Constitutional judgment 3-3-1-46-03

JUDGMENT
OF THE SUPREME COURT *EN BANC*

No. of the case	3-3-1-46-03
Date of judgment	19 April 2004
Composition of court	Chairman Uno Lõhmus and members Tõnu Anton, Jüri Ilvest, Henn Jõks, Ott Järvesaar, Eerik Kergandberg, Hannes Kiris, Lea Kivi, Indrek Koolmeister, Ants Kull, Villu Kõve, Lea Laarmaa, Jaak Luik, Jüri Põld, Harri Salmann, Tambet Tampuu and Peeter Vaher.
Court Case	Avanduse rural municipality government to declare the Government of the Republic Regulation no. 66 of 5 February 2002 unlawful and § 2 of the "State Budget for 2002" Act unconstitutional.
Disputed judgment	Judgment of the Tallinn Administrative Court of 6 August 2002 in administrative matter no. 3-656/2002 and judgment of the Tallinn Circuit Court of 31 January 2003 in administrative matter no. 2-3/160//22003.
Petitioner and type of action	Appeal in cassation of the Avanduse rural municipality government.
Type of proceeding	Written proceeding.

DECISION

To dismiss the appeal in cassation of the Avanduse rural municipality government and to uphold the judgment of the Tallinn Circuit Court of 31 January 2003 in administrative matter no. 2-3/160/2003

FACTS AND COURSE OF PROCEEDING

1. On 19 December 2001 the Riigikogu passed the "State Budget for 2002" Act, § 2 of which provides for a formula for the calculation of support to be appropriated to local governments from the support fund.

2. On 5 February, by its Regulation no. 66, the Government of the Republic approved the "Procedure for allocating budget funds appropriated for the support fund of rural municipality and city governments in the "State Budget for 2002" Act", appendix 1 of which stipulates the total amount of support allocated to local government units and separate funds for subsistence benefits.

3. On 12 March the Avanduse rural municipality government filed an action with the Tallinn Administrative

Court applying for the invalidation of The Government of the Republic Regulation no. 66 of 5 February 2002. It was argued in the action that for 2002 the Avanduse rural municipality was allocated from the state budget 1.3 million kroons less than the average of three previous years. Upon calculating the support the Government took into account the extraordinary revenue of 2.28 million kroons, accrued to the rural municipality budget in 2001 in the form of income tax on a sale of securities by a resident of the rural municipality. In 2002 the rural municipality no longer accrued such revenue. Because of the decrease of the amount allocated from the support fund the rural municipality is not capable of fulfilling the functions proceeding from law and is endangered by insolvency. Expenditure section 159 of § 1, and §2 of the "State Budget for 2002" Act, on which the contested Regulation is based, are in conflict with §§ 3(1), 12(1), 116(2), 123(2) of the Constitution, with paragraphs 4 and 5 of Article 9 of the European Charter of Local Self-Government (hereinafter "the Charter"), §§ 2(1) and 5(3) of the Rural Municipality and City Budgets and State Budget Correlation Act (hereinafter "the Correlation Act"), § 16(3) of the Roads Act, with § 28(1) of the Public Transport Act, and it should not be applied.

4. By its order no. 197-k of 19 March 2000 the Government of the Republic allocated the Avanduse rural municipality 200,000 kroons from the reserve, and by Regulation no. 207 of 27 June 2002 additional 500,000 kroons from supplementary budget to compensate for the decrease of the receipt of income tax paid by resident natural persons.

5. The Avanduse rural municipality government amended its action in the course of the court proceeding and applied for the declaration of unlawfulness of the referred Regulation of the Government of the Republic to the extent that upon allocating support from support fund the Regulation proceeds from the average of actual receipt of income tax paid by resident natural persons in 2000 and 2001, and upon calculating the revenue base of previous financial years of local governments does not allow to exclude single extraordinary receipts. This violates the rights of the rural municipality to adequate financial resources within national economic policy (Article 9(1) of the Charter), to financial resources commensurate with the responsibilities provided for by the Constitution and the law (Article 9(2) of the Charter), to a sufficiently diversified and buoyant financial system for guaranteeing financial resources (Article 9(4) of the Charter), to financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden (Article 9(5) of the Charter), to appropriations from the support fund of rural municipality and city budgets on the basis of forecast receipt of resident natural persons (§ 5(3) of the Correlation Act). The assessment of unlawfulness was applied for in order to file a claim for compensation for damage caused by an unlawful administrative legislation later on.

6. The Tallinn Administrative Court dismissed the action for the following reasons:

1) § 2 of the "State Budget for 2002" Act is not in conflict with the provisions of the legislative acts of general application referred to by the complainant. None of the provisions demand that a state, upon appropriating support to a local government, should not take into consideration a part of the revenue received by the local government. The complainant was under no obligation nor forced by emergency circumstances to spend the 2,2 million kroons received in 2001, and instead could have saved it for the following years, to compensate for the smaller support allocable by the state. The complainant was aware of how the support from support fund to the budgets of local government units is calculated, because the same formula was used in 2001. The revenue basis of local governments is based on a diversified and buoyant system. The revenue of local governments does not depend solely on the appropriations from the state budgets, but first and foremost on the state taxes accrued to local governments' budgets, and on economic activities;

2) as pursuant to § 6(5) of the Local Government Organisation Act the state must cover the expenses incurred in the performance of duties of the state imposed on a local government pursuant to law from the state budget, a local government must cover other expenses related to the functions of local government units with the resources found by itself, and the support fund is but for support;

3) the formula is not in conflict with § 5(3) of the Correlation Act, pursuant to which the forecast income to

the budgets from state taxes and fees is the basis for distribution of the support fund. The expression "forecast income" implies forecasting, which can be done on the basis of the receipts of previous years or on some other bases. As the "State Budget for 2002" Act is lawful, so is the Regulation issued on the basis of the Act.

7. In its appeal the Avanduse rural municipality government applied for the annulment of the judgment and for rendering of a new judgment. The Tallinn Circuit Court dismissed the appeal.

8. In its appeal in cassation the Avanduse rural municipality government applied for the annulment of the judgment of the administrative court and of the judgment of the district court and rendering of a new judgment without referring the matter for a new hearing.

9. The Administrative Law Chamber of the Supreme Court held that the hearing of the administrative matter requires the adjudication of an issue reviewable under the Constitutional Review Court Procedure Act – the conformity of § 2 of the "State Budget for 2002" Act to § 154 of the Constitution – and on the basis of § 70(1 [1]) of Code of Administrative Court Procedure referred the matter to the Supreme Court *en banc* for a hearing.

JUSTIFICATIONS OF PARTICIPANTS IN THE PROCEEDING IN THE SUPREME COURT

10. The Avanduse rural municipality government requests that § 2 of the "State Budget for 2002" Act be not applied to the extent that, upon allocating support, it allows only to proceed from the average of the actual receipt of income tax paid by resident natural persons in 2000 and 2001, and does not allow, upon calculating the revenue basis of local governments of previous years, to take into consideration the single extraordinary receipts. The rural municipality government argues that the referred formula is in conflict with § 3(1) and 123(2) of the Constitution, with paragraphs 4 and 5 of Article 9 of the Charter and with § 5(3) of the Correlation Act. The appeal in cassation is substantiated as follows:

1) Estonian system of financing of local governments is in conflict with Article 9(4) of the Charter, because the formula of support fund is too rigid. The circuit court interpreted Article 9(4) of the Charter formally, finding that the requirement of buoyancy of the system of financing local governments established therein is fulfilled when the amounts appropriated from the state budget are determined by the state budget for each year;

2) a system of financing local governments is not buoyant if it does not take into account the unequal annual distribution of financial sources. Extraordinary revenue, as well as a bankruptcy of the major employer of a local government, may cause unequal distribution of financial sources in different years. In such cases it is contrary to reason that irrespective of the decrease of the receipt of income tax, which can be foreseen with a great certainty, the revenue basis of a local government is rigidly calculated on the basis of the average receipt of two previous years;

