Constitutional judgment 3-4-1-12-07

**JUDGMENT
OF THE CONSTITUTIONAL REVIEW CHAMBER
OF THE SUPREME COURT**

No. of the case	3-4-1-12-07
Date of judgment	26 September 2007
Composition of court	Chairman Märt Rask, members Eerik Kergandberg, Hannes Kiris, Ants Kull and Julia Laffranque.
Court Case	Petition of the Tallinn Administrative Court of 9 May 2007 to review the constitutionality of § 15(2)6) of the Value Added Tax Act.
Hearing	Written proceeding
DECISION	**To declare § 15(2)6) of the Value Added Tax Act, to the extent that it establishes the condition that in order to apply the 5% value added tax rate to the tickets of performances and concerts the funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia must amount to at least 10 per cent of the budget revenue for the calendar year of the performing arts institution organising a performance or a concert, unconstitutional and invalid.**

FACTS AND COURSE OF PROCEEDING

1. MTÜ Muusikaliteater sold tickets to musicals “Georg” and “Tuhkatriinu” at 5% value added tax rate, and in the value added tax returns from August 2005 until January 2006 declared 9 729 375 kroons of turnover taxable by value added tax at the rate of 5%.

2. By its notice of assessment no 12-5/864 of 19 December 2006, the tax authority of the Põhja tax and customs centre of the Tax and Customs Board (hereinafter “PTCC”) required the non-profit association Muusikaliteater to pay, under § 92(1)2) and 3) and § 95(1) of the Taxation Act, 1 254 440 kroons of value added tax, because the non-profit association had incorrectly applied the 5% rate of value added tax.

3. As the MTÜ Muusikaliteater rectified the value added tax return of November 2005 in September 2006, increasing the turnover of that month by 296 631 kroons and the amount of value added tax at the rate of 5% calculated on the sum by 14 831 kroons, the PTCC tax authority required, by its notice of assessment no 12-4/11, of 8 January 2007, that the non-profit organisation Muusikaliteater pay the additional 48 941 kroons of value added tax.

4. MTÜ Muusikaliteater filed an action with the Tallinn Administrative Court applying for the annulment of the referred notices of assessment and requesting that § 15(2)6) of the Value Added Tax Act (hereinafter "VATA") be not applied, because the latter is in conflict with § 12(1) and with § 31 of the Constitution of the Republic of Estonia and with the European Union law.

5. On 9 may 2007 the Tallinn Administrative Court satisfied the action of MTÜ Muusikaliteater and annulled the contested notices of assessment. The administrative court declared the condition established in § 15(2)6) of the VATA, that in order to receive the value added tax incentive, the funds received by the organiser of the performance or concert from the state, rural municipality or city budget or the Cultural Endowment of Estonia must amount to at least 10 per cent of its budget revenue for the calendar year, to be in conflict with § 12(1) and § 31 of the Constitution and did not apply the provision upon adjudication of the case.

JUSTIFICATIONS OF THE PARTICIPANTS IN THE PROCEEDING

6. The Tallinn Administrative court held that the condition established in § 15(2)6) of the VATA, pursuant to which the funds received by the organiser of the performance or concert from the state, rural municipality or city budget or the Cultural Endowment of Estonia must amount to at least 10 per cent of its budget revenue for the calendar year, was in conflict with §§ 12(1) and 31 of the Constitution.

The court compared national, municipal or private performing arts institutions and the national Opera in a situation where the funds received amount to at least 10 per cent of their budget revenues for the calendar year, to the same persons in a situation where the funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia do not amount to at least 10 per cent of their budget revenues for the calendar year, and court concluded that the unequal treatment of organisers depending on the sources of financing was arbitrary. It is also arbitrary to make the rate of value added tax dependent on the assessment, given by third persons, on whether a concert or a performance meets public interests. That is why the restrictions in § 15(2)6) of the VATA are in conflict with § 12(1) of the Constitution.

The court is of the opinion that the condition for the application of the value added tax rate of 5 per cent, included in § 15(2)6) of the VATA, that the organiser must have received the funds from the state, rural municipality or city budget or the Cultural Endowment of Estonia in the amount of at least 10 per cent of its budget revenue for the calendar year, is in conflict with the freedom to engage in enterprise, arising from § 31 of the Constitution.

