

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

No. of the case	3-4-1-4-09
Date of decision	26 June 2009
Composition of court	Chairman Märt Rask, members Peeter Jerofejev, Hannes Kiris, Indrek Koolmeister, Priit Pikamäe.
Court Case	Request of the Tallinn City Council to repeal § 105(6) of the Taxation Act, and § 11(1) and (2) of the Minister of Finance regulation no. 51 of 19 December 2008 "Procedure for recording in the accounts, payment and refund of claims and obligations administered by the tax authority for state taxes".
Basis of proceeding	Request of the Tallinn City Council of 19 February 2009.
Hearing	Written proceeding
DECISION	To dismiss the request of the Tallinn City Council.

FACTS AND COURSE OF PROCEEDING

1. On 4 December 2008 the Riigikogu passed an Act to Amend the Taxation Act and Other Related Acts. The President of the Republic proclaimed the Act on 18 December 2008 by his resolution no. 388. The Act was published on 30 December 2008 and entered into force on 1 January 2009. § 1(9) of the referred Act amended in its entirety § 105 of the Taxation Act (hereinafter "the TA"), which regulates the payment and set-off of financial obligations of taxable persons.

2. On 19 December 2008, on the basis of § 105(9) of the TA and § 65(3) of the Customs Act, the Minister of Finance issued regulation no. 51 "Procedure for recording in the accounts, payment and refund of claims and obligations administered by the tax authority for state taxes" (hereinafter "regulation no. 51"). The regulation was published on 31 December 2008 and it entered into force on 3 January 2009.

3. On 26 February the Tallinn City Council submitted a request to the Supreme Court to repeal § 105(6) of the TA and § 11(1) and (2) of the Minister of Finance regulation no. 51 of 19 December 2008 due to the conflict thereof with the constitutional guarantees of the local government.

OPINIONS OF PARTICIPANTS IN THE PROCEEDING

4. The Tallinn City Council argues that the amendment to § 105(6) of the TA and § 11(1) of regulation no. 51 are in conflict with the constitutional guarantees of the local government, namely with §§ 154 and 157 of the Constitution, which can be deemed as constitutional norms establishing the financial guarantees of the local government.

The Tallinn City Council points out that by the amendments to the Taxation Act, which entered into force on 1 January 2009, and by regulation no. 51 the previous procedure for payment and set-off of financial obligations was amended. Since 2009 all the claims between a taxable person and the Tax and Customs Board are reflected in the prepayment account of the tax authority. The new computer system, which is being implemented, enables a taxable person to pay all its taxes and other financial obligations by using one single reference number. By the payments made into the prepayment account all financial obligations which have arisen are considered as performed if the taxable person's claim for refund (i.e. the right to have refunded the greater amount of tax than prescribed by law, or other excess payment) covers the financial obligations which have arisen and the taxable person has submitted a tax return by the due date.

Pursuant to the procedure for payment of claims, established in the Taxation Act before the referred amendments were enacted, the amounts paid by a taxable person were calculated to cover the financial obligations indicated by the taxable person upon payment and in the order they were created.

Proceeding from the first sentence of § 105(6) of the TA the primary criterion upon performance is the time of creation of obligations, i.e. an earlier claim is covered before a later one, irrespective of the type of claim. Pursuant to § 11(1) of regulation no. 51 the obligations entered in the accounts shall be performed from the prepayment account as of the due date of performance of obligations, according to the order referred to in § 105(6) of the TA. Proceeding from subsection (2) of the same section the performance is commenced by performing the obligation with the earliest due date.

It appears from what was described above that the provisions on payment and set-off of financial obligations which have been entered in the accounts, which are valid since 1 January 2009, do not allow to bear in mind the aim of collecting taxes and the interests of the local government who is the recipient of taxes, because the amounts of state taxes that were meant to accrue to the budget of the local government may be used to cover the taxable person's earlier arrears for other financial obligations which, pursuant to the Act, accrue only to the state budget.

The Tallinn City Council is of the opinion that the referred contested provisions compromise the financial guarantees of the local government and thus violate the constitutional guarantees of the local government.

