under the Pension Law of 1995 enjoy equal and comparable conditions. Pensions of both groups can be admitted as age pensions, they are allocated in a similar order and they are paid from the state social budget.

Hence the persons who receive old age pensions under the Pension Law of 1990 and the Pension Law of 1995 enjoy equal and comparable conditions.

13. In order to find out whether the contested provisions provide for different treatment, it is necessary to assess consequences that could be caused in the result of application of the contested provisions.

It follows from the contested provisions, that old age pensions that were granted before January 1, 1996, are fully exempted from taxation with the personal income tax. But the pensions that were granted after the above date are charged with the personal income tax if they exceed 1980 lats per year or 165 lats per month. Hence the equal treatment manifests itself through the condition that the fact whether pensions are or, on contrary, are not charged with the personal income tax depends on the date of granting a pension.

Such treatment is also determined by the Cabinet of Ministers in Articles 110 and 112 of the Regulation of the Cabinet of Ministers of September 29, 21006 No. 793 (hereinafter Regulation No. 793) that specifies application of tax relieves for pensions.

Hence the contested provisions provide for different treatment.

14. The submitter of the claim holds a view that the different treatment has no reasonable basis. If the personal income tax is not imposed on the old age pensions that were granted before January 1, 1996 taking into consideration the principle of redistribution, then it should not be imposed on pensions that depend directly on payments of social insurance. Hence, as the submitter of the constitutional claim holds, already made social insurance contributions are being taxed.

In the period when old age pensions were granted to persons, the length of service of whom was formed before 1996, the system of social insurance was not applicable to these pensions (Article 12 of the Pension Law of 1995 and Paragraph 13 of the Transitional Provisions). Hence in calculation of pensions not only the capital of a pension that was registered from 1 January 1996 and does not correspond to contributions made by the person, but also initial capital is taken into account. This, in its turn, is determined for the period of employment till December 31, 1995 taking into account average wage form making social insurance payments for the later period of time – from January 1, 1996 to December 31, 1999 (depending on the year of retirement). Hence it becomes obvious that the calculated pensions in general are not adequate with the individual contributions of a person during the entire period of employment *(see: Judgment of the Constitutional Court of March 19, 2002 in the case No. 2001–12–01, Para 1 of the Concluding Part).*

Thereby the amount of a pension depends not on the amount of the tax that a person has paid under the Law of December 14, of 1990 "On Social Tax", but on the average wage for making social insurance comtributions for the time period from January 1, 1996 to December 31, 1999. The fact that from January 1, 1991 to December 31, 1995 a person was liable to pay the social tax can serve as grounds for admission of the contested provisions as being in conflict with the Satversme. In such situation no causal relationship is formed between person's social insurance contributions for the above period and the old age pension granted in 2003.

One also has to take into consideration the fact that, in accordance with Item 1 of the first part of Section 10 of the Law on Personal Income Tax, before taxation of incomes, the sum of the social tax and state mandatory social insurance payments are

subtracted from the total of taxable annual earnings. In the annotation of Section 10 of the Draft Law "Amendments to the Law "On Personal Income Tax"" it was established: "The fact that the sum of social tax is subtracted from the wage of a person before calculation of personal income tax does not mean that the social tax shall be paid from the income that is not taxed. In other words, payments in to the state pension fund shall not be taxed. This principle is into force since January 1, 1994 and have not been amended since creation of tax system of Latvia" *(see: Volume 2 of the material of the case, pp. 6 – 9 and pp.12).*

15. The Saeima in its letter justifies the different treatment of two groups of pensioners by the following arguments:

1) In January 1, 1996 the Pension Law of 1995 came into force and it provided for another way of calculation of pensions. It is based on the system of pension insurance that is established on the basis of the principle of solidarity and operates between generations, as well as in the framework of generations (*inter alia* between receivers of services);

2) pensions that were granted before January 1, 1996 under the Pension Law of 1990 were considerably lower that the non-taxable minimum – 1200 lats per year or 100 lats per month;

3) pensions that were granted till January 1, 1996 were not recalculated.

