Constitutional judgment 3-4-1-5-00

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JUDGMENT
OF THE CONSTITUTIONAL REVIEW CHAMBER

of 12 May 2000

Review of the petition of the Tallinn Administrative Court to review the constitutionality of the Government of the Republic Regulation no. 161 of 27 May 1993 "Reimbursement of expenses of the use of personal automobiles for business travel".

The Constitutional Review Chamber
presided over by Chairman Uno Lõhmus
and composed of members justices Tõnu Anton, Ants Kull and Jüri Põld,
at its session of 13 April 2000,
with the representative of the Government of the Republic Erle Kõomets, the representative of the Chancellor of Justice Aare Reenumägi and the Minister of Justice Märt Rask appearing,
and in the presence of the secretary to the Chamber Piret Lehemets
reviewed the petition of the Tallinn Administrative Court of 29 February 2000.

I. FACTS AND COURSE OF PROCEEDINGS

1. On 15 January 1999 the Tax Board of Harju County issued a precept to public limited company Modely, which stated that the referred public limited company had from 1996 to 1997 paid compensation for the use of personal automobiles for official trips to four of its employees, who were not owners of personal automobiles. The compensations should have been subjected to income and social taxes. That is why additional amount of income tax, social tax and interest to be paid by the company was determined.

2. The AS Modely filed a complaint against the precept with the same tax board, which left the precept in force. After that the AS Modely filed a complaint with the National Tax Board, who satisfied it partially. By the resolution of National Tax Board:

1) the resolution of county tax board was annulled to the extent that it required the company to pay the taxes and interest on the compensation, which had been paid for the use of two automobiles which were registered in the names of the spouses of the employees.

2) it was found that income tax and social tax are payable on reimbursements for the use for business travel of such automobiles which are not in the ownership of an employee or not in the joint ownership of an employee and his or her spouse. Automobiles, for the use of which for business travel compensation had

been paid to the other two employees of the company, were in the ownership of third persons, that is why income and social tax should have been paid on the compensation paid to them.

3) for the referred reasons, a new, smaller than previously assessed additional amounts of income and social tax were determined and the interest was reduced.

3. The AS Modely appealed the resolution in the Tallinn Administrative Court. The applicant claimed that it does not proceed from § 9(2)10) of the Income Tax Act that the personal automobile used for business travel should be in the ownership of the employee to whom compensation was paid.

4. In its judgment of 29 February 2000 the Tallinn Administrative Court declared clause 3(2) the Government of the Republic the Regulation of 27 May 1993 "Reimbursement of expenses of the use of personal automobiles for business travel" unconstitutional. The complaint of AS Modely was satisfied and the Tax Board precept was annulled to the extent that it related to assessing income and social tax and interest on the compensation paid to two employees of the company.

5. On 29 February 2000 the Tallinn Administrative Court filed a petition with the Supreme Court requesting that it review the constitutionality of clause 3(2) of the referred Regulation.

LEGAL JUSTIFICATION

Justifications of parties

6. It is stated in the petition of the Tallinn Administrative Court that clause 3(2) of the Regulation is in conflict with §§ 3(1), 11 and 87(6) of the Constitution.

The court justified the opinion as follows:
1) According to Pursuant to § 87(6) of the Constitution the Government of the Republic shall issue regulations and orders on the basis of and for the implementation of law.
2) § 9(2)10) of the Income Tax Act and § 2(3) of the Social Tax Act do not refer to personal automobiles of employees. The purpose of these provisions was to reimburse to persons, who use automobiles which do not belong to their employer in the interest of the employer, the expenses incurred by users of the vehicles. For the purposes of the application of the Acts it is irrelevant whether the user of a vehicle is the owner thereof or a possessor on the basis of a contract or an authorisation document.
3) It proceeds from § 13(3)2) of the new Income Tax Act, which was not applicable at the time the complaint of AS Modely was adjudicated, that it is only now that the legislator requires that an automobile be in the personal ownership of an employee who uses it, and has authorised the government to establish pertinent conditions. Also, the new Act makes it possible to pay compensation to the user of an automobile leased on the basis of a finance lease contract. This reinforces the conclusion of the court that the aim and purpose of the old Income Tax Act was to reimburse expenses to a user of a vehicle.
4) The Government was authorised to establish the procedure for and the limits of the implementation of § 9(1)10) of the Income Tax Act. Establishment of the procedure for implementation means regulation of such organisational issues, with which it would not be justified to burden the text of a law. Authorisation to establish the procedure for the implementation of the Act does not include the right to establish conditions or grounds in addition to those specified by law. An Act can not be extended or restricted by a regulation. By clause 3(2) of the contested Regulation a restriction which does not proceed from the Act has been imposed, namely that the employee who uses a personal automobile for business travel must be the owner of the automobile.

