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## Constitutional judgment 3-4-1-8-02

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

**No. of the case** 3-4-1-8-02

**Date of decision** 5 November 2002

**Composition chamber** of Chairman Uno Lõhmus, members Tõnu Anton, Lea Kivi, Ants Kull, Jüri Pöld

**Court case** Tallinn Administrative Court to review the constitutionality of § 28(4) of the Taxation Act (in the wording in force until 11 May 1996, and from 12 May 1996 until 30 June 2002) and of the Regulations of the Minister of Finance issued on the basis thereof.

**Date of court session** 1 October 2002

**Persons participating session** Representative of the Riigikogu Marek Sepp, representative of the Chancellor of Justice Aare Reenumägi and representative of the Minister of Justice Kai Kullerkupp.

#### Decision

**1. To declare that § 28(4) of the Taxation Act (in the wording in force from 1 January 1994 until 11 May 1996, and from 12 May 1996 until 30 June 2002) was unconstitutional to the extent that it provided that the Minister of Finance establishes the uniform rate for the interest provided for in § 28(1) of this Act.**

**2. To declare that the interest rate established by the Minister of Finance Regulation no. 16 of 12 January 1994 was unconstitutional to the extent that it established the rate for the interest provided for in § 28(1) of the Taxation Act.**

**3. To declare that the interest rate established by the Minister of Finance Regulation no. 85 of 14 November 1996 was unconstitutional to the extent that it established the rate for the interest provided**

for in § 28(1) of the Taxation Act.

**4. To declare that the interest rate established by the Minister of Finance Regulation no. 20 of 2 March 1998 was unconstitutional to the extent that it established the rate for the interest provided for in § 28(1) of the Taxation Act.**

**5. To declare that the interest rate established by the Minister of Finance Regulation no. 78 of 24 September 1998 was unconstitutional to the extent that it established the rate for the interest provided for in § 28(1) of the Taxation Act.**

## **FACTS AND COURSE OF PROCEEDINGS**

**1.** On 16 October 2001 the Jõgeva Tax Board Office issued a precept to the AS Põltsamaa Põllumajand, obligating the public limited company to pay 124 187 kroons of interest on the income tax withheld on payments made, 195 267 kroons of interest on value added tax, 232 687 kroons of interest on social tax and 38 767 kroons of interest on land tax. According to the precept, the interest arrears were carried over from ETK Põllumajand Ltd in connection with the reorganisation of the latter on 31 December 1995. To the interest arrears were added the calculated interests on outstanding taxes from 1 January 1996 onwards.

**2.** The AS Põltsamaa Põllumajand disputed the precept, arguing that the precept did not indicate the origin of the tax arrears before 1 January 1996. The Tax Board did not amend the precept. Subsequently, the AS Põltsamaa Põllumajand had recourse to the administrative court. Upon the trial of the matter the complainant requested that § 28(4) of the Taxation Act (hereinafter "the TaA") be not applied because of the conflict with §§ 3(2) and 113 of the Constitution.

**3.** On 23 May 2002, by its judgment in administrative matter no. 3-446/02 the Tallinn Administrative Court revoked the decision of the Tax Board and the precept of the Jõgeva Tax Board Office and declared partly unconditional and did not apply §28(4) of the TaA and the Regulations of the Minister of Finance issued on the basis thereof.

## **REASONING OF THE COURT AND PARTICIPANTS**

### **Justifications of the applicant**

**4.** The Tallinn Administrative Court is of the opinion that pursuant to the established interpretation of § 113 of the Constitution this provision has to be interpreted broadly. The area protected by § 113 of the Constitution includes all financial obligations, with the aim of ensuring that all payments in public law are imposed only by the law. The obligation to pay interest, arisen from the delay in fulfilling tax liability, is protected by § 113 of the Constitution. The obligation to pay interest has been provided by law. This implies that the legislator has considered interest as a payment, which essentially falls under the concept of tax for the purposes of § 113 of the Constitution.