3) it is impossible to consent to the opinion of the circuit court that the possibility of covering incidental expenses from the reserve of the Government of the Republic increases the buoyancy of the system. The problem of the Avanduse rural municipality was solved with the help of the reserve to a minor extent. Yet it is not right that the only possibility of solving such situations is the reserve of the Government of the Republic, which is not meant for solving the situations the occurrence of which can be foreseen with certainty already before the adoption of the state budget. The situation where the existence of resources necessary to local governments for the discharge of their duties depends solely on the discretion of the Government, is not normal;

4) the opinion that a local government has no legitimate expectation that extraordinary revenue shall not be counted into the revenue basis of the following year, is erroneous. In the summer of 2000 the Avanduse rural municipality informed the Ministry of Finance of a possible extraordinary receipt of income tax. The local governments division of the budget department of the Ministry assured the Avanduse rural municipality that the extraordinary receipt of 2001 will not be taken into account in 2002. So far the practice had been that

upon a reasoned request the extraordinary receipts were not included in the revenue basis. The circuit court states these considerations are “alleged”, although during the dispute in court no one has called the existence of these into question and it appears from the evidence submitted to courts that the existence of these considerations was recognised during the budget negotiations between the local government associations and the Government of the Republic;

5) the local government does not know the formula of the next year’s support fund, because the formula is determined by annual budgets. It is absurd to require that a local government save extraordinary receipts for the following years without knowing how extraordinary receipts may affect the receipts from support fund. Allocations from the support fund should be made on the basis of the actual revenue basis of the following year;

6) the circuit court violated § 330(6) of the Code of Civil Procedure by failing to assess the conformity of the support fund formula to Article 9(5) of the Charter and by not applying the principles of the referred Article upon interpreting § 5(3) of the Correlation Act. Thereby the circuit court has distorted the statements of the Avanduse rural municipality;

7) the support fund formula is unconstitutional, because it does not allow to exclude extraordinary receipts from the revenue basis. Proceeding from paragraphs 4 and 5 of Article 9 of the Charter and from § 5(3) of the Correlation Act the increase of the revenue of a local government in one fiscal year should affect the allocation of support from the following year’s support fund only if the extraordinary receipt gives rise to foreseeing greater receipts in the following year. Yet the support fund formula excluded the possibility of exceptions when it was obvious that the rigid observance of the receipts of previous years would result in a manifestly wrong prognosis;

8) the circuit court violated § 15(1) of the Code of Administrative Court Procedure by ascertaining facts about which the parties could not express their opinions. From the minutes of the budget negotiations between the local government associations and the Government of the Republic the court concluded that the Avanduse rural municipality should have been aware that the extraordinary revenue of 2001 shall be calculated into the revenue basis of 2002. The circuit court should have given the Avanduse rural municipality a chance to express its opinion on the issue, because the ascertained facts can not be contested in cassation proceedings.

11. The Constitutional Committee of the Riigikogu is of the opinion that the existence of an unconstitutional situation can not be proved because it is not clear to what extent the Avanduse rural municipality has not received financing for the fulfilment of its duties of the state. To ascertain a violation of the financial guarantees of a local government it is necessary to ascertain the duties of the state that a rural municipality had to unconstitutionally finance out of its own revenue. As the support fund was not the only source of financing the performance of the duties of the state in 2002, then the support fund distribution formula in itself can not create an unconstitutional situation. The distribution of duties and financial relationships between local governments and the state need to be determined with greater precision.

12. The Government of the Republic is of the opinion that § 2 of the “State Budget for 2002” Act is in conformity with the Charter and the Constitution and that the judgments of the administrative court and the circuit court are correct.

The Government argues the following:

1) the Avanduse rural municipality has not presented evidence to the effect that in 2002 it was unable to perform the duties imposed on it. In 2002 the Avanduse rural municipality received 366,000 kroons more than it actually spent, in addition the cash reserves remained intact and a part of the surplus of 2001 with the total amount of 21,400 kroons;

2) it is impossible to ascertain the extraordinary nature of the receipt of income tax in every concrete case.

Neither is it possible to foresee the receipt or non-receipt of extraordinary income tax for the next fiscal year. The state has come to the conclusion that the most correct way to forecast the estimated receipts is to use the actual receipts of previous years as a basis. As the support fund formula is a norm of general application, the forecast of estimated receipts based on actual receipts may, for some, result in a less suitable solution. The decreased well-being of some addressees of the norm does not automatically render the norm unlawful. A legislation of general application can not take into account all subjects or contain the absolutely best possible regulation for all subjects. Failure to take into account the extraordinary receipt of income tax by a concrete local government would do injustice to the majority of local governments who do not receive extraordinary income tax revenues;

3) Article 9(5) of the Charter does not refer to yearly equalisation of revenue and expenditure within one local government, instead it refers to the equalisation of differences between the revenue and expenditure bases of different local governments. The idea behind the support fund is to allocate additional funds to local governments with smaller financial resources. The support fund formula of 2002 equalises the revenue basis of the Avanduse rural municipality, which was bigger in 2001, with that of other local governments. A local government has no timeless subjective right or a legitimate expectation to receive support from the support fund. The Avanduse rural municipality received the money it was not appropriated from the state budget of 2002 in 2001 in the form of the extraordinary receipt of income tax;

4) taking into account the reforms affecting the drafting of the state budget and distribution mechanism of the support fund, the support fund formula can not be established by the State Budget Act. The fact that the formula is established annually in a state budget for each year increases the buoyancy of the system of financing local governments. The local governments have been given sufficient possibilities to have a say in the formation of the support fund formula, and therefore substantial amendment of the formula does not violate the principle of legal certainty;

5) the declaration of unconstitutionality of the support fund formula established in the state budget for 2002 would affect the formulae established by the state budgets of subsequent years. The declaration of unconstitutionality of the formula may result in numerous claims for compensation against the state.

13. The Chancellor of Justice argues the following:

1) The Rural Municipality and City Budgets and State Budget Correlation Act does not specify how the estimated receipts are forecast. That is why § 5(3) of the Acts allows for different interpretations. Taking into account the average of the actual receipts of income tax during the two previous years when calculating the amount of support fund, is one way of ascertaining the forecast receipts established in § 5(3) of the Correlation Act;

2) there is a gap in the State Budget Act as well as in the state budget Acts for each year. A situation where there are exceptional revenues in the budgets of rural municipalities and cities, which affect the level of support calculated into the state budget of the following year, has not been regulated. The support fund distribution formula of § 2 of the “State Budget for 2002” Act does not contain a possibility to make exceptions in the case of unforeseen revenues, and provides for the average of the actual receipts of income tax of resident natural persons in 2000 and 2001 as the basis. This means that the unforeseen revenue will result in the decrease of the support in next year. Bearing in mind the hierarchy of legislative acts the State Budget Act as a constitutional Act should provide for the general principles of the distribution of the support fund and establish the criteria in regard of which the formula could be amended annually without violating the general principles;

3) §§ 154(2) and 157 of the Constitution and the Charter in their conjunction create for a local government a legitimate expectation that the state shall guarantee, in the longer run and for each year, a sufficient revenue basis for a local government for the discharge of the duties imposed on it. The objective of the support fund is to allocate additional funds to local governments with smaller financial resources, and to finance the performance of obligations prescribed by law and the creation of prerequisites for development (subsections

(1) and (2) of § 5 of the Correlation Act). The formula of distribution of support fund must always guarantee a sufficient revenue basis for local governments, including a mechanism for taking into account exceptional revenue and revenue foregone when planning the estimated receipt of income tax in the following year. The failure to regulate the referred situations does not contribute to the fulfilment of the objective the state has undertaken under paragraphs 2, 4 and 7 of Article 9 of the Charter. The rigid rule, based on the actual average, does not help to fulfil the objective of § 154 of the Constitution and Article 9 of the Charter, either. There is a more suitable measure to guarantee paragraphs 2 and 4 of Article 9 of the Charter than the formula of distribution of support fund of § 2 of the "State Budget for 2002" Act. This measure is a system of exceptions, that would guarantee the maintenance of the average volume of support fund support in the case of extraordinary receipt of income tax;

4) there are no indisputable justifications for the intensity of the infringement contained in § 2 of the "State Budget for 2002" Act or for the annual amendment of the formula of distribution of the support fund. That is why substantial amendment of the support fund distribution formula requires a *vacatio legis*.