The court also holds that § 15(2)6) of the VATA is in conflict with Article 14 of the Treaty establishing the European Community, pursuant to which the free movement of goods, persons, services and capital should be guaranteed on the internal market. Although, theoretically, a performing arts institution registered in some other Member State of the European Union can apply for grants from the Cultural Endowment of Estonia, it proceeds from the objectives and duties of the Cultural Endowment of Estonia that it is not meant for financing the performing arts institutions of other countries.

7. MTÜ Muusikaliteater is of the opinion that the restriction established in § 15(2)6) of the VATA in regard to the source of financing as a criterion for application of a tax rate is unconstitutional and must therefore not be applied.

The non-profit organisation argues that the comparable groups who are treated unequally are the state, municipal or private performing arts institution or the national opera, at least 10% of the budget revenue for

the calendar year of who is made up of the funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia, and the institutions of the same type in the case when their budget revenue for the calendar year contains the funds received from the referred sources of financing in the amount of less than 10 per cent. The unequal treatment consists in different taxation of the services rendered (performance or concert) by the referred subjects, whereas the rate of tax depends on the source of financing. The aim of taxation with value added tax and the conditions for application of a tax rate must be in reasonable correlation.

The condition established in § 15(2)6) of the Value Added Tax Act has an inhibiting effect on enterprise, as it restricts a performing arts institution upon budgeting and does not give an operator certainty upon planning its business activities. Pursuant to the earlier practice of the Administrative Law Chamber of the Supreme Court it is the consumer, and not the business operator, who has to carry the burden of value added tax. Thus, making the tax incentive dependent on the performing arts institution's source of financing is arbitrary. This amounts to a disproportionate restriction on the right to engage in enterprise.

8. The Chancellor of Justice is of the opinion that § 15(2)6) of the VATA is in conflict with the Constitution to the extent that it does not allow to apply the 5% value added tax rate to the organisation of a performance or a concert by a state, municipal or private performing arts institution or the national opera, if the funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia do not amount to at least 10 per cent of its budget revenue for the calendar year.

As the application of the value added tax rate of 5 per cent, established in § 15(2)6) of the VATA is made dependent on a subjective decision of national, rural municipality or city powers or the Cultural Endowment of Estonia, a question may arise whether all elements of relationships under tax law have been exhaustively regulated by the law. The referred provision does not make it possible for taxable persons to foresee whether the funds it receives from the state, rural municipality or city budget or the Cultural Endowment of Estonia will amount to at least ten per cent of their budget revenue by the end of the year, and therefore the provision lacks legal clarity and is unconstitutional in the formal sense.

§ 15(2)6) of the Value Added Tax Act affects the performing arts institutions to their disadvantage, and constitutes, thus, an infringement of the freedom to engage in enterprise. The contested norm, which has been established with the aim of supporting and promoting high culture and performing arts institutions acting in the public interests, is not a proportional restriction on the right to engage in enterprise. The aims of the legislator can be achieved by measures less encumbering on persons. Neither is the contested measure proportional in the narrow sense, because the 10% financing requirement has an unfavourable or, indeed, hindering effect on enterprise. At the same time the organisers of performances, who offer essentially the same type of service, can be taxed differently, depending on the amount of received support. A performing arts institution who has received sufficient support may, at the same time, apply the more favourable rate of value added tax to performances of both high culture and mass culture.

Form the aspect of taxation, § 15(2)6) of the VATA accords advantages to those organisers of concerts and performances who receive funds from the state, rural municipality or city budget or the Cultural Endowment of Estonia in the amount of at least 10% of their budget revenue for the calendar year, in comparison to those organisers who do not receive such funds or who receive funds in the amount of less than 10 per cent. Consequently, this also amounts to unequal treatment of the referred two types of organisers of performances. There are no convincing arguments for the justification of the described unequal treatment, and thus the differentiation between those who receive support in the amount of at least 10% and those who do not receive these funds is in conflict with the general right to equality, established in § 12(1) of the Constitution.

If the Supreme Court declared § 15(2)6) of the VATA unconstitutional and invalid to the extent that it allows to apply the 5% value added tax rate to the organisation of performances or concerts on the condition that the finances received from the public power amount to at least 10%, the value added tax incentive would uniformly apply to all performances and concerts organised by different performing arts institutions. It is

possible to support the high culture in other and more effective ways, and the Chancellor of Justice proposes that the Supreme Court require the Riigikogu to review, in a an integrated way, the value added tax rate applicable to the organisation of performances and concerts.