When assessing the fact whether the contested provisions justifiably contain the boundary "January 1, 1996", it is necessary to inspect the historical conditions of creation of the contested provisions.

During the period from 1994 to 1996 there was a political discussion about imposing the personal income tax on pensions. In the result of the discussions, there was a compromise made, which provided that pensions shall be included into the list of taxable incomes with a condition that pensions that were granted before January 1, 1996 shall not be taxed *(see: Volume 1 of the materials of the case, pp. 41, 42 and pp.166 and Volume 2, pp.49).*

In accordance with the arrangement, the Ministry of Finance in September 27, 1996 elaborated a Draft Law "Amendments to the Law "On Personal Income Tax"". It included a principle, under which pensions were acknowledged as an object of personal income tax. It is indicated in the annotation of the Draft Law that: "total increase of expected income depends on the approach accepted for taxation of receivers of pensions. This questions can be divided into two parts; on the one hand, one considers a group of pensioners who were granted a pension before January 1, 1996, and, on the other, a group of pensioners who were granted a pension after January 1, 1996" *(see: Volume 2 of the materials of the case, pp.51).*

The above amendments were passed by the Saeima by providing in Item 3 of the first part of Article 13 that the non-taxable minimum for pensions that were granted after January 1, 1996 shall be 1200 lats per year *(see: Volume 1 of the materials of the case, pp.100).*

One can conclude from these documents that the boundary between the two groups of pensioners – January 1, 1996 – is not unintentional since the decision about realization of such approach in the Law on Personal Income Tax has been made in the result of long political discussions.

However the fact that this division has formed in the result of long political discussions does not justify on its own, nor denies the argument of the submitter of the claim concerning incompliance of the contested provisions with Section of 91 of the Satversme. In order to establish whether the contested provisions do not violate what has been established in the Satversme, it is necessary to investigate whether the date "January 1, 1996" that is provided for in these provisions has objective and reasonable grounds.

The Saeima indicates that this date is related to enactment of Pension Law of 1995, because it was prognosticated that pensions would rise. The pensions allocated before the above date were small and these pensions were not recalculated.

The date "January 1, 1996" that divides receivers of a pension into two groups is justified with the fact that in this date Pension law of 1995 came into force and it established fundamentally new order of pension calculation. Simultaneously guarantee

mechanism was incorporated in the Law On Personal Income Law and it protected those pensioners who were granted a pension before January 1, 1996 and whose pensions were not recalculated, i.e. these pensions were not taxed.

It follows form the materials of the case that in 1996, 56 pensioners received a pension that is higher that 100 lats, but the average amount of pensions was 40.56 lats (see: Volume 2 of the materials of the case, pp. 25 and pp. 155). Taking into account the small amount of these pensions, it is important not to tax them, although in the result of pension indexation, pensions of some persons would exceed the non-taxable minimum provided for in Item 3 of the first par of Section 13 of the Law On Personal Income Tax.

If a pensioner who was granted a pension before January 1, 1996 took advantage of the rights to recalculate the pensions then the provisions of Item 3 of the first part of Section 13 of Law On Personal Income Tax is applicable to the person. Hence the personal income tax is imposed on pensions that exceed 165 lats per month.

Hence the approach of the legislator, in accordance to which pensioners are divided into two groups due to the date of granting a pension, has objective grounds and is proportionate with the objective to provide relieves for the pensioners who were granted a pensions before January 1, 1996.

The date "January 1, 1996" included in the contested provisions is established by maintaining reasonable grounds – for introduction of the new pension system.