14. The Minister of Justice is of the opinion that the support fund distribution formula of § 2 of the "State Budget for 2002" Act and the Government of the Republic Regulation no. 66 of 5 February 2002 are in conflict with § 154 of the Constitution to the extent that upon distribution of support fund the extraordinary receipts of income tax are always taken into consideration. In sum, the Minister justifies the unconstitutionality with the fact that there were no suitable legislative alternatives to balance the possible consequences of such restrictions. The Minister of Justice argues the following:

1) although paragraphs 4 and 5 of Article 9 of the Charter are not self-implementing, they contain a guideline on how to assess the performance of international obligations undertaken by a state. Also, Article 9 helps to substantiate the concept of a sufficient revenue basis. The substance of paragraphs 4 and5 of Article 9 has been transposed into Estonian law first and foremost through § 5 of the Correlation Act;

2) if the possibility to take into consideration extraordinary receipts when making appropriations from the support fund had been left out of § 2 of the "State Budget for 2002" Act, it could have resulted in the violation of the principle of equal treatment – a local government unit which had received extraordinary revenue would have been placed in an advantaged position in comparison with those local government units who had no such receipts. § 2 of the "State Budget for 2002" Act is not in conflict with the requirement of a sufficient revenue basis for local governments, if there exist other appropriate possibilities for taking into account the facts of a concrete case, in order to guarantee the fulfilment of the requirement of a sufficient revenue basis. Neither does Article 9(5) of the Charter prescribe for any obligatory measures that the states should take to equalise the uneven distribution of expenditure of financial sources. At the same time, what is to be guaranteed, is that the financial resources be commensurate with the responsibilities imposed on local governments (paragraph 2 of Article 9);

3) there is no dispute that due to the shortage of money the Avanduse rural municipality could not fulfil the duties prescribed by law or that the shortage of money was caused by the taking into account of the extraordinary receipts when making appropriations on the basis of the formula included in the state budget for 2002. This is exactly why in 2002 the rural municipality applied for and was allocated additional resources;

4) the only legal possibilities for alleviating the rigidity of the formula of distribution the support fund of 2002 were the reserve of the Government of the Republic and appropriations from the supplementary budget. The need for a supplementary budget is but hypothetical when adopting a budget. Allocating money from the reserve fund is a discretionary decision of the Government of the Republic, and the discretion is not restricted by law. Pursuant to § 154 of the Constitution the regulation for guaranteeing a sufficient revenue basis for local governments should be established by an Act. The legislator can not make the guarantee of a sufficient revenue basis dependent on the resolutions of the executive. Appropriations from the reserve fund of the Government of the Republic are of incidental nature and not in conformity with the principle of legal certainty.

CONTESTED PROVISIONS

15. § 2 of the "State Budget for 2002" Act (RT I 2002, 4, 8), the constitutionality of which was contested, was in force in the following wording:

"§ 2. Support allocated from support fund to the budget of a local government unit (Tn) shall be calculated as follows:

$T_n = ((m \times a_k - a_n)\ 0.9 \times c_n) + T_s$/ ? $T_s \times 338400000$, wherein the negative value of the mathematical expression $(m \times a_k - a_n)\ 0.9 \times c_n)$ is considered to be 0 upon calculating support fund;

m - is the factor of support level;

a_k - the total amount in kroons per one inhabitant in Estonia of the average of the actual receipt of income tax paid by resident natural persons in 2000 and 2001, of estimated land tax in 2002, and of estimated fees for the use of natural resources;

a_n - the total amount of the average of the actual receipt of income tax paid by resident natural persons in 2000 and 2001, of estimated land tax in 2002, and of estimated fees for the use of natural resources per one resident in a local government unit;

c_n - number or residents of a local government unit;

$T_s = 0.7 \times tt_{2201} + 0.3 \times tt_{2000}$

T_s - financial resources allocated to a local government unit in 2002 for the payment of subsistence benefits;

tt – the amount of resources allocated for subsistence benefits in a concrete local government unit in a concrete year."

16. By Appendix 1 to the Government of the Republic Regulation no. 66 of 5 February 2002 (RT I 2002, 16, 95) money was allocated to local governments from the support fund. The Avanduse rural municipality government contested the referred Regulation to the extent that it concerns the Avanduse rural municipality, i.e. the entry '518,000 kroons', of which 243,000 kroons were meant for subsistence benefits.

OPINION OF THE SUPREME COURT EN BANC

I.

17. At the time of adoption of the state budget for 2002 and issuing of the Government of the Republic Regulation no. 66 of 5 February 2002, the formation of the budgets of local governments and financing of local governments was regulated by the Rural Municipality and City Budget Act and by THE Rural Municipality and City Budgets and State Budget Correlation Act. The latter became invalid on 20 July 2002 (RT I 2002, 64, 393).

18. § 2(2) of THE Rural Municipality and City Budgets and State Budget Correlation Act required that the financial resources of local governments must be commensurate with the responsibilities provided for by the Constitution and the law.

Pursuant to § 2(1) of the Rural Municipality and City Budgets Act the independent budget of a rural municipality or city is composed of all the revenue and expenditure of the corresponding local government for a budgetary year, which shall be balanced ultimately. Pursuant to § 5 of the Rural Municipality and City Budgets Act the budget revenue of a local government included revenue from taxation, revenue from municipal enterprises, agencies and assets, financial support and revenue intended for specific purposes, loans and receipts on interest and other receipts. Out of state taxes the local government budgets received

56% of the income tax paid by resident natural persons (§ 5(1) of the Income Tax Act) and land tax (§ 6 of the Land Tax Act). Fees for mining rights at deposits and for the special use of water were also paid to the budgets of local governments (§ 5(3) of the Correlation Act).

19. Pursuant to § 2(1) of the Rural Municipality and City Budgets and State Budget Correlation Act allocations from state budget to local governments were made in the form of allocations to the fund for supporting the budgets and as allocations intended for specific purposes.

The establishment of a support fund was prescribed by § 5 of the Correlation Act. The support fund was established in the state budget for every year for the allocation of additional resources to the budgets of local governments, and the performance of obligations prescribed by law and the creation of prerequisites for development were financed from the support fund. The forecast income to the budgets from state taxes and the fees for mining rights at deposits and for the special use of water, the size of the permanent population of the rural municipalities and cities, and other attributes of the rural municipalities and cities were the bases for distribution of the support fund.

II.

20. The financial guarantees of local governments are established in §§ 154 and 157 of the Constitution. The Supreme Court *en banc* is of the opinion that in relation to the present case it is necessary to clarify § 154 of the Constitution, which establishes the following:

"All local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law.

Duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget."

21. Pursuant to § 154 of the Constitution the duties of local governments can be divided into duties inherently belonging to local governments (resolution and management of local issues) and the duties of the state, which can be imposed on a local government either pursuant to law or by agreement with the local government. Proper performance of both, the duties of local governments and the duties of the state, requires that a local government has sufficient resources for that. It proceeds from § 154 of the Constitution that the establishment of a mechanism of financing local governments to guarantee them sufficient financial resources is a responsibility of the state.

22. A prerequisite for observing § 154 of the Constitution upon financing local governments is clarity about the duties of the state imposed on local governments by law. Unfortunately, the valid law does not define clearly the duties of the state imposed on local governments by law. That is why it is unknown how much money all local governments together or individual local government units separately need for the performance of the duties of the state.

23. The funding of the expenditure related to duties of the state imposed by law on a local government is regulated by the second sentence of § 154(2) of the Constitution, pursuant to which such expenditure shall be funded from the state budget. It is important for the observance of § 154(2) of the Constitution whether the system of financing local governments as a whole guarantees that local government units get sufficient funds from the state. The Supreme Court *en banc* is of the opinion that in a situation where the line between inherently local government duties and the duties of the state imposed on local governments by law is unclear, allocation of additional funds to local governments through the support fund established by a state budget for a specific year or, if necessary, from the state budget of a concrete year, may prove to be sufficient for the fulfilment of the provisions of § 154(2) of the Constitution.

