Ability to pay and human rights: a case-law analysis[1]

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1. The ability to pay as a principle of human rights

The ability-to-pay principle has been part of the Italian tax system since the enactment of the Constitution in 1948 (Article 53)[3]. The Italian national framework envisages a relationship between a taxpayers' income and their duty to contribute to public expenses. This principle is not present only in the Italian system, but is to be found in every European tax system[4].

Clearly the ability-to-pay principle is based on the active protection of human rights by the State. The fundamental reason for taxation is to ensure that the State can provide public services. In particular, general taxation is needed to finance essential services and these services are intended to protect human rights. This means that the main aim of general taxation is to distribute among all taxpayers the burden of the cost of education, public health and social services, as well as law enforcement and national defence. At the same time the exercise of this power is closely related to fundamental rights. Many of the fundamental rights are protected by the Constitution: for example, Art. 32 protects the right to health, Art. 33 the right of access to higher education for all, Art. 24 the right to a fair trial, and Art. 31 the right to family life.

This concept of taxation as a way to distribute the cost of public services is

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[3] For a complete description of the historical developmen of this principle see G. FALSITTA *Il principio della capacità contributiva nel suo svolgimento storico fino all'assemblea costituente* in Riv. Dir. Trib., 2013, I, 749.

[4] As R.A. De Mooij and L.G.M. Stevens argue in: Exploring the future of ability to pay in Europe, EC Tax Review, 2005/1, 9ss. "*European tax systems rely heavily on the ability-to-pay principle. For instance, countries usually adopt the Schanz-Haigh-Simons (SHS) concept of comprehensive income as the basis for taxation. This income is considered a good indicator for the ability to pay. Moreover, individualized incomes are taxed at progressive rates to obtain a redistributive impact from taxation*".

a fundamental part of the Italian system of taxation. Political decisions determine how to manage public expenditure and what kind of services should be provided for taxpayers as citizens. The ability-to-pay principle has the aim of solidarity, as it requires all citizens to contribute to public expenditure. At the same time, it ensures that this contribution is required only of those with an effective ability to pay[5]. The ability-to-pay principle is based on equity and equality and places a limit on the State's power of taxation in order to ensure a fair distribution among taxpayers.

Traditionally, the idea that taxes should be levied according to the taxpayers' ability to contribute to public expenditure mainly concerned the relationship between taxpayers and the State in their own tax jurisdiction. However, the application of the ability-to-pay principle is problematic in cross-border scenarios, particularly considering the fact that when two or more tax jurisdictions are involved, different measures will apply in each jurisdiction with different regulations for residents and non-residents.

2. Taxation of individuals: the ability-to-pay principle

The Court of Justice of the European Union (CJEU) (formerly the ECJ) considers the role of the relationship between taxation and the taxpayer, both from a personal and an economic point of view, in the context of personal income taxation. On this point the leading case is *Schumacker*[6] in which the ECJ held that residents and non-residents are in principle not comparable in connection with the country where income is sourced, but these differences are no longer important and cannot be justified when the major part of the taxable income is earned in the host country (90% of the total income earned by the taxpayer). This ruling could be considered as the cornerstone of the ability-to-pay principle in the EU.

The ability to pay, in an EU perspective, could be described as a subjective

[5] See G. FALSITTA, Corso Istituzionale di Diritto Tributario, 2007, Padova, 64.

[6] See ECJ, 14 Feb. 1995, Case C-279/93, Roland Schumacker v. Finanzamt Köln-Alstad (hereinafter, Schumacker), giving rise to the "Schumacker Doctrine". See Sjored Douma, "The three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation", European Taxation 46, no. 11 (2006).

ability to pay or as an objective one[7]. The subjective ability to pay is related to the individual's ability to contribute in relation to their personal circumstances, whereas the objective ability to pay refers to the determination of income, or, more exactly, the kind of revenues to be considered as income for tax purposes.