The Tallinn City Council is of the opinion that the system of automatic payment of claims according to the time of creation of financial obligations does not allow to bear in mind the interests of the local government who is the recipient of a state tax and, thus, an entitled subject, or the principles of distribution of taxes as established in the Income Tax Act (hereinafter "the ITA"), the Land Tax Act and the Local Taxes Act. The income tax of natural persons, land tax and local taxes which are meant to be received by a local government may instead be used to cover the arrears of other claims which have arisen earlier and which, pursuant to the Act, are meant to accrue to the state only. Consequently, the amendments to the provisions regulating the payment of taxes have created a situation where the taxes established by law might not accrue to the local government which is

the recipient of the taxes pursuant to law. At the same time no amendments have been made to those provisions of the Acts concerning taxes regulating the receipt of taxes, pursuant to which it is still the local government who is to receive the income tax of natural persons (partly), land tax and local taxes, paid by taxable persons. Consequently, a situation may arise where a taxable person's arrears of tax liabilities (e.g. value added tax and excise duties) to be accrued to state budget, arisen during an earlier period of taxation, are covered out of the amounts accrued to the prepayment account of the Tax and Customs Board, whereas the taxable person has paid the sums to cover the tax liabilities meant to accrue to a local government budget (income tax of natural persons, land tax). Thus, the valid procedure for payment and set-off of obligations creates a situation where the state can cover arrears of taxes to be accrued to the state budget out of the tax revenue which, pursuant to the Acts concerning taxes, is subject to be transferred to local governments.

The Tallinn City Council points out that the new procedure for payment and set-off of financial obligations has already resulted in the decrease of receipt of income tax into the budget of the city. Namely, in January 2009 the Tax and Customs Board transferred to the city of Tallinn income tax of natural persons in the amount of 223 009 kroons, which is 28 697 kroons, i.e. 5.6% less than in January 2008. It appears from the reply of the Tax and Customs Board to the enquiry of the city that in December 2008 the total amount of declared taxable income of persons who derive taxable income and whose registered residence is Tallinn was 71 208 754 kroons, i.e. 2.4% more than in December 2007. The received income tax is transferred to local governments from the declared taxable income of the previous month, consequently, in January 2009 from the income of December 2008. In December 2008 the declared taxable income in Tallinn was 2.4 % bigger than in December 2007, which allows to presume that the decrease of the income tax transferred to Tallinn in January 2009 by 5.6% as compared to January 2008 is attributable, on the one hand, to the general increase of tax arrears of taxable persons because of economic crisis, but on the other hand, it is highly probable that the main reason is the principles of payment and set-off of obligations arising from tax law relationships which entered into force on 1 January 2009. This is further supported by the data, obtained from the Tax and Customs Board, about the overall income of local governments, because according to this data the Tax and Customs Board transferred to local governments 6.8% less of income tax than in January 2008.

The new provisions regulating the payment and set-off of financial obligations are also in conflict with the principle of proportionality. The city council admits that there is no doubt that the principles of payment and set-off of financial obligations arising from tax law relationships, which entered into force in the beginning of 2009, have a number of positive aspects, especially from the point of view of facilitation of administration of obligations. However, the city council is of the opinion that the positive effect of the provisions regulating the payment and set-off of obligations in the administration of claims does not counterbalance the negative consequences that the implementation of the referred norms may bring about for the local government and which have already become apparent, as can be seen from the above analysis of the receipt of income tax. In a situation where the provisions regulating the payment and set-off of financial obligations, established by the legislator, do not guarantee the receipt into local budget of prescribed part of state taxes in due time and in the prescribed amount, rises – in addition to the referred infringement of financial guarantees – the question of conformity of the referred provisions with the principle of proportionality, arising from § 11 of the Constitution. It is important that the measures to facilitate the administration of financial obligations, taken by the state, must not compromise the right of the local government to receive the funds necessary for the performance of local government functions. There is the danger that the possible harmful consequence of implementation of these measures might be bigger than the positive results facilitating the administration of tax law claims.

