The tax rates established in Article 6 of the law "On Solidarity Tax" are incompatible with the equality principle enshrined in the *Satversme*

On 19 October 2017 the Constitutional Court pronounced the judgement in case No. 2016-14-01 "On Compliance of Section 3, 5, 6, 7 and 9 of the law "On Solidarity Tax" with the First Sentence of Article 91 and Article 109 of the *Satversme* of the Republic of Latvia".

Contested Norms

Section 3 of the law "On Solidarity Tax":

"The tax object shall be the income, which has been defined in Section 14 and Section 20[2] [1] of the law On State Social Insurance and exceeds the maximum amount[2] of the object of mandatory state social insurance contributions (hereinafter – object of mandatory contributions).

Section 5 of the law "On Solidarity Tax":

Taxpayers shall be employers, employees, domestic employees at a foreign employer, foreign employees at a foreign employer and self-employed persons, who are subject to state social insurance and whose income in the respective taxation year exceeds the maximum amount of the object of mandatory contributions as defined in the law On State Social Insurance.

[1] [...] The object of mandatory contributions by an employer and an employee is all income calculated in paid employment, from which personal income tax must be deducted, without deducting untaxable minimum, tax reliefs and eligible expenditure, for which the tax payer has the right to decrease the taxable income. [...]

[2] From 9 December 2014 to 23 August 2016 the maximum the maximum amount of mandatory state social insurance contributions was set as **48 600 EUR annually** *(The Cabinet Regulation of 9 December 2014 No. 756 "Amendments to the Cabinet Regulation of 17 December 2013 No. 756 "Regulation on the Minimum and Maximum Amount of the Object of Mandatory and Voluntary State Social Insurance Contributions*", *Para 1.1)* Since 23 August 2016 the maximum amount of the mandatory state social insurance contributions has been defined as **52 400 EUR annually** *(The Cabinet Regulation of 17 December 2013 No. 1478 "Regulation on the Minimum and Maximum Amount of the Object of Mandatory and Voluntary State Social Insurance Contributions", Para 5).*

Section 6 of the law "On Solidarity Tax":
The tax rate shall correspond to the rate of mandatory contributions defined pursuant to Section 18 of the law "On State Social Insurance"[3].

Section 7 of the law "On Solidarity Tax":

(1) The State Social Insurance Agency, on the basis of information provided by the State Revenue Service, shall aggregate the object of mandatory contributions of a socially insured person and the mandatory state social insurance contributions that have been made. The State Social Insurance Agency shall record the actually paid solidarity tax, after the maximum amount of the object of mandatory contributions, defined in the law On State Social Insurance, has been reached.
(2) The State Social Insurance Agency shall calculate the solidarity tax once per month.

Section 9 of the law "On Solidarity Tax":
The State Social Insurance Agency shall transfer the actually paid tax for the reporting month into the account of the revenue of the state basic budget until the fifteenth date of the month following the reporting month.

Norms of Higher Legal Force

The first sentence of Article 91 of the *Satversme*: "All human beings in Latvia shall be equal before the law and the courts".

Article 109 of the *Satversme*: "Everyone has the right to social security in old age, for work disability, for unemployment and in other cases as provided by law."

Facts of the Case

The case was initiated with respect to applications submitted by 37 natural persons. All applicants are employees, who, in accordance with the contested norms, have the obligation to pay the solidarity tax. The applicants hold that the solidarity tax, essentially, is equal to

[3] [...] The rate of mandatory contributions, if the employee is insured for all types of social insurance, is 34.09 per cent, of which 23.59 per cent are paid by the employer and 10.50 per cent – by the employee (*Section 18(1) of the law "On State Social Insurance")*

mandatory state social insurance contributions (hereinafter – insurance contributions). Although the state social insurance and the solidarity tax are regulated by different laws, these laws are said to have the same structure and purpose – financing the needs of social security. The only difference is that the insurance contributions are paid into the special budget, whereas the solidarity tax – into the basic budget.