16. Passing of any law is the result of a political compromise, which is why the Constitutional Court has to refrain from assessing political issues because initially are at the jurisdiction of the democratically legitimized legislator *(see: Judgment of the Constitutional Court of November 11, 2005 in the case No. 2005-08-01, Para 9).*

The Constitutional Court has to investigate whether the legislator, when establishing the differentiated approach in taxation of pension, has not assumed without reason violation of basic rights of the submitter of the claim. Moreover, the Court has held that "in the period, when also the persons, employed before January 1, 1996 require granting of pensions […], the insurance system cannot be attributed to

them" *(judgment of the Constitutional Court of November 1, 2005 in the Case No. 2005-08-01, Para 9.2).*

As unsound can be regarded the argument of the submitter of the claim that the pension granted to him depends directly on the social insurance instalments made. Pensions of pensioners whose length of service began since 1 January 1996 was calculated taking into account not only Article 12 of the Pension Law of 1995, but also Paragraph 13 of the Transitional Provisions. Hence it becomes obvious that the calculated pension is not adequate to individual contributions of a person during the entire period of employment *(see: Judgment of the Constitutional Court of March 19, 2002 in the case No. 2001–12–01, Para 1 of the Concluding Part).*

The Constitutional Court holds that the legislator has justifiably divided receivers of old age pensions into two groups by using the date when the Pension Law of 1995 came into force as a boundary, and it has adopted different attitude towards each of the groups. This is not in conflict with the principle established in the first sentence of Section 91 of the Satversme.

Hence words and figures "up to January 1, 1996" of the Item 1 of the first part and Item 3 of Section 13 of the Law On Personal Income Tax complies with Section 91 of the Satversme.

17. Although the Constitutional Court declared the contested provisions as being in conflict with Section 91 of the Satversme, one has to take in to account that the rights, provided for in Section 91 of the Satversme are "comparable", namely, they may require equal attitude but - just by themselves – they cannot reveal what the above attitude shall be, namely, favourable or unfavourable *(see: Judgment of the Constitutional Court of November 8, 2006 in the case No. 2006-04-01, Para 15.1).*

For example, if it were concluded that determination of deductions violates the principle of equality, one shall know only the fact that the above deductions had to be established either to all pensioners disregarding the date of granting a pension or to no one. To choose one of the solutions, other reasons, which are out of the framework of the notion of equality, shall be used.

18. Similarly one has to take into account that the case was initiated on the compliance of words and figures "up to January 1, 1996" of Item 2 and Item 3 of the first par of Section 13 of the Law On Personal Income Tax with Section 91 of the Satversme. However the Saeima, in its answer assessed whether pensions are justifiably included into the list of incomes chargeable with the personal income tax. The Saeima held that "the submitter of the claim wants to paraphrase provisions on relieves on personal income tax in order to exclude, in fact, Item 10 of the third par of Section 8 of the Law On Personal Income Tax" *(Volume 2 of the materials of the case, pp.155).*

The Law Enforcement institution in its conclusions held that the submitter of the claim, by contesting the non-equal attitude provided for by the provisions, in fact wants to achieve that for all receivers of pensions the non-taxable minimum would constitute the entire amount of the pension. Hence one can conclude that the submitter of the claim, in fact, contests Item 10 of the third part of Section 8 of the Law On Personal Income Tax, which includes pensions in to the list of incomes chargeable with the personal income tax.

Item 10 of the third part of Section 8 of the Law On Personal Income Tax provides that pensions irrespective of the source of payment shall be regarded as the rest of the income of a natural person that should be taxed. This provision includes the common principle that provides that all pensions (e.g. old age pensions, long service pensions or special pensions) shall be included into the list of incomes chargeable with the personal income tax. It follows from the constitutional claim of the submitter, that the regulation that provides that age pensions shall be charged with the personal income tax is contested.

Item 10 of the third part of Section 8 of the Law On Personal Income Law equally relates to old age pensions that was granted the submitter of the claim in accordance with the Pension law of 1995, as well as special pensions or long service pensions. Taking into account the fact that the submitter of the claim was granted an old age pension, application of this provision to the old age pension affects his legal interests.

But Section 13 of the Law On Personal Income Tax provides only for relieves for payers of the personal income tax. If no legal order established in the contested provisions, which *expressis verbis* is contested in the constitutional claim, existed, then the pension of the submitter of the claim or pensions of other persons, as well as special pensions and long service pensions, for which no non-taxable minimum is defined, would be charged with the personal income tax, i.e. they would fully become the taxable income.