7. The representative of the Government of the Republic argues that the contested provision of the Regulation is not unconstitutional. The aim of the Regulation was taxation and the aim was achieved by clause 4 of the Regulation. Clause 3(2) of the Regulation was not related to taxation. This provision declared the right of persons in private law to enter into mutual agreements. Although this declaration did not have any legal value, it was important for practical reasons, informing persons of their rights. This is not a

constitutional dispute, instead this is an administrative dispute over whether the Tax Board had applied the law correctly. Clause 4 of the Regulation does not make taxation conditional on the ownership of the beneficiary of the vehicle used. Administrative court has to ascertain whether the restrictive interpretation of the Regulation by the Tax Board was lawful.

8. The Chancellor of Justice is of the opinion that the contested provision of the governmental Regulation is unconstitutional, and he agrees with the justifications of the Tallinn Administrative Court.

9. The Minister of Justice is of the opinion that the contested provision of the governmental Regulation is unconstitutional. He justifies his opinion as follows:
1) The purpose, extent and content of the Government of the Republic Regulation no. 161 of 27 May 1993 are not compatible with the Income Tax Act and the Social Tax Act, because the Regulation provides for the procedure to grant compensation exempt from tax and the limits thereof only to some of the compensation cases provided by these Acts. The purpose of law is to guarantee the reimbursement of expenses of the use of personal automobiles for business travel pursuant to the procedure and within the limits provided by the government. “Personal automobile” has to be understood as “not business automobile”. That is why it is not relevant whether an employee uses for official travel the automobile belonging to him or her or to his or her spouse or an automobile leased on the basis of a finance lease contract. The use of terms in the Regulation is outdated.
2) The norms delegating authority, which were in force at the time the Regulation was issued, are no longer valid. Yet it is not justified to declare invalid the part of the Regulation which is in conformity with the law. It is only clause 3(2) that has to be declared invalid.
3) Beginning with 1 January 1996, when the new Government of the Republic Act took effect, the extent of a regulation must not differ from the extent of the Act which contains a norm delegating authority to issue a regulation, because § 27(2) of the Act establishes a requirement that a governmental regulation must contain a reference to the provision of the Act which is the legal basis of the regulation. The only exceptions are the cases when implementation provisions of an Act *expressis verbis* stipulate otherwise.

Opinion of the Constitutional Review Chamber

10. The taxation dispute on the basis of which this constitutional review case was initiated relates to payments of income and social taxes on reimbursements of expenses of the use of personal automobiles for business travel in 1996 and 1997.

A. Analysis of the constitutionality of subjecting reimbursement to income tax

I.

11. At the time when the reimbursement was subjected to income tax, the Income Tax Act, passed on 8 December 1993, was in force (hereinafter “the 1993 Income Tax Act”).

12. The contested Regulation was issued when the Personal Income Tax Act, passed on 11 October 1990, was in force (hereinafter “the Personal Income Tax Act”). The Personal Income Tax Act lost effect on 1 January 1994, when the 1993 Income Tax Act took effect. The latter was declared void on 15 December 1999, by the new Income Tax Act (hereinafter “the 1999 Income Tax Act”).

13. § 6(4) of the Personal Income Tax Act established that income tax is not imposed on payments for reimbursement of costs relating to business travel and the use of a personal vehicle for business purposes pursuant to the procedure and within the limits established by the government.

This provision served as a provision delegating authority to issue regulation no. 161 of the Government of the Republic, dated 27 May 1993, to the extent that it regulated the imposition of income tax on payments for reimbursement of costs relating to the use of a personal automobile for business travel. The Regulation did not make a direct reference to the norm delegating authority.