It is maintained that the applicants cannot receive social security proportional to the social insurance contributions that have been made, compared to those employees, who are not obliged to pay the solidarity tax. Thus, the contested norms are said to be incompatible with Article 109 of the *Satversme*. Moreover, the applicants hold that the law "On Solidarity Tax" envisages different treatment of various groups of payers of solidarity tax, depending upon the types of social insurance that they have. Allegedly, such differential treatment is incompatible with the principle of equality enshrined in Article 91 of the *Satversme*.

The applicants hold that the law "On Solidarity Tax" was drafted and adopted in haste, without assessing its impact upon the national taxation policy in the context of sustainable social policy. The legislator, in adopting the contested norms, did not examine the alternatives. Social partners were not heard and the practice of other countries had not been examined in preparing the draft law.

The Court's Findings and Ruling

On termination of legal proceedings in the part of the claim regarding compliance of the contested norms with Article 109 of the *Satversme* (the right to social security)

The Constitutional Court found that the contested norms did not pertain to the State's obligation to create and maintain a social security system that would guarantee social security to every person. Moreover, the Constitutional Court noted that the legislator, in adopting the contested norms, did not restrict a person's fundamental right to social security in cases envisaged by law. All persons have the right to social security that is proportionate to the amount, in which a person has participated in accumulation of social security capital, as well as in other measures of guaranteed social security. [19.1., 19.2., 19.3.]

The Constitutional Court recognised that the solidarity tax, essentially, is a new type of income tax. The solidarity tax is not an insurance contribution and in no aspect can be attributed to receipt of social insurance services, therefor the Constitutional Court decided to terminate legal proceedings in the part regarding compliance of the contested norms with Article 109 of the *Satversme*. [19.3., 19.4]

On termination of legal proceedings in the part of the claim regarding compliance of Section 7 and Section 9 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* (the equality principle).

The Constitutional Court noted that the addressees of Section 7 of the law "On Solidarity Tax" are the Agency and SRC. This section defines the competence of public administration in calculating the solidarity tax. Section 9 of the law "On Solidarity Tax", likewise, pertains to the competence of public administration, envisaging the obligation for the Agency to transfer the tax revenue into the basic budget of the state. This regulation does not grant subjective rights to a person. The Constitutional Court ruled that compliance of Section 7 and Section 9 of the law "On Solidarity Tax" with Article 91 of the *Satversme* would not be examined and decided to terminate legal proceedings in this part of the claim. [21.]

On termination of legal proceedings in the part of the claim regarding compliance of Section 3 and Section 5 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* (the equality principle)

The Constitutional Court noted that following introduction of a new tax changes to regulation always defined two groups of persons, at the same time envisaging differential treatment of them, i.e., persons, who were tax payers, and persons, who were not obliged to pay the tax. However, this circumstance *per se* is not a violation of the equality principle. The Constitutional Court underscored that the feature that allowed comparing payers of the solidarity tax, was the object of solidarity tax, i.e., the amount of income, to which the solidarity tax was applied. Therefore the employees, who are payers of the solidarity tax, and employers, who are not payers of the solidarity tax, in this aspect of the obligation to pay a tax are not in comparable circumstances. [22.1]

However, all those employees and self-employed persons, whose income exceeds the maximum amount of insurance contributions set for the respective year, are in comparable circumstances. [22.2., 22.3.]

The Constitutional Court found that in the case under review the differential treatment of comparable groups followed from the rates of solidarity tax that had been established. Thus, Section 3 and Section 5 of the law "On Solidarity Law" cannot be examined in the framework of the first sentence of Article 91 of the *Satversme*, because they do not create

restrictions upon fundamental rights. The Constitutional Court decided to terminate legal proceedings in this part of the claim. [23]

On the legislator's constitutional obligations in the field of tax policy and the principles of taxation policy

Assessing the process of legislation and the legal technique, the Constitutional Court found that the solidarity tax had been established by law adopted in due procedure. [25.1., 25.2., 25.3.]

The Constitutional Court recognises that the legislator has the right to choose the solutions for ensuring revenue into the basic budget of the state that is necessary for financing the increasing needs of social security and for decreasing inequality. However, in implementing taxation policy, the legislator's actions should comply with the general principles of law and provisions of the *Satversme*. The legislator, in exercising its discretion in the field of taxation policy, must abide by the principled of effectiveness, justice, solidarity, and timeliness. [26.]