Hence the Constitutional Court taking into account *inter alia* the principle of the unity of the Satversme has to assess whether the provision of Item 10 of the third part of Section 8 of the Law on Personal Income Tax, in accordance to which old age pensions are included into the list of incomes chargeable with the personal income tax (hereinafter also – the contested provision).

19. 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 rights, as well as it is related to other restrictions established in the Law that should be proportionate with the legitimate objective – protection of constitutionally significant values *(see: Judgment of the Constitutional Court of April 11, 2007 in the case No. 2006-28-01, Para 19.1).*

Although the Constitutional Court *expressis verbis* has declared that the liability to pay taxes always means restriction of property rights, one should also hold that it has not expressively indicated in the previous case-law whether rights to old age pension *per se* are protected by Section 105 of the Satversme.

Therefore the Constitutional Court has to investigate whether rights to disbursement of a pension pertain to the context of the notion "property" included in the first sentence of Section 105 of the Satversme.

20. In the answer of the Saeima it is indicated that after January 1, 1996 the present system "does not provide people for protected rights to request a recognizable share, but it allows hoping that the persons shall receive material support that would depend on circumstances at the moment when a person is granted a pension. A possibility for a person to request a recognizable share can be used in cases when an

old-age pension is granted to a person who became employed or started making social insurance payments after January 1, 1996".

This conclusion of the Saeima is to be recognized as unsubstantiated since it is based on Para 1 and Para 2 of the Judgment of the Constitutional Court of June 26, 2001 in the case No. 2001-02-0106 of the concluding part where the pension system of Latvia that exists since January 1, 1996 was analysed.

One has to take into account that the above pension system was based on the principle of solidarity, which provided for responsibility of the entire society and did not form a direct link between contributions and amount of a pension. Pensions of this system were based on the so-called collective security principle and they could not be granted by assessing one's personal contribution. Moreover, this system did not motivate employees to make their social contributions, which is the source of pension disbursement *(see: Pensions will Rise along with Wages, Latvijas Vēstnesis, No 12, January 23, 2004).*

The system, which, in its turn, was established in Latvia under the Pension Law of 1995, forms a link between contributions and amount of a pension. This system does not allow hoping that a person could receive material support that depends on the circumstances at the moment of granting a pensions, but it establishes rights to count on the fact that the amount of a pension shall be defined in accordance with the scheme of pension calculation provided for in the normative acts. This system orientates persons on active participation and care for regular contributions in one's pension capital fund.

The Constitutional Court has already held: in order to establish whether the contested provisions violate rights to own property, one has to assess the nature of pension granting system. I.e. in accordance with the Pension Law of 1995 the established pension system is of the property "creating" character. It is based on the principle that the participant has made contributions into certain funds where the person accumulates a definite share. And its amount can be determined at each particular moment *(see: Judgment of the Constitutional Court of June 26, 2001 in the case No. 2001-02-0106, Para 2).*

One can also agree to the opinion of the Law Enforcement Institution that the provision, in accordance to which pensions are included into the list of incomes chargeable with the personal income tax, should be regarded together with the rights established in the Satversme, which could be restricted by the provision, i.e. rights to own property guaranteed by Section 105 of the Satversme. Hence the fact whether the particular payment is based on previous contributions of the receiver is if no importance.

This conclusion if confirmed by the case-law of the European Court of Human Rights, which is used for disclosing the contents of the basic rights provided for in the Satversme. It provides:

"In the modern democratic state persons depend on social security and social welfare all their life or a part of it. Legal systems of many states provide that these persons are to be guaranteed a certain level of security, as well as these persons should be allocated benefits in accordance with the law. In the case if a person is provided by the nation legal system for rights to social security, the significance of such interest should be reflected under Article 1 of Protocol No. 1 *(Stec and Others v. the United Kingdom [GC], nos. 65731/01 and 65900/01, 12 April 2006, § 51).* But in the Article 53 of the judgment, the ECHR holds that, when assessing applicability of Article 1 of Protocol No. 1, there is no reason for further justification of division of social security payments due to the source or their funding.