9. The Minister of Justice is of the opinion that § 15(2)6) of the VATA is in conflict with the principle of equal treatment, arising from § 12 of the Constitution.

It is not prohibited to allow for the application of value added tax incentives on a group of persons on the condition, that certain conditions are met, but when doing this the legislator must observe the principle of equal treatment. The requirement established in § 15(2)6) of the Value Added Tax Act, that a precondition for a tax incentive is the receipt of funds from public law sources, ties the more favourable value added tax rate to the existence of public interest. At the same time, the persons not applying for grants may also organise performances in public interests. The requirement that the funds received from public law sources make up at least ten per cent of the organiser's annual budget revenue, means that the content of a performance or a concert organised has no bearing on the conditions for granting incentives. On the basis of the foregoing it is incomprehensible what the considerations for differentiating the business operators who organise a performance or a concert in public interests are. The requirement concerning the amount of public law financing creates a situation wherein the operators with bigger economic activities or operators who apply for support for only one performance or concert organised in public interest, are not allowed to apply the more favourable value added tax rate. The aim of the incentive is in direct relation to the event organised.

As § 15(2)6) of the VATA makes the possibility of application of the more favourable value added tax rate dependent on the budget revenue for the calendar year, the unequal treatment is also conditioned by the time of organising a performance or a concert. Depending on the duration of the process between applying for support and the actual time of the performance or concert and the sale of tickets, the organisers of cultural events of equal value are or are not allowed to apply the more favourable value added tax rate. Thus, there is no good reason for the unequal treatment or organisers of events, and this amounts to a violation of § 12 of the Constitution.

10. The President of the Riigikogu authorised the Finance Committee and the Constitutional Committee to deliver the opinion on § 15(2)6) of the VATA in the name of the Riigikogu.

The Constitutional Committee of the Riigikogu is of the opinion that § 15(2)6) of the VATA is in conflict with the Constitution, because it infringes the right to engage in enterprise, arising from § 31 of the Constitution, and is at the same time of discriminatory nature and in conflict with the principle of equal treatment, established in § 12 of the Constitution.

The Finance Committee of the Riigikogu explained that that the tax specification of cultural services, which has been in force since 1993 and is presently provided in § 15(2)6) of the VATA, was established with the aim of promoting the consumption of high culture in the public interests. The legislator has failed to define the concepts of high culture and events of high culture in the public interests. As the groups of experts of the Cultural Endowment of Estonia, the cultural affairs committees of local governments and the Ministry of Culture are competent to decide on the rate of public interest of cultural events, the support they decide to grant constitutes an expert appraisal of the public interest rate of the services provided.

On 19 October 2005 the Chancellor of Justice sent to the Finance Committee of the Riigikogu a memorandum on the conflict of § 15(2)6) of the VATA with the constitutional principle of equal treatment, the requirement of fiscal neutrality, and the principle of free movement of services, established in the Community law.

During the discussions following the Chancellor of Justice's memorandum the Finance Committee and the Cultural Affairs Committee of the Riigikogu did not manage to agree on how to bring § 15(2)6) of the VATA into conformity with the Constitution. In April 2006 the Finance Committee proposed to the Ministry of Finance that it analyse the created legal situation and find a solution for the elimination of the referred

conflicts. The Ministry of Finance supported the abolition of the referred tax incentive, but did not introduce a relevant draft Act through the Government of the Republic. Since 2005 the there have been three draft Acts in the legislative proceeding of the Finance Committee of the Riigikogu, which were aimed at substantial extension of the value added tax incentive on cultural services, but the Committee has decided not to support these draft Acts. The extension of the incentive to the events of mass and commercial culture would bring about – in the light of the purpose of the provision – a disproportional, unjustified and undesired pressure on the budget and the support to persons who do not need it. The Finance Committee of the Riigikogu is of the opinion that the state as well as the recipients of tax incentive need an adaptation period when the legal situation is changed. If § 15(2)6) of the VATA is not constitutional, the Financial Committee considers it appropriate to totally abolish the tax incentive under discussion.

