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Austerity measures under judicial scrutiny: the Portuguese constitutional case-law

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Austerity measures under judicial scrutiny: the Portuguese constitutional case-law

Portuguese Constitutional Court

Decision 399/2010 (*Surtax on Personal Income Tax 2010*)

Decision 396/2011 (*State Budget 2011*)

Decision 353/2012 (*State Budget 2012*)

Decision 187/2013 (*State Budget 2013*)

Decision 474/2013 (*Public Workers Requalification*)

Decision 602/2013 (*Labour Code*)

Decision 794/2013 (*40-Hour Work Week*)

Decision 862/2013 (*Pensions Convergence*)

Decision 413/2014 (*State Budget 2014*)

Decision 572/2014 (*Special Solidarity Contribution 2014*)

Decision 574/2014 (*Pay cuts 2014-2018*)

Decision 575/2014 (*Special Sustainability Contribution*)

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INTRODUCTION

The impact of the Eurozone sovereign debt crisis in Portugal has been particularly severe.¹ The first Portuguese Stability and Growth Programme, which contained

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several austerity measures including increase in taxation and public sector workers' salaries reductions, adopted in order to decrease the budget deficit, dates back to March 2010.

General elections held in Portugal in September 2009 were won by the Socialist Party (PS) – which was the incumbent party – but without an absolute majority in Parliament. The Stability and Growth Programme 2010-2013 was adopted on 12 March 2010 by the PS minority Government after the parliamentary approval of the State Budget for 2010, and included a strategy of budgetary consolidation aiming at the reduction of the general government deficit to 2.8 per cent of the GDP by 2013, and control of the general government debt growth by 2013. This first set of austerity measures was adopted autonomously by the Portuguese Government and sent to the European Commission (EC or Commission).

As to the severity of the crisis impact in Portugal, the executive summary of the Stability and Growth Programme 2010-2013 points out that Portugal was strongly affected by the spread of the effects of the crisis, primarily during 2009, though also significantly in 2008. After zero growth in 2008, and despite following closely the first Eurozone countries' economic recovery in the second quarter of 2009, the Portuguese GDP recorded a negative growth of 2.7 per cent in 2009. At the same time, the unemployment rate increased significantly, registering an annual average of 9.5 per cent. The decline of government revenues and, in general, the automatic stabilisers – in addition to the concerted measures by the various member states of the European Union to stimulate the economy and support businesses, the unemployed and households – had a negative impact on the general government accounts of Portugal. The process of fiscal consolidation that had been in progress with apparent success since 2005 was interrupted in 2008, largely due to a significant reduction of tax revenues. Thus, the Portuguese Government decided to initiate the process of reducing the general government deficit in 2010, and intensify that reduction in subsequent years by a further 5.5 percentage point, in order to achieve the aforementioned target of 2.8 per cent of GDP in 2013.²

¹ Between 2008 and 2013, public debt went up from 71.7 to 129 per cent of the GDP; during the same period, investment has fallen almost 40 per cent in nominal terms. In a country with approximately 10 million people, between 2010 and 2013 almost 500,000 jobs were destroyed. Unemployment increased from 7.6 per cent in 2008 to 16.2 per cent in 2013; the percentage of unemployed youth (15 to 24 years of age) grew from 16.7 per cent in 2008 to 38.1 per cent in 2013. More than 100,000 people (48 per cent between 20 and 40 years old) left the country, definitively or temporarily, in 2011, and over 120,000 (57 per cent between 20 and 40 years old) in 2012. After important changes of the rules of application to unemployment benefits, the number of jobless citizens receiving public aid fell from 60 per cent to slightly over 40 per cent between 2010 and 2013. Numbers can be found at: <www.ine.pt> and <www.pordata.pt>.

² *Executive summary of the Stability and Growth Programme 2010-2013*, <ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2009-10/01_programme/pt_2010-03-29_sp_en.pdf>, visited 8 May 2015.

One year after that Stability and Growth Programme, on 16 May 2011, following a series of downgrades of the Portuguese Republic's sovereign credit rating by the ratings agencies, which led to the adoption of two more packages of austerity measures³, like Greece and Ireland, the Portuguese Government, then led by outgoing Socialist Prime Minister José Sócrates, negotiated a bailout programme with the EC, the European Central Bank (ECB) and the International Monetary Fund (IMF). The bailout took the form of an agreement on a Financial and Economic Adjustment Programme⁴ with the 'Troika' (composed of the ECB, the Commission and the IMF) whereby the Portuguese Republic undertook several commitments in exchange for a financial loan of 78 billion euros at lower rates than the ones offered by the markets.⁵ The agreement was also signed by two opposition parties: the Social-Democrat Party (PSD) and by the Popular Party (CDS/PP). Both those parties, in June 2011, following general elections, formed a new coalition Government led by Prime Minister Pedro Passos Coelho.⁶ The left-wing parties with parliamentary representation, the Communist Party (PCP) and the Left Bloc (BE), refused to sign the agreement with the Troika.

This Economic and Financial Adjustment Programme specified not only yearly fiscal objectives but also commitments to adopt reforms in public policies. The implementation of the Programme was closely monitored by representatives

³ Internationally, clear signs were given that these measures were insufficient. As yields in the sovereign bond market kept increasing and the financial conditions of Portuguese banks kept deteriorating, two additional austerity measures packages followed in May 2010 and October 2010 (the latter included in the State Budget for 2011). In both cases, additional sets of fiscal and social measures to control expenditure were adopted, including a rise in value-added tax and a sharp cut in public sector workers wages. In March 2011, under increasing pressure from national banks, the financial markets, the ECB and other EU institutions and governments, the PS Government submitted to the parliament a new austerity package. This package was rejected by all opposition parties and the Government resigned. On 7 April 2011, Portugal requested financial assistance from the EU, the Euro Area member states and the IMF.

⁴ Which comprises three documents: the *Memorandum of Economic and Financial Policies*, <www.portugal.gov.pt/media/371354/mefp_20110517.pdf>, visited 8 May 2015; the *Technical Memorandum of Understanding*, <www.portugal.gov.pt/media/371360/tmou_20110517.pdf>, visited 8 May 2015; and the *Memorandum of Understanding on Specific Economic Policy Conditionality*, <www.portugal.gov.pt/media/371369/mou_20110517.pdf>, visited 8 May 2015.

⁵ The financial loan was provided by the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility and the IMF.