Even before this ruling, the EU Commission attempted to identify a common criterion for all Member States (Recommendation 94/79). According to this Recommendation, the major part of taxable income should be interpreted as 75 percent of the total income of the taxpayer[8]. In particular, the Commission states in the Preamble to the Recommendation that the principle of equality of treatment stemming from the Treaty requires that where the preponderant part of their income is received in the country of activity, persons earning income should not be deprived of the tax reliefs and deductions enjoyed by residents[9]. This means that the basic idea that undertakes the ability-to-pay principle is recognized by the EU Commission, in spite of the fact that the problem today, considered in a cross-border perspective, is mainly a problem of the distribution of the power to raise taxes between different member States.

3. Judgment C-39/10, European Commission v. Republic of Estonia

According to the Schumacker Doctrine and to Recommendation 79/94/CE it is possible to read the ECJ ruling C-39/80 in connection with Article 258 TFEU in terms of a failure to fulfil obligations.

In this case the Republic of Estonia applied a law on income tax which did not grant non-resident taxpayers the individual allowance to which they would have been entitled if they had been resident in the national territory.

In particular the Commission received a complaint from a person of

[7] See C. BALDINI, The Ability to Pay in the European Market: an impossible Sudoku for the ECJ, in "INTERTAX", 38/2010, Kluwer Law International, BV.

[8] Article 2(2) of the recommendation provides that application of the same condition to resident and non-resident taxpayers "shall be subject to the condition that the items of income […] which are taxable in the member State in which the natural person is not resident constitute at least 75% of that person's total taxable income during the tax year".

[9] See Recommendation 94/79/EC.

Estonian nationality resident in Finland concerning income tax on the pension paid to him by the Republic of Estonia. The individual complained that the tax allowance for residents was not been applied to him, nor did he receive the supplementary tax allowance for residents in receipt of a pension[10].

The Commission held that in Estonia the tax burden of a non-resident in a similar situation to that of the complainant was higher than it would have been if they had received all their income as a pension paid by just one member State.

In relation to the ability-to-pay principle, below a certain level, when incomes are too low to be able to contribute to public expenditure, there is a personal tax exemption. Considering that according to the 1979 EC Recommendation, the ability to pay has to be considered in relation to the entire household, the Estonian law seems to be harmful to this principle, and also harmful to the general principle of the non-taxation of minimum incomes.

In the opinion of the ECJ, (point 58) "the general nature of the condition laid down in Paragraph 28(3) of the Law on income tax, which takes no account of the personal and family circumstances of the taxpayer concerned is liable to penalise persons such as the complainant who have made use of opportunities offered by the rules on freedom of movement for workers, and is therefore incompatible with the requirements of the Treaties as they follow from Article 45 TFEU".

Whereas the Law that grants an exemption for low incomes aims to comply with the ability-to-pay principle, the refusal of a Member State to grant allowances provided for under its tax legislation penalizes non-residents simply because they have exercised the freedom of movement guaranteed

[10] The complainant, after reaching retirement age in Estonia, moved to Finland, and worked and acquired the right to a pension there. The complainant thus receives two retirement pensions, one in Estonia and one in Finland, of almost the same amount. The pension received in Estonia is subject to income tax, whereas in Finland, on account of the low level of the complainant's total income, there is no liability to tax. The aggregate amount of the two pensions, moreover, is only slightly above the allowance threshold laid down in Paragraph 23(2) of the Estonian law on income tax. According to the Estonian Law on income tax (Paragraph 23) a tax-free amount of 27,000 EEK is deducted from the income of a resident natural person during a tax period, and the corresponding figure was 36,000 EEK in the case of income from a pension payable under the law by a contracting State.

by the Treaty. What is more interesting is that, in this case, the ECJ interpreted the ability-to-pay principle in the strongest possible way as an expression of the freedom of movement, more than as a consequence of the non-discrimination principle.