THE CONSTITUTIONAL COURT
OF THE REPUBLIC OF LATVIA

JUDGMENT
ON BEHALF OF THE REPUBLIC OF LATVIA
in Riga, April 11, 2007
in case No. 2006-28-01

The Constitutional Court of the Republic of Latvia composed of the Chairperson of the court session Gunārs Kūtris, as well as the justices Kaspars Balodis, Aija Branta, Juris Jelģains, Uldis Ķinis and Viktors Skudra,

in accordance with Section 85 of the Satversme of the Republic of Latvia (Constitution), Paragraph 1 of Section 16, Paragraph 9 of the first part of Section 17, Section 19^1 and 28^1 of the Constitutional Court Law,

having regard to the application lodged by the Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia (*Latvijas Republikas Augstākās tiesas Senāta Administratīvo lietu departaments*) and the Administrative Regional Court (*Administratīvā apgabaltiesa*)

on May 13, 2007 at the Court session in writing examined the case

"On the Compliance of the Second Sentence of the Fourth Part of Section 22 of the Law "On Personal Income Tax" with Section 92 of the Satversme of the Republic of Latvia (Constitution)".

The Constitutional Court has established:

1. On May 11, 1993, the Supreme Council of the Republic of Latvia (*Latvijas Republikas Augstākā Padome*) passed the Law "On Personal Income Tax", which was enforced on January 1, 1994. This Law regulates the procedure of calculating, withholding and payment of the personal income tax, as well as the rights, obligations and liability of the tax payers and tax administration.

1.1. Under Section 2 of the Law "On Personal Income Tax", the tax shall be paid by natural persons (hereinafter - the payer). Whereas, Section 1 of the Law provides that personal income tax shall be a tax, which is imposed on income acquired by a natural person and it can be calculated in two ways: in advance, also in the form of payroll tax and patent fee, and in accordance with the summary procedures, by drawing up an annual income declaration (hereinafter - Declaration).

Personal income tax is calculated in accordance with the summary procedures for the total amount of the taxable income presented in the Declaration. The Declaration along with documents annexed thereto is to be submitted at the territorial office of the State Revenue Service (*Valsts ieņēmumu dienests*) (hereinafter - SRS) of the place of residence of the payer not later than until April 1 of the year following the taxation year. The Law "On Personal Income Tax" provides the list of documents attesting the information, which shall be attached to the Declaration or to be presented at the time of submission of the Declaration.

1.2. The SRS investigates credibility and accuracy of the facts provided in the Declaration, as well as executes payment control of personal income tax.

If the income declared by the Payer or income of the Payer indicated in reports (notices) at disposal of the SRS fails to conform with the thereof in the taxation year, the SRS shall request within the time period specified in the Law, an additional declaration regarding incomes, receipts, monetary and other provisions, property and change in value thereof (hereinafter - Additional Declaration), or a declaration of annual income for the taxation year, if it had not been submitted in accordance with the procedures prescribed for in this Law.

When establishing the amount of taxable income and the amount of the tax to be paid, the SRS uses the Additional Declaration of the Payer together with the appended corroborative documents regarding income and expenditure of the Payer, as well as the data of the Enterprise Registry (*Uzņēmumu reģistrs*), Road Traffic Safety Directorate (*Ceļu satiksmes drošības direkcija*), land registry office and other State registries. Furthermore, the SRS is entitled to request and receive free of charge from all merchants (including credit institutions), co-operative societies, non-resident permanent representations, institutions, organisations, associations, foundations and other persons all the information necessary for clarifying the amount of taxable income in respect of transactions, income, amounts paid out, transferred valuables, property and other items..

1.3. The fourth part of Section 22 of the Law "On Personal Income Tax" includes the following condition: "Only those corroborative documents of income and expenditure of the Payer (submitted true copies of the documents), as well as other documents and evidence, shall be recognised as evidence of the payer for challenging the amount of the tax, which has been presented (submitted) simultaneously with the annual income declaration, Declaration specification and the Additional Declaration". The words "as well as other documents and evidence" were included into the contested provision by amendments of the Law of December 20, 2004, which came into force on January 1, 2005.

1.4. Having regard of the Cabinet of Ministers Regulations No. 331 of September 26, 2000 on "Procedure how the State Revenue Service on the basis of calculations determines the taxable income of physical persons", the SRS determines the taxable income for the payer of the personal income tax based on calculations. On September 19, 2006, the Cabinet of Ministers passed new regulations No. 780 "Regulations on Additional Declaration Regarding Income, Receipts, Monetary and other Provisions, Property and Change in Value thereof, and the Procedure how the State Revenue Service on the Basis of Calculations Determines the Income of Payers Chargeable with the Personal Income Tax". Observing the above regulations, in case if, in accordance with the income of the Payer of the personal income tax indicated in reports (notices) at disposal of the SRS, as well as in accordance with the amount of income indicated in the Declaration submitted by the personal income tax payer and with information

indicated in the Additional Declaration it appears that the amount of income of the personal income tax payer is lower than the amount of the expenditures, the tax administration makes a decision on performing tax auditing. If, during the audit, the above fact is confirmed, the State Revenue Service on the basis of calculations determines the amount of taxable income and tax to be paid.

2. Having regard to the application lodged by the Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia, on October 31, 2006, the Constitutional Court of the Republic of Latvia (hereinafter - the Constitutional Court) has instituted proceedings, but on December 21, 2006 – proceedings upon application by the Administrative Regional Court. In order to promote a versatile and expeditious hearing, both cases were joined on January 24, 2007 under the sixth part of Section 22 of the Constitutional Court Law.