24. § 154(1) of the Constitution requires that the state establish a mechanism to guarantee that a local

government has sufficient funds for performing the duties which are inherently local government duties. It is up to the legislator to decide whether the receipt of funds is guaranteed, among other things, by imposition of local taxes, by payment of state taxes directly into local budgets or by appropriations from the state budget.

25. The Supreme Court *en banc* is of the opinion that the stability of the system of financing local governments is an essential value. A stable financing system, which is known beforehand, enables local government units to draft development plans with greater precision and to implement these more effectively. On the other hand, the stability of financing system of local governments can not be an end in itself.

III.

26. The Avanduse rural municipality government argues in its appeal in cassation that the formula of § 2 of the "State Budget for 2002" Act is in conflict with Article 9 of the European Charter of Local Self-Government ("the Charter").

27. The Riigikogu ratified the Charter on 28 September 1994 (RT II 1994, 26, 95).

Article 9 (Financial resources of local authorities) of the Charter refers to the financing of local governments as follows:

1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.

3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

4. The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

5. The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.

6. Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.

7. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

8. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

28. Paragraphs 1 and 2 of Article 9 of the Charter impose a duty on the state to guarantee adequate financial resources to local governments for the performance of their duties. In the Republic of Estonia the right of local governments to adequate financial resources derives from § 154 of the Constitution (see above paragraphs 20-24of this judgment). It is up to the legislator to decide whether the resources are guaranteed by the possibility to impose local taxes, by payment of state taxes directly into local budgets or by

appropriations from the state budget.

29. Article 9(4) of the Charter prescribes that the financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

The Supreme Court *en banc* is of the opinion that the diversity of the financial system was guaranteed through the above referred different receipts to local governments and through the additional appropriations from the state budget (see paragraphs 18 and 19 of this judgment). The requirement of buoyancy was guaranteed, among other things, by § 9(2) of the State Budget Act, which established that decreases in budget revenue and increases in budget expenditure on the basis of legislation enacted by the Riigikogu or the Government of the Republic after the passage of the budget shall be covered from the state budget. The requirement of buoyancy of a system of financing local governments means also that upon allocating funds to local governments it should be possible to take into account all revenue received by a local government, including extraordinary revenue.

30. Article 9(5) of the Charter provides for additional guarantees for the protection of local governments with smaller financial resources and requires the institution of financial equalisation procedures or equivalent measures to correct the effect of unequal distribution of potential sources of finance and expenditure. The Article does not prescribe the criteria a state must take into consideration when equalising financial resources. It is important that the measures a state takes should equalise the differences upon unequal distribution of potential sources of finance and expenditure.

IV.

31. The Avanduse rural municipality government filed an action applying for the establishment of unlawfulness of Appendix 1 of the Government of the Republic Regulation no. 66 of 5 February 2002, in order to contest entry no. 1 of the Appendix, concerning the rural municipality, to the extent that pursuant to the procedure established in § 2 of the "State Budget for 2002" Act, from the funds designated for the support fund of rural municipality and city budgets, the Avanduse rural municipality was appropriated 518,000 kroons, including 243,000 kroons for subsistence benefits. These entries regulate individual cases and can be contested in administrative courts under § 4(1) of the Code of Administrative Court Procedure. Thus, the hearing of the action of the Avanduse rural municipality government was within the competence of administrative courts.

32. § 2 of the "State Budget for 2002" Act establishes a regulatory framework of general character (formula of support fund), on the basis of which the Government of the Republic issued the contested Regulation. Proceeding from § 15 of the Constitution it is possible, together with an administrative act, to contest also the constitutionality of the legislation of general application which served as the basis for issuing the administrative act.

The Avanduse rural municipality government filed the action with an administrative court at the time when the Constitutional Review Court Procedure Act, passed in 1993, was still in force. During the time of validity of the Act the administrative court procedure was the only court procedure available to local governments for requiring the establishment of unconstitutionality of a norm regulating individual cases, included a Regulation of the Government of the Republic.

33. §§ 6 and 7 of the Code of Administrative Court Procedure do not preclude the hearing of an action applying for declaration of unlawfulness of an administrative act in one administrative court proceeding and the filing of a claim for compensation against the state in another administrative court proceeding. Pursuant to the second sentence of § 7(1) of the same Code an action for the establishment of the unlawfulness of an administrative act or measure may be filed by a person who has legitimate interest in the matter. If the action for the establishment of unlawfulness was filed with the intent of filing a claim for compensation later on,

then the satisfaction of the action for the establishment of unlawfulness requires that first the violation of the subjective rights of the complainant be established. The amount of compensation for damage can subsequently be determined during the hearing of an action for compensation for damage.

34. The Avanduse rural municipality government filed the action for establishment of unlawfulness in order to file a claim for compensation later on. For such an action to be satisfied the Avanduse rural municipality government had to show the violation of subjective rights by the contested administrative act.

35. The Avanduse rural municipality government argued in the action filed with the court that due to the decrease of sums allocated from the support fund it could not perform the duties prescribed by law and that it was in danger of becoming insolvent. In the amendments to the action, filed on 23 July 2002, the Avanduse rural municipality government argued that the contested regulatory framework violated the rights of the rural municipality to adequate financial resources (Article 9(1) of the Charter) and to financial resources commensurate with the responsibilities provided for by the Constitution and the law (Article 9(2) of the Charter).

Thus, the rural municipality government proceeds from the basis that the contested administrative act is unlawful because by the act the rural municipality was allocated less money than it required for the performance of its constitutional duties. Consequently, in the course of review of unlawfulness, it has to be established whether in 2002, because of the contested administrative act, the Avanduse rural municipality did not have enough money for the performance of its duties and the duties of the state. If there was no shortage of money, the allegation of the Avanduse rural municipality government that the contested administrative act violated its right to receive adequate financial resources from the state, is unfounded.

36. Irrespective of the allegations about financial difficulties, the Avanduse rural municipality government has failed, in the course of the court proceeding, to refer to any duty provided for by the law, which was not fulfilled due to the shortage of money. Neither have the courts ascertained that the duties of the Avanduse rural municipality remained unfulfilled because of the shortage of money.

37. In 2002 the Avanduse rural municipality applied for additional financial resources from the state. By its Order no. 197-k the Government of the Republic allocated 200,000 kroons to the Avanduse rural municipality from its reserve, and by its Regulation no. 207 of 27 June 2002 the Government allocated 500,000 kroons to compensate for the decrease of the income tax paid by resident natural persons. The Avanduse rural municipality has not argued that after these receipts it still could not fulfil some of its duties.

38. As appears from what has been said above (see paragraphs 33-37 of this judgment) the courts have not established that the contested administrative act has violated the right of the Avanduse rural municipality to adequate financial resources. § 2 of the “State Budget for 2002” Act is not a relevant provision, because the action of the Avanduse rural municipality should have been dismissed irrespective of the provision.

As § 2 of the “State Budget for 2002” Act is not of decisive importance for the adjudication of the action, the Supreme Court has no ground to review the constitutionality thereof.

39. Because of the above reasons there is no need to deal with the allegations of the appellant in cassation concerning the violation of the rules of court procedure.

40. The appeal in cassation of the Avanduse rural municipality shall be dismissed.

CONCURRING OPINION
of justice Uno Lõhmus

I agree with the opinion of the majority of the Supreme Court *en banc* that the appeal in cassation of the

Avanduse rural municipality should be dismissed. I can not, though, agree to all arguments of the judgment. The following is my opinion.

1. The Avanduse rural municipality government requested in the administrative court that the court declare unlawful one part of the Regulation of the Government of the Republic of 5 February 2002. By this Regulation the Government distributed the support fund money, provided for by the "State Budget for 2002" Act, between local governments. The amounts allocated to local government were determined according to the formula included in § 2 of the "State Budget for 2002" Act. By that Regulation the Avanduse rural municipality was allocated 518 000 kroons, including 243 000 kroons for the payment of subsistence benefits.