14. The original text of § 9(2)10) of the 1993 Income Tax Act stipulated *inter alia* that payments for reimbursement of costs relating to the use of a personal automobile for business travel pursuant to the procedure and within the limits established by the Minister of Finance do not form a part of the income of a tax payer residing in Estonia.

The Minister of Finance did not issue the regulation stipulated in the Act. Instead of a regulation of the Minister of Finance the governmental regulation issued under the Personal Income Tax Act was applied.

15. § 9(2)10) of the 1993 Income Tax Act (as of 22 November 1995) established *inter alia* that payments for reimbursement of costs relating to the use of a personal automobile for business travel pursuant to the procedure and within the limits established by the government do not form a part of the income of a tax payer residing in Estonia.

This regulation, too, was not issued. Still, the governmental regulation issued under the Personal Income Tax Act was being applied.

16. § 13(3)2) of the 1999 Income Tax Act stipulates that income tax is not imposed on payments for reimbursement of costs relating to the use of an automobile, which is in the ownership of a tax payer or which is leased under a finance lease contract, for business travel, made to a public servant, a person in the service of the armed forces, employee or a member of a management board of a legal person or of a alternate body to the management board.

17. Pursuant to § 62 of the 1999 Income Tax Act, the Act took effect on 1 January 2000. The Government of the Republic Regulation “The procedure for and limits of reimbursement of expenses of the use of personal automobiles for official travel”, required by the Act, was issued on 7 March 2000.

According to the Regulation it is applied as of 1 March 2000, that is retroactively. The Regulation was published in the Riigi Teataja [Official Gazette] on 14 March 2000. According to § 5(5) of the Riigi Teataja Act a regulation of the Government of the Republic shall take effect on the third day after publishing in the Riigi Teataja, if a later date is not specified in the regulation. Thus, pursuant to law the regulation took effect on 17 March 2000.

18. In conclusion: the governmental Regulation issued under the Personal Income Tax Act, passed in 1993, was applied when the Personal Income Tax Act, the 1993 Income Tax Act and the 1999 Income Tax Act were in force, that is when three different laws concerning taxes were in force, and in respect of two different national taxes - personal income tax and income tax. The Regulation was applied to different tax law relations. The tax payer, object of taxation and tax rate were different, too.

The regulations to regulate taxation of payments of reimbursement for the use of a personal automobile for official travel, required by the 1993 Income Tax Act, were not issued. The Minister of Finance and the Government of the Republic did not fulfil the obligation, imposed by law, to issue a regulation necessary for the implementation of law. The regulation provided for by the 1993 Income Tax Act was issued by the government later than the specified due date.

The Regulation issued for the implementation of the 1999 Income Tax Act is scanty in size. The Regulation consists of four clauses. Two of these are implementation provisions. Thus, the size of the Regulation could not have been an obstacle to issue the Regulation so that it could have become effective simultaneously with the Act passed on 15 December 1999, that is on 1 January 2000.

19. On 28 September 1999 the Government of the Republic issued Regulation no. 279 “Rules of drafting legislation of general application”. Clause 50 of the rules provides: “A provision relating to the effective date of a regulation shall provide that the date of entry into force of the regulation is the date of entry into force of the Act delegating authority. If it is impossible to enforce a regulation simultaneously with the Act delegating authority, a later date of application may be provided for the regulation.”

This provision was ignored when drafting the new Regulation.

II.

20. The Administrative Court was of the opinion that clause 3(2) of the Regulation was in conflict with § 87(6) of the Constitution, as there was no provision delegating authority for issuing this provision in the 1993 Income Tax Act.

Clause 3(2) of the Regulation provided that in enterprises, agencies and organisations not enumerated in clause 3(1) the costs related to the use of a personal automobile for business travel shall be reimbursed under agreement between the employer and the employee who owns the automobile.

21. As the regulation required by the 1993 Income Tax Act was not issued, the first question to answer is whether the Regulation issued under the Personal Income Tax Act was at all applicable for the implementation of the 1993 Income Tax Act. The answer depends on whether the Regulation was to grant benefits or burden with financial obligations. If the Regulation was to grant benefits to a tax payer, it should have been applied, in the interests of the protection of trust of tax payers, under the 1993 Income Tax Act, irrespective of the fact that the Regulation had been issued for the period of being in force of the Personal Income Tax Act. If this is the case, the Chamber will also have to analyse the view of the administrative court that clause 3(2) of the Regulation is unconstitutional. If the Regulation was to impose financial obligations, it has to be determined whether it was allowed to apply a regulation issued under the Personal Income Tax Act during the period when the 1993 Income Tax Act was in force.