⁶ A general election was held in Portugal on 5 June 2011 to elect the Portuguese Parliament. The social-democrats (PSD) won the election with 38.66 per cent of the votes cast. The defeat of the incumbent PS was severe, as it fell below 30 per cent of the votes cast (28.05 per cent). Given the election result had made it impossible to form a majority Government with parliamentary support from a single party, PSD established a coalition agreement with CDS/PP. The XIX Constitutional Government took office on 21 June 2011.

of the Troika and the delivery of the subsequent tranches of the loan depended on a positive evaluation by the monitoring committee, conducted on a regular basis.

The Economic and Financial Adjustment Programme and its Memoranda have functioned as a catalyst of national legislation adopted in order to *transpose* the commitments to the national legal order. A significant part of this legislation establishes austerity measures that have been challenged by unconstitutionality claims before the Constitutional Court. The review proceedings have earned the Portuguese Constitutional Court unprecedented attention not only nationally but also internationally. The focus on the Portuguese Constitutional Court and its case law on austerity legislation have reignited the national debate on the problem of the *guardian* of the Constitution and who should be the last interpreter of the fundamental law.

In this article we present an overview of the constitutional case law on ‘austerity legislation’. By ‘austerity legislation’ – or ‘austerity measures’ – we refer to the legislation directly adopted as a means to cope with the reduction of the budget deficit and that has a direct impact on individual constitutional rights and freedoms.⁷ To this end we also consider case law on legislation enacted prior to the bailout agreement. However, the more relevant austerity legislation is the one which pertains to the enforcement of the compromises expressed in the bailout agreement.

The implementation of the austerity measures has had economic, social and fiscal consequences that raise several constitutional issues. Some of these issues have been brought to the Constitutional Court under abstract review requests. Others have been raised in judicial disputes and have reached the Court under concrete review proceedings. This article only deals with the case law adopted on abstract review proceedings.⁸ Such abstract reviews have been filed both in *a priori* (preventive) and *a posteriori* (successive) proceedings, i.e. before the bill has been ratified by the President of the Republic, or after the legislative procedure has been duly concluded and the legislative act has entered into force. The *a priori* review proceedings of laws such as the state budget can only be triggered by the President

⁷This selection does comprise all the legislation adopted in order to cope with the financial crisis. For example, legislation was approved limiting the recruitment powers, the budgetary discretion and financial autonomy of the autonomous regions and municipalities. However, despite the fact that this legislation also has a relevant constitutional impact, it will not be considered in the present article since it does not directly affect individual rights and freedoms.

⁸It should be noted that the access to the Constitutional Court on concrete review proceedings takes the form of a ‘constitutionality appeal’, following the exhaustion of ordinary remedies. The admissibility of such appeals lies only on formal requirements, regardless of its merits. Therefore, the number of concrete review procedures concerning austerity measures and the scope of constitutionality challenges brought before the Constitutional Court are such that it would be impossible to include all of them in this analysis. Furthermore, the decisions issued in concrete review proceedings are only binding *inter partes*.

of the Republic.⁹ Posterior review proceedings may be filed by a larger number of entities: the President of the Parliament (*Assembleia da República*), the Prime Minister, the Ombudsman, the General Attorney or one-tenth of the Members of Parliament. If a breach of the rights of the autonomous regions is invoked, the Representatives of the Republic in the Azores and Madeira, the legislative regional assemblies, their presidents or one-tenth of their members, and the presidents of the regional governments can also file a request of *a posteriori* abstract review.

It is not our intention to provide a critical assessment of the case law on austerity legislation. We solely intend to put forward a concise description of such case law. However modest this intent may seem, it is a relatively burdensome task since such case law is quite extensive and presents rather complex arguments. The fact is that the serious financial distress of the state has posed challenges to the constitutional system that had never been addressed before.

Hitherto, the Court has delivered 12 decisions meeting the selection criteria we detailed above. Most of these decisions are rather long for the normal standards of the Court's decisions and argumentatively complex. Instead of adopting the traditional style of presenting the decisions on an individual basis, we have divided the presentation along the lines of the different subjects dealt with by the Court in the selected case law. This structure should allow for a clearer perception of the complexity of issues that lie behind the so-called 'austerity case law', providing a straightforward narrative of the several issues that have been brought under judicial scrutiny. We hope that this informative note may be especially useful for the non-Portuguese audience interested in this subject since the full text of the decisions is only publicly available in Portuguese.¹⁰

We consider 12 decisions of the Constitutional Court divided in accordance with three main subjects: first legislation concerning public sector workers, then legislation concerning retired citizens and lastly legislation concerning taxes and other sources of tax revenue. The consideration of these three subjects will be subdivided as follows:

- Legislation concerning public sector workers deals with pay cuts in the years 2011 to 2015, with extra work and working time and with requalification of public workers.
- Legislation concerning retired citizens deals with pay cuts and special solidarity contribution, with pensions systems convergence and with special sustainability contribution.

⁹In case of regional norms or organic laws, the Representatives of the Republic in the Autonomous Regions, the Prime Minister and the Members of Parliament, also have the right of bringing prior review claims of unconstitutionality.

¹⁰An extended English summary has been prepared by the Court for each decision and can be accessed through the Court's English version of the website, <www.tribunalconstitucional.pt/tc/en/home.html> under Jurisprudence – Summaries.

- Legislation concerning taxes and other sources of tax revenue deals with surtax on personal income tax, with personal income tax brackets reduction, with additional solidarity tax, with reduction of itemised deductions and with contribution imposed upon sick and unemployment benefits.

In some cases, the decisions deal exclusively with one matter (for e.g. the *Requalification* or the *Pensions Convergence* decisions). However, the decisions on state budgets deal with the multitude of problems raised by the petitioners and are dealt with on different parts of the text. The 12 decisions treated are those mentioned under the title of this case note, from Decision 399/2010 (*Surtax on Personal Income Tax 2010*) to Decision 575/2014 (*Special Sustainability Contribution*).

LEGISLATION APPLIED TO PUBLIC SECTOR WORKERS

Pay cuts

The first issue we will address is public sector workers' pay cuts. This austerity measure has been repeatedly adopted both by the socialist Government, in 2011, and by the conservative coalition now in office, in 2012, 2013, 2014 and 2015. The rules imposing the cuts have been brought before the Constitutional Court on several occasions, and analysed in Decisions 396/2011 (*State Budget 2011*), 353/2012 (*State Budget 2012*), 187/2013 (*State Budget 2013*), 413/2014 (*State Budget 2014*) and 574/2014 (*Pay cuts 2014-2018*).

Pay cuts in 2011

The first pay cuts imposed upon public workers were applied to all state employees with a wage above 1,500 euros before taxes and other legal contributions, and varied between 3.5 and 10 per cent, progressively augmenting depending on the amount received, and with an average cut of 5 per cent. This measure was adopted along with others, such as the prohibition of career promotions and progressions; the prohibition of hiring new public sector workers and the reduction of the number of public employees; the additional pay cuts in extra time and special subsidies and the increase in the employee's contribution for public sector health insurance.