Although in the Convention for the Protection of Human Rights and Fundamental Freedoms no provision analogical to Section 109 of the Satversme of the Republic of Latvia is included, these international norms of human rights binding on Latvia and practice of their application at the level of constitutional rights serve as means of interpretation in order to determine the contents and range of basic rights and principles of a judicial state insofar as this leads to reduction or restriction of basic rights provided for in the Satversme *(see: Judgment of the Constitutional Court of May 13, 2005 in the case No. 2004-18-0106, Para 5 of the Concluding Part).*

Constitutional courts of other states have also held similarly by admitting that rights to a pension forms the content of rights to own property established by the constitutions of the corresponding states. E.g. Federal Constitutional Court of

Germany in the Judgment of April 28, 1999 held that property-creating features in the sense of Article 14 of the Fundamental Law is characteristic to the positions that are statutory and emerge from pensions insurance system *(BVerfGE 100, 1 [32]).*

Similarly the Constitutional Court of the Republic of Lithuania, when assessing constitutional protection of rights to pension, held:

"The provision of Article 52 of the Satversme that the state shall guarantee the right to receive an old age pension is to be construed while taking account of the other provisions of the Satversme, while in the context of the case at issue, of the constitutional principle of a law-governed state, of the right of the human being to freely choose a job and business, and of the provisions of Article 23 of the Satversme on the inviolability of property and the protection of the rights of ownership. […] The person who meets the conditions established by law in order to receive the old age pension, and who has been awarded and paid this pension, has the right to a monetary payment of a respective amount, i.e. the right to possession. Under Article 23 of the Satversme, this right must be protected and safeguarded" (*Chapter 2, Clause 2, Sub-clause 2 of the concluding part in the Judgment of Lithuanian Constitutional Court of 25 November 2002 in Case No. 41/2000,* http://www.lrkt.lt/dokumentai/2002/r021125.htm).

Hence rights to pensions irrespectively the date of granting a pension or source of funding pertain to the content of the notion "property" included in the first sentence of Section 105 of the Satversme.

21. Prior to assessing whether the provision of the Law On Personal Income Law, in accordance to which pensions are included into the list of incomes chargeable with the personal income tax, comply with Section 105 of the Satversme, it is to be taken into account that in this case contestation about validity of restriction of rights still indirectly relates to the field of social rights. Hence the Constitutional Court holds that in this case the rights of the submitter of the claim and legal interests can not be protected at the same extent as in the case if the property rights were restricted in their "classical" sense *(see, e.g.: Judgment of the Constitutional Court of May 20, 2002 in the case No. 2002-01-03 or judgment of the Constitutional Court of December 16, 2005 in the case No. 2005-12-0103).*

However a person may have a necessity to protect social benefit provided for him/her. In these cases, taking into account the circumstances of a particular case, a person could be conferred rights to refer to Section 105 of the Satversme which provides a person's rights for a higher level of protection.

22. 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.

The contested provision is included into the Law On Personal Income Tax by the Law of the Saeima of December 19, 1996 "Amendments to the Law "On Personal Income Tax"", which is published in "Latvijas Vēstnesis" on January 3, 1997 and is operative.

Hence the contested provision is statutory.

23. In the basis of any restriction of the basic rights, there should be conditions and arguments for why the restriction is necessary, i.e. the restriction is established for the sake of important interests – a legitimate objective *(see: Judgment of the Constitutional Court of December 22, 2005 in the case No. 2005-19-01, Para 9).*

When establishing restriction of human basic rights, the responsibility to present and justify the legitimate objective of such restrictions, during the proceedings of the Constitutional Court, falls upon the institution, which has passed the contested provision – the Saeima. However it was not indicated in the answer of the Saeima what is the legitimate objective of the provision of the Law On Personal Income Tax, in accordance to which pensions are included into the list of incomes chargeable with the personal income tax, and the responsibility of the Constitutional Court *ex officio* is to assess objectively all circumstances of the case and state presence or, on contrary, absence of such legitimate objective.

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.