The cause of dissatisfaction of the Avanduse rural municipality government was not the allocation of finances but the fact that the allocated sum was by 14% smaller than that in 2001. The rural municipality government was of the opinion that the Regulation was unlawful because of the fact that the support fund formula of the "State Budget for 2002" Act was in conflict with the Constitution and the European Charter of Local Self-Government. The formula took into consideration how much income tax of natural persons local governments accrued in 2000 and 2001.

The year 2001 was a lucky one for the Avanduse rural municipality, the local municipality accrued 4 million 79 thousand kroons of income tax of natural persons, which was more than two times the amount of 1 million 717 thousand, accrued in 2000. The tax revenue of the rural municipality increased in 2001 because of a big income of one of the residents of the municipality that year. Unfortunately, the luck of 2001 turned into misfortune in 2002. In addition to the fact that the amount of income tax of natural persons accrued into the municipality budget that year was materially smaller that in the previous year, i.e. 2 million 2233 thousand kroons, the big tax revenue in 2001 also resulted in the decrease of the rural municipality and city support fund allocation. That is why the rural municipality found that the formula, which did not take into account the extraordinarily big revenue in one of the years to be taken into consideration, was unconstitutional.

2. The argument of the complaint of the rural municipality government, submitted to the administrative court on 12 March 2002, that because of the decrease of the amount allocated from support fund the rural municipality was unable to fulfil the tasks prescribed by law, seemed justified, as one weak after the filing of the complaint with the court the Government of the Republic allocated 200 000 kroons to the municipality from its reserve, and by the Regulation of 27 June 2002 the Government allocated additional 500 000 kroons from the supplementary budget for the compensation for the decrease of the income tax revenue.

The rural municipality government argued that the part of the Regulation allocating support fund finances which concerned the Avanduse rural municipality was unlawful and the support fund distribution formula was unconstitutional, because the formula did not guarantee sufficient resources for the rural municipality for the performance of its duties, and that is why the municipality had to apply for additional finances from the Government of the Republic. The Supreme Court *en banc* came to an opposite conclusion on the basis of the same facts. The majority of the Supreme Court *en banc* is of the opinion that the rural municipality had not argued, nor had the courts ascertained that "[…] after these receipts it still could not fulfil some of its duties." (paragraph 37, see also paragraph 36). The majority of the Supreme Court*en banc* also found that § 2 of the "State Budget for 2002" Act was not a relevant provision, because irrespective of the provision the complaint of the Avanduse rural municipality government should have been dismissed (paragraph 38).

3. In my opinion the assessment of the lawfulness of the Regulation of the Government of the Republic, providing for the amount allocated to the Avanduse rural municipality government from the support fund by the budget for 2002, and the assessment of the constitutionality of formula for distributing finances of the state budget Act for the same year, depend on whether the individual parts of the formula, taken separately, condition to what extent a local government is capable of fulfilling duties of the state assigned to a local government pursuant to law and duties which essentially belong to the competence of local governments. In other words, is it at all possible to assess the constitutionality of the rules for the formation of local

governments' revenue on the basis of individual norms?

4. First of all, it has to be clarified, what are the duties of a local government and what financial guarantees are provided for local governments by the Constitution. I agree with the majority of the Supreme Court en banc that pursuant to § 154 of the Constitution the duties of a local government are divided into essentially local government duties and the duties of the state. The Constitution fails to determine what are the duties of the state and what are the local duties of a local government. The Constitution imposes certain duties on local governments and the state for joint fulfilment. Thus, families with many children and persons with disabilities shall be under the special care of the state and local governments (§ 28(4) of the Constitution), the state and local governments shall maintain the requisite number of educational institutions (§ 37(2)). § 14 stipulates that the guarantee of rights and freedoms is the duty of the legislative, executive and judicial powers, and of local governments (§ 14). The duties of local governments are also imprecisely determined in the Acts.

Some conclusions can still be drawn on the basis of § 154 of the Constitution. Firstly, the extent of the duties of the state depends on the legislator. Secondly, the extent of duties may be increased or decreased by law. Thirdly, the expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget. The latter expresses the financial guarantee of a local government. If a state imposes a duty on a local government, it shall also, pursuant to the Constitution, provide for resources for the fulfilment of the duty.

Some of the Acts *expressis verbis* refer to the funding of expenses from the state budget. For example, pursuant to the Social Welfare Act subsistence benefits shall be paid by local governments from funds earmarked for a specific purpose from the state budget (§ 22(3)). Other expenditure relating to state social welfare shall also be financed from the state budget (§ 42). Pursuant to § 16(3) of Roads Act the division of funds for the management of local roads and streets shall be specified in the state budget for each budgetary year, pursuant to § 28(1) of Public Transport Act on commercial lines school pupils and students shall be compensated for their travel expenses out of the funds allocated from the state budget.

5. The Supreme Court *en banc* did not reach a consensus on how to interpret the second sentence of the second paragraph of § 154 of the Constitution. The majority is of the opinion that the sentence "Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget" does not mean the state's obligation to allocate the finances necessary for the fulfilment of duties of the state annually through the state budget. The majority of the Supreme Court en banc found that the system of financing local governments as a whole should guarantee that the local governments receive adequate resources from the state (§§ 21-23).

It is difficult to consent to such an interpretation. The system of financing local governments and the state budget are not concepts to be regarded identical. A local government receives only a part of finances necessary for the fulfilment of duties through the state budget. Part of income tax of natural persons is accrued by a local government unit of the place of residence of the tax payers. The revenue of a local government is supplemented by land tax, local taxes, receipts from economic activities, etc. The function of the financing system is wider, it shall guarantee the fulfilment of duties of the state and create preconditions for the development of local governments. The European Charter of Local Self-Government states that the financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks. According to my conviction the objective of the second sentence of the second paragraph of § 154 of the Constitution is to preclude under-financing of the duties imposed on local governments by the state. A local government must be confident that necessary finances shall be allocated to it from the state budget, and it must have a possibility to plan the development of the local government in the long run.

It is my understanding that the second sentence of the second paragraph of § 154 of the Constitution should be interpreted to mean that when drafting the state budget the expenditure of local governments for fulfilling

duties of the state should be forecast and the expenditure should be financed from the state budget.

6. This interpretation leads to the conclusion that the regulation of financing the performance of duties of the state imposed on local governments does conform to the letter and spirit of the Constitution. Thus, it was not a component of the support fund distribution formula that was a problem, but the regulation as a whole. In 2002 the state distributed 1.37 billion kroons to local governments through the support fund. The total amount to be distributed affected the amount received by the Avanduse rural municipality just as much as did any other component of the formula. If the amount to be distributed were bigger, the Avanduse rural municipality would also have received more.

The objective of the support fund was not only allocation of finances for the fulfilment of duties of the state. Money was allocated, *expressis verbis,* for the payment of subsistence benefits. Some local governments only received money for the performance of this duty of the state. The reason is also understandable, as in those local governments the tax revenue per resident is significantly higher than in the majority of other local governments. Through the support fund the state redistributed the income tax revenue it has accrued to those local governments where the revenue is smaller. The lower the revenue of a local government per resident, the more money the local government was to receive, to bring the revenue level closer to the average. The support fund formula was to balance the revenue differences in local governments. Accordingly, the new wording of § 9 of the State Budget Act implements the term “compensatory fund”.

7. In my opinion, the reason why financing through the support fund or compensatory fund is not compatible with the Constitution, lies in the fact that the amount of the support fund is not determined by the actual needs of a local government, but by the budgeting policy of the Government, which in turn depends on the balance of powers.

8. Nevertheless, the necessity of mechanisms for financial harmonization to protect the local governments with smaller financial resources can not be called into question. This is also emphasized by Article 9(1) and (2) of the European Charter of Local Self-Government, and by § 154(1) of the Constitution, pursuant to which the state has to guarantee that local governments have adequate revenue basis, enabling them to act independently and manage all local issues.