Pursuant to § 7 of the Taxation Act, a tax Act shall provide, *inter alia*, the name of the tax, the objects of taxation and the tax rate. Consequently, interest rates must be established by an Act. The fact that interest rates are established by the Minister of Finance is in conflict with the principle of legal certainty, proceeding from § 10 of the Constitution, because the situation wherein tax liability does not proceed only from an Act but also from the activities of the executive power, is uncertain for a tax payer. Also, the principle of separation of powers has been violated.

§ 113 of the Constitution does not exclude the imposition of maximum and minimum limits of taxes. But the imposition of tax rates must not be delegated wholly to the executive. As the delegation of the authority to establish interest rates to the Minister of Finance is unconstitutional, the Regulations of the Minister of Finance issued on the basis of this delegation are also in conflict with the Constitution. Pursuant to § 3(1) of the Constitution the powers of state may be exercised solely pursuant to the Constitution and laws which are in conformity therewith. Conflict with § 113 of the Constitution means also a conflict with § 102 of the

Constitution. Pursuant to § 59 of the Constitution the legislative power is vested in the Riigikogu. Pursuant to § 65(16) of the Constitution the Riigikogu shall resolve national issues, which the Constitution does not vest in other state bodies. Other national issues includes imposition of national taxes.

On the basis of the foregoing the administrative court found that § 28(4) of the Taxation Act (in the wording in force when the judgment was made, as well as in the earlier wording), as far as it related to subsection (1) of the same section, was in conflict with §§ 113, 102, 4, 10, 59, 3(1) and 65(16) of the Constitution.

As the delegation of the right to establish interest rates to the Minister of Finance is in conflict with the Constitution, the corresponding Regulations of the Minister of Finance are also unconstitutional (in the wording in force when the judgment was made, as well as in the earlier wording).

### **Justifications of participants**

**5.** Pursuant to the explanations of the Finance Committee of the Riigikogu the delegation of the right to establish interest rates was motivated by the desire to give the Minister of Finance a simpler possibility to lower the interest rates. The Minister of Finance has repeatedly lowered the interest rates and has not abused the powers vested in him by the Riigikogu.

The Finance Committee is of the opinion that an interest is not a tax, but an obligation accessory to a tax. An interest is not an ordinary financial obligation in public law, as it can not be imposed as a separate obligation. The conditions for imposing a tax and an interest need not be the same.

If the provision of the taxation Act, valid before 1 July 2002, which delegated the right to establish interest rates to the Minister of Finance, is declared unconstitutional, the persons who owe arrears will be treated unequally. In that case the tax authority will no longer be able to demand interests for the period before 1 July 2002, while the persons to whom the demand to pay interest was addressed earlier and who have not disputed this, will still have to pay interest.

**6.** The Ministry of Finance points out in its opinion that in the given case the imposition of tax or interest has not been delegated to the executive power. The interest has been provided by law. Only the right to establish a rate for interest has been delegated.

The Minister of Finance is of the opinion that the financial obligations in public law, referred to in § 113 of the Constitution, are unilateral, i.e. the state imposes an obligation and persons have to fulfil it. § 28 of the Taxation Act did not establish an obligation only to taxable persons, but also to the state - the interest is also calculated for the benefit of a the taxpayer, if the taxpayer pays a greater amount of tax pursuant to a precept of a tax authority than is due (§28(2)). If we regard a tax interest as a tax, we could come to the conclusion that there are also taxes that the state pays to the taxpayer. An interest is not a tax, it is a compensation for the damage caused by delay. This does not have to be fixed in law.

The disputed Regulations of the Minister of Finance have been issued on the basis and for the implementation of law and are not in conflict with the Constitution.

**7.** The Chancellor of Justice is of the opinion that the interest payable under § 28 of the Taxation Act can not be regarded as a tax, as it does not meet all the characteristics of a tax, referred to in § 2(1)1) of Taxation Act. Tax interest is an accessory obligation, proceeding from a tax law relationship, the purpose of which is to compensate to the creditor the loss of income caused by the person who owes arrears. In substance, an interest corresponds to a fine for delay in civil law and it is used to help to guarantee that the persons who owe arrears perform their financial obligations.