III.

22. In order to disclose the nature of the Regulation the 1993 Income Tax Act has to be analysed. It is necessary to establish the consequences of the application of the Regulation to a tax payer, and what type of regulation was required to be issued under the Act.

23. § 9(2) of the 1993 Income Tax Act enumerated the amounts of money and things which were not considered as income of a tax payer residing in Estonia and on the value of which the income tax was not to be paid. An employee was also considered to be a tax payer residing in Estonia. Under § 9(2)10) the payments for the reimbursement of costs related to the use of a personal automobile for business travel, paid by an employer pursuant to the procedure and within the limits established by the government, did not form a part of the employee's income. Under § 9(2)5) of the same Act the fringe benefits taxable under § 33 were not included in the income of an employee. The reimbursements paid for the use of a personal automobile in excess of what had been established by the government or paid pursuant to a procedure different from that established by the government, were also considered as fringe benefits on which an employee did not have to pay income tax.

24. § 33 of the 1993 Income Tax Act burdened the employer with the obligation to pay income tax on the value of a fringe benefit granted to an employee. Pursuant to § 33(2) any commodity, service, other payment in kind or a benefit the value of which can be assessed in money, granted by an employer to an employee in relation to employment relationship, constituted a fringe benefit. The subsection also contained a specimen list of fringe benefits. Pursuant to § 33(2)6) a reimbursement for the use of a personal car for business travel in excess of the limits established by the government was a fringe benefit.

25. In conclusion: an employer had to pay income tax on that part of the reimbursement payment paid to an employee, which exceeded the limits established by the government. Also, an employer had to pay income tax on the total amount of reimbursement, which had not been paid pursuant to the procedure established by the government. An employee did not have to pay taxes on the reimbursement payments.

26. These provisions of the Act concerning the tax restricted the employer's right to deduct from the income the value of fringe benefits, and a tax was imposed on fringe benefits. These provisions imposed financial

obligations. Thus, the 1993 Income Tax Act required the issuance of a regulation which imposes financial obligations.

27. The central provision of the Regulation imposing income tax on reimbursements was clause 4(1), which established that payments exceeding 500 kroons a month, paid to reimburse to a person working in an enterprise, agency or organisation under employment contract the expenses of the use of a personal automobile for business travel, shall be considered fringe benefits for the purposes of imposing income tax.

This provision imposed financial obligations on a tax payer.

28. In this respect the Chamber considers it necessary to point out that the new Regulation issued to replace the contested one is encumbering. Clause 1 of the Regulation of the Government of the Republic of 7 March 2000 states that reimbursements exceeding 500 kroons in a calendar month are considered to be fringe benefits.

In paragraph 17 of this judgment the Chamber came to the conclusion that the Regulation of the Government of the Republic of 7 March 2000 was issued retroactively. § 20(1) of the Regulation of the Government of the Republic "Rules of legislative drafting" stipulates the requirement that retroactively applicable provisions of law are prohibited, if this brings about the increase of obligations or responsibility of persons or the decrease of rights and freedoms or some other negative consequence. According to § 20(2) retroactively applicable provisions are allowed only in cases not stipulated in subsection (1) and if there is a justified need. § 39 of the rules extends these legislative requirements to regulations of the executive power.

Thus, the government has ignored the rules established by itself when drafting the new Regulation. This violation in itself is not the basis for declaring the provision of the new Regulation, providing for the date of implementation thereof, null and void.

IV.

29. § 87(6) of the Constitution prescribes that the Government of the Republic shall issue regulations on the basis of and for the implementation of law. The provision also establishes that the government shall issue a regulation for the period when the law, which contains the provision delegating authority to issue the regulation, is in force.

30. In its judgment of 6 October 1997 (RT I 1997, 74, 1267) the Constitutional Review Chamber interpreted § 87(6) of the Constitution to the effect that the state authority has an obligation not only to guarantee that a regulation is in conformity with the Constitution and laws when it is issued but also to see to it that previously enacted regulations are in conformity with new laws.