9. In summary, pursuant to § 154(2) of the Constitution, by the state budget for each year each local government should be allocated finances in the amount that covers the expenditure of performing duties of the state. The observance of this principle requires that it be clear, what the duties of the state are, and that expenditure be forecast for each budgetary year.

The first indent of § 154 obligates the state to implement measures for harmonizing the revenue of local governments, in order to balance the unequal financial sources and expenditure, and to guarantee adequate financial resources to local governments.

10. The establishment of support (compensatory) fund distribution formula by the state budget for each year is not compatible with the principle of legal certainty. The effect of an annual budget is limited to one year, and thus local governments are unaware of the principles of distribution of compensatory fund until the draft annual budget is completed, in fact there is no certainty until the annual budget Act has entered into force. Such a situation does not foster making long-term plans. Financing system must be sufficiently diversified and buoyant, but it also must give local governments certainty and possibility to plan their development.

11. When hearing the complaint of the Avanduse rural municipality the Supreme Court could not assess the system of financing local governments as a whole, because the complainant had not posed the question like that. On the basis of the complaint the review function of the court was confined to assessing whether the support allocated to the rural municipality was calculated correctly and whether the support fund distribution formula was constitutional. As the finances allocated on the basis of support fund distribution formula constituted but a part of the finances necessary for the performance of the tasks of the rural municipality, it is not possible to decide on the basis of the formula only, whether the legislator had violated the financial

guarantees of local governments provided for in § 154 of the Constitution.

That is why I consent to the opinion of the majority of the Supreme Court *en banc* that the Avanduse rural municipality had failed to show that the contested Regulation of the Government of the Republic, taken separately, violated the rights of the local government.

DISSENTING OPINION
of justice Jüri Põld,
joined by justices Tõnu Anton, Indrek Koolmeister,
Jaak Luik and Harri Salmann

I do not consent to the opinion of the Supreme Court *en banc* that the contested Regulation of the Government of the Republic does not violate the rights of the Avanduse rural municipality. To substantiate my opinion I shall, first of all, state my understanding of what requirements are set by the Constitution to financing local governments (I). Then I shall deal with the issue of whether the contested Regulation violated the rights of the Avanduse rural municipality (II). In part III of the dissenting opinion I shall analyse the constitutionality of the support fund formula established in § 2 of "State Budget for 2002" Act and of §§ 2 and 5 of the Rural Municipality and City Budgets and State Budget Correlation Act.

I.

1. The financial guarantees of local governments are stipulated in §§ 154 and 157 of the Constitution, the content of which is not confined to financial guarantees. In the court case of the Avanduse rural municipality it is necessary to interpret § 154 of the Constitution. § 154 of the Constitution establishes the following:

"All local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law.

Duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget."

2. The financial guarantees of local governments are directly related to the duties imposed on local governments by the Constitution. According to the Constitution the duties of local governments can be divided into those which are of essentially local government nature (resolution and management of local issues) and into duties of the state, which can be imposed on a local government only pursuant to law or by agreement with the local government. The proper performance of both duties, those of an essentially local government nature and the duties of the state imposed on a local government, requires that a local government must have money for that. The formulation of rules for financing local governments and guaranteeing sufficient financial resources to local governments is, proceeding from § 154 of the Constitution, a duty of the state.

3. A prerequisite of observance of § 154 of the Constitution is clarity about at least what the duties of the state imposed on local governments pursuant to law are and what the essentially local government duties are. The valid law fails to determine the duties of the state imposed on local governments pursuant to law precisely and unambiguously. That is why it is not known how much money the local governments on a whole and each separately need for the fulfilment of such duties.

The failure to determine by law the duties of the state imposed on local governments does not prevent the possibility of review of constitutionality of financing local governments. A conclusion to the contrary would inevitably result in a view that the state may evade observance of § 154 of the Constitution by not determining by law the duties of the state imposed on local governments.

In a situation where the referred duties have not been determined by law it is the court adjudicating a dispute that has to determine the duties. Thus, the Constitutional Review Chamber has been trying, in its judgments, to determine what are the duties of local governments, essentially local in nature, and what are the duties imposed on local governments by law (see judgment of 22 December 1998, case no. 3-4-1-11-98 – RT I, 1998, 113/114, 1887; judgment of 9 February 2000, case no. 3-4-1-2-2000 – RT III, 2000, 5, 45).

4. The funding of the expenditure related to duties of the state imposed on local governments pursuant to law is regulated by the second sentence of the second indent of § 154 of the Constitution, according to which such expenditure shall be funded from the state budget.

The concept of state budget can be derived through § 115(1) of the Constitution, which establishes: "The Riigikogu shall pass as a law the budget of all state revenue and expenditure for each year." Thus, the state budget is a law, passed by the Riigikogu for each year, which establishes all state revenue and expenditure. There is nothing that can lead to a conclusion that the concept of state budget referred to in § 154 is understood differently than in § 115(1). The latter conclusion is also supported by the State Budget Act, which regulates the drafting, adoption and implementation of annual state budgets. Namely, § 9 of the State Budget Act establishes some principles of financing local governments from the state budget. The amounts allocated annually to local governments from the state budget are the expenditure for the purposes of § 115 of the Constitution. Failure to express state expenditure necessary for the fulfilment of duties of the state in the state budget would constitute a violation of § 115(1) of the Constitution.

§ 154 of the Constitution requires that the state must, in the budget for each year, provide for financial resources to local governments for the fulfilment of all duties of the state imposed on them pursuant to law. Proceeding from the general constitutional requirements concerning the drafting of a state budget (§ 115 of the Constitution) such expenditure shall be expressed in the state budget transparently. Transparency requires that the amounts prescribed for the fulfilment of certain duties are expressed in the state budget as separate entries.

5. The second sentence of the second indent of § 154 of the Constitution should be interpreted to mean that the amount of expenditure related to duties of the state imposed on a local government pursuant to law must be in direct correlation with the concrete duties imposed on a concrete local government unit. Thus, the referred provision requires that the funding of the duties of the state imposed on a local government should be cost-oriented. The income-oriented funding of duties of the state may guarantee sufficient amounts for the fulfilment of those duties in the case of certain local government units. But income-oriented funding of duties of the state is not in conformity with § 154 of the Constitution.

Cost-oriented funding has two levels. Cost-oriented funding of duties of the state imposed on local governments requires, first of all, that it be determined how much money is required for the fulfilment of each duty. This must be unambiguously and transparently expressed in annual budgets. Secondly, it must be determined how much money would each local government unit need for the fulfilment of those duties. Distribution between local government units of certain amounts of money necessary for the fulfilment of some duties of the state on the basis of cost-oriented formula can not be excluded. In order to eliminate the inaccuracies that may inevitably occur upon distributing finances for the fulfilment of duties of the state to local governments there must be a legal possibility to obtain the sums they lack for the fulfilment of those duties of the state the performance of which a local government can not refuse. The procedure under which a local government must find funding for fulfilment of duties of the state from its own revenue or to choose which duties to fulfil is in conflict with the Constitution.

The requirement that all expenditure related to fulfilment of duties of the state imposed on local governments shall be expressed in a state budget as cost-oriented entries, can not be regarded as a too formalistic one. Cost-oriented entries are necessary for the observance of §§ 115 and 154 of the Constitution. Proceeding from clauses (1) and (6) of § 65 of the Constitution the Riigikogu must have a possibility to check how the duties of the state imposed on local governments by the Acts passed by the Riigikogu are

funded. The existence of such a control is, at the same time, also one of the constitutional guarantees of local governments.

6. Constitutional requirements to funding of essentially local government duties are different. § 154(1) requires that the state establish a regulation under which the local governments have a sufficient revenue of their own for the fulfilment of local government duties. It is up to the legislator to decide whether the revenue is guaranteed through imposition of local taxes, through receipt of state taxes directly into local budgets or through allocations from the state budget. The revenue base must guarantee the fulfilment of local duties at least in the minimum necessary amount. A local government unit the revenue of which does not allow for the fulfilment of minimum local duties, must have the right to state assistance.