In conclusion the Tallinn City Council argues that § 105(6) of the TA and § 11(1) and (2) of regulation no. 51, regulating the payment and set-off of obligations since the beginning of this year, unlawfully infringe the constitutional guarantee of the local government, because the principles of payment and set-off of claims established by the referred provisions do not guarantee the receipt into local budgets of the required part of state taxes in due time or in the prescribed amount.

5. The Minister of Finance is of the opinion that it is neither legally nor factually possible to infringe the constitutional guarantees of the local government by § 105(6) of the TA and § 11(1) and (2) of regulation no. 51, and that the referred infringement can not be ascertained within abstract norm control proceedings. For these reasons the request does not meet the requirements of § 7 of the Constitutional Review Court Procedure Act (hereinafter "the CRCPA") and should be dismissed.

The Minister of Finance argues that the performance of the duty of the state to guarantee sufficient financial resources to the local government, arising from §§ 154(2) and 157 of the Constitution and from Article 9 of the European Charter of Local Self-Government (RT II 1994, 95; hereinafter "the Charter"), can be assessed only when the revenue of the local government in its entirety is taken into account. The wording of § 105(6) of the TA and of regulation no. 51, which entered into force on 1 January 2009, did not change the percentage referred to in § 5(1)1) of the ITA or the obligation to pay land tax into the budget of the local government; consequently, the contested norms did not change anything in the revenue base of the local government. The amendments to the record-keeping system of taxes did not bring about such consequences that would allow to conclude that the state does not fulfil the referred obligation. Indeed, the city council does not argue that the state does not fulfil the obligation to ensure sufficient funds to the local government, because otherwise the city council would have to prove such arguments. The sufficient revenue base of the local government has neither increased nor decreased as a result of the contested provisions.

The Ministry of Finance is of the opinion that it is impossible to abstractly control the performance of the obligation to guarantee sufficient revenue base to the local government, because verifying whether the obligation to guarantee sufficient revenue base is fulfilled requires, as a minimum, an analysis of whether the sufficient revenue base is guaranteed to the local government. The city council has not pointed this out. The local government is deprived of sufficient revenue base not by just any impact on the allocation of finances to the local government, but by such an impact that may result in the infringement of the right to self-management of the local government. The latter can only be assessed when analysing the whole of the revenue base of the local government. No arguments have been set out in the request on the basis of which it could be concluded that the valid record-keeping system of taxes causes an infringement of the right to self-management of the local government. The legislator is competent to establish the system for keeping record of state taxes. The valid system ensures universal and flexible performance of tax obligations.

6. According to the opinion of the Constitutional Committee of the Riigikogu the request of the Tallinn City Council is admissible, because the system of payment and set-off of taxes, established by § 105 of the TA, affects the financial situation of the local government.

The majority of the Constitutional Committee is of the opinion that the contested provisions are not in conflict with the constitutional guarantees of the local government. The legislator is competent to establish the system of tax administration. The system, created by the legislator, pursuant to which tax arrears are calculated on the basis of the time when the claims arose, can not in itself violate the financial interests of the local government, because these provisions are addressed to tax payers, not to the local government. The tax payer has no subjective right to decide which obligations to perform in time and which to delay.

The negative impact of the Taxation Act on the financial situation of the local government can not be verified within abstract norm control, because the new system of payment and set-off of taxes, which allows for the set-off of arrears and excess payments existing in different types of taxes, may – in principle – put local governments at a disadvantage, yet it may – for the same reasons – have an advantageous effect by allowing to cover, out of the taxes to be accrued to the state, the taxes to be accrued to the local government budget.

The minority of the Constitutional Committee was of the opinion that the contested provisions violate the principle of independence of the local budget, arising from § 157 of the Constitution, because the timely receipt of taxes in the prescribed amount is not guaranteed to the local government and therefore the local government can not perform the duties imposed on it by law.

7. According to the opinion of the Chancellor of Justice the request of the Tallinn City Council is not admissible, because the provisions referred therein do not directly decrease the revenue base of the local government. Furthermore, the Tallinn City Council has failed to indicate the obligations of the city the performance of which is adversely affected by these provisions.