3. The applicant - **Department of Administrative Cases of Senate of the Supreme Court of the Republic of Latvia** (hereinafter - the Senate) – on September 19, 2006, on sitting of the court regarding the cassation complaint of Māris Gulbinskis on the judgment of the Administrative Regional Court of February 17, 2006, examined an administrative case – an application of Māris Gulbinskis regarding cancellation of the Decree No. 19/24381 of September 24, 2003 of the General Director of the SRS.

3.1. In the above administrative case, it was established that from April 1 to June 30, 2003, the SRS had performed a personal income tax audit for years 2000 – 2002 in regards to M. Gulbinskis. Having established that expenditures of resources have exceeded the resources of funds, the Auditing Division of the Tax Control Department of Zemgale Regional Office of the SRS (*VID Zemgales reģionālās iestādes Nodokļu kontroles pārvaldes Audita daļa*) obligated M. Gulbinskis to pay the additionally calculated tax and fine into the budget. M. Gulbinskis contested this Decree at the Zemgale Regional Office of the SRS and thereafter also with the General Director of SRS. The decree remained valid, therefore M. Gulbinskis submitted an application to the Court of Jelgava. The Court rejected the application.

On September 6, 2004, the Administrative Regional Court, having examined the case in respect to the appeal by M. Gulbinskis, partially met the complaint.

On January 11, 2005, the Senate cancelled the decree of the Administrative Regional Court of September 6, 2004 and the case was transferred for a repeated hearing to the Administrative Regional Court.

On February 17, 2006, the Administrative Regional Court dismissed the application of M. Gulbinskis and M. Gulbinskis appealed thereto.

When hearing the case regarding the cassation appeal of M.Gulbinskis, the Senate decided on September 19, 2006 to suspend the proceedings in the administrative case and to submit an application at the Constitutional Court on the compliance of the second sentence of the fourth part of Section 22 of the Law ”On Personal Income Tax” with Section 92 of the Satversme.

3.2. The Senate established that in the specific case, the SRS has applied the second sentence of the fourth part of Section 22 of the Law “On Personal Income Tax”, wherefrom it follows that the corroborative documents, which have been submitted after the date established by the SRS for submission of a Declaration or specification thereof, shall be recognized as evidence and shall not be applied in the case. Hence, in this case, only the corroborative documents, which were submitted to the SRS before the date established by the SRS shall be recognized as evidence. Therefore, the obligation provided in Section 154 of the Administrative Procedure Law (hereinafter - APL) regarding assessing the evidence in accordance with “convictions of the court, which shall be based on comprehensively, completely, and objectively verified evidence”, in the specific case shall be applied only to such corroborative documents, which are submitted by the tax payer within the date established by the SRS.

The Senate agrees with the M. Gulbinskis' argument that the contested provision restricts the institution, wherein the administrative act is contested, as well as the Court to accept evidences, which has not been submitted before the deadline established by the SRS, therefore this provision restricts the rights to fair court. Although it is suggested that the restriction is of legitimate nature and it is necessary for the interests of the society, the Senate nevertheless considers that the objective can be achieved by means that restrict the rights of an individual at a lesser extent.

Moreover, in the decision it was established that the collected fine "shall be considered a criminal penalty in the sense of the European Convention of Human Rights" and such situation, when it becomes impossible to provide additional evidence "causes problems with the principles established in the criminal procedures, providing that evidences can be submitted until the end of a trial".

4. The applicant – **Administrative Regional Court** – in the court hearing of October 31, 2006 on the appeal complaint of the SRS regarding the judgment of the Administrative District Court of December 29, 2004, examined an administrative case – an application by Sigma Rubīne regarding the Decree No 19/16717 of July 1, 2003 by the General Director of SRS.

4.1. In the above administrative case it was established that the SRS had performed the personal income tax auditing concerning S.Rubīne from March 29, 2001 to December 11, 2002. In the result of the audit, the chairwoman of the First Auditing Division of the Auditing Department made a decision, wherewith S. Rubīne was obliged to pay into budget the personal income tax and a fine. S. Rubīne contested this decision to the director of the SRS regional institution of Riga and thereafter also to the General Director of the SRS. The decision was cancelled only partially, therefore S. Rubīne submitted an application in the Court regarding the Decree No. 19/16717 of July 1, 2003 by the General Director of the SRS.

The application of S. Rubīne was satisfied by the judgment of the Administrative District Court of December 29, 2004. The SRS submitted an appeal complaint regarding the latter judgment.

The Administrative District Court indicates that the case entails a dispute about the information on the expenditures of the applicant that should have been taken into consideration by the SRS when determining the amount of the personal income tax payment.

4.2. When reviewing the case on the SRS appeal complaint, the Administrative Regional Court decided on December 31, 2006 to suspend the proceedings in the administrative case and submit an application at the Constitutional Court regarding the compliance of the second sentence of the fourth part of Section 22 of the Law "On Personal Income Tax with Section 92 of the Satversme.

In its judgment, the Administrative Regional Court provides the same arguments and conclusions as have been mentioned in the decision of September 19, 2006 by the Senate (*see Para 3 of the Judgment*).

5. During preparation of the proceedings, the Constitutional Court received the information about suspension of proceedings in the administrative cases from the Senate and the Administrative Regional Court. The Courts, having established that the Constitutional Court has made a decision on October 31, 2006 to initiate the case No. 2006-28-01 "On the Compliance of the second sentence of the fourth part of Section 22 of the Law "On Personal Income Tax" with Section 92 of Satversme of the Republic of Latvia (Constitution)", decided under Paragraph 3 of Section 273 and Paragraph 3 of Section 275 of the APL to suspend the proceedings in the above administrative cases until the day when the judgment of the Constitutional Court becomes effective.