Conformity of a regulation with new laws means also that if a new law provides for a provision delegating authority to issue regulations, a new regulation has to be issued under the provision. The regulation issued under the previous law has to be declared void.

A provision delegating authority in a new law, which is analogous to that in the previous law, does not give effect to a regulation issued under the previous law for the time the new law is in effect. A regulation issued under the previous law can be implemented under the new law only if the implementation provisions of the new law *expressis verbis* provide so.

31. In its judgment of 17 June 1998 (RT 1998, 58, 939) the Constitutional Review Chamber considered it necessary to point out the following:

a) "... the application of the Regulation of the Government of the Republic, issued prior to the delegation norm, constitutes a violation of the principle of legal certainty. Bearing in mind the future-oriented substance of a delegation norm, an addressee of law is entitled to expect that a pertinent act of general application of the executive has to be looked for in the time following the issuance of the delegation norm. An addressee of

law can not be required - for the organisation of his or her conduct - to look for the acts of the executive which have been issued before the adoption of a law which requires that this or that field be more specifically regulated by the acts of the executive."

b) "An addressee of law must be certain that the act of the executive which is obligatory for him or her is in conformity with the law and that he or she will not have to check the legality of the act. If the applicable act of the executive has been issued before the delegation norm, the addressee of law will not have this certainty and he or she is in a situation where he or she is forced to check the legality of the act."

c) "Proceeding from the principle of a state based on democracy and the rule of law, the system of legal acts must be comprehensible to the addressee of law."

32. In the same judgment the Chamber expressed the opinion that a delegation norm in a law is not merely an authorisation to the executive to issue regulations for the implementation of law. A delegation norm is also an order to the executive to issue regulations which are necessary for the implementation of law. Implementation of law would prove impossible unless the regulations that the legislator deems necessary are issued.

33. In regard to taxation it is in principle impossible to accept a regulation of the executive power, which imposes financial burdens on a tax payer, which has not been issued within the scope of the provision delegating authority to issue regulations.

V.

34. On the basis of the aforesaid the Chamber is of the opinion that the contested Regulation is, as of 1 January 1994, in conflict with § 87(6) of the Constitution to the extent that the Regulation stipulated that payments of reimbursement for the expenses of the use of a personal automobile for business travel shall be considered fringe benefits for the purposes of imposing income tax.

35. In order to enforce the 1993 Income Tax Act the government had to establish the limit of reimbursement so that income tax could be imposed on the amounts exceeding that limit. As there was no such regulation, there were no legal grounds to impose income tax on payments of reimbursement for the expenses related to the use of a personal automobile for business travel. If it is ascertained that a personal automobile was not used for business travel, tax has to be imposed on the reimbursements.

VI.

36. The Government of the Republic has declared its Regulation no. 161 of 27 May 1993 invalid. That is why the Chamber admits the unconstitutionality of the Regulation as of 1 January 1994 to the extent that it related to imposition of income tax.

37. As the judgment of the Chamber has *ex nunc* effect in time, this judgment provides no ground to refund the income tax paid on fringe benefits to those tax payers who had not contested the tax or in respect of whose complaints a judgment of an administrative court has become effective. Also, § 75 of the Administrative Court Procedure Act does not regard a judgment made by way of constitutional review as a ground for review of an administrative court judgment.

B. Analysis of the constitutionality of subjecting reimbursements to social tax

VII.

38. At the time of issuance of the Regulation the Republic of Estonia Social Tax Act (hereinafter "the 1990 Social tax Act"), passed on 12 September 1990, was in force. This Act lost validity on 1 January 1999, when the Social Tax Act of 15 April 1998 (hereinafter "the 1998 Social Tax Act") became effective. Thus, at the

time the reimbursements were subjected to social tax, that is in 1996 and 1997, the 1990 Social Tax Act was in effect.

39. § 2(3) of the 1990 Social Tax Act (as of 12 September 1991) provided that social tax is not imposed on payments for reimbursement of expenses of the use of a personal vehicle for business travel pursuant to the procedure and within the limits established by the government. This provision served as a provision delegating authority to the Government of the Republic to issue Regulation no. 161 of 27 May 1993 to the extent that it regulated imposition of social tax on reimbursements. The Regulation itself contained no reference to the provision delegating authority.