The Regulations of the Minister of Finance issued on the basis of § 28(4) of the Taxation Act are *praeter legem* regulations by nature. Imposition of an interest rate does not amount to specifying an Act, it is independent regulation. Such a *praeter legem* regulation is in conflict with the principle provided in § 3(1) of the Constitution, pursuant to which powers of state shall be exercised solely pursuant to the Constitution and

laws which are in conformity therewith.

The Chancellor of Justice agrees with the administrative court that § 113 of the Constitution must be interpreted broadly. The right to establish interests and tax liability are included in the sphere of protection of § 113, irrespective of whether an interest, by nature, meets all the characteristics referred to in a tax Act and whether it is called a tax or not.

Delegation of the right to establish interest rates also violates the principle of separate and balanced powers and is in conflict with § 4 of the Constitution. Also, a question arises as to the conformity to the principle of legal certainty, proceeding from § 10 of the Constitution. A regulation issued on the basis of an unconstitutional delegation is in conflict with the Constitution. It proceeds from § 3(1) of the Constitution that the powers of state may be exercised solely pursuant to the Constitution and laws which are in conformity therewith. The Chancellor of Justice agrees with the opinion of the administrative court that in addition there is also a conflict with §§ 102, 59 and 65(16) of the Constitution.

The Chancellor of Justice points out that legislative acts of specific application, issued on the basis of unconstitutional legislation, are not null and void, and these can not be declared invalid without limitations. This would be contrary to the principle of legal certainty. Declaration of unconstitutionality of the disputed parts of the legal acts does not result in the return of the interests already paid to those taxpayers, who have not disputed the calculation and demand of interests or in regard of whose complaints a judgment of a administrative court has already entered into force.

**8.** The Minister of Justice is of the opinion that an interest is not a tax, but an accessory obligation to a financial obligation. There may be a reciprocal obligation to pay interests - the obligation may rest with a taxable person, with the state as well as with a local government. In case of a tax the entitled subject should always be either the state or a local government.

It is true that an interest is a part of tax arrears (§2(1)7) of the TaA); yet it is not an element of any tax law relationship. Neither is an interest a penalty fine, instead it is a coercive measure, - not a punitive financial sanction, the purpose of which is to remind the subject of his or her obligation to fulfil its proprietary obligations on time.

The Minister of Justice is of the opinion that §28(4) of the TaA and the Regulations of the Minister of Finance issued on the basis thereof are in formal conflict with §§ 113, 3(1) and 102 of the Constitution. But these constitute norms, which have been in force for a long time, the declaration of invalidity of which because of a mere formal error would prejudice several constitutional values and would bring about new injustice.

In the given case the declaration of invalidity of a Regulation, which is essentially correct but deficient in its form, would be in conflict with the principle of legal certainty (§ 10 of the Constitution) and would prejudice the stability of legal order. Also, it would result in violation of the principle of equal treatment (§ 12(1) of the Constitution) in regard to these persons who, under the regulatory framework still in force, have been paying interests for eight years without any dispute. Weighing different constitutional values - legality, legal certainty, equal treatment - the two of the latter have to be considered as most important.

### **The legislation disputed and not applied**

**9.1.** § 28(4) of the Taxation Act, also subsections (1) and (2) of the same section, which are important for understanding the former, read as follows in the wording in force until 11 May 1996:

#### **"§ 28. Interest**

(1) If an amount of tax paid by a taxpayer or transferred by a withholding agent is lower than the amount of tax to be paid or transferred pursuant to a tax Act, interest is calculated on the amount which is outstanding or has not been transferred as of the day following the day on which payment or transfer of the tax was due

pursuant to law until the day on which payment is effected, inclusive of the latter.

(2) If a taxpayer pays a greater amount of tax pursuant to a precept of a tax authority than is due according to a tax Act, interest is calculated for the benefit of the taxpayer on the excess amount as of the day on which the excess amount of tax was paid until the refund of the amount of tax or the transfer of the amount of tax to cover other tax liabilities of the taxpayer.