6. The institution, which passed the contested provision – **the Parliament of the Republic of Latvia** (*Latvijas Republikas Saeima*) (hereinafter - the Saeima) – does not agree with the opinion of the applicants.

Tax administration is generally based on the information submitted by the tax payer. It is generally recognized that the tax payer must be familiar with the legal acts regulating the tax field and must be aware of the risks related to violation thereof.

It results from the first part of Section 15 of the Law on Taxes and Fees, that the obligation of a tax payer to pay the taxes to pay taxes and fees in due time and to the full extent, submit to the tax administration the declarations, reports, or tax assessments provided for in specific tax laws, as well as to preserve documentation verifying income from and expenditures of financial and economic activities in order to prove the correctness of tax assessments. Hence it can be concluded that "the documentation verifying the information included in the Declaration, must be at disposal of the tax payer".

The Saeima indicates that the contested provision has a legitimate objective, namely, "to ensure timely collection of the personal income tax and preclude tax evasion". The task of the Legislator was to establish the procedure, according to which the needs of effective tax administration and the rights of persons to protect their rights

and legal interests are balanced. In addition, the objective of the provision also is not to allow that the audit would, in fact, be performed by the Court.

The Parliament holds that the restriction provided by the contested provision "complies with the principle of proportionality if it is applied reasonably and by observing the limits of judiciary and is not interpreted mechanically and isolated from other laws".

In the response letter, it states: "If application of the contested provision is assessed only as a restriction during the court proceedings, imprecise or even erroneous conclusions could be made. Necessity of the contested provision and the essence of the established restriction therein, in fact, lies in the procedure, which occurs in the stage of the institution prior to making such decision, which under, the normative acts, can be contested or appealed against."

The Saeima draws attention to the order precisely indicated in the Law and in regulations of the Cabinet of Ministers (*Ministru kabinets*), according to which an Additional Declaration is requested and the audit performed, the process whereof is explained in detail in methodological materials of the SRS. This order provides for the rights of a person to express objections and arguments during the time of investigation, as well as to participate in the conclusive negotiations prior to completing the audit. According to the objections and arguments expressed by the tax payer and in accordance with the submitted documentation, the tax auditing report can be adjusted. Hence a person's rights to submit additional evidence during the auditing investigation, too, are, in fact, guaranteed.

In the response letter it was stated that the Court cannot substitute the state administration and perform an audit. Otherwise, the judiciary limits would be violated. The Parliament holds that "the rights established in Section 92 of the Satversme would lose the meaning if it would be allowed that the tax payer has no obligation to indicate and justify the income in detail in the Declaration, the Additional Declaration and during the auditing, but only to submit it to the Court." Such situation "would encumber the Court with performance of uncharacteristic functions and would allow some persons to act in bad faith, as well as would make it impossible to implement efficient tax administration".

The Legislator, when passing the contested provision, was not intending to completely forbid the Court to assess, accept, and request evidence. The contested provision does not prohibit the Court to gather evidence, accept them, assess and apply. It establishes only one restriction – "such situation cannot be permitted when a person would act malevolently, by failing to provide evidence to the relevant institution, however producing it in the Court".

7. The State Revenue Service, in reply to the questions inquired by the Constitutional Court, indicates that the contested provision, on the one hand, confers the tax payer with rights to submit additional justification documentation, and, on the other, in respect to time, limits the submission of justification documents. This restriction is necessary in order to ensure efficient activities of tax administration - timely collection of income tax and to preclude tax evasion.

The SRS makes references to the APL norms and indicates that the responsibility of the Court is to examine the evidence in respect to the facts, which are mentioned in the justification of the appealed administrative act, and only in such case, when the evidence submitted by the participants of the administrative process is insufficient, collect evidence at its own initiative. Tax administration is the jurisdiction of the SRS, however the jurisdiction of the Court involves examination of legality and feasibility of the SRS administrative act.

The SRS holds that the normative regulation and the option included therein entailing extension of the term for submission of the documents confer the tax payer rights and options to submit any information and evidence.

In the response letter, it is explained that "in most cases, the person submits evidence only if the tax administration establishes hidden taxable income, without giving argumentation why such information had not been provided prior to making the calculation". Furthermore, most frequently in stead of an evidence explanations of persons, lending agreements concluded with companies, company accounting registers, bank account statements are provided.

The SRS considers that evaluation of documents submitted after the end of term established in the Law can be permitted only in case if the person indicates full income in the Additional Declaration and provides information on peculiarities of origination

thereof, however cannot ensure timely submission of documents justifying the declared information.

Also the SRS indicates that the tax payer has an opportunity to express objections and argumentation during the investigation progress regarding findings of the tax auditing, as well as to participate in the final negotiations. It is indicative of the fact that "an official assesses the objections and arguments expressed by the tax payer, including additionally submitted documentation, and correspondingly amends the auditing report or rejects the objections of the tax payer by giving counterarguments".

8. Associate professor Dr.oec. Kārlis Ketners of the Customs and Tax Department of the International Economic Relations and Customs Institute of the Faculty of Engineering Economics of the Riga Technical University considers that the contested provision is "partially in conflict with the provisions of Section 38 of the Law on Taxes and Fees, namely, if a tax payer does not agree with the amount of the tax payments assessed by the tax administration, evidence regarding the amount of tax payments shall be provided by the tax payer".