One has also take into consideration the fact that the greatest part of personal income tax is transferred to the budget of the local government that is the domicile of the tax payer. Hence the greatest part of municipal budget incomes is ensured, and these incomes *inter alia* are shifted to realization of municipal social programmes (Section 15 of the Law "On Local Governments").

It follows from the aforesaid that encashment of the personal income tax is established in interest of society's welfare.

Hence the contested regulation has a legitimate objective.

24. 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. If, after evaluating the legal norm, it is acknowledged that it does not comply with even one of the above criteria, then it shall be considered as not being in conformity with the principle of proportionality and illegitimate *(see: e.g. Judgment of the Constitutional Court of March 19, 2002 in the case No. 2001–12–01, Para 3.1 of the Concluding Part and judgment of June 27, 2004 in the case No. 2003–04–01, Para 3 of the Concluding Part).*

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, although political dimensions

dominates in the field of tax rights, i.e. decisions are usually made in regard with political rather than juridical considerations.

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.

The submitter of the constitutional claim contests the regulation of the Law On Personal Income Tax, which acknowledge old age pensions as the object of personal income tax and the submitter indicated that the old age pension as such can not be charged with the personal income tax. This action of the legislator is in conflict with the Satversme. It was also substantiated that the above regulation of the Law On Personal Income Tax provides for double taxation of the old age pension, and the resources of insurance are utilized against the regulation "On State Social Insurance".

Hence the Constitutional Court in this case, *inter alia* taking into consideration the social aspect of the case, has to investigate:

1) whether the old age pension as a source of incomes can be recognized as the object of the personal income tax;

2) whether the regulation that acknowledges the old age pension as incomes that should be charged with the personal income tax provides for double taxation of the old age pension;

3) whether the argument of the submitter of the claim maintaining that his and other people's resources of social insurance are utilized otherwise than it is provided for in the Law "On State Social Insurance".

24.1. The basic function of a pension as a social insurance is to provide (substitute) incomes for a person when the anticipated social risk – the particular age provided for by law – sets in. Pension insurance differs from other kinds of social insurance due to its specific social risk, because only in this kind of insurance the

moment when the unfavourable period, i.e. loss of working ability, sets it, is presumed, and, in addition, the insured social risk (loss of working abilities due to the age) is sustained – the entire expected lifetime of a pensioner after granting a pension, and during this period pension is the basic income.

Pensions are recognized as incomes of a person also by the Constitutional Court, holding that the objective of the old age pension is to guarantee subsistence to a person who is no more able to actively take part in legal labour relations and provide for himself/herself.

When assessing the principles of old age pension formation, one has to agree to the opinion of the Saeima that it is the jusrisprudence of the legislator to include pensions into the list of taxable incomes. This inclusion is based on the principle that state social insurace payments are exempted from the personal income tax.

Such inclusion of pensions into the list of taxable incomes is explained in the annotation of the Draft Law "Amendments to the Law "On Personal Income Tax"", which provides: "if payments to the pensions funds are exempted, then the disbursements, i.e. pensions, shall be taxed" *(Annotation of the Draft Law of "Amendments to the Law "On Personal Income Tax"", Volume 1 of the materials of the case, pp.163).*

The Constitutional Court also takes into account the fact that in other European States, in the field of social rights there is a principle in force, providing that pensions shall be include into the list of taxable incomes with the exception of Lithuania, Slovakia and Hungary where pensions are not taxed. On the other hand, the majority of the European States, e.g. the United Kingdom, Austria, Belgium, the Check Republic, Denmark, France, Greece, Estonia, Iceland, Italy, Ireland, Cyprus, Liechtenstein, Netherlands, Luxemburg, Malta, Norway, Poland, Portugal, Slovenia, Finland, Spain, Switzerland, Germany and Sweden have established in their legal acts that old age pensions shall be taxed.