Essentially, any tax is a solidary payment, because it allows adding to the state budget resources that are used to finance measures that are important for society in general. By paying taxes a person assumes shared responsibility for satisfying the needs of society and maintaining the state of Latvia. The legislator, in turn, has the obligation to create in the field of taxation policy a mechanism that would be solidary and fair, and based upon certain criteria, for levelling out socio-economic differences, aimed at sustainable development of the state, moreover, not only in the formal meaning thereof, but by ensuring effective functioning of this mechanism, as well as timely and well-considered implementation of necessary changes to the taxation policy. Implementation of such taxation policy ensures public welfare. [26.]

On incompatibility of Section 6 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* (equality principle)

The Constitutional Court noted that different rates of the solidarity tax had ben established for various groups paying the solidarity tax, in view of the type of social insurance that the person had. Thus, Section 6 of the law "On Solidarity Tax" envisages differential treatment of payers of solidarity tax, who are in comparable circumstances. [24]

The Constitutional Court recognised that simplicity of administration, which in the circumstances of the case under review manifests itself as taking over the rates established in social insurance, does not provide objective substantiation for choosing the rates of

solidarity tax on its merits. Application of different tax rates should be substantiated by objective differences between the subjects of the tax in connection with the object of the tax chosen by the legislator. [27.2.]

The Constitutional Court found that the amount of state budget revenue, which was collected from the solidarity tax, could not be considered as being the legitimate aim of differential treatment. Significant amount of budget revenue *per se* cannot be used to substantiate restrictions upon fundamental rights in the meaning of the first sentence of Article 91 of the *Satversme*. [27.3.]

In ensuring sufficient revenue into the state budget, the legislator is obliged to develop such regulation on taxation that ensures compliance with the principles of justice, solidarity, effectiveness, and timeliness. In the case under review that would mean setting such rates of the solidarity tax that have objective and reasonable grounds. [27.3.]

In the case under review the differential treatment of groups of payers of solidarity tax does not have a legitimate aim, therefore Section 6 of the law "On Solidarity Tax" is incompatible with the principle of equality enshrined in the first sentence of Article 91 of the *Satversme*. [27.3.]

<u>On the force of the judgement by the Constitutional Court in time</u>

Immediate revoking of the solidarity tax, before a new legal regulation has entered into force, is impossible, since gaining of the planned tax revenue is directly linked to the State's ability to perform its functions. That would jeopardise public welfare and security. The Constitutional Court found that the legislator needed a reasonable period of time for adopting a new legal regulation and also that the amendments had to be harmonised with the general taxation policy, and the stability of the state budget had to be ensured, therefore Section 6 of the law "On Solidarity Tax" should be recognised as being invalid as of 1 January 2019. [28.]

The Constitutional Court held:

1) to terminate legal proceedings in the case in the part regarding compliance of Section 3, Section 5, Section 6, Section 7 and Section 9 of the law "On Solidarity Tax" with Article 109 of the *Satversme* of the Republic of Latvia;

2) to terminate legal proceedings in the case in the part regarding compliance of Section 3, Section 5, Section 7 and Section 9 of the law "On Solidarity Tax" with the first sentence of Article 91 of the *Satversme* of the Republic of Latvia;

3) to recognise Section 6 of the law "On Solidarity Tax" as being incompatible with the first sentence of Article 91 of the *Satversme* of the Republic of Latvia and invalid as of 1 January 2019.

The judgement by the Constitutional Court is final and not subject to appeal, it shall enter into force on the day of its publication.

The text of the judgement [in Latvian] is available on the homepage of the Constitutional Court:

http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/07/2016-14-01_Spriedums-2.pdf

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The press release was prepared with the aim to facilitate understanding of the actual facts of the case. It shall not be regarded as part of the judgement and is not binding to the Constitutional Court. The judgements, decisions and other information regarding the Constitutional Court are available at the homepage of the Constitutional Court www.satv.tiesa.gov.lv.

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