The submission term restriction could be ensured by establishing the SRS rights "to review the personal income tax auditing opinion, considering the documents and additional evidence submitted by the tax payer and by ensuring also evaluation of credibility of the submitted evidence, as well as considering the justification of the tax payer in cases of overdue submission of evidence".

When commenting upon the practice of foreign countries regarding restrictions, K.Ketners indicates that "usually the Legislator does not establish special conditions in respect to submitting the evidence, because the normative acts prescribe the responsibility of the tax payers to cooperate with the tax administration and upon the first request to submit all of the information necessary for tax assessment, which can be used as evidence".

The Constitutional Court holds that:

9. The application includes a request to assess the compliance of the contested provision with Section 92 of the Satversme, however it follows from the application

that in the essence the compliance of the above provision with the first sentence of Section 92 of the Satversme, which establishes that everyone has the right to defend his or her own rights and lawful interests in a fair court, is contested.

When analyzing the first sentence of Section 92 of the Satversme, the Constitutional Court has acknowledged that the concept "fair court" included therein provides for two aspects, namely, "fair court" as an independent judiciary institution, which examines the case, and "fair court" as a proper process relevant for a judicial country, wherein this case is examined. Section 92 of the Satversme provides for both - the responsibility to create a relevant judicial institution system and the responsibility to adopt relevant procedural norms (*see Paragraph 2 of the Concluding Part of the Judgment of the Constitutional Court of March 5, 2002 in case No. 2001-10-01*).

Hence, Section 92 of the Satversme provides for examining civil cases, criminal cases, administrative cases, and *inter alia* tax cases in the order, which ensures fair and objective adjudication of these cases.

The applicants hold that the contested provision disproportionately limits the rights of a person to fair court, since it prohibits the institution and the court to accept evidence, which has not been submitted within term established by the SRS when assessing legality of the SRS decisions.

10. Implementation of good and proper management at the tax administration, as well as protection of tax payer rights and legal interests cannot be feasible without wholesome, fair, competent and efficient court control. The Legislator, as it has been indicated in the response letter of the Saeima, by passing the contested provision did not intend to restrict evaluation, acceptance and request of evidence. The Saeima indicates that by interpreting the contested provision under the principle of good administration and by applying it together with the APL norms, "the contested provision does not restrict the court to collect evidence, or to accept, evaluate and use them" (*case materials, p.76 of Volume 1*).

If the Court, when assessing the case, holds that it is impossible to reach a fair solution, because the specific legal norm, which ought to be applied, is in conflict with the key objectives with the APL, then the second part of Section 3 of the APL permits the Court not to apply this specific norm. Hence, the Court, when deciding on the

applicable norm, assesses whether its application would not be in conflict with the key principles of a judicial state and human rights. Furthermore, the principle of objective investigation is binding on the Court , i.e., if evidence of participants to the administrative process are not sufficient, the Court, under the fourth part of Section 150 of the APL, can collect evidence at own initiative.

Hence, within the framework of the administrative process, it is not prohibited for the Court to accept corroborative documents (evidence), which the Payer has submitted after the deadline established by the SRS.

11. The objective of a judicial state is to ensure efficient control of operations of state administration. Such control occurs in two stages - in the superior institution in the frameworks of state administration, and thereafter - in court.

11.1. Under the first part of Section 81 of the APL, the superior institution examines the case repeatedly in point of fact. However, under the first part of Section 103 of the APL, the Court implements control over lawfulness or considerations of expediency of an administrative act passed by the institution in the frameworks of freedom of action.

In the case if a person contests the assessed tax and imposed fine, the court shall evaluate lawfullnes of the administrative act. The considerations of expediency should be evaluated in the case if the applied norm would grant the institution freedom of action. In the contested provision, the Legislator has used a specific and unambiguous formulation "only those […] documents shall be recognized". Thus, the contested provision provides for a mandatory action for the institution, excluding freedom of action, - the institution assesses only the information, which the tax payer has submitted to the SRS until the deadline, i.e. prior to making assessments of the personal income tax. The Saeima in the response letter has not questioned the fact that freedom of action of the institution is prohibited by the contested provision. Moreover, the SRS response letter explains that the corroborative documents that are submitted after the deadline established by the SRS cannot be considered as evidence and cannot be used in the case (*see case materials, Volume 1, pp. 83*). Hence the court assesses, whether the action of the institution in general has been in compliance with the principle of legality provided for in Section 7 of the APL, namely, whether the

officials of each institution has been acting within the limits of authorization established in legal acts and in compliance with the concept of authorization.

In the administrative process, the Court *inter alia* investigates, whether the administrative act and the factual action of the institution comply with the provisions of the APL and other legal acts. In order to reach a judgment, in compliance with the first part of Section 250 of the APL, the Court examines, firstly, whether the administrative act has been passed observing procedural and formal prerequisites, secondly, whether the administrative act complies with the norms of material rights, and thirdly, whether the justification of the administrative act justifies the responsibility delegated to the addressee or the allocated, confirmed, or refused rights of the adresse. The Court must investigate, whether the institution has observed the norms of material and procedural rights when passing the administrative act.

11.2. The Senate has examined a range of cases, wherein the payers have contested the assessed personal income tax and the imposed fine by argumenting their objections with documents, which had been submitted at the court after the deadline established by the SRS. The Senate, in its judgments, has indicated that the corroborative documents submitted after the term for submitting Declaration or specification thereof established by the SRS cannot be considered as evidence and cannot be applied to the case *(see Judgment of September 13, 2005of the Department of the Administrative Cases of the Senate of the Supreme Court in case No. SKA-217; Judgment of January 11, 2005 in case No. SKA-5;Judgment of September 16, 2005 in case No. SKA-133*). Hence the Senate, in the cases in adjudication, has not taken into consideration such evicence, which has been submitted by the Payer after submission of annual Declaration, Declaration specification, and Additional Declaration. This implies that the Court has evaluated lawfullness of the administrative process, however has not evaluated the case in its terms.