Thus, when imposing a social tax on reimbursements there is no question whether the Regulation was at all applicable to such taxation law relations.

40. The Chamber considers it necessary to point out that the Act contained a provision delegating authority to issue a regulation, which should have regulated imposition of social tax on reimbursements for the use of all personal vehicles for business travel. The regulation was confined to personal automobiles only.

VIII.

41. When adjudicating the part of complaint which was related to imposition of social tax on reimbursements, the administrative judge did not apply clause 3(2) of the Regulation, arguing it to be in conflict with § 87(6) of the Constitution. The administrative judge was of the opinion that this provision of the Regulation in conjunction with clause 4(1) was relevant for the resolution of the taxation dispute.

Clause 3(1) of the contested Regulation provided: “In state enterprises, state public limited companies, state agencies and state organisations the reimbursement in the amount of 1 kroon per each kilometre of business travel shall be paid irrespective of the make of a personal automobile.” Clause 3(2): “In enterprises, agencies and organisations not enumerated in sub-clause (1) the costs related to the use of a personal automobile for business travel shall be reimbursed under agreement between the employer and the employee who owns the automobile.”

Clause 4(1) provided: “Amounts paid to persons working under employment contract in an enterprise, agency or organisation (irrespective of the form of ownership thereof) for the reimbursement of expenses of the use of a personal automobile for business travel (including the price of motor fuel received without charge), exceeding 500 kroons in month, are considered as fringe benefits for the purposes of imposition of income tax and shall be subjected to social tax.”

42. When interpreting these provisions it is necessary to proceed from § 2(3) of the 1990 Social Tax Act. One of the objectives of the provision was to grant an employer the right to reimburse reasonable costs, which an employee incurred in relation to business travel.

§ 2(3) did not refer to a vehicle in the ownership of an employee, instead it referred to a personal vehicle. Thus, a personal vehicle used for business travel, which is referred to in the Act, was differentiated from a vehicle which is in the possession or in the use of an employer. Any vehicle which is not in the ownership or possession of an employer has to be regarded as a personal vehicle.

Under the 1990 Social Tax Act the government was authorised to establish the limits of tax-exempt reimbursement and the procedure for payment of such reimbursements. To establish a procedure for reimbursement also requires that it be provided that reimbursements shall be paid under an agreement between an employee and an employer. Clause 3(2) of the contested Regulation established an additional requirement concerning one party, namely that the employee must be the owner of the automobile used for business travel. By establishing this requirement the government has exceeded the limits of the provision of the 1990 Social Tax Act delegating authority to issue a regulation, and that is why this provision of the Regulation was in conflict with § 87(6) of the Constitution.

IX.

43. The petition of the Tallinn Administrative Court is to be satisfied. As the Government of the Republic has already annulled its Regulation no. 161 of 27 May 1993, the Chamber declares that clause 3(2) of the Regulation was unconstitutional.

44. The Chamber considers it necessary to point out that the Regulation issued under the 1990 Social Tax Act was applied upon imposition of social tax on reimbursements even after the Act was declared void, that is when the 1998 Social Tax Act was in force. The Regulation was declared invalid by the Regulation of the Government of the Republic of 7 March 2000.

The latter Regulation only governs the imposition of income tax on reimbursements for the use of a personal automobile for business travel. A regulation to govern imposition of social tax on reimbursements has not been issued. The provision authorising issuance of a regulation is § 3(1) of the 1998 Social Tax Act, which provides that social tax is not imposed on reimbursements for the use of a personal automobile for business travel pursuant to the procedure and within the limits established by the government.

X.

Pursuant to § 4(1)4) of the Constitutional Review Court Procedure Act **the Constitutional Review Chamber has decided:**

1. To declare that clause 3(2) of the Government of the Republic Regulation no. 161 of 27 May 1993 "Reimbursement of expenses of the use of personal vehicles for business travel" was unconstitutional.

2. To declare that the referred Regulation was unconstitutional as of 1 January 1994 to the extent that it imposed income tax.

The judgment is effective as of pronouncement, is final and is not subject to appeal.

U. Lõhmus
Chairman of the Constitutional Review Chamber