In some states different tax relieves are applied to the state pensions. E.g., in Estonia, old age pensions that do not exceed EUR 2328 per year, in Portugal – EUR 7500 per year, whereas in Liechtenstein – 70% form the first level old age pension, are

exempted from taxation *(see for details: http://ec.europa.eu/employment_social/social_protection/missoc_tables_en.htm).*

The Constitutional Court holds 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 functional context. It follows from essential judicial, social, political, historical and systemic differences of legal systems of different states. However, for solution of the particular legal issue, functionally resembling legal regulations of other states can be indirectly applied, e.g. as an indicator of a guideline or solution of a particular problem by bearing in mind potentially different context.

Hence one can conclude that the principle established in Item 10 of the third part of Section 8 of the Law On Personal Income providing that old age pension is an object of taxation, is at present regarded as admissible in the legal systems of other European States.

Hence 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.

24.2. When assessing whether the regulation that acknowledges old age pensions as income that shall be charged with the personal income tax provides for double taxation of pension, one has to take into account the provision of the first part of Section 14 of the Law "On State Social Insurance". The above provision provides that "The object of mandatory contributions of an employer and employee shall be all calculated employment income from which personal income tax must be deducted without deduction of the non-taxable minimum, tax concessions and eligible expenses for which the taxpayer has the right to reduce the taxable income."

Listing of justified expenses is provided in the Law on Personal Income Taxes, and the order of their calculation is specified by other legal acts, e.g. Regulation No. 793.

Under Item 1 of the first part of Section 10 of the Law On Personal Income Tax, before taxation of income, expenses of a tax payer at the amount of state social

insurance contribution are subtracted from annual earnings taxable. But pensions are not the object of social insurance payments but, in its terms, is social insurance service, which is funded from the national special pension budget that is formed form mandatory social insurance payments. Hence the part of incomes that is transferred to the state social insurance special budget in the form of social insurance payments (before – social tax) and is used for funding social insurance services (state pensions included) has not been charged with personal income tax.

The principle, under which social insurance payments are exempted from taxation, is also established in other laws. E.g. the fourth part of Article 5 of Law "On Indemnification against Loss Resulting from Unlawful or Unsubstantiated Actions of the Investigation Entity, Prosecution Office or Court" provides that "compensation for losses to be paid a person due to unpaid wage and unearned income (profit) shall be charged taxes and fees un the order established in the Law "On Taxes and Fees" and specific tax laws, except for social insurance payments".

Hence one can conclude that when making social insurance payments or disbursing pensions form the state special budget as accumulation of the corresponding sum, no double taxation of incomes with the personal income tax takes place. Taxation takes place only once – when the pension is disbursed – and only in regard to the part, which exceeds 165 lats per month (1980 lats per year).

Hence no double taxation of old age pension with the personal income tax takes place.

24.3. When investigating whether the resources of social insurance of persons are utilized against the regulation of the Law "On State Social Insurance", one has to take into account the fact that this argument of the submitter of the constitutional claim, in fact, is not related to the conformity of the consisted regulation with legal acts of a higher legal power. I.e. the above argument does not directly concern constitutionality of certain norms of Law On Personal Income Tax. In this aspect the submitter of the claim does not directly indicate, which regulations of the Law On Personal Income Tax are in conflict with a particular provision of the Satversme, but he draws the attention of the Court on the fact that there are certain contradictions of

the Law On Personal Income Law and the Law "On State Social Insurance", and these without reason restricts his basic rights.

However the basic function of the Constitutional Court is not evaluation of contradictions of legal regulations (acts) of presumedly equal legal power, still, having regard to the context of the arguments established in the constitutional claim, the Court has to investigate their validity.

When evaluating whether the resources of social insurance of persons are utilized otherwise than established in the Law "On State Social Insurance" – for payment of personal income tax, one has to take into account Item 2 of the second part of Section 3 of the above Law. It provides for one of the basic principles of social insurance, i.e. social insurance funds shall be utilized only for social insurance services in accordance with the Law. Resources obtained in the social insurance system (mainly from social contributions) shall be used only for payments provided for by the corresponding social insurance laws.