The constitutional review of the norms of the State Budget Law for 2011 imposing the pay cuts was soon requested by opposition Members of Parliament, under an abstract review-of-constitutionality procedure. Such a procedure leads to the elimination of the norms from the legal order in case an unconstitutionality ruling is reached.

The first remark made by the Court – and a fundamental premise of the *ratio* of the *State Budget 2011* decision – is that these provisions should be deemed to be *temporary*. In the Court's words:

these measures will last for several years, but that does not allow us to question their transitory character, bearing in mind the nature and objectives pursued, which consist in a normative answer to an exceptional situation that is supposed to be corrected, urgent and briefly, back to normal standards.¹¹

This conclusion was actually grounded in the Government's Report on the State Budget, where it was stated that

a measure such as the one introducing pay cuts is only adopted under extraordinary and extremely difficult conditions, endangering the very sustainability of the Welfare State. We do not intend to establish any kind of pattern of social regression, but to ensure the obligations of the Portuguese State, both internally, maintaining a high level of public services, and externally, especially in the context of the European Union.¹²

The Court then recognised that the right to pay is a fundamental right enshrined in the Portuguese Constitution and that it enjoys the special protection conferred upon liberty rights (*direitos, liberdades e garantias*). However, it stressed that there is an important difference between the right to be paid and the right to receive a specific amount of money, not reducible by law, however the circumstances and the economic and financial variables influencing it. Again, using the Court's words,

[o]ne cannot state that the irreducibility of pay is a dimension of the constitutional protection of the workers' right to wages [...] If an express constitutional rule of prohibition of pay cuts does not exist and cannot be inferred from the fundamental right to wages, we must conclude that only constitutional principles, such as the protection of legitimate expectations [*princípio da protecção da confiança*] and equality, may be used as a valid parameter in the present.¹³

The Constitutional Court then analysed whether or not the imposition of sacrifices only to some (in this case, to public workers only) to ensure the fulfilment of a public goal that benefits the whole political community, violated fundamental constitutional principles, such as the principle of equality. The Court

¹¹ Decision 396/2011 (*State Budget 2011*) point 5, 'Vigência temporal das normas impugnadas', *in fine*.

¹² Again, Decision 396/2011 (*State Budget 2011*) point 5, 'Vigência temporal das normas impugnadas', *in fine*.

¹³ Decision 396/2011 (*State Budget 2011*) point 7, 'Irredutibilidade dos Salários'.

declared that it is not within its powers to enter into the debate over the equivalence of effects between measures that reduce the state's expenses (such as pay cuts) and others that increase the state's gains (such as raising taxes). Therefore, in the absence of a definitive answer, the Constitutional Court decided that the measures under appreciation should be considered admissible and constitutional. The Court stated that, 'within certain "limits of sacrifice" [...] it is acceptable that this may be a legitimate and necessary way to reduce the State's expenses',¹⁴ particularly if one recalls the urgency of the measures. Bearing in mind that public workers are paid from public resources and are especially bound to the pursuit of public objectives, they are not in a position of equality with their fellow citizens. Therefore, the additional demands made upon them are not unreasonable and do not result in an unjustified inequality.

Pay cuts in 2012

The State Budget Law for 2012 was approved by a newly elected Parliament as mentioned above. The centre-right Social-Democratic party (PSD) won 108 out of 230 seats and formed a coalition with the smaller right wing People's Party (PP). The Socialist Party (PS), who had been governing since 2005, faced a significant defeat. The campaign was heavily dominated by the economic crisis and austerity measures, as the former socialist Prime Minister, José Socrates, had resigned after the parliamentary rejection of another austerity package, and subsequently asked for the Troika bailout. During the campaign, the then candidate Pedro Passos Coelho promised not to enforce further austerity legislation in case of election. However, the new majority not only maintained the 2011 pay cuts which had already been cleared by the Constitutional Court but also added a new austerity feature: the partial or total suspension of Christmas and holiday pay¹⁵ for all public sector employees with salaries between 600 and 1,100 euros, or over 1,100 euros per month, respectively.

The Constitutional Court was again asked to review the constitutionality of these new measures by opposition Members of Parliament. The first aspect it noticed was that the Christmas and holiday payments are part of yearly wages, both under private and public law, so their partial or total suspension amounts to another pay cut, which must be added to the ones already imposed to public sector employees earning more than 1,500 euros per month. The Court then went on to explain that the previous pay cut had been considered constitutionally admissible because it was still within certain limits, although it treated public

¹⁴ Decision 396/2011 (*State Budget 2011*) point 9, 'Princípio da Igualdade', *in fine*.

¹⁵ Christmas and holidays' pay, also known as 13th and 14th month, correspond to additional monthly pays, usually due in June/July and November.

workers unequally. It was accepted because it was an effective and swift way of reducing public debt, under exceptional economic and financial circumstances. These conditions were still fulfilled, but it was necessary to prove that, more than one year later, additional pay cuts were the least painful (or the only) measure at the Government's disposal to reach important public goals.

The Constitutional Court also rejected the Government's arguments according to which public employees have higher wages than private sector workers and enjoy more security in their jobs. It considered that even if these statements were true – and that had not been demonstrated – that would not be sufficient to justify the unequal treatment of public servants. Therefore, the only justification for the additional pay cut was the effectiveness of the measure to obtain the Government's desired goal, which the Court recognised to be of high public interest: the swift reduction of public expenses. The Constitutional Court admitted that the legislature's choice was particularly effective and produced quick results. It also conceded, as it had done before in the *State Budget 2011* decision, that a certain degree of differentiation between public and private workers is admissible, and lies within the margin of appreciation of the legislature; all the more so, the Court added, bearing in mind the very difficult economic and financial context. However, the Constitutional Court ruled that even in that context there must be a limit to the possibility of discrimination against public workers, by cutting their wages. The difference in the degree of sacrifice demanded from these citizens and from every other individual in order to reach a balanced budget and reduce public debt cannot be unlimited. Legal equality is at stake in this case, so the justification for the pay cuts must be submitted to a proportionality review. On the basis of this reasoning, the Court concluded that the sacrifices imposed upon public workers had no equivalent to what was demanded from their fellow citizens, even from those receiving high incomes from other sources. Therefore, the Constitutional Court declared the unconstitutionality of the additional pay cuts (i.e., of the partial or total suspension of the Christmas and holiday pay), stating that the difference of treatment by the legislature was so big that it could not be justified on grounds of urgency or effectiveness of the measures to pursue certain public interests, and so it violated the principle of equality.