11.3. The tax administration institution shall act in compliance with the norms if evicence submitted after the term established by the SRS is not accepted. Hence there is no reason to cancel the decision of the institution.

The Court, however, is entitled to accept this evidence; nevertheless, it is not entitled to evaluate it in its terms. The limits of authorization of the administrative

courts are established by the principle of division of state power. “The objective of administrative courts is to subject actions of executive power to independent, objective, and competent court control, which does not refer to any specific publicly judicial relations between a person and the State. It follows from this task that the obligation of the administrative courts is to perform control of operations and expediency of state administration. [...] The principle of division of power that follows from Section 1 of the Satversme is binding on the administrative courts, prohibiting the courts to undertake implementation of state administration functions.” *(additional judgment of the Administrative Regional Court, of November 1, 2004 in case No. AA204-04/5, Para 9).* It follows from the principle of division of state power that the administrative court is not entitled to make decisions, adoption whereof is of the jurisdiction of the executive power. “The function of a court is to control lawfulness of state administration operations, rather than make decisions on expediency of decisions. Otherwise, the court in fact would functionally incorporate into the state administration and would become a higher state administration institution. Hence the court can only investigate, whether state administration, by applying its freedom of action, has been acting judicially” *(Judgment of the Department of Administrative Cases of the Senate of the Supreme Court of September 7, 2004 in case No. SKA-120. Para 6. . Book ref.: Latvijas Republikas Augstākās tiesas Senāta Administratīvo lietu departamenta spriedumi un lēmumi. 2004. – Rīga: Tiesu Namu Aģentūra, 2005, pp. 307).*

The Constitutional Court agrees with the opinion expressed by the Saeima and the SRS regarding the fact that a court cannot undertake the functions of tax administration, cannot substitute the state administration institution and perform and audit. Taking into consideration this position, the opinion expressed by the Saeima stating that the contested provision does not limit the Court in collecting or accepting evidence, as well as evaluating and applying it, must be considered as contradictory. When acknowledging that the Court can collect and accept evidence, one can conclude that evaluation and use thereof is limited.

The principle of division of power prohibits the Court to consider the case in its terms, by accepting evidence submitted after the deadline established by the

SRS. Furthermore, the Court has no reason to recognize the decision made by the institution to be illegitimate and cancel it.

12. The right to fair court includes the guarantees of a fair court process. In order to establish the meaning of Section 92 of the Satversme, it must be considered in connection with other norms of the Satversme. From Section 1 of the Satversme there follows a range of principles of a judicial state, including the principle of justice and legality that requires that cases shall be considered in accordance to a procedure, which ensures just and objective adjudication thereof, and that the result of every criminal, civil, and administrative procedure is equitable. However, for equitable examination procedure of cases, one has to observe the requirement ensuring the right for a person to be heard out in the matter under examination, along with the rights to procedural equality or equal opportunity guarantees, an opportunity to express argumentation in respect to evidence submitted by the opposing party, and the rights to use the option of submitting evidence to full extent.

By forbidding the rights to submit evidence during the court proceedings, the right to fair court is limited. A judgment cannot be considered as equitable if all evidences have not been assessed in the specific case.

13. The European Court of Human Rights (hereinafter - the ECHR), admits that the tax disputes, as far as they are related only to the obligation of a person to pay a tax, are beyond the apllication field of the European Convention on Human Rights and Fundamental Freedoms (hereinafter - the Convention). The State is entitled to establish the duty of paying taxes, and such duty *per se* does not concern the basic rights of a person.

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. Hence the dispute of a tax payer with the State on tax payment is often related to correctness of activities of tax administration and validity of the imposed fine.

As it follows from the case-law of the ECHR, tax cases, as far as they are related to means of liability to be applicated, can be assessed within the framework of Section 6 of the Convention *(see: Bendenoun v. France judgment of 24 February 1994, Series A no. 284, p. 20, para 47).*

The fine established by the Law at the amount of tax deficiency, *inter alia* when applying the contested provision, is directly related with the tax, in respect to which no additional evidence be submitted in the supreme institution and court. Therewith, in fact, it is not impossible to submit additional evidence concerning the imposed penalty.

The ECHR has established that, in the sense of Section 6 of the Convention, the fine imposed for failure to observe the legal regulations on taxes, taking into account their punitive and preventative objective is of punitive character, which is peculiar for sanctions of the criminal sphere. Therewith the corresponding sanctions are equal to criminal punishment. Hence, the objective of the Convention requires that legal relations, wherein sanctions equal to criminal punishment are applied, would be protected under Section 6 of the Convention and under Section 2 of Protocol No. 7 of the Convention.

Taking into account the fact that the rights to fair court also include the rights to use an option to submit evidence at full extent, the State must ensure implementation of such procedures that allow a person exercising the above-mentioned rights. The responsibility of the State to ensure an possibility for a person to submit evidence at any stage of the procedure, as well as express argumentation in respect to the evidence submitted by the opposing party follows from the rights to fair court.

The contested provision prohibits a tax payer to submit evidence during both, the stage of contesting the administrative act and the following stage, when it is appealed against in court. The institution and the Court, based on the contested provision, do not assess any of evidence submitted by the tax payer after the deadline established by the SRS, in order to justify the argumentation for the assessments performed by the institution. Although the legal regulations provide for an possibility for the tax payer to get acquainted with the justification of the institution and the collected evidence, the contested provision though prohibits the tax payer to give counterarguments in respect

to those arguments of the institution, which are assessed in the supreme institution or during the court proceedings.