11. The Põhja tax and customs centre of the Tax and Customs Board is of the opinion that § 15(2)6) of the VATA is not in conflict with the Constitution of the Republic of Estonia or the European Community Law.

Persons are treated equally when applying for support from the state, rural municipality or city budget or the Cultural Endowment of Estonia, in order to meet the conditions for the application of the more favourable value added tax rate, established in § 15(2)6) of the VATA, and consequently there is no violation of the general right to equality, established in § 12 of the Constitution. The restrictions on the freedom to engage in enterprise can be established if there are reasonable justifications.

The amount of budget and the proportion of grants therein are in proportion to each other, and the amount of grants determines the right to apply the more favourable value added tax rate established in the contested provision. In the case of sufficient finances there is no need for grants, or the proportion thereof can not be but marginal. Artificial insufficient financing of a budget of a performance or a concert through giving up the actually existing sources of financing, with the aim of maintaining the proportion of the amount of grants and that of the budget, does not create a situation where the freedom to engage in enterprise is restricted without a reasonable justification.

The opinion of the Tallinn Administrative Court that § 15(2)6) of the VATA impedes the free movement of goods and services, required by Article 14 of the Treaty establishing the European Community, is erroneous. §§ 1 and 2 of the Cultural Endowment of Estonia Act do not prevent the distribution of Cultural Endowment grants to companies registered in a Member State of the European Union, if the content of the project organised is in conformity with the purposes and duties established in the Cultural Endowment of Estonia Act. The performing arts institutions of a European Union Member State may receive grants from both the state budget and the budgets of local governments on an equal footing with the Estonian organisers of performances and concerts.

CONTESTED PROVISION

“§ 15. Value added tax rates

[…]

(2) The rate of value added tax on the following goods and services shall be 5 per cent of the taxable value:

[…]

6) organisation of performances or concerts by a state, municipal or private performing arts institution or the national opera on the condition that the funds received by the organiser of the performance or concert from the state, rural municipality or city budget or the Cultural Endowment of Estonia amount to at least 10 per cent of its budget revenue for the calendar year;”

[…]

OPINION OF THE CONSTITUTIONSL REVIEW CHAMBER

12. Pursuant to § 9(1) of the Constitutional Review Court Procedure Act (hereinafter “CRCPA”) a court shall transfer its judgment or ruling to the Supreme Court, if upon adjudication of a case it did not apply any relevant legislation or international agreement and declared it unconstitutional.

Only a norm which is decisive for the resolution of a matter can be regarded as relevant.

13. The Tallinn Administrative Court is of the opinion that § 15(2)6) of the VATA is in conflict with the constitution and is a norm which is of decisive importance for the adjudication of the case of the MTÜ Muusikaliteater.

The Constitutional Review Chamber of the Supreme Court agrees with the Tallinn Administrative Court in that the MTÜ Muusikaliteater could not apply the 5% value added tax rate to the sale of tickets for musicals “Georg” and “Tuhkatriinu” because of § 15(2)6) of the VATA, which makes the application of the more favourable value added tax rate conditional on the receipt of funds from the state, rural municipality or city budget or the Cultural Endowment of Estonia in the amount of at least 10% of budget revenue for the calendar year. Consequently, this is a norm having decisive importance for the adjudication of the dispute, which is the basis for this constitutional review matter.

14. The Chamber considers it necessary to point out that at the time the dispute emerged, that is from August 2005 until January 2006, the taxation of cultural services with value added tax was regulated by Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (the Sixth Directive). Article 13A(1)n) of the directive required that the states exempt from value added tax certain cultural services and goods closely linked thereto supplied by bodies governed by public law or by other cultural bodies recognized by the Member State concerned, yet it allowed the states to do so on the conditions established by themselves, taking into account the additional conditions established in the preamble of Article 13A(1) and in Article 13A(2).

The same sphere was also regulated by Article 12(3)c) of the Sixth Directive, which established that Member States were allowed to apply a reduced rate which was not to be less than 5 %, and was to apply only to supplies of the categories of goods and services specified in Annex H. Annex H provided for a group of goods and services that included admissions to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities.

Without evaluating the conformity between the referred provisions of the Sixth Council Directive the Chamber argues that at the material time of the dispute § 15(2)6) of the VATA must have been based on the provisions of the referred directive.