Nevertheless, the Court decided to suspend the effects of its ruling. This implied, in practice, that the suspension of Christmas and holiday pay was effectively applied during 2012, and only forbidden from then on. It should also be noticed that the 2011 pay cuts were maintained and applied in 2012 as well.

Pay cuts in 2013

Facing the consequences of the *State Budget 2012* decision, the Government decided to redraw the austerity measures adopted to reduce the deficit and

public debt. The State Budget Law for 2013 enacted one of the biggest tax rises the country has ever seen, especially as regards the personal annual income tax (IRS), with a revision and reduction of all income tax brackets and the introduction of a new, flat-rate surtax. These mechanisms were reviewed by the Constitutional Court and considered constitutionally valid, as we will detail below. However, added to this, another pay cut was imposed on public workers, this time the suspension of the additional holiday pay (the Christmas pay was not suspended). The 2011 pay cuts, previously approved by the Constitutional Court, as was mentioned earlier, also remained in place. Several other measures intended to reduce public expenses were adopted, such as the prohibition of bonuses or increased wages as a result of promotions or career progression as well as a yearly reduction of 2 per cent of public workers.

This time, the Court's intervention was requested by several public institutions. The first one to raise doubts about the constitutionality of the new pay cuts was the head of state, President Cavaco Silva, a politician historically belonging to the right wing of the social democratic party (PSD), the main Government coalition party. He argued that the new pay cut violated the principle of proportional equality, stating that this additional differentiation between public and private workers was against the constitutional demands of taking into account the taxpaying capacity of each citizen. One should remember, the President said, that the economic capacity to pay taxes (or to contribute to the deficit reduction in general) is not determined by the legal type of contract that a citizen has with his employer, nor by the stability or duration of that contract.

Two groups of opposition Members of Parliament, including the ones that had initiated the 2011 and 2012 proceedings of constitutional review, also presented allegations to the Court regarding the pay cuts. They considered such cuts to be unconstitutional not only because of the violation of the principle of equality, but also for being contrary to the principle of protection of legitimate expectations and the principle of proportionality. These Members of Parliament recalled that public sector workers had been suffering an average pay cut of 5 per cent since 2011 and that they had effectively lost up to extra 14.2 per cent of their wages in 2012 due to the suspension of the effects of the Constitutional Court's ruling of unconstitutionality. They were now being subjected to yet another cut, which was supposed to be maintained until 2014, that is, during the rest of the economic surveillance period foreseen in the Memoranda. It was also noted that, with all the austerity measures combined, in 2013 public sector workers would in fact suffer a reduction in pay very similar to the one declared unconstitutional by the Constitutional Court in 2012, because the increase in the personal income tax amounted roughly to one month's pay.

In its judgment, the Court started by explaining that it did not regard the pay cuts as taxes, but rather as an attempt to reduce public expenses; the measure

should be approached as an act of the state as an employer and not as a decision of the state as political sovereign, whose norms must affect all the citizens. The Constitutional Court also recalled, following its previous case law, that the right to wages enshrined in the Constitution does not imply that it is impossible, under any circumstance, to apply pay cuts, and therefore that Article 59 of the Constitution¹⁶ cannot ground a ruling of unconstitutionality in this case. Other than that, the Court relied heavily on its 2011 and 2012 decisions, affirming that the question, in this case, was not to verify the existence of a valid public interest that could be ensured by the measures under review: no doubts were raised on this point. The problem was to assess whether the sacrifice the restrictive measures implied for public sector workers could be considered valid and in accordance with the principles of equality, proportionality and the protection of legitimate expectations. The Court eventually ruled the suspension of the holiday pay unconstitutional, relying solely on the principle of equality, in its dimension of equality as regards public burdens or objectives (*égalité devant les charges publiques*).

In the *State Budget 2013* decision it is stated that ‘the legislature [...] could not have ceased to attribute an autonomous value to the principle of equality as to the repartition of public burdens, which is traditionally put into practice through the fiscal system.’¹⁷

The Constitutional Court also added that

the combined and continuous effects of the sacrifices imposed upon public sector workers, which has no equivalent for the general population with income obtained from other sources, corresponds to a difference of treatment that no longer finds justification in the objective of reducing the public deficit. Therefore, it implies a violation of the principle of proportional equality [...]. The tax raise, identical to all taxpayers, independently of their income’s source is not able to diminish that difference, which only affects those whose salary is paid by public money.¹⁸

This time, however, the Court did not moderate any of the consequences of the unconstitutionality ruling, so the Government was forced to pay the full amount of the holiday pay to all public employees.

¹⁶ Article 59 (Workers’ rights): ‘1. Regardless of age, sex, race, citizenship, place of origin, religion and political and ideological convictions, every worker shall possess the right: a) To the remuneration of his work in accordance with its volume, nature and quality, with respect for the principle of equal pay for equal work and in such a way as to guarantee a proper living; [...] 3. Salaries shall enjoy special guarantees, as laid down by law.’ An English version of the Portuguese Constitution can be found at <www.tribunalconstitucional.pt/tc/conteudo/files/constituicaoingles.pdf>, visited 8 May 2015.

¹⁷ Decision 187/2013 (*State Budget 2013*) point 44.

¹⁸ Decision 187/2013 (*State Budget 2013*) point 44, *in fine*.

Pay cuts in 2014

In 2014 and pay cuts in 2014-2018, yet again two opposition groups of Members of the Parliament demanded the constitutionality review of several norms of that year's State Budget Law. Among the contested norms was the one that introduced new pay cuts, designed by the Government to overcome the previous declarations of unconstitutionality of the suspension of the holiday and Christmas pay. According to the Government, 2014 was supposed to be a transitional year between the economic adjustment programme that had been followed so far and the new budget rules to be applied to all Euro Area countries, in particular the rules contained in the Stability and Growth Pact. Having this scenario in mind, priority was to be given to the reduction of public expenses, rather than tax increases, and some permanent restrictive measures were to be adopted, especially as to what concerns expenses on wages and social subsidies.

Following these guidelines, a new pay cut varying from 2.5 to 12 per cent was to be applied to public sector workers with wages greater than 675 euros. These cuts were to replace the 2011 cuts (which ranged between 3.5 and 10 per cent to wages greater than 1,500 euros) that had been enforced since then up to the end of 2013. These new cuts were joined by other measures that had also been applied before, such as the prohibition of raising wages on the basis of promotions or career progressions and the reduction in the number of public workers through voluntary agreements between employees and the state.