The regulation of funding of duties that are of essentially local government nature must also be in conformity to the principle of legal certainty. The stability of rules for funding local governments is an essential value. Funding rules that are stable and known beforehand allow a local government unit to make long-term development plans with greater precision and to implement these more effectively. Essential amendment of laws regulating funding of duties of the local governments requires a *vacatio legis* of a reasonable duration. Otherwise a conflict with the principle of legal certainty may arise.

7. The funding of local government units on a uniform basis may not eliminate the factual economic inequality of local government units, instead it may even increase such inequality. There are several constitutional possibilities to balance the factual inequality and to create prerequisites for development.

II.

8. I can not agree with the opinion of the majority of the Supreme Court *en banc* that the rights of the Avanduse rural municipality had not been violated.

The Supreme Court *en banc* justifies its finding that the rights of the Avanduse rural municipality had not been violated as follows. Eventually, the Avanduse rural municipality did not lack money for the fulfilment of its own duties or the duties of the state in 2002. The Avanduse rural municipality has not pointed out any duties of the state or its own duties which were not fulfilled for the lack of money. Neither have the courts ascertained that the duties of the rural municipality remained unfulfilled. The Avanduse rural municipality has not argued that after receipt of additional funding from the reserve of the Government of the Republic there were some duties still left unfulfilled (paragraphs 35-38).

9. In order to oppose this view it is necessary, first of all, to have a look at what the Avanduse rural municipality had disputed in the court.

The Avanduse rural municipality contested in the court the Regulation of the Government of the Republic, by which it was allocated money from the state budget on the basis of support fund distribution formula in 2002. The rural municipality argued that the Regulation was unconstitutional because by the Regulation the municipality was allocated insufficient finances for the fulfilment of duties of the state. The rural municipality is of the opinion that the unconstitutionality of the formula and the Regulation lies in the fact that in 2002, upon allocating finances, the extraordinarily big income tax revenue of 2001 was taken into account. The big income tax revenue became possible because a resident of the rural municipality had sold shares in 2000. The inflexible formula established in the state budget for 2002 took into account the extraordinary receipt of 2001 and that is why the rural municipality had a shortage of money. The Avanduse rural municipality filed a complaint for the ascertainment of unlawfulness in order to be able, subsequently, to file a claim for compensation against the state. In the cassation proceeding the rural municipality retained the same views.

10. §§ 6 and 7 of the Code of Administrative Court Procedure do not exclude the possibility of hearing a request for declaration of unlawfulness of an administrative act in one administrative court proceeding and

filing of a claim in another administrative court proceeding. Pursuant to the second sentence of § 7(1) of the same Code an action for the establishment of the unlawfulness of an administrative act or measure may be filed by a person who has legitimate interest in the matter. The filing of a possible claim in the future is one of the main interests for filing an action for the establishment of unlawfulness. The legitimate nature of such claims has been recognised in court practice. If an action for establishment of unlawfulness has been filed in order to be able to file a claim for compensation later on, it is necessary to establish the violation of subjective rights of a complainant in order to allow the action for establishment of unlawfulness. The fact whether the complainant has incurred damage can be ascertained when hearing a complaint for compensation and not when hearing the action for establishment of unlawfulness (see paragraph 15 of the judgment of the Administrative Law Chamber of the Supreme Court of 19 March 2002, case no. 3-3-1-11-02 – RT III 2002, 12, 122; paragraph 19 of the judgment of the Administrative Law Chamber of the Supreme Court of 3 April 2002, case no. 3-3-1-14-02 – RT III 2002, 12, 124).

The Supreme Court *en banc* did not take into account that the violation of subjective rights has to be ascertained bearing in mind the material time of performing a contested administrative procedure or issuing a contested administrative act. Subsequent elimination of consequences or commencement of elimination of consequences can not affect the legal opinion on the administrative act or procedure. It is impossible and contrary to law to find, proceeding from the elimination of consequences, that a person's rights have not been violated. Pursuant to § 24(1)3) of the Code of Administrative Court Procedure an administrative court shall terminate the proceedings if an administrative act against which an action or protest is filed has been repealed, or an unissued administrative act has been issued, or a suspended administrative act has been executed or a measure taken, except if the person who filed the action or protest applies for the hearing of the matter. This giver rise to the principle that even after the elimination of consequences the legality of the procedure or act should be assessed as at the time the procedure was performed or act issued, if the complainant so requests. The Avanduse rural municipality requested also in the cassation proceeding that its action be adjudicated. Thus, the lawfulness of the legislation affecting the Avanduse rural municipality should be reviewed as at the time the act was issued. Subsequent acts or procedures can not affect the lawfulness of an administrative act or procedure. These are not the objects of the action.

The fact whether a possible claim for compensation is justified or not can not be assessed upon adjudicating an action for the establishment of unlawfulness.

11. It is clear that in 2002 the Avanduse rural municipality had shortage of money because of the implementation of the formula established in the "State Budget for 2002" Act. That is exactly why the Avanduse rural municipality applied for additional funds.

By order no. 197-k of the Government of the Republic of 19 March 2002 the Avanduse rural municipality was allocated, from the reserve of the Government of the Republic, 200 000 kroons "to compensate for the decrease in the receipt of income tax of natural persons in comparison with the estimated receipt of income tax of natural persons taken into account in the distribution formula established in § 2 of the "State Budget for 2002" Act (RT I 2002, 4, 8), and for the funding of expenditure on social sphere" (RTL 2002, 41, 585). By Regulation no. 207 of the Government of the Republic of 27 June 2002 the Avanduse rural municipality was allocated, from the supplementary budget, additional 500 000 kroons to compensate for the decrease of receipt of income tax of natural persons (RT I 2002, 55, 346). There is no dispute about the fact that additional funds were applied for and received precisely for the reason that when distributing money on the basis of the support fund formula of 2002, the exceptional revenue of 2001 had been taken into account.

The Government of the Republic allocated supplementary funds to the Avanduse rural municipality after the rural municipality had contested in court the Regulation by which it had been allocated funds from the state budget on the basis of support fund distribution formula.

12. It is not possible to state in the present case the fulfilment of which concrete duties and to what extent were affected by the distribution of support fund money in 2002 to the Avanduse rural municipality. The legislator has failed to properly differentiate the duties of the state imposed on local governments pursuant to

law and the duties of local governments. It is also unclear the fulfilment of which duties was financed from the support fund. According to § 5(2) of the Rural Municipality and City Budgets and State Budget Correlation Act, the distribution of state budget funds to local governments through the support fund served to objectives – support fund money was used for funding both, duties of the state imposed on local governments pursuant to law, and duties essential to local governments.

Nevertheless, we must presume that the Avanduse rural municipality lacked finances for the fulfilment of those duties that the support fund was meant to fund. Otherwise the Government of the Republic would not have allocated supplementary funds with the above referred justification.

13. As, by the contested Regulation of the Government, resources sufficient for the fulfilment of duties imposed on it were not guaranteed to the Avanduse rural municipality, the Regulation was in conflict with § 154 of the Constitution at the time it was issued. Subsequent elimination of consequences (additional allocation of funds) can not eliminate the violation of rights or the unconstitutionality of the Regulation. In the case of the Avanduse rural municipality the object of dispute was the Regulation of the Government of the Republic, not the funding in 2002.

III.

14. The unconstitutional Regulation was issued because the support fund formula established in § 2 of the state budget for 2002 itself was unconstitutional. Next, I shall explain why the support fund distribution formula of § 2 of the state budget for 2002 was in conflict with the Constitution. Several regulatory provisions of the Rural Municipality and City Budgets and State Budget Correlation Act were unconstitutional, too.

A.

15. Pursuant to the wording “the total amount of the average of the actual receipt of income tax paid by resident natural persons in 2000 and 2001” of the support fund formula established by § 2 of the state budget for 2002 (see paragraph 15 of the judgment of the Supreme Court *en banc*), when distributing the support fund of 2002 the exceptional revenue that local governments had received in two preceding years had to be taken into account. According to this formula the receipt of extraordinary revenue resulted in the decrease of funds from the support fund. In the case of the Avanduse rural municipality the taking into account of extraordinarily big income tax revenue in 2001 resulted in the decrease of funds allocated from the support fund of 2002.