15. In addition to the aforesaid the Chamber points out that similarly with the earlier Sixth Council Directive, the taxation of cultural services with value added tax is now regulated by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

The Chamber is of the opinion that when enacting § 15(2)6) of the Value Added Tax Act the Riigikogu was required to observe the Constitution, the general principles of European law and the relevant provisions of the Sixth Council Directive.

16. The present constitutional review case is based on a dispute about whether that part of § 15(2)6) of the VATA, which provided for additional conditions for value added tax incentive, was in conformity with the principle of equal treatment. The observance of the principle of equal treatment is required by the Constitution as well as by the general principles of European law; consequently, the petition is admissible and the Constitutional Review Chamber of the Supreme Court is entitled to check the conformity between the principle of equal treatment and the condition, established in § 15(2)6) of the VATA, pursuant to which only those performing arts institutions whose funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia amount to at least 10 per cent of their budget revenue for the calendar

year could apply the 5% value added tax incentive when organizing concerts or performances.

17. The Tallinn Administrative Court declared § 15(2)6) of the VATA unconstitutional, because the court held that the norm was not in conformity with the principle of equal treatment, established in § 12(1) of the Constitution, and with the freedom to engage in enterprise, arising from § 31 of the Constitution.

18. Next, the Supreme Court shall first examine whether § 15(2)6) of the VATA is a norm conforming to the requirement of equality in legislation, arising from § 12(1) of the Constitution.

19. The equality in legislation requires that the laws treat equally all persons who are in a similar situation. This principle manifests the idea of substantial equality: equals must be treated equally and unequals unequally. But not every instance of unequal treatment of equals amounts to a violation of the right to equality. The prohibition to treat equals unequally is violated when a group of persons or a situation is treated unequally on an arbitrary basis. Unequal treatment can be regarded arbitrary when there is no reasonable justification for such differentiation. If there is a reasonable and appropriate ground, the unequal treatment by law is justified.

20. The Chamber is of the opinion that in this concrete case and in regard to value added tax incentives, what should be compared are the private performing arts institutions of whose budget revenue for the calendar year at least 10 per cent were funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia, and those private performing arts institutions of whose budget revenue for the calendar year the referred funds made up less than 10%. MTÜ Muusikaliteater belonged to the latter group.

21. The Constitutional Review Chamber of the Supreme Court argues that although the Riigikogu had pursued a reasonable aim when enacting this norm, the norm was not appropriate from the aspect of its actual effect, because if failed to achieve the desired aim.

The participants in the proceeding have pointed out that § 15(2)6) of the VATA enables the performing arts institutions, who meet the requirement of financing from public law funds in the amount of 10%, to apply the 5% value added tax rate to all their performances and concerts, irrespective of whether these are high culture performances and concerts or not. Furthermore, the Chamber is not convinced that the circle of private performing arts institutions offering high culture events is confined to those institutions who receive from the state, rural municipality or city budget or the Cultural Endowment of Estonia funds the amount of which is at least 10 per cent of their budget revenue for the calendar year.

22. On the basis of the foregoing the Chamber holds that the condition for the application of the value added tax incentive, established in § 15(2)6) of the VATA, pursuant to which the funds received from the state, rural municipality or city budget or the Cultural Endowment of Estonia must amount to at least 10 per cent of the annual budget revenue of the organiser of performances or concerts for the calendar year, is an arbitrary one. The Chamber can not see any other reasonable and appropriate grounds which could justify the discrimination prescribed by § 15(2)6) of the VATA.

That is why § 15(2)6) of the VATA, to the extent described above, is not in conformity with the principle of equal treatment, arising from § 12(1) of the Constitution.

23. Having found that the condition established in § 15(2)6) of the Value Added Tax Act does not meet the requirements of § 12(1) of the Constitution, the Chamber does not consider it necessary to analyse the allegations of the Tallinn Administrative Court about the conflict of the provision with the freedom to engage in enterprise, established in § 31 of the Constitution.

24. The Chamber hereby declares the provision unconstitutional and invalid to the extent that it establishes the condition that in order to apply the 5% value added tax rate the funds received from the state, rural municipality, or city budget or the Cultural Endowment of Estonia must amount to at least 10 per cent of the budget revenue of an organiser of performances or concerts for the calendar year.