The prerequisites of admissibility of a request of the local government are that the procedure for submitting the request is lawful, that legislation referred to in § 7 of the CRCPA is contested, that the request is submitted for the protection of constitutional guarantees of the local government, and the infringement of the constitutional guarantees of the local government must be possible.

Pursuant to § 154 of the Constitution it is the duty of the state to ensure such a financing mechanism of local governments that guarantees sufficient funds to the local government for the performance of duties. Pursuant to § 154(2) of the Constitution the expenditure related to duties of the state imposed on local governments must be funded from the state budget. Consequently, the funding of the duties of the state must match the expenditure related to the performance of these duties. Secondly, § 154(1) in conjunction with § 157 of the Constitution gives rise to the obligation of the state to create such a system of financing the local government that would guarantee to the local government a sufficient revenue base for the performance of the functions of the local government. It is up to the legislator to decide whether to guarantee the financial resources, among other things, through levying local taxes, accruing state taxes directly into the local budget, or through allocations from the state budget.

The financial guarantees of the local government are an inevitable prerequisite of the main guarantee – the right to resolve local issues independently.

If we were to consider that any measure which – at least to some degree - unfavourably affects the broad financial guarantee of the local government entitles the local government to have recourse to the court on the basis of § 7 of the CRCPA, the local government's right of appeal on the basis of § 7 of the CRCPA would become unlimited in essence.

The Chancellor of Justice argues that the alleged violations of the financial guarantees of the local government are to be examined only in the cases when a contested measure directly decreases the revenue base of the local government, or imposes additional duties which increase expenditure without changing the revenue base and, thus, render the performance of the functions of the local government more difficult. Consequently, the local government's request must set out, among other things, the functions of the local government the performance of which is rendered more difficult by the contested measure. When the provision of the legislation contested by the local government directly decreases the revenue base of the local government, or when a measure imposes additional duties which increase expenditure without changing the revenue base and, thus, render the performance of the duties of the local government more difficult, the request is admissible.

§ 105(6) of the TA and § 11(1) and (2) of regulation no. 51 regulate the payment and set-off of taxes. The contested provisions do not regulate the funding of the local government, instead they regulate the procedure for payment of taxes. The provisions regulate the relationship between the tax authority and the taxable persons and do not regulate the financing of the revenue base of the local government.

The unfavourable effect of § 105(6) of the TA and § 11(1) and (2) of regulation no. 51 on the tax receipt of the local government can not be unambiguously ascertained, neither can direct decrease of the revenue base of the local government be concluded from that.

Under the new system of payment and set-off, similarly with the previous one, the receipt of taxes is primarily influenced by how tax-abiding and solvent the taxable persons are. The receipt of taxes depends on whether sufficient sums are transferred into the prepayment account.

When the taxable persons perform their obligations correctly, the revenue base of the city will not decrease because of the provisions contested by the Tallinn City Council. In a state based on the rule of law the correct behaviour of taxable persons is to be presumed. At the same time, when a taxable person does not pay taxes in a timely manner or fails to pay taxes because of solvency problems, then the decrease of the revenue base of the local government is not attributable to the contested provisions but, instead, to some other circumstance, e.g. deteriorated economic situation.

The Chancellor of Justice points out further that the general rule that taxes are paid in the order that they arise is neutral and does not favour one category of tax to others. In the order pursuant to which claims with the same due date are to be satisfied preference is attributed – from among the payments and taxes intended for specific purposes to the taxes accrued to the state. When the amounts accrued to the prepayment account are used to cover the tax arrears which have arisen earlier, it is possible that the arrears of the claims of taxes accrued to the local government are covered.

The Tallinn City Council presumes in the request that the receipt of taxes in January 2009 in the smaller amount than prescribed may be attributable to economic crisis, but is, instead, with great probability caused by the principle of payment and set-off of obligations arising from tax law relationships, which entered into force on 1 January 2009. However, this allegation is not reasoned. An infringement of the financial guarantees of the local government can not consist in the fact that due to economic crisis the revenue in the budget proves smaller than planned. For a request of a local government, submitted under § 7 of the CRCPA, to be admissible, the decrease of the revenue base of the local government must be caused by the contested measure.

