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**JUDGMENT
OF THE CONSTITUTIONAL REVIEW CHAMBER
OF THE SUPREME COURT
of 7 December 1994**

Review of the petition of the Chancellor of Justice for the declaration of invalidity of the third indent of clause 1.5 of the Income Tax Act Implementation Instructions.

The Constitutional Review Chamber sitting in panel presided over by the Chairman of the Chamber Rait Maruste, and composed of members of the Chamber Tõnu Anton, Lea Kalm, Jaano Odar and Jüri Põld at its session of 23 November 1994,

with the Deputy Chancellor of Justice-Adviser Aare Reenumäe and the representative of the Ministry of Finance Kalev Järvelill appearing, and in the presence of the secretary to the Chamber Kerdi Raud

reviewed the petition of the Chancellor of Justice of 6 October 1994, requesting the declaration of invalidity if the third indent of clause 1.5 of the Income Tax Act Implementation Instructions.

From the documents submitted to the Constitutional Review Chamber **it appears that:**

On 20 April 1994 the Chancellor of Justice made a proposal to the Minister of Finance to bring the Income Tax Act Implementation Instructions, approved by the Minister of Justice Regulation of 21 January 1994, into conformity with the Constitution. The Minister of Finance satisfied the proposal in part. The Chancellor of Justice held that indent 3 of clause 1.5 of the Instructions still remained in conflict with the Constitution and the law.

Indent 2 of clause 1.5 of the Income Tax Act Implementation Instructions establishes that 48% of the income tax revenue be transferred into state budget and 52% into rural municipality and city budgets; indent 3 of clause 1.5 of the Instructions prescribes that indent 2 of clause 1.5 "shall apply to the income tax of resident natural persons which, after 1 January 1994, had been transferred into public revenue account of the Tax Board and to the budgets of rural municipalities and cities, regardless of for what period the income tax transferred to the budgets has been calculated."

In his petition the Chancellor of Justice reminds the Supreme Court about the fact that, pursuant to § 2(1) of the Individual Income Tax Act of the Republic of Estonia (which was effective until 31 December 1993) the

individual income tax was exclusively paid into the budgets of local governments. The Chancellor of Justice is of the opinion that indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions redistributes the income tax calculated from the income of 1993 but received in 1994, and decreases local governments' tax revenues for the benefit of the state.

The Chancellor of Justice is of the opinion that indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is in conflict with § 113 of the Constitution, with §§ 38(4), 6(1) and 8(1) of the Income Tax Act and with the principles of the Taxation Act, and makes a proposal to the Supreme Court that it declare (on the basis of § 152(2) of the Constitution) indent 3 of clause 1.5 of the referred Instructions invalid.

Having examined the documents submitted and having given a fair hearing to the representatives of the Chancellor of Justice and the Minister of Finance, the Constitutional Review Chamber finds that:

The tax system changed on 1 January 1994. The individual and corporate income taxes were replaced by a new tax encompassing both individuals and companies, named "income tax". This state tax was established by the Income Tax Act, which became effective on 1 January 1994. The Income Tax Act Implementation Instructions have been approved by the Minister of Finance Regulation no. 20 of 21 January 1994. These Instructions were published in Supplement VI of *the Riigi Teataja* [State Gazette] on 6 February 1994. Clause 3 of the Regulation prescribes that these Instructions be implemented from 1 January 1994, that is - retrospectively.

Pursuant to the Instructions they have been adopted "on the basis of the Republic of Estonia Income Tax Act for the purposes of calculating and transferring income tax to budget." Thus, the Instructions determine the procedures for calculation and payment of a concrete tax, namely - the income tax.

Although indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions uses the terms "income tax of a resident natural person" and "income tax", not "individual income tax", it follows from the spirit of this clause and from the letter of the Minister of Finance of 21 November 1994 to the Constitutional Review Chamber of the Supreme Court, that indent 3 of clause 1.5 of the Instructions is also applicable to individual income tax paid on the basis of income of 1993 and received in 1994. In the letter the Minister of Finance claims that the partial transfer of individual income tax to the state budget under indent 3 of clause 1.5 of the Instructions is based on § 35 of the State Budget Act, pursuant to which the estimated revenue not received in a specified fiscal year shall be counted as revenue of the fiscal year when it is received.

According to § 2(1) of the Individual Income Tax Act, in 1993 the referred tax is exclusively received into the budgets of local self-government units and not into state budget. Thus, § 35 of the State Budget Act is not a legal basis for the transfer of 48% of individual income tax, received in 1994, to state budget. § 8 of the Income Tax Act establishes the income tax of natural persons, and does not provide that 48% of individual income tax is to be paid into state budget and 52% into the budgets of local self-governments.

§ 38(1) of the Income Tax Act provides that the procedure for implementing the Act shall be established by the Minister of Finance. Thus, the Minister of Finance was obliged to fulfil the duty imposed by law and approve the Income Tax Act Implementation Instructions. But neither the Income Tax Act nor other laws oblige the Minister of Finance to establish that 48% of the individual income tax be transferred to state budget.

Indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is in conflict with § 3(1) of the Constitution, which establishes that state power shall be exercised solely on the basis of the Constitution and such laws that are in conformity with the Constitution. Pursuant to § 94(2) of the Constitution the ministers shall issue regulations on the basis and for the implementation of law. By establishing indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions the Minister of Finance has, without any legal basis, provided that 48% of individual income tax be transferred to state budget in 1994. That is why indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is in conflict with §§ 3(1) and 94(2) of the Constitution.

§ 20 of the Rural Municipality And City Budgets Act establishes that the outstanding revenue by the end of a fiscal year shall be considered to be the revenue of the rural municipality and city budgets of the fiscal year when they are received. Thus, it follows that the end of a fiscal year constitutes no basis for re-distributing the revenue. § 3(1)1 of the State Budget Act states that revenue from taxation pursuant to Acts concerning taxes constitutes one of the sources of state budget revenue. § 2(1) of the Individual Income Tax Act of the Republic of Estonia did not provide and § 8 of the Income Tax Act does not provide that individual income tax be transferred to state budget. Thus, indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is in conflict with § 20 of the Rural Municipality and City Budgets Act and with § 3(1)1 of the State Budget Act.

According to § 38(4) of the Income Tax Act the individuals shall submit income-tax returns concerning the income of 1993 and shall pay the tax in accordance with the Individual Income Tax Act. Yet, § 39(1) of the same Act repeals the Individual Income Tax Act of the Estonian Republic.

Indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is not in conflict with § 113 of the Constitution - pursuant to which state taxes shall be provided by law - as the Chancellor of Justice stated in his petition. The purpose of this constitutional provision is to prohibit imposition of state taxes, duties, fees, fines and compulsory insurance payments by legislative acts ranking lower than law. Indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions does not establish the income tax, instead it groundlessly, unconstitutionally and unlawfully extends the scope of application of § 8 of the Income Tax Act to individual income tax to be received in 1994.

For the aforementioned reasons, indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions is in conflict with §§ 3(1) and 94(2) of the Constitution, with § 20 of the Rural Municipality and City Budgets Act, and with § 3(1)1 of the State Budget Act.

Pursuant to § 152(2) of the Constitution and § 19(1)2) of the Constitutional Review Court Procedure Act, **the Constitutional Review Chamber has decided:**

1. To satisfy the petition of the Chancellor of Justice.

2. To declare indent 3 of clause 1.5 of the Income Tax Act Implementation Instructions, approved by the Minister of Finance Regulation no. 20 of 21 January 1994, invalid.

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

Rait Maruste
Chief Justice of the Supreme Court

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