The Constitutional Court recalled its 2011, 2012 and 2013 decisions, stressing that it had already admitted a certain degree of difference in treatment between public and private sector workers, provided that the difference in question was proportional and justified. The Court then went on to compare the sacrifice that resulted from these new pay cuts, the one that had been applied since 2011 (considered to be in accordance with the Constitution – see *State Budget 2011*) and the cuts imposed in 2012 and 2013 (ruled unconstitutional – see *State Budget 2012* and *State Budget 2013*). It found that the 2014 cuts were, in practice, quite similar to the ones of 2013. On the other hand, the Constitutional Court stated that the degree of sacrifice demanded with the new law was significantly greater than what resulted from the one applied from 2011 onwards, especially as to what concerned wages above 1,500 euros and, mainly, wages between 675 and 1,500 euros (that had been spared from the pay cuts up to 2014). Some of the wages affected, the Court said, 'are so low in the first place that any reduction has a strong negative impact and produces a sacrifice much greater than its objective quantification'.¹⁹ Therefore, the Court once again declared the pay cuts unconstitutional, due to the violation of the principle of equality, especially of equality as to what regards public burdens.

¹⁹ Decision 413/2014 (*State Budget 2014*) point 42, *in fine*.

However, the Constitutional Court decided to repeat the limitation of effects of its decision and ruled that they would only be applied *ex nunc*, that is, from the moment of the decision onwards. Since the decision was handed down at the end of May, this limitation meant that, in practice, the cuts were kept in force for five months.

Following this judgment, the Government quickly sent to Parliament a new legislative proposal that established pay cuts for public workers to be applied until 2018, although the cuts were to be reduced and eventually withdrawn by the end of that same period. The President of the Republic, following a direct and public appeal of the Prime Minister, requested a preventive (*a priori*) review of constitutionality, in order to trigger the Court's ruling on this legislation before it entered into force. The purpose of the request was, according to the head of state, to clarify that the long-term solutions proposed by the Government did not violate the Constitution, and to prevent further requests of *a posteriori* constitutionality review. These demands, if initiated only after the norms entered into force, could possibly be a burden to the stability of Portugal's economic recovery process.

The new bill reinstated the 2011 pay cuts and established a timeframe for the reduction of those cuts; they were supposed to diminish by 20 per cent in 2015 and then more in the remaining years, up to 2018, when the full wage should be reinstated to all public workers. That meant that the 2011 pay cuts should be applied in full during the rest of the year of 2014, 80 per cent in 2015, and somewhat less in the subsequent years (subject to future determination).

Again, the Court's reasoning²⁰ is centred on the principles of equality and of the protection of legitimate expectations, which were also the arguments employed in the President's request.

The Court dismissed the principle of the legitimate expectations as a justification for the unconstitutionality of the norms under review. It considered that although public workers' expectations of improvement of their wages were normal and legitimate, in the framework of a slow economic recovery and of the end of the economic adjustment programme agreed with the Troika, nothing justified or supported the expectation that the full amount of the wage was to be paid from the beginning of 2015.

The Constitutional Court also recognised the importance of European Union law, especially of the norms related to the member states' obligation to avoid excessive deficits. That obligation and all the secondary law procedures related to it, the Court has said, justify the need to keep in force certain austerity measures that allow for the reduction of the public deficit and debt. However, the Court added,

notwithstanding the doubts about the real mandatory character of these [the European Union's] recommendations – adopted in the course of an excessive deficit

²⁰ Decision 574/2014 (*Pay cuts 2014-2018*).

procedure – the truth is that they do not impose upon Portugal concrete measures to keep public expenses under control and reduce the deficit, but they only limit themselves to clarify the objectives that must be accomplished under binding European Union law [...].²¹

The Constitutional Court went on to explain that

the binding character of European Union law, in this domain, does not include the means chosen by Member States to achieve the goals imposed upon them. For this reason, the fact of admitting that the norms enacted and the ones yet to be approved by the national legislature must comply with the prescriptions issued by the European Union has no consequences as regards the application of national constitutional norms. On the contrary, in a multilevel constitutional system, within which several different legal orders interact, internal legal measures must necessarily be in accordance with the Constitution, it being the Constitutional Court's competence, as stated in the Portuguese Constitution itself, to administer justice in constitutional matters (Article 221 of the Constitution of the Portuguese Republic). Furthermore, even European Union law establishes that the Union shall respect Member States' national identities, inherent in their fundamental structures, both political and constitutional (Article 4(2) of the Treaty on European Union).²²

The Court continued its reasoning by stating that it was aware that, in practice, pay cuts could be imposed on public sector workers until 2018, in what constitutes a rather painful treatment, especially if we take into account that other measures have had detrimental effects on these workers' salaries, such as (i) the wage reduction that results from the unpaid increase in working hours (see extra work and working time, *infra*), (ii) the increase of the workers' contribution to *ADSE* (public workers medical insurance), or (iii) the prohibition of promotions and career progressions. Following previous case-law, in particular the *State Budget 2014* decision, the Court admitted the possibility of pay cuts for the remaining of the year 2014 and 2015, bearing in mind that the country was still subject to an excessive deficit procedure by European authorities and that the whole economic and financial situation could not yet be considered normal. To reach this judgment, it was considered highly relevant that the pay cuts for 2015 would be 20 per cent lower. However, for the period 2016-2018, the Constitutional Court affirmed that one could no longer consider the cuts to be a temporary measure, adopted in response to an emergency situation, even more so when the progressive reduction of the cuts was not fully determined by the bill. Therefore, the Court declared the pay cuts for the years 2016-2018 to be unconstitutional, for violating

²¹ Decision 574/2014 (*Pay cuts 2014-2018*) point 12.

²² Decision 574/2014 (*Pay cuts 2014-2018*) point 12.

the principle of equality. The Court also recalled that it is not constitutionally admissible to base the whole strategy for balanced public finances on the reduction of expenses focused on a continuous sacrifice of public sector workers.

Overtime and Working time

The legislation regarding overtime and working time was subjected to important changes during the period of economic crisis, which was justified by the Government with the need to reduce salaries (the amount for an hour's work) and to increase productivity.

The reduction of overtime pay was one of the measures the Government agreed with the Troika. It was first put in practice with the amendments to the Labour Code (*Código do Trabalho*) approved in 2012, which reduced the payment for extra hours by 50 per cent and eliminated the period of rest that was given to the worker as compensation for doing extra work. The opposition parties asked the Court to review these changes. In its decision,²³ the Court stressed that despite the strong reduction of compensation for extra working hours, there was still a more favourable treatment of that kind of work as far as payment is concerned. For this reason, the norms were considered in accordance with the Constitution.