For the above reasons the Chancellor of Justice is of the opinion that the norms contested by the Tallinn City Council do not directly decrease the revenue base of the local government. The provisions affect the revenue base indirectly and on the condition that taxable persons do not perform their obligations or do not perform the obligations on time.

Furthermore, the city of Tallinn has failed to indicate in the request which of the duties imposed on the city it will now not be able to fulfil.

8. The Minister of Justice is of the opinion that the provisions contested by the Tallinn City Council do not violate the constitutional guarantees of the local government and are not in conflict with the Constitution.

The system of payment and set-off of taxes established in the Taxation Act influences the financial situation of the local government (§§ 154(1) and 157 of the Constitution), because the order established in § 105(6) of the TA and the commencement of performance with the obligation of the earliest due date imposes restrictions on the local government in deciding on the use of its financial resources. That is why there is an infringement of the guarantee of the local government, and the review of constitutionality is admissible.

As the local government is not a subject of fundamental rights, the reference to violation of the principle of legitimate interests (§ 10) is not appropriate.

The legitimate aim of establishment of this restriction is to reduce the number of persons who owe arrears, to increase the taxable persons' convenience and the administrative capacity of the tax authority. The record-keeping system of taxes enables to fulfil the financial claims arising from different Acts by one single payment. Depending on the time of creation of tax liability and the type of obligation payment is effected automatically, and the taxpayer is free of all the obligations concerning payments.

The fact that both the local government taxes and the state taxes accrue with one reference number allows the tax authority to set off the arrears of different categories of tax against excess payments, depending on the situation, either in favour of the local government or the state. Consequently, the measure is suitable for the achievement of the aim.

The tax administration system can be necessary only when the referred aims are not achievable by some other measure which is less burdening on the local government. The Tallinn City Council is of the opinion that the local government taxes should be accrued into the budget of the local government without the state being able to re-distribute these in favour of the state budget. Proceeding from the purpose of tax administration the establishment of a system of the order of tax-collection is necessary for the state to be able to monitor the receipt of taxes, collect taxes from tax payers, and have an overview of the accrued taxes for drafting the budget.

By implementing a single prepayment account and the system of tax administration the state helps the local government to economise the maintenance expenses of the system which the local government would have to cover when administering the taxes independently.

What is important for the local government is to obtain the payments receivable on the basis of law, but this does not guarantee that under a different tax administration system the tax payer would always prefer a local government tax to a state tax.

The collection of taxes through the prepayment account of the Tax and Customs Board enables the tax payer more easily to fulfil the financial claims and obligation arising from law with only one payment (plus submission of a tax return). The tax payer must pay the taxes imposed by law and has no subjective right to decide whether to pay or not to pay this or another tax.

The right of the local government to use the resources necessary for the performance of its duties is violated when the state does not guarantee that the part of state taxes which is accrued to the local budget is not received on time or in the prescribed amount. The tax payer has the obligation to pay all taxes, both local and state taxes, prescribed by law. The tax payer can not decide in favour of payment of one or another tax.

The Tallinn City Council has, within abstract norm control, contested an abstract situation where due to the ranking of taxes the local government will not receive the amount to which it is entitled under the Acts concerning taxes. It would be erroneous to conclude that the tax payer would pay, in timely manner, only local government taxes, or that the tax payer pays taxes depending on whether the tax is a local tax or a state tax. Should the tax payer prefer local taxes to state taxes, he would violate the interest of the state by the unpaid taxes, and vice versa. As the tax payer is required to pay all the taxes imposed by law, the legislator is entitled to establish a system so that the payment of all taxes would be as easy as possible for the tax payer. Neither can it be proved that the provision of the Act would result in a situation where the financial interest of the local government would succumb to the interests of the state. Upon putting the taxes in a specific order the state proceeded from the principle that first come the individually registered taxes and payments, which have been withheld from the person and are directly related to state insurances of natural persons. Next come other taxes and accessory obligations. The last in the order are other obligations accrued into the state budget, such as fines and penalty payments. This does not violate the autonomy of the local government and is not in conflict with the Constitution.