Order or social insurance fund formation is provided in the Chapter III the Law "On State Social Insurance". Section 8 of the above Law provides that the State pension special budget of shall consist of mandatory and voluntary contributions for pension insurance except for payments made in the State funded pension scheme, dividends from capital shares transferred to the State pension special budget and revenue from the sale thereof and other revenue.

Whereas, under Pension Law of 1995, old age pension is a social insurance service (Item 1 of Section 4 of Law "On State Social Insurance") and it is not recognized as a social insurance measure. In fact personal income tax is charged upon social insurance services – the old age pension of the submitter of the constitutional claim, rather than means of social insurance, as it was indicated in the claim.

Hence the contested provision is not in conflict with the principle established in Item 2 of the second part of Section 3 of the Law "On State Social Insurance" providing that social insurance funds shall be used only for social insurance services.

Hence there is no reason to assume that the social insurance funds are utilized against the regulation of the Law "On State Social Insurance".

Taking into account the aforesaid, the Constitutional Claim holds that the contested regulation still should be assessed from the point of view of the property rights; however it does not form the above violation of rights. This opinion is to be considered as restriction of rights to own property established in the framework of freedom of action of the State, and this restriction is justified by the necessity to form the national and municipal budgets in order to reach a legitimate objective – protection of welfare of the society.

Hence regulation of Item 10 of the third part of Section 8 of the Law On Personal Income Tax, which acknowledges the old age pension as the object of personal income tax, complies with Section 105 of the Satversme.

25. In the letter to the Constitutional Court, the Law Enforcement Institution has *inter alia* assessed the compliance of the contested provision with Section 109 of the Satversme and held that it complies with the above basic rights. One can also conclude from the answer of the Saeima, that the contested provision is not in conflict with Section 109 of the Satversme.

The Constitutional Court holds that the compliance of the contested provision with social rights established in the Satversme, e.g. rights to social security established in Section 109 of the Satversme, is concerned indirectly. Namely, the aspect of social rights in this case should be regarded insofar as restriction of property rights – personal income tax – is charged upon pensions as a social insurance service.

In this case, one assesses not the fact whether the legislator has fulfilled its responsibility delegated by the Satversme in the field of social rights, but the fact whether the allocated benefit is justifiably charged with the personal income tax. This question was analysed by assessing the compliance of the contested provision with Section 105 of the Satversme.

Hence Item 10 of the third part of Section 8 does not violate basic rights established by Section 109 of the Satversme.

26. Although the Constitutional Court acknowledged the contested provisions as being in compliance with the Satversme, it draws the attention of the Saeima on the fact that the latest amendments to Item 3 of the first part of Section 13 of the Law On

Personal Income Law *inter alia* were passed due to high indices of inflation, which still has not decreased and they affect the most the socially unprotected people. These amendments regarding increase of the non-taxable minimum from 1320 lats to 1980 lats per year are related to the subsistence wage defined by the Central Statistical Board and increase of inflation during the last years *(see: Answer of the Ministry of Finance to the Constitutional Court, Volume 2 of the case, pp.193).*

In its case-law, the Constitutional Court has held that, if in a long period of time the amount of social insurance services is not revised, the different treatment may loose its substantiation *(see, e.g.: judgment of the Constitutional Court of November 1, 2005 in the case No. 2005-08-01, Para 9).*

The Constitutional Court holds that the obligation of the legislator is to gradually improve the social insurance system and to increase the amount of social security in the frameworks of State resources available. But the objective of revision of the amount of social insurance services is to prevent deterioration of welfare of the inhabitants.

Hence the Saeima has to proceed with periodical assessment of the necessity to increase the non-taxable pension minimum provided for in Item 3 of the first part of Section 13 of the Law On Personal Income Tax.

The Substantive Part

Under Articles 30 – 32 of the Constitutional Court Law, the Constitutional court

holds:

words and figures “up to January 1, 1996” of Item 2 of the first part of Section 13 and Item 3 of the first part of Section 13 of the Law “On Personal Income Tax” comply with Section 91 of the Satversme of the Republic of Latvia.

The Judgment is final and not subject to appeal.

The Judgment takes effect as of the day of publishing it.

The Presiding judge G. Kūtris