Hence, the contested provision violates the rights to fair court established in Section 92 of the Satversme, because it prohibits implementation the principles of versatile, objective, and fair examination of the case established in the procedural laws.

14. The contested provision refers to a situation, where the interests of the society and of an individual "confront". The task of the Legislator is to find the balance between efficient tax administration, on the one hand, and to rights of a person to fair court, on the other. Basically, reaching the balance is related to reasonable restriction of rights of a person.

The contested provision not only established the right of the tax payer to submit additional corroborative documents in the case if the SRS is planning to determine the taxable income on grounds of assessments, but also restricts in time the submission of these corroborative documents, as well as other documents and evidence.

15. The Constitutional Court has indicated several times: although the Satversme does not directly provide for the cases, when the rights to fair court could be restricted, the rights are, however, not absolute. The Satversme is an undivided entirety and the norms included therein are to be interpreted systematically *(see judgment of the Constitutional Court of October 22, 2002 in case No. 2002-04-03)*. The assumption that the rights of each person established in Section 92 of the Satversme can be subjected to restrictions would be in conflict with both, the guaranteed fundamental rights of other persons established in the Satversme, as well as other norms of the Satversme. The ECHR also holds that the rights to fair court are not absolute. They can be limited to the extent where a person are yet not deprived of rights in its terms *(see: Golder v. United Kingdom, judgment of 21 February 1975, Series A no. 18, p. 18, Para 38)*. Nevertheless, the restrictions of these rights, just like restrictions of other basic rights must be established by law or based on a law, they should be justifiable with a legitimate objective and should be proportionate to this objective.

16. The rights of a tax payer to fair court are restricted by a law that has been passed in accordance with the proper order. Namely, the contested provision is

included in the Law ”On Personal Income Tax”, which was passed and validated in accordance with the order established in the Satversme and in the rules of order of the Satversme.

Hence restriction of basic rights included in the contested provision is established by law.

17. In the basis of any restriction of the basic rights there should be conditions and arguments stating the necessity thereof. The restriction requires a legitimate objective, i.e. it must be established for protection of interests relevant for the society.

It follows from the contents of the response letter by the Saeima that the contested provision has two objectives.

Firstly, not to encumber the Court with performance of untypical functions and to exclude the possibility that the Court could in fact perform a tax audit. The Court must observe the boundaries of the judicial power - it cannot substitute the state administration institution and perform an audit.

Secondly, to ensure timely collection of the personal income tax and prevent tax evasion. Likewise, the ECHR considers tax evasion prevention as a legitimate objective *(see: Hentrich v. France, judgment of 22 September 1994, Series A no. 296-A, pp. 19-20, Para 39).*

The legitimate objective of the contested provision is not timely collection of the tax and ensuring efficient functioning of the court *per se*, but rather protection of interests of the society, i.e. protection of other human rights and social welfare.

Hence, the restriction has a legitimate objective.

18. In order to evaluate, whether the restriction is proportionate to the legitimate objective, which the State, by establishing this restriction, has strived to achieve, it is necessary to examine, whether a reasonable balance is ensured between interests of persons and State or society. The contested provision must provide for such balance between prerequisites of efficient tax administration, on the one hand, and the ability of a person to protect one's rights and legal interests in a fair court, on the other.

In order to evaluate, whether the restriction included in the legal norm adopted by the Legislator complies with the principle of proportionality, one has to establish:

firstly, whether the means applied by the Legislator are suitable for achieving the legitimate objective;

secondly, whether such conduct is necessary, i.e. whether the objective could not be reached by other means that restrict the rights and legal interests of a person at a lesser extent;

thirdly, whether the conduct of the Legislator is proportionate, i.e. whether the benefit for the society is greater than the damage caused to the rights and legal interests of a person.

If, when evaluating the legal norm, it is established that the restriction provided for therein does not comply with any of these criteria, then the restriction does not comply with the principle of proportionality and is illegal.

19. In order to evaluate, whether the contested provision meets the objective, it must be investigated, whether the means applied by the Legislator are appropriate for reaching the legitimate objective.

19.1. The Legislator has established a time restriction for submission of information as the means for reaching the legitimate objective allowing the payer to submit or produce the receipts and expenditure corroborative documentation not later than within the term for submitting annual income Declaration or Additional Declaration established by the SRS.

Proper tax administration includes timely and efficient tax collection and at the same time prevents tax evasion. Tax payment is the responsibility of both – legal persons and natural persons. The tax rate of each tax payer is established by law. The duty of paying taxes always entails restrictions of property rights, as well as can be related to other restrictions established by law, which must be proportionate to the legitimate objective – protection of values of constitutional importance.

The Legislator has a considerable freedom of action in establishing the tax control and procedure thereof. It means that the Legislator is entitled at own discretion, observing the principle of proportionality, to establish the procedure and terms of tax assessment, withholding, and payment, as well as the rights, responsibilities, and liability of the tax payers and the tax administration.

The restriction provided for by the contested provision promotes timely collection of the personal income tax and prevents tax evasion, thus the means applied by the Legislator are appropriate for achieving this legitimate objective.

19.2. To remind about the principle of division of state power, the Saeima indicates that the situation when the Court would in fact implement tax audit –axamine the case in its terms, having regard of evidence submitted at the court cannot be permitted. Therefore, the objective of the restriction established in the contested provision is not to encumber the Court with performance of untypical functions.