9. The Association of Estonian Cities supports and considers justified the request of the Tallinn City Council to repeal § 105(6) of the TA and § 11(1) and (2) of regulation no. 51.

10. The Association of Municipalities of Estonia agrees with the opinions expressed in the request of the Tallinn City Council and fully supports these.

CONTESTED PROVISIONS

1. § 105(6) of the Taxation Act (RT I 2002, 26, 150; 2008; 27; 177) reads as follows:

“ § 105. Payment and set-off

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(6) The financial obligations of a taxable person shall be paid or set off in the order of creation of obligations, except when before the due date of performance the taxable person applies for the exclusion of the performance of an obligation referred to in clauses 14) 16) of this subsection from set-off. The claims with one and the same due date shall be fulfilled on the basis of the following order:

- 1) contribution to mandatory funded pension;
- 2) unemployment insurance premium;
- 3) withheld income tax;
- 4) social tax;
- 5) income tax of a natural person;
- 6) land tax;
- 7) customs duty;
- 8) gambling tax;
- 9) excise duties;

- 10) heavy goods vehicle tax;
- 11) income tax of permanent establishments of resident legal persons and non-resident legal persons;
- 12) value added tax;
- 13) local taxes;
- 14) interest;
- 15) penalty payment;
- 16) other obligations.”

12. § 11(1) and (2) of the Minister of Finance regulation no. 51 of 19 December 2008 “Procedure for recording in the accounts, payment and refund of claims and obligations administered by the tax authority for state taxes” reads as follows:

“§ 11. Performance of obligations

- (1) The obligations entered into accounts shall be performed from the prepayment account as at the end of the due date, taking into account the order established in § 105(6) of the Taxation Act.
- (2) Performance is commenced with the obligation with the earliest due date of payment.”

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13. Pursuant to § 7 of the CRCPA a local government council may submit a request to the Supreme Court to repeal an Act which has entered into force, a regulation of the Government of the Republic or a minister or a provision thereof if it is in conflict with constitutional guarantees of the local government.

14. Consequently, the Supreme Court can adjudicate on the merits only such requests that meet the following three requirements: firstly, the request must be submitted by a local government council; secondly, the request must argue that legislation referred to in § 7 of the CRCPA or provision thereof is in conflict with constitutional guarantees of the local government, and thirdly, the infringement of the constitutional guarantees of the local government by the contested legislation or a provision thereof must be possible (see the judgment of the Constitutional Review Chamber of the Supreme Court of 16 January 2007 in case no. 3-4-1-9-06, paragraph 16).

15. The Tallinn City Council argues in the request that § 105(6) and § 11(1) and (2) of regulation no. 51 infringe the financial guarantees of the local government, which arise from §§ 154 and 157 of the Constitution. Consequently, the first two requirements referred to in the previous paragraph are met. Next, the chamber shall analyse whether the third requirement is met, i.e. whether the contested provisions are capable of infringing the financial guarantees of the local government.

16. In paragraph 42 of its judgment no- 3-4-1-2-09 of 9 June 2009 the Constitutional Review Chamber of the Supreme Court has explained the meaning of the financial guarantee as follows:

“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 (the judgment of the Supreme Court *en banc* of 19 April 2004 in case no. 3-3-1-46-03, paragraph 21).

Consequently, § 154(1) of the Constitution gives rise to the right to have sufficient financial resources, allowing the local government to resolve and manage both mandatory and voluntary local government issues. The same right is also established by Article 9(1) and (2) of the Charter. Pursuant to the referred subsections 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. Local authorities’ financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.

§ 154(2) of the Constitution gives rise to the right of the local government to require that the expenses relating to performance of duties of the state, imposed by the law, be covered from the state budget. The content of this right, too, must be determined taking into account Article 9(2) of the Charter, which requires that financial resources should be commensurate with the responsibilities imposed on local governments by the constitution and the law.