[...]

(4) The Minister of Finance establishes the uniform rate for the interest provided for in subsections (1) and (2) of this section."

**9.2.** § 28(4) of the Taxation Act, also subsections (1), (1<sup>1</sup>) and (2<sup>1</sup>) of the same section, which are important for understanding the former, read as follows in the wording in force from 12 May 1996 until 30 June 2002 (established by the taxation Act Amendment Act passed on 10 April 1996, - RT I 1996, 29, 577):

### **"§ 28. Interest**

(1) If an amount of tax paid by a taxpayer or transferred by a withholding agent is lower than the amount of tax to be paid or transferred pursuant to a tax Act, or if an amount of tax is not paid or transferred by the due date, interest is calculated on the amount which is outstanding or has not been transferred. Interest is calculated as of the day following the day on which payment or transfer of the tax was due pursuant to law until the day on which payment is effected, inclusive of the latter.

(1<sup>1</sup>) If, at the request of a taxpayer, an amount of tax is refunded to the taxpayer or is transferred to cover other tax liabilities of the taxpayer and if such amount of tax is greater than is due to be refunded or transferred pursuant to a tax Act, interest is calculated on the excess amount of tax refunded or transferred as of the day on which the amount of tax was refunded or transferred to cover other tax liabilities until the day on which the taxpayer pays back such amount of tax, inclusive of the latter.

[...]

(2<sup>1</sup>) If a taxpayer applies for a refund from a tax authority of an amount of tax paid in excess of that prescribed in a tax Act, and if the tax authority does not refund such amount within the term provided for in § 10(2) of this Act, interest is calculated on the unrefunded amount as of the day following the day on which the refund of the amount of tax was due to be effected until the day on which the amount of tax is refunded, inclusive of the latter.

[...]

(4) The Minister of Finance establishes the uniform rate for the interest provided for in subsections (1), (1<sup>1</sup>), (2) and (2<sup>1</sup>) of this section."

**9.3.** Clause 1 of the Minister of Finance Regulation no. 16 of 12 January 1994 (RTL 1994, 7, p 217) reads as follows:

"1. The rate for the interest provided for in subsections (1) and (2) of § 28 of the Taxation Act shall be 0.15% per each day."

**9.4.** Clause 1 of the Minister of Finance Regulation no. 85 of 14 November 1996 (RTL 1996, 131, 663) reads as follows:

"1. To establish that the rate of interest provided for in § 28 of the Taxation Act shall be 0.12% per day."

**9.5.** Clause 1 of the Minister of Finance Regulation no. 20 of 2 March 1998 (RTL 1998, 74/75, 315) reads as

follows:

"1. To establish that the rate of interest provided for in § 28 of the Taxation Act shall be 0.07% per day."

**9.6.** Clause 1 of the Minister of Finance Regulation no. 78 of 24 September 1998 (RTL 1998, 289, 1187) reads as follows:

"1. To amend clause 1 of and to supplement with clause 2 the Minister of Finance Regulation no. 85 of 14 November 1996 "Establishment of the rate of interest provided for in § 28 of the Taxation Act" (RTL 1996, 131, 663; 1998, 74/75, 315) and to word these as follows:

"1. To establish that the rate of interest provided for in § 28 of the Taxation Act shall be 0.07% per day, with the exception of the provisions of clause 2.

2. To establish that in between 1.10.1998 and 15.01.1999 the rate of interest provided for in § 28 of the Taxation Act shall be 0.035% per day.""

### **Opinion of the Constitutional Review Chamber**

**10.** The Tallinn Administrative Court declared § 28(4) of the TaA unconstitutional to the extent that the Minister of Finance establishes the uniform rate for the interest provided for in subsection (1) this section, and the rates of interest established by the Regulations of the Minister of Finance issued for the implementation of § 28(1) of the TaA. Thus, the judgment of the administrative court pertains to § 28(4) of the TaA and the Regulations of the Minister of Finance only to the extent that these regulated the rate of interest only in the case when taxpayer or the withholding agent did not pay or transfer the amount of tax on time. The judgment of the administrative court does not pertain to the regulatory framework established by Taxation Act and the Regulations of the Minister of Finance to the extent that these established an interest for the benefit of the taxpayer.