The contested provision does not prohibit the Court to accept the corroborative documents (evidence), which have been submitted by the tax payer after the term established by the SRS (*see Para 10 of this judgment*). Nevertheless, the Court cannot assess the case in its terms because the boundaries of jurisdicion of the administrative courts are determined by the principle of division of state power that follows from Section 1 of the Satversme. It prohibits the administrative court to make decisions, which are in the jurisdicion of the executive power, and evaluate the case in its terms. Hence the boundaries of control by the judiciary are established in Section 1 of the Satversme, rather than by the contested provision.

Control of state administration operations takes place at two stages – in the supreme institution and the Court (*see Para 11 of this judgment*). Efficient control and protection of the tax payer rights is to be ensured in both stages. In the stage of contestation, two tasks are completed – a person exercises its rights, if he/she considers that the rights have not been exercised in the initial institution, however the state administration uses the possibility to correct its mistake by method of self-control. The task of the court stage is to give an opportunity to a person to exercise the rights if in the opinion of the individual it has not been possible in the government institution *[see: Levits. E. Ģenerālklauzulas un iestādes (tiesas) rīcības brīvība. Funkcijas likumā, piemērošana konkrētā gadījumā, kontrole augstākā iestādē un tiesā. // Likums un Tiesības, 2003, No. 7, pp. 203]*. By ensuring an efficient procedure of contestation - i.e., by allowing a person to exercise the relevant rights at full extent and efficiently in state administration – it is possible to achieve that the case does not come before court.

The ways to improve the administrative proceedings are also mentioned in the conception of making the administrative process in the institution and in court more efficient, which was announced on March 8, 2007 at the state secretary meeting. One of the tasks to be accomplished is to make the administrative process more efficient in the institution, namely, by of implementing its public power in the frameworks of state administration, the State is obliged to ensure a control mechanism of the same efficiency of manifestation of theis public power.

19.3. Section $14.^1$ of the APL provides that the institution, when making decisions, shall observe impartiality and shall give the participants in the proceedings an appropriate opportunity to express the viewpoint thereof and to submit evidence. The APL is applicable in the administrative procedure insofar as another procedure is established by other special legal norms. Section 38 of Law "On Taxes and Fees" permits that the tax payer has an opportunity to provide evidence for the amount of tax payments, if he/she does not agree with the amount of the tax payments assessed by the tax administration. The Senate indicates that this norm only generally states that the tax payer is obliged to provide evidence for the amount of the tax to be paid, however the contested provision establishes the procedure, as well as the term, according to which and within which evidence is to be submitted *(see the judgment of the Department of Administrative Cases of the Senate of the Supreme Court of February 7, 2006 in case No. SKA-38, Para 11.2).* Nevertheless, one cannot fully agreed with viewpoint expressed by the Senate entailing that Section 38 of Law "On Taxes and Fees" establishes the obligation to provide evidence. In this norm, there is an unambiguous indication of the time period, within which evidence is to be submitted, namely, after the tax administration has assessed the amount of tax payments. The obligation of the tax payer to cooperate with officials of the tax administration is provided by Section $32.^2$, as well as Section 15 of the same Law, wherein other obligations of the tax payer are listed.

However, taking into account the provisions of Section 51 of theAPL, i.e. that the institution reviews the administrative case in accordance to its jurisdiction, which is assigned thereto by a normative act, one has to conclude that the contested provision prohibits accepting evidence after the established term. This provision is to be interpreted equally regarding both, the tax administration institution – the decision-

maker regarding the personal income tax to be paid, and a higher institution in case of contesting the administrative act.

The mechanism of rights protection cannot be acknowledged as efficient, if due to inefficiency of the contestation phase there is no reason to contest in a higher institution the corresponding decision regarding evidence submitted later. Furthermore, the restriction included in the contested provision rather causes an opposite effect – issues that could be solved during the stage of contestation, are brought to court. If the institution would also accept evidence submitted later for evaluation, then, in most cases, the cases would possibly not be brought to court and thus the operations of the administrative courts would be unburdened.

The restriction included in the contested provision is not suitable for accomplishing the objective indicated by the Saeima – to unburden the operations of the courts and to eliminate the possibility that the court should in fact perform tax auditing.

Hence the means selected by the Legislator are not approperiate for achieving this legitimate objective.

20. The Court must assess, whether the restriction is indispensable, i.e. whether the legitimate objective – timely collection of the personal income tax and prevention of tax evasion – can be achieved by equally efficient means, which restrict the rights of an individual at a lesser extent.

20.1. Freedom of action of the Legislator in establishing the tax control is not restricted. Freedom of action is to be used only insofar as to ensure performance of the tax payer's obligations, namely, the Legislator must not create prerequisites for violating the constitutional rights of a tax payer. In activities of the Legislator, there are no areas free of constitutional control. The main objective of laws in a democratic and judicial state is ensuring justice. The objective has other subordinate goals; in this case - efficient tax administration, for guaranteeing whereof no adoption of unfair laws shall be permitted. No such law, which non-proportionally restricts the basic rights of a person, cannot be considered as fair.

Hence freedom of action of the Legislator in tax matters is not and cannot be unrestricted.

20.2. The tax administration institutions are subject to normative acts establishing the boundaries of control authorization. Furthermore, not only exceeding the authorization, but also use thereof in a formally legal way, but still against the control purposes and objectives of protection of rights of persons and social interests, are not compatible with the principles of a judicial state. The institution, just like the court, must not only act within the framework of authorization established by normative acts, but also use the authority only in compliance with the meaning and objective of authorization.