To the rights referred in two previous sub-indentents corresponds the obligation of the state to guarantee sufficient financial resources to local governments for the performance of national as well local duties (see in this regard the referred judgment of the Supreme Court *en banc* no. 3-3-1-46-03, paragraphs 20 24). In the performance of this obligation the state must take into consideration the requirements arising from Article 9 of the Charter.

The basic guarantee of the local government established in § 154(1) of the Constitution, i.e. the right to independently resolve and manage local issues, is inevitably accompanied by the necessity to have an independent budget. And the Constitution, indeed, does clearly provide the right to an independent budget and does it in § 157(1) and not in § 154(1), as referred to by the applicant. Pursuant to § 157(1) of the Constitution a local government shall have an independent budget for which the bases and procedure for drafting shall be provided by law.

In addition to the rights enumerated above a local government has the right – proceeding from § 157(2) of the Constitution – to levy and collect taxes and to impose duties on the basis of law.”

17. Consequently, to decide on the admissibility of the request of the Tallinn City Council it is necessary to find out which of these rights may be infringed by § 105(6) of the TA and § 11(1) and (2) of regulation no. 51.

18. From among the taxes enumerated in § 105(6) of the TA land tax and local taxes are accrued in full amount to the budget of the local government, and income tax is partly accrued to the local government budget. The revenue from these taxes is used by the local government for the performance of both state and local government functions.

Consequently, the procedure for payment and set-off of financial obligations of taxable persons may bear upon the right arising from § 154(1) of the Constitution (right to sufficient financial resources for the performance of local government function) as well as on the right arising from § 154(2) of the Constitution (right to have the expenditure related to duties of the state imposed by law on a local government funded from the state budget).

19. The most important constitutional guarantee of the local government is, nevertheless, the right of self-management, established in § 154(1) of the Constitution. A local government must have sufficient financial resources primarily for independent resolution and management of all local issues on the basis of law. Consequently, the rights relating to the financial guarantee are

oriented at the creation of necessary conditions for the exercise of the right of self-management (judgment of the Constitutional Review Chamber of 9 June 2009 in case no. 3-4-1-2-09, paragraph 43).

20. The relationship between the rights belonging to the financial guarantee and the right to self-management must be born in mind also upon ascertaining whether the right to sufficient funds for the performance of local government functions or the right to have the expenditure related to duties of the state imposed by law on a local government funded from the state budget are infringed. These rights can not be deemed infringed merely because the financial situation of the local government will probably change due to the adoption of legislation of general application. This would give the local government too broad a right of appeal and would thus enable to contest any legislation which affects the financial situation of the local government to any extent, being at the same time very loosely related to independent resolution of local issues. As already pointed out above the existence of sufficient resources is not an independent end in itself. The former of the rights under discussion has been established in order to guarantee the existence of sufficient resources for the resolution of local issues, the latter – in order to guarantee that the local government would not have to use the finances meant for the performance of local government functions for the performance of duties of the state imposed on it by law.

Thus, the right to sufficient financial resources for the performance of local government functions may be infringed when the contested measure decreases the income of a local government or increases the volume of mandatory local functions without allocating additional financial resources, and thus renders the performance of the local duties more difficult (judgment of the Constitutional Review Chamber of 9 June 2009 in case no. 3-4-1-2-09, paragraph 48).

The right to have the expenditure related to duties of the state imposed by law on a local government funded from the state budget may be infringed when the contested measure is capable of decreasing the funds meant for the performance of duties of the state or increasing the volume of the duties of the state without allocating finances in the same amount.

These rights may also be infringed when the contested measure is capable of affecting the periodic nature of receipt of finances by the local government so that this will prejudice the proper performance of duties of the state or duties relating to local government functions (including making of disbursements).

21. The Tallinn City Council points out correctly in its request that the establishment of such a procedure for the performance and set-off of tax obligations pursuant to which obligations are fulfilled in the order of their creation and the obligations which are created on the same day are performed in the order prescribed by law, wherein some of the taxes that are partly or fully accrued to the local government budget are ranking lower than the taxes accrued to the state budget, may affect the periodic nature of receipt of financial resources by the local government. Thus, the request is admissible.