16. § 5 of the Rural Municipality and City Budgets and State Budget Correlation Act established the following:

“(1) The support fund is established in the state budget for the allocation of additional resources to the budgets.

(2) The performance of obligations prescribed by law and the creation of prerequisites for development are financed from the support fund.

(3) The forecast income to the budgets from state taxes and the fees for mining rights at deposits and for the special use of water, the size of the permanent population of the rural municipalities and cities, and other attributes of the rural municipalities and cities are the bases for distribution of the support fund. (18.02.97 no. 296, entered into force 16.03.97 - RT I 1997, 16, 263)

(4) The amount of the support fund in a draft state budget and the distribution of the support fund shall be determined on the basis of an agreement between the authorised representatives of the local governments and of the local government associations and the Government of the Republic. Failing agreement, the Government of the Republic shall decide the amount of the support fund in the draft state budget and its

distribution."

17. Thus, § 5 of the Correlation Act regulated the drafting of annual budgets. In a situation where the support fund formula is established in the budget for each year, these provisions of the Rural Municipality and City Budgets and State Budget Correlation Act constitute regulations that should be included in the Act referred to in § 104(2)11) of the Constitution, that is the State Budget Act. The legal nature of a provision which, by its nature, should be included in the Act referred to in § 104(2)11) of the Constitution, can not possibly depend on the fact in which Act bearing which title is has actually been included into.

The Rural Municipality and City Budgets and State Budget Correlation Act was not adopted by the majority vote required by § 104(1) of the Constitution. The Riigikogu passed the Act on 13 December 1995 by 49 votes in favour. The Act amending § 5(3) of the Rural Municipality and City Budgets and State Budget Correlation Act was passed by the Riigikogu on 18 February 1997 by 50 votes. Nevertheless, we can not draw a conclusion that because of the referred procedural incorrectness § 5(3) of the Correlation Act was not binding on the Riigikogu, when the latter passed the "State Budget for 2002" Act. For the Avanduse rural municipality the principle fixed in § 5(3) of Rural Municipality and City Budgets and State Budget Correlation Act is favourable in relationship with the state. Proceeding from the principle of protection of trust there is no possibility to question whether § 5(3) of the Correlation Act is applicable in the adjudication of the present dispute. The principle*lex posterior derogat priori* can not be applied to the relationship between § 5(3) of Rural Municipality and City Budgets and State Budget Correlation Act and § 2 of the "State Budget for 2002" Act.

18. The contested formula has several components, yet in the present matter the decisive one is the taking into account of extraordinary revenue of 2001 when predicting the revenue of 2002. § 5(3) of the Rural Municipality and City Budgets and State Budget Correlation Act required unambiguously that upon distributing support fund the forecast income from state taxes (income tax) had to be taken into account. The receipts in 2002 can not be forecast on the basis of the fact that in 2001 the Avanduse rural municipality accrued a big income tax revenue because of a transaction (sale of shares) of one resident in 2000. The ignoring of the requirement of § 5(3) of the Rural Municipality and City Budgets and State Budget Correlation Act upon establishing the formula of § 2 of the state budget for 2002, and the implementation of that formula upon distributing the support fund resulted in a situation where the Avanduse rural municipality lacked sufficient resources for the fulfilment of duties imposed on it, i.e. in the violation of § 154 of the Constitution.

That is why I am of the opinion that the regulatory framework included in § 2 of the "State Budget for 2002" Act, pursuant to which, upon distributing the support fund, the extraordinary income tax receipts have to be taken into account each time, is in conflict with § 154 of the Constitution. Appendix no. 1 to The Government of the Republic Regulation no. 66 of 5 February 2002, by which, upon distributing support fund money to the Avanduse rural municipality in 2002, the extraordinary income tax receipt of the preceding year was taken into account, is also in conflict with § 154 of the Constitution.

B.

19. The formula according to which the average of the actual receipt of income tax of two preceding years served as the basis for distributing support fund money, was first established for the year 2001 (RT I 2001, 4, 11). In the previous years it had been possible not to take into account the extraordinary income tax revenue. Thus, § 2(2) of the "State Budget for 2000" Act established that the support shall be calculated on the basis of "predicted income from the income tax of natural persons" (RT I 2000, 1, 1). An analogous principle was also established in § 2(2) of the "State Budget for 1999" Act (RT I 1999, 3, 49).

20. Substantial amendment of the support fund distribution formula of 2002 in comparison with that for 2000 is in conflict with § 154 of the Constitution also because of the violation of the principle of legal certainty. The violation of the principle of legal certainty is not eliminated by the fact that the formula, taking into account the predicted income, had also been in force in 2001. It could not have been known in

2001 what the support fund distribution formula for 2002 would look like. Substantial amendment of support fund distribution formula requires a*vacatio legis*.

21. The assessment of the formula can not be affected by the fact that local government associations participated in the negotiations about the agreement referred to in § 5(4) of the Correlation Act, or by the fact that the agreement referred to in the provision was reached. The Avanduse rural municipality and local government associations are different subjects of law. An association of local governments is not a legal representative of the rural municipality.

To support the constitutionality argument of the contested formula in the court proceedings it has been stated that the Avanduse rural municipality had no obligation to spend the 2.2 million kroons accrued in 2002 at once, that it could have saved it to compensate for the smaller state support allocable for years 2002 and 2003. The law did not provide for such a requirement to save funds. Interpretation of § 5(3) of the Rural Municipality and City Budgets and State Budget Correlation Act leads to the conclusion that the predicted income does not include extraordinary receipts of income tax. On the basis of the provision the Avanduse rural municipality has a reasonable a sufficient ground to believe that when making forecasts as to the income of 2002 the actual receipt of income tax of two preceding years will not be rigidly taken into account. The argument of the Avanduse rural municipality that the officials of the Ministry of Finance assured the municipality in 2001 that the extraordinarily big income tax of natural persons accrued that year will not be taken into account when distributing the support fund of 2002, has not been refuted in the court proceedings.

Neither could the legality of the formula be substantiated by the argument that the Avanduse rural municipality had agreed to the implementation of the support fund distribution formula valid for 2001. The Avanduse rural municipality had neither a cause nor procedural possibilities to contest the support fund formula for 2001, because it did not violate the rights of the municipality.

The constitutionality of the contested regulatory framework can not be justified by the wording of § 9(2) of the State Budget Act, valid until 20 July 2002, which established that: ”Decreases in budget revenue and increases in budget expenditure on the basis of legislation enacted by the Riigikogu or the Government of the Republic after the passage of the budget shall be covered from the state budget.” This provision does not bear in mind a situation where the Government of the Republic implements the support fund distribution formula and the revenue of a rural municipality or city budget decreases because of that.

C.

22. The support fund distribution formula established by the state budget for 2002 was unconstitutional also because the formula was clearly income-oriented – upon distributing the support fund money the forecast tax revenue into the local government budget for the next year was taken into account. § 5(2) of the Rural Municipality and City Budgets and State Budget Correlation Act established: “The performance of obligations prescribed by law and the creation of prerequisites for development are financed from the support fund.” Thus, the performance of duties of the state was also to be financed through the support fund. Yet, the second sentence of § 154(2) of the Constitution requires the cost-oriented financing of duties of the state imposed on local governments pursuant to law.

D.

23. Not only the support fund distribution formula for 2002 was unconstitutional, but also several regulatory provisions of the Rural Municipality and City Budgets and State Budget Correlation Act. § 5(2) of the Act was, due to ambiguity, in conflict with the principle of legal clarity, proceeding from § 13(2) of the Constitution. § 5, which regulated the formation of annual budgets in regard to support fund was, as a whole, in conflict with § 104(2)11) of the Constitution. Pertinent regulation should have been included into the State Budget Act. Proceeding from § 2(1)2) and § 5 of the Rural Municipality and City Budgets and State Budget Correlation Act the support fund distribution formula was established for each year. The provision

was in conflict with the principle of legal certainty to the extent that each year it allowed to make substantial, unpredictable amendments to the formula, prejudicing the interest of local governments.