The objective of the restriction of the contested provision is to ensure timely submission of all documents, however for making an objective and just decision one needs as complete information as possible. The Constitutional Court agrees with the applicants, which indicate that it is possible, by evaluating critically the credibility of evidence submitted after the term established by the SRS, to decide opon admissibility thereof, clarify the reason why such evidence is submitted with delay and evaluate justification thereof. The principle of justice means that the institution and the Court, when making the decision, must orientate themselves on reaching just result by observing the rights and legal interests of the involved perons. By allowing evaluation of admissibility of evidence in the institution, legal instrument would be used - freedom of action of the institution, in order to achieve a higher level of justice in each individual case.

20.3. Prior to completing the tax audit, the opinion, objections, and arguments of the tax payer in respect to violations detected during tax audit are heard out. If necessary, the auditor determines a deadline for the tax payer to prepare additional arguments and opinion. As it has been indicated in information provided by the SRS, "an official evaluates the objections, arguments, including additionally submitted documents of the tax payer and correspondingly adjusts the tax audit report or rejects the objections of the tax payer by giving counterarguments" *(case materials, pp. 83 of volume 1).* Furthermore, Paragraph 3.4 of the methodological material of the SRS on "Auditing Process of Natural Persons" it is indicated that the institution, when making

the decisions, observes objectiveness and provides an appropriate opportunity for the participants of the proceedings to express their opinion and to submit evidence, "hence, during the process of auditing, when evaluating the compliance of accruals indicated in the Additional Declaration, in all cases additionally provided evidence must be paid attention to and assessed [...]" (*case materials, p. 95, volume 1*). As it follows from the explanation provided by the SRS and the above-mentioned methodological materials, there have been certain cases in practice, when the tax administration institutions, regardless of the contested provision, would later accept the submitted evidence. Hence unequal attitude towards the tax payers is permited, since the right to submit evidence after the established term is not conferred to all tax payers.

20.4. The Constitutional Court holds that there also exist other softer means for achieving the above legitimate objective. For instance, the possibility to impose a penalty on performing repeated tax auditing due to failure to submit information in a timely manner is permitted, or a demand to cover the expenses of performing a repeated tax auditing incurred due to the latter reason. If the norms included in the normative acts list the mandatory documents and information to be submitted, then there also is an option to set a penalty for failure to submit the requested documents within the established term.

The Legislator, when passing the contested provision, has not ensured application of a restriction as soft as possible. Namely, the Legislator has not provided for an option to evaluate admissibility of evidence submitted later. In a judicial state, it is possible to elaborate a better-weighed mechanism, in order to take into account the interest of the person audited along with the interests of the society, when collecting taxes. Unburdening of tax administration (refusal of reviewing auditing results after receipt of additional documents) is not compatible with restrictions of rights of an individual, i.e. with establishing of a contestable tax amount and fine.

Hence it is possible to establish softer means in order to restrict the rights of a person to fair court at a lesser amount, and simultaneously to ensure efficient tax administration and operation of court institutions.

21. The contested provision restricts the rights of a person to a fair court, this restriction is established by a law and it has a legitimate objective. The means selected by the Legislator are appropriate for achieving the legitimate objective –ensuring of efficient tax administration. However the Legislator also had an opportunity to provide for sofet means for achieving this legitimate objective. Hence the benefits for the society do not exceed the damage caused to the rights and legal interests of a person. The effective normative regulation does not provide for the rights to fair court established by Section 92 of the Satversme.

Hence, the restrictions set forth by the Legislator are not proportionate, because the contested provision does not allow exercising the rights to fair court to a fullest extent.

22. By determining the moment when the contested provision becomes invalid, the Constitutional Court takes into account the fact that the Legislator requires time for improving the normative regulation since the contested provision did not ensure achievement of the legitimate objective, namely, efficient tax administration. If the contested provision is recognized as invalid prior to Legislator having made a softer regulation, achievement of the specific legitimate objective can be endangered. It implies that there would be no the disciplinary regulation and that each tax payer could submit the corroborative documents (evidence) at any moment. Such situation, which would evolve if there would be no regulation regarding this matter, would be even less compliant with the Satversme than the current situation. The Constitutional Court has held several times (*see judgment of the Constitutional Court of October 22, 2002 in case No. 2002-04-0306, Para 3 of the Concluding Part*): in such situation it is admissible that the norm that is in conflict with the Satversme remains valid for a certain period of time so that the Legislator would have an opportunity to solve the situation, wherein both, the interest of the society and of individual tax payers are observed.

Simultaneously, the Constitutional Court takes into account the fact that the administrative courts in each specific case have an option to adjudicate the case by applying directly the norms of the Satversme. However, in order not to violate the basic rights of persons established in the Satversme by decisions of the tax

administration while the contested provision is still effective, the contested provision during this period is to be applied *inter alia* observing the instructions provided in this judgment of the Constitutional Court.

Judgment

On the basis of Articles 30-32 of the Constitutional Court Law, the Constitutional Court

h o l d s :

1. to recognize the second sentence of the fourth part of Section 22 of the Law "On Personal Income Tax" to be in conflict with Section 92 of the Satverme of the Republic of Latvia and invalid as of October 1, 2007.

2. In regard to the administrative cases, which have been initiated prior to the date of publishing this judgment of the Constitutional Court, recognize the second sentence of the fourth part of Section 22 of the Law "On Personal Income Tax" to be in conflict with Section 92 of the Satversme of the Republic of Latvia and invalid as of the date of the judgment taking effect.

The judgment is final and cannot be appealed against.

The judgment shall take effect as of the day of publishing it.

The Presiding judge G. Kūtris