22. However, to establish an infringement the Chamber shall have to ascertain that the contested provisions not only affect the periodic nature of receipt of financial resources by the local government, but that they also hinder the proper performance of duties of the state or duties relating to local government functions (including making of disbursements).

23. First of all the effect of the contested provisions on the receipt of taxes by the local government must be analysed. For this purpose the Chamber shall first discuss the procedure for payment and set-off of tax obligations which was in force before the enactment of the contested provisions, i.e. before 1 January 2009; thereafter the Chamber shall analyse the presently valid procedure and examine the differences of the two procedures.

24. Pursuant to the procedure in force before 1 January 2009 there existed a separate reference number for the accounting for and setting off each tax, payment and interest obligation and accounts of these were kept on separate personalised accounts. When a tax payer had submitted a tax return or when tax liability had been imposed on the tax payer by administrative legislation, then, on the basis thereof transfer was made to the personalised account. When a taxable person was unable to perform all obligations on time, the person could choose which obligation to perform first. In the case of compulsory collection the collected amount was distributed equally between all categories of taxes (§ 128(5) of the TA). In the case of excess payment and arrears the taxable person was free to request the set-off of the excess payment and the arrears. Consequently, the taxable person could decide on the order of performance of tax liabilities. There is no ground to believe that under this procedure the taxable person would have preferred – on his or her own initiative – to first pay those taxes that accrue partly or fully to the local government budget.

Pursuant to the new procedure, which entered into force on 1 January 2009, the accounts of performance of tax obligations are not kept by category of tax, but generally. Every tax payer has one single account and one reference number for all taxes. The tax payer can no longer choose to which account to transfer money and in what order to pay the arrears. Set-off of excess payments and arrears is made automatically and does not depend on the requests of tax payers. Thus, the new procedure reduces the incidental nature of tax receipt by excluding the taxable person's freedom to decide on the order of payment of different taxes.

25. Under both, the new and the old procedure, taxes are not received into the local government budget only when the taxable person fails to perform tax obligation on time. The Chamber is of the opinion that this procedure does not change the periodicity of tax receipt to such an extent that it would hinder the proper performance of duties of the state or duties relating to local government functions.

26. The opinions expressed in the request – that through the order of performance of tax obligations the state redistributes for its own benefit the revenue meant for the local government – speak for the desire of the Tallinn City Council to achieve that those taxes which fully or partly accrue to the local government budget were first in the order. The Chamber is of the opinion that the Constitution does not prescribe that when collecting tax arrears the state should, in any case, prefer the taxes accrued to local governments to the taxes retained by the state. The state must ensure sufficient funds to the local government for the resolution and management of local issues and ensure that the local government would not have to spend these funds on the performance of duties of the state imposed on it by law.

Also, the referred opinions are substantially unfounded, because just as it is possible under the new procedure to cover the earlier tax arrears that, on the basis of law, accrue only to the state budget, out of the amounts subject to accrue to the local government budget, it is also possible to cover – out of the state taxes to be accrued to the state budget – the earlier tax arrears of other financial obligations which, by law, accrue only to the local government budget.

27. In the light of what was discussed above it can be stated that § 105(6) of the TA and § 11(1) and (2) of regulation no. 51 do not reduce the revenue of the local government or render the performance of local government functions more difficult. Neither do these provisions reduce the funds meant for the performance of the duties of the state or increase the volume of duties of the state without allocating additional resources. Furthermore, these provisions do not affect the periodicity of receipt of taxes in a

manner that would prejudice the proper performance of duties of the state or duties related to local government functions. Consequently, the contested provisions do not infringe the right to have sufficient resources for the performance of local government functions or the right to have the expenditure related to duties of the state imposed by law on the local government funded from the state budget. That is why, on the basis of § 15(1)6) of the CRCPA, the request of the Tallinn City Council is to be dismissed.