



Satversmes tiesa

Press Release

Case No. 2021-06-01

07.01.2022.

The norms that set out the procedure for determining the income, to which the personal income tax is applied, for persons engaged in economic activities are incompatible with the *Satversme*

On 7 January 2022, the Constitutional Court delivered its judgement in case No. 2021-06-01 “On the compliance of Section 11 (3¹⁰) and Section 11¹⁰(6¹⁰) of the law “On Personal Income Tax” with Article 105 of the Constitution of the Republic of Latvia”.

THE CONTESTED NORMS

- Section 11 (3¹⁰) of the law “On Personal Income Tax”:

“Expenditure related to economic activity is applied in the amount that does not exceed 80 per cent of a natural person’s total revenue from economic activities.”

- Section 11¹⁰(6¹⁰) of the law “On Personal Income Tax”:

“If after making corrections laid down in this Section the taxable income of the payer is less than 20 per cent of revenue from economic activities, the tax shall be calculated from the amount which is not less than 20 per cent of revenue from economic activities.”

THE NORM OF HIGHER LEGAL FORCE

- The first three sentences of the *Satversme* of the Republic of Latvia (hereafter – the *Satversme*):

“Everyone has the right to own property. Property shall not be used contrary to the interests of the public. Property rights may be restricted only in accordance with law.”

THE FACTS

The case was initiated on the basis of the Ombudsman's application. The applicant noted that the contested norms were incompatible with the first three sentences of Article 105 of the *Satversme* because they provided that a person engaged in economic activities who had chosen to pay the personal income tax from the economic activities was obliged to pay the aforementioned tax even if the economic activities incurred losses. Allegedly, the legitimate aim of the restriction defined in the contested norms cannot be reached by it. The restriction on the right to property, included in the contested norms, which has been defined on the basis of presumption, is said to be incompatible with the principle of justice and other legal principles derived from it.

THE COURT'S FINDINGS

On assessing the contested norms

The Constitutional Court found that both contested norms applied to the procedure for determining the income of a person engaged in economic activities, to which the personal income tax would be applied. Since both contested norms envisage that the income to which the personal income tax is applied is at least 20 per cent of the revenue from economic activities, the Constitutional Court assessed these simultaneously. [13.]

On the restriction on fundamental rights

The Constitutional Court noted that the contested norms were part of the legal regulation that envisaged the obligation to pay the personal income tax. They restrict the right to property of a person engaged in economic activities since they define the minimum income, to which the personal income tax is applied, and, thus, also influence the amount of personal income tax payable. [14.]

The contested norms allow a situation where the personal income tax must be paid also if actual income has not been gained but the income has been only presumed. [14.]

On whether the restriction on fundamental rights had been established by a law adopted in due procedure

The Constitutional Court found that, in the adoption of the contested norms, the procedure envisaged in regulatory enactments had been complied with and that substantive violations of the legislative procedure could not be identified. [16.3.]

On presumption and general legal principles in tax law

The law "On Personal Income Tax" is based on the taxpayer's ability to pay the tax. Namely, the amount of personal income tax depends on the actual income so that the

financial burden, caused by the obligation to pay the tax, would be proportional. In the case of income tax, the ability to pay taxes is assessed in accordance with the principle of net profit and loss, which provides: to determine the amount of income to which the personal income tax is applied, the possibility to deduct expenditure related to economic activities should be provided. [14.]

The ability to pay taxes and the element specifying it in the case of income tax – the principle of net profit and loss – follow from the principles of justice and legal equality; i.e., the legislator must ensure that taxpayers with equal abilities would be taxed similarly, and the tax burden should be proportionate to the taxpayer's income. [14.]

The contested norms provide that income of a person engaged in economic activities, to which the personal income tax is applied, is at least 20 per cent of the revenue. Hence, the income to which the personal income tax is applied is defined as presumption in the contested norms. Application of such presumption is derogation from the principle of net profit and loss, which envisages that the personal income tax should be applied only to the taxpayer's actual income. [17.1.]

On the legitimate aim

The Constitutional Court found that the restriction on fundamental rights, defined in the contested norms, had a legitimate aim – protection of public welfare. [17.2.]

On compliance of the contested norms with the proportionality principle

The Constitutional Court verified whether the restriction on the right to property, included in the contested norms, had been established on the basis of objective and rational considerations aimed at ensuring justice and legal equality. [19.]

The Constitutional Court, assessing the data on persons engaging in economic activities, concluded that the restriction on the right to property, included in the contested norms, had not influenced in the envisaged way the actions of exactly those persons engaged in economic activities due to whom the contested norms had been adopted. Likewise, the restriction on rights, included in the contested norms, does not facilitate presentation of actual income. [19.3.]

The Constitutional Court found that the commercial profitability of 20 per cent, assumed on the basis of the contested norms, was an inaccurate indicator and did not reflect the ability of all persons engaged in economic activities to pay the tax because the differences between sectors in terms of profitability could be even fourfold. [19.4.1.]

Likewise, the Constitutional Court found that due to the application of the contested norms part of the persons engaged in economic activities remained outside the scope of risk assessment conducted by the State Revenue Service, although the possibility

remained that the expenditure related to economic activities, declared by them, was not entirely applicable to the economic activities; whereas those persons engaged in economic activities, whose entire expenditure was validly related to their economic activities, could not deduct it in full amount. [19.4.2.]

The Constitutional Court, taking into account, in particular, that the scope of the contested norms included also those natural persons who were engaged in economic activities and who were liable for their commitments with their entire property, held that the derogation from assessing a taxpayer's genuine ability to pay the tax, *inter alia*, derogation from the principle of net profit and loss, was not justified. [19.4.2.]

In view of the above, the restriction on the right to property, included in the contested norms, was not established on the basis of objective and rational considerations aimed at ensuring the principle of justice and legal equality. Therefore the Constitutional Court concluded that the measures used by the legislator were not suitable for reaching the legitimate aim of the restriction on the right to property. [19.5.]

The Constitutional Court held:

To recognise Section 11 (3¹) and Section 11¹ (6¹) of the law "On Personal Income Tax" as being incompatible with the first three sentences of Article 105 of the *Satversme* of the Republic of Latvia.

The Constitutional Court's judgement is final and not subject to appeal, it enters into force on the date of its publication.

The text of the judgement is available on the Constitutional Court's homepage: https://www.satv.tiesa.gov.lv/web/viewer.html?file=https://www.satv.tiesa.gov.lv/wp-content/uploads/2021/02/2021-06-01_Spriedums.pdf#search=2021%E2%80%9106%E2%80%9101

The press release was prepared to inform society about the Constitutional Court's work. More detailed information about recent developments, cases initiated and heard by the Constitutional Court is available on the Constitutional Court's webpage www.satv.tiesa.gov.lv. Please follow also information published on the Court's *Twitter* account [@Satv_tiesa](https://twitter.com/Satv_tiesa) and *Youtube* [channel](#).

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