Similar but even higher cuts concerning overtime pay were imposed upon public workers both in the State Budget Law for 2012 and the State Budget Law for 2013. The Constitutional Court reviewed the measure in its *State Budget 2013* decision, upon request filed by a opposition group of Members of Parliament. The Court stated that the additional payment of overtime could not be technically considered as salary, unlike the holidays and Christmas pay, because it did not have the regularity that is the latter's characteristic feature. Since overtime is not included in the concept of salary, at least in a direct and necessary way, the constitutional protection of the right to wages cannot be invoked as a ground of unconstitutionality. On the other hand, being a variable and not predictable compensation, because it depends on management decisions adopted by the employer, the reduction of pay for extra work does not violate the principle of the protection of legitimate expectations. There are no legitimate expectations to an additional compensation for extra work that deserve constitutional protection. Therefore, the Constitutional Court did not declare the norms under scrutiny unconstitutional.

As concerns working time, the Parliament approved legislation proposed by the Government, increasing the normal working time of public employees from 7 hours a day and 35 hours a week to 8 hours a day, and 40 hours a week. This measure was highly contested by trade unions and the entire political opposition,

²³ Decision 602/2013 (*Labour Code*).

who immediately used their Parliamentary factions to ask the Constitutional Court to review the new norms. They alleged that these norms breached several fundamental constitutional principles, such as the principle of equality, the principle of protection of legitimate expectations and the principle of proportionality.

However, the Court considered²⁴ that the new law and 40 hours per week working time corresponded to a free and fundamental choice of the legislature, that should be understood in the context of a reform of public administration, in order to make its legal regime closer to that of private sector workers. The Constitutional Court recognised that the 5 hours increase in working time implied a big sacrifice for public workers, making it more difficult to harmonise their private and family lives with their working lives, and even causing additional public expenses. Furthermore, the Court also admitted that the new working time entrenched a real pay cut, by raising the working time without equally increasing the salary. But such a loss of salary was considered similar to the decrease in overtime pay, which the Court had already ruled constitutionally admissible. Even the cases, also foreseen by the new norms, in which a public employee can now be demanded to work more than 40 hours a week were not judged unconstitutional by the Court, because the 40-hour limit can only be overcome by the legal flexibility mechanisms. These mechanisms, identical to the ones that exist for private working relations, had already been reviewed by the Court and considered to be permissible by the Constitution, as a legitimate restriction to the worker's right to rest and to leisure time.²⁵ Moreover, the Constitutional Court recalled that the principle of the protection of confidence could not be used as an impediment to any changes in legislation that may disappoint or frustrate the citizens' legitimate expectations. In fact, the Court considered that the new working time of public workers had some advantages for the general public, as it allowed an expansion in the opening hours of public services, which had a positive effect to every individual user and in broader terms, to the whole of the society. It also complied with one of the demands of the European Commission, the European Central Bank and the International Monetary Fund to decrease the expenses with public workers' pay, through the reduction in overtime compensation and the restrictions to new hires. For these reasons, the Constitutional Court declared that the norms under review were constitutionally valid.

Requalification

Finally, as to what regards austerity measures affecting public employees, it is important to mention Decision 474/2013 (*Public Workers Requalification*) adopted following an *a priori* review request by the President of the Republic.

²⁴ Decision 794/2013 (*40-hour Work Week*).

²⁵ Decision 602/2013 (*Labor Code*).

The Constitutional Court was asked to review draft legislation approved by the Parliament, upon the Government's initiative, that set up a new system of reduction of the number of public employees. That system effectively allowed for the dismissal of public workers (i) if the agency or public institution they worked for was restructured or reorganised, (ii) if their budget decreased due to lower transfers of money from the State Budget, or (iii) if it was found that the workers needed to be 'requalified' to better suit the needs or new goals of their employers. In case any of these circumstances took place, the worker was to be placed temporarily in a situation of 'requalification' (learning new skills). If after 12 months an adequate place for the said worker in the state's institutions or agencies could not be found, he could be dismissed.

Since the Portuguese Constitution expressly forbids firing a worker without due cause (Article 53), the reasons to justify the dismissal, in this case, were all presented as having an objective ground, which both the law and constitutional case-law had already admitted could be applied both to private and public employees. In fact, the Constitutional Court had said several times that the Constitution does not guarantee an absolute protection from sacking to public employees. The Court also recalled that there have been several reforms that made the legal regime of public workers quite similar to the law on private workers. However, the Court found that the conditions for the dismissal of workers were too undetermined, according to its case-law on "due cause". Moreover, there is a dimension of job security applicable to public employees with tenure that has not really been affected by those reforms – a dimension which made their jobs immune to dismissal on objective grounds. Such workers could only be fired on subjective causes, where there is an element of personal guilt. This implied that, despite the major legal reforms of legislation that directly affected public employees, a strong element of job security remained. Therefore, the Court stated, it is reasonable to say that the workers who enjoyed those safeguards had created legitimate expectations on the possible causes of dismissal and these did not include any objective elements.

The workers' expectations on this issue were also reinforced by many of the austerity measures imposed upon them to reduce public expenses and public deficit. Pay cuts and other disadvantages specifically addressing public workers were justified by the legislature with the greater job security enjoyed by them, considered very important in a period of economic crisis and high unemployment. Moreover, the Constitutional Court explained, the legislature did not explain the public interest reasons that could possibly justify yet another unfavourable change of the public workers' status, especially one that clearly goes against the expectations created by previous state's actions. Therefore, the Constitutional Court concluded, there does not seem to exist an argument that is able to legitimate the violation of the constitutional principle of the protection of confidence that the new measures would necessarily imply. For this reason, the norms under review were considered unconstitutional.

LEGISLATION APPLIED TO RETIRED CITIZENS

Pay cuts and Special Solidarity Contribution

Retired citizens were another category highly affected by the sacrifices demanded in order to achieve the goal of reducing public deficit and public debt. In fact, they have suffered pay cuts very similar to the ones imposed upon the public sector workers, although not always through the same legislative measures.