The Supreme Court agrees with such limitation of pertinent legislation and will not assess, in the present case, the constitutionality of interest established for the benefit of the taxpayer.

**11.** The interest referred to in the Taxation Act and in the Regulations of the Minister of Finance in essence also constitutes a fine for the delay of the taxpayer or the withholding agent in the payment or transfer of tax. The purpose of establishing an interest is to protect the financial interests of the state, as well as motivating the taxpayers and the withholding agents to fulfil proprietary obligations before the state on time.

§ 113 of the Constitution does not refer to an interest or a fine for delay. Yet the protected area of the provision is broader and does not include only the financial obligations listed therein but all financial obligations in public law. The purpose of § 113 of the Constitution is to achieve a situation where all financial obligations in public law are established solely by the Acts passed by the Riigikogu (see judgment of the Supreme Court *en banc* of 22 December 2000 in case no. 3-4-1-10-2000. - RT III 2001, 1, 1). Interest on a tax as an accessory obligation to tax liability constitutes a financial obligation in public law which, pursuant to § 113 of the Constitution, shall be provided by law.

**12.** The Supreme Court admits that under certain conditions it would be possible to establish the minimum and maximum levels of interest on a tax by law and to delegate the right to establish a concrete interest rate to the executive (see also judgment of the Constitutional Review Chamber of the Supreme Court of 23 March 1998 in case no. 3-4-1-2-98. - RT I 1998, 31/32, 432). In the present case the legislator has left the interest rate in its entirety to be imposed by the executive power. Such a delegation norm in an Act and the Regulations issued on the basis thereof are in conflict with § 113 of the Constitution.

**13.** Pursuant to § 94(2) of the Constitution a minister shall issue regulations on the basis and for the implementation of law. The same principle in regard to regulations of the Government of the Republic is established in § 87(6) of the Constitution. These norms reflect that the executive power is bound by law. The

purpose of the right to issue regulations, vested in the ministers and the Government of the Republic, is to decrease the workload of the legislator and to transfer the task of specifying norms to the executive power. The executive power is authorised to issue *intra legem* regulations, that is regulations specifying law (see also judgment of the Constitutional Review Chamber of the Supreme Court of 20 December 1996 in case no. 3-4-1-3-96. - RT I 1997, 4, 28).

Delegation of the right to establish interest rates on a tax to the executive power substantially amounts to delegation of the right to issue *praeter legem* regulations. Such a delegation norm and regulations issued on the basis thereof are not in conformity with § 94(2) of the Constitution. The executive power can not, by issuing *praeter legem* regulations, regulate areas which, pursuant to the Constitution, must be regulated by law (see also judgment of the Constitutional Review Chamber of the Supreme Court of 23 January 1994 in case no. III-4/A-2/94. - RT I 1994, 8, 130).

**14.** As the Constitutional Review Chamber is of the opinion that § 28(4) of the TaA and the Regulations of the Minister of Finance issued on the basis thereof are in conflict with §§ 113 and 94(2) of the Constitution, the Chamber does not consider it necessary to analyse whether there is a conflict with other provisions of the Constitution, referred to by the administrative court. Neither does the Chamber consider it necessary to analyse the material conformity of the provisions to the Constitutions.

**15.** The Taxation Act, which contained the disputed provision, has lost its validity and the interest rate established by Regulations of the Minister of Finance is replaced by the interest rate established by § 117 of the Taxation Act, which entered into force on 1 July 2002. That is why the Supreme Court confines itself to declaration of unconstitutionality of the disputed provisions. This judgment does not prejudice the obligation of the Tax Board to pay interest to taxpayers pursuant to these Regulations.

Uno. Lõhmus

Chief Justice of the Supreme Court

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