One common cut was the suspension of the extra holiday and Christmas pay in 2012 and the suspension of the payment of 90 per cent of the holiday pay in 2013. These norms were brought before the Constitutional Court and analysed in the *State Budget 2012* and *State Budget 2013* decisions. The Court affirmed in both decisions that all the arguments presented to justify the rulings on the public sector workers' pay cuts were also relevant as regards retired citizens, especially what had been stressed about the principle of equality regarding public burdens and the principle of proportionality. Moreover, the Court added that there were also specific grounds of unconstitutionality that only concerned retired citizens. In fact, in their case the principle of the protection of legitimate expectations had a high relevance because, in most cases, these citizens cannot chose an alternative source of income or change their life plans; unlike workers, who at least in theory may seek a better job, enhance their qualifications or even try emigration, for retired citizens the fundamental life choices have already been made. These individuals can only hope that the state pays their pension, in accordance to the long-established regime. For that reason, the Court stated, for retired citizens the suspension of Christmas and holidays pay might mean 'the utter impossibility of adapting their life plan to a new scenario', and declared them unconstitutional both in 2012 and 2013.²⁶

In order to impose another pay cut, similar to the one applied from 2011 to 2013 to public workers, on retired citizens, a Special Solidarity Contribution (CES) was approved. The measure was first applied in 2011 by imposing a 10 per cent contribution on pensions above 5,000 euros per month before taxes and other contributions (as all the other amounts mentioned in this section). In 2012, these rules were aggravated, and the contribution increased to 25 per cent for the amounts above approximately 5,030 euros and 50 per cent for the amounts above 7,545 euros. In 2013, however, this mechanism was thoroughly revised and a much greater number of pensioners were affected. In fact, the pensions between 1,350 and 1,800 euros were subjected to a contribution of 3.5 per cent. The amounts between 1,800 and 3,750 euros had to pay a contribution of 16 per cent. For pensions above 3,750 euros a 10 per cent contribution was applied to the

²⁶ Applying the same restriction of its decision's effects, in 2012, as was stated above – see *Pay cuts 2012, supra*.

whole amount, with a 15 per cent extra for the amounts between 5,030 and 7,545 euros and a 40 per cent extra for amounts superior to this. The contribution paid by the pensioners was destined to the different branches of the social security system responsible for paying their retirement allowances, so it was an intra-systemic measure.

This measure was highly contested, both from the political and constitutional points of view, and its declaration of unconstitutionality was taken for granted by many commentators, following the review requests made by the President of the Republic, the Ombudsman and opposition Members of Parliament in 2013. However, that was not the conclusion reached by the Constitutional Court. First of all, in its *State Budget 2013* decision, the Court considered the measure as a special social security contribution and not a real tax; the Court said it was not an entirely unilateral contribution, which is one of the main features of taxes, so the whole set of constitutional fiscal norms was not applicable to the case. The Constitutional Court also recognised that this kind of obligation to contribute incumbent upon the current beneficiaries of the pensions system was a deviation to the normal functioning of social security. Nevertheless, the possibility of using other sources of financing is within the margin of appreciation of the legislature. Finally, the Court stressed that this special contribution was a temporary measure, created in times of severe economic and financial crisis to ensure that the social security system is able to fulfil all the obligations taken on by the state. Bearing in mind the specific relationship of the retired citizens with that system, the Court found that the special contribution imposed upon them could be considered proportional and justified.

Following the declaration of unconstitutionality of the convergence between the different legal regimes of pensions (see pensions convergence, *infra*), the Special Solidarity Contribution was yet again redesigned and once more brought to the Constitutional Court for review by Members of Parliament of the opposition. The main changes were the inclusion of pensions between 1,000 and 1,350 euros among those paying the contribution of 3.5 per cent, and the decrease of the threshold to which higher rates are applied (from 5,030 to 4,611 euros, and from 7,545 to 7,126 euros, respectively). In its Decision 572/2014 (*Special Solidarity Contribution 2014*), the Constitutional Court maintained its 2013 reasoning, stating that the importance of the contribution's purpose (the balance and short-term sustainability of the social security system) justified its prevalence over the rights of pensioners. Two main arguments were crucial to this position. In the first place, the fact that the Court still considered the special solidarity contribution to be temporary and exceptional, a measure designed to comply with Portugal's international obligations to reduce the public debt and the deficit in a context of severe economic crisis, and destined to cease at the end of 2014. Secondly, the fact that the contribution still was, to some degree, a redistributive

measure, due to its different and progressive rates, which was in harmony with the principle of self-financing of the social security system and in accordance with the principle of proportionality.

Pensions convergence

At the end of 2013, the Government proposed to the Parliament a reform of the legal regime of former public workers pensions. Retired public workers have a separate social security system – CGA or *Caixa Geral de Aposentações* – to which they contributed during their careers and which is responsible for paying their pensions; this system was closed to new entrances a decade ago, and public workers who started their careers after 2006 no longer contribute to it, but to the general social security system. The Government considered that this system had had more favourable rules in the past, and that it applied a formula for the calculation of the amount of pensions that was better for the pensioners, but that was not necessarily fair nor sustainable. It was argued that the CGA system should have a legal regime more similar to the general social security system. For this reason, the Parliament approved legislation that established a unilateral and definitive 10 per cent cut in the total amount of former public workers' pensions already in payment and imposed that a part of those pensions should be recalculated according to the formula used for the general social security system.

The head of state, President Cavaco Silva, challenged the measures and sent them to the Constitutional Court for prior review. In a unanimous decision, the Court ruled this legislation unconstitutional, on grounds of the violation of the principle of the protection of legitimate expectations.²⁷ The Court did not share the President's view, according to which the cut in pensions should be considered a tax, but it nevertheless stated that a mere pay cut was not adequate to achieve the purposes alleged by the Government: to ensure the sustainability of the CGA system, to guarantee intergenerational justice and to make the two main social security systems more equal. The Constitutional Court stressed that the burden of sustainability of the former public workers social security system cannot be left solely to its beneficiaries; the fact that the system is closed since 2006 makes it necessarily unsustainable without sources of financing other than contributions, a situation that was intentionally created by the state, and must therefore be paid for by the whole society. The Court also noted that the systems are much more complex than one would say only by looking at the formulas used to calculate pensions, and both have an intricate set of rules, some of which are less favourable in the CGA than in the general social security system. For this reason, the Court explained that to allow a cut in pensions already being paid, a measure that entails

²⁷ Decision 862/2013 (*Pensions Convergence*).

a very strong violation of the confidence that its beneficiaries have in the system and in the state itself, could only be justified if it was integrated in a general, structural and well studied reform that took into account several different factors. This was not the case. The Constitutional Court considered the norms under review as an isolated measure with the sole purpose of immediately reducing expenses. Bearing in mind the specific characteristic of pensioners, and their special vulnerability, the Court sustained that it could do nothing else than judging the norms under review unconstitutional.

Special Sustainability Contribution

Finally, we must pay attention to the Constitutional Court's decision on the Special Sustainability Contribution²⁸. This contribution was designed to replace the Special Solidarity Contribution applied to retired citizens between 2011 and 2014 (see Pay cuts and Special Solidarity Contribution, *supra*), and it basically consisted of a contribution very similar to its predecessor but with lower applicable rates. According to the new rules, all pensions up to 2,000 euros per month before taxes should pay a contribution of 2 per cent, the amounts between 2,000 and 3,500 were due a 5.5 per cent contribution, and for pensions above 3,500 euros there was a contribution of 3.5 per cent over the whole amount. Unlike its predecessor, the new contribution was to be permanent and it did not include the amounts paid by private pensions schemes, outside the general public social security system. In the legislative proposal, the Government alleged that it was of vital importance to the long-term sustainability of social security. It also affirmed that this measure was a special contribution to social security, similar to the one applied in 2013 and 2014 that had been characterised as such by the Constitutional Court. The Court, however, did not agree. It stressed that by excluding private pensions schemes, the legislature had transformed the measure in a simple and straightforward cut.

The Government justified the definitive reduction of pensions already being paid on grounds of intergenerational justice. It said that the sustainability of the social security system and a balanced budget are essential elements for the guarantee of pensions in the long run. The Constitutional Court stressed that the adoption of public policies that can ensure balanced budgets are not only fundamental but also an obligation under European Union law. However, that does not allow the legislature to have an absolute freedom to choose the measures it finds more efficient. The Court affirmed that

the constitutional principles of equality, proportionality and the protection of confidence, which have served as a parameter for the Constitutional Court to review

²⁸ Decision 575/2014 (*Special Sustainability Contribution*).

the constitutionality of national norms concerning matters connected with the ones now in appreciation, are part of the core of the rule of law, and integrate the European common constitutional *acquis*, to which the Union is also bound.²⁹

The Court then went on to explain that the applicable isolated reduction of the rates could not transform a typical austerity measure – meant to allow immediate savings and the decrease of public expenses – into a structural measure, able to guarantee the medium and long term sustainability of the public pensions system. Moreover, the Court stressed, the decrease in the contribution's rates was bigger for higher pensions than for medium-lower ones (for pensions between 3,750 and 4,611 euros per month before taxes and other contributions it goes from 10 per cent to 3.5 per cent, while it only decreases from 3.5 per cent to 2 per cent for pensions between 1,000 and 1,800 euros). This demonstrates that the legislature's purpose was not really to ensure the system's sustainability, but yet again to obtain savings in the short term. Bearing in mind the heavy sacrifice imposed upon the citizens affected by this measure, and all the other solutions adopted in the past to guarantee that sustainability (including real structural reforms of the public pensions system), the Court decided to ascertain the unconstitutionality of the special sustainability contribution.

TAXES AND OTHER SOURCES OF TAX REVENUE

Surtax on personal annual income tax

In Decision 399/2010, the Constitutional Court ruled on the constitutionality of a law establishing a surtax on the IRS enacted in June 2010 (prior to the bailout).

The surtax introduced an additional level of taxation, subjecting personal annual incomes above 150,000 euros to the tax rate of 45 per cent, from 2010 until 2013 (during the financial assistance period). Previously, under the Budget Law adopted a month and a half before, these same taxpayers had been subject to the highest band applicable (which was applicable from 64,623 euros), with a tax rate of 42 per cent. In July of that the same year, another law increased the tax rate to 45.88 per cent.

Since the surtax was established in June (and increased in July) but it was applicable to all of the 2010 personal annual income, the question brought before the Constitutional Court was focused on the retroactive character of the measure. In fact, Article 103(3) of the Portuguese Constitution establishes that '[n]o one shall be obliged to pay taxes that are not created in accordance with this

²⁹ Decision 575/2014 (*Special Sustainability Contribution*) point 25.

Constitution, are retroactive in nature, or are not charged or collected as laid down by law’.

According to long-standing case law of the Constitutional Court, one must distinguish between ‘genuine’ or ‘authentic’ retroactivity and ‘ungenuine’ or ‘inauthentic’ retroactivity (often called ‘retrospectivity’). Only the former is considered to be forbidden by the Constitution.

The Constitutional Court decided that it is possible to enact legal provisions on a given tax, during their tax periods, which are designed to produce effects for the entire period. This possibility, however, must pass the test of the principle of the protection of legitimate expectations. The Constitutional Court, in applying this test, concluded that, on the one hand, given the socio-economic situation and the political discourse around it, the taxpayers could reasonably and objectively expect a tax-increase in the short-term. On the other hand, the relative importance of the public interest at stake – the soundness of the state’s public finances – was considered to be sufficient to justify the measure when the Court balanced it against the public’s expectations. It concluded that the law could not be considered intolerable or unbearable to the taxpayers.

The Budget Law of 2013 established another surtax on the personal annual income tax. The tax-payers should pay 3.5 per cent of the sum of: the part of their annual personal income (the various categories of income earned in each year, after specific deductions) which exceeded the annual value of the minimum wage³⁰, plus the income subject to special rates set out in the Personal Income Tax Code (such as income from bonuses, from ‘high value added’ activities, from ‘unjustified wealth increases’ and certain types of capital income).

The question of constitutionality brought before the Constitutional Court was the compatibility of this surtax with Article 104(1) of the Constitution which establishes that ‘personal income tax shall be aimed at the reduction of inequalities, shall be single and progressive and shall pay due regard to the needs and incomes of households’. There are, therefore, two principles that must be followed in terms of personal income tax law: there must be a single tax and it must be progressive.

The problem with the 2013 personal income surtax was that, on the one hand, given the fact that it had a calculation method, tax rate, tax deduction and itemised deduction regimes which were different from the personal annual income tax regime, it should be considered a different and additional tax – and that was inconsistent with the single nature of the personal annual income tax required by the Constitution. On the other hand, given the fact that the tax rate was fixed or flat (3.5 per cent for all levels of income), it could not be considered progressive, because the same tax rate would be applied to all income irrespective of its amount.

³⁰ 485 euros of monthly minimum wage times 14 (for 12 months plus Christmas and holiday pay), amounting to 6,790 euros per annum.

The Constitutional Court, in Decision 187/2013 (*State Budget 2013*), considered the 2013 surtax not unconstitutional. The Court began by recognizing that, despite the link between the surtax and the personal annual income tax – because the personal income subjected to surtax and tax was calculated by the same rules, and the same rules applied to the tax assessment and payment – there were differences.

However, the Constitutional Court considered that the tax incidence of both taxes was the same – on the same income – which is the ‘essential dimension of the constitutional requirement of unity’ of the personal income tax. For the Court, the differences between regimes existed only in secondary aspects of tax law and were ‘exceptions’ which represented the ‘temporary’ adaptation of the personal income tax system to relevant public interests’.³¹ These ‘adaptations’ were due to be within the ‘margin of appreciation’ of the legislature as long as it did not infringe the constitutional principles of equality and of justice within the tax system.

The flat tax rate of 3.5 per cent was considered to ‘deviate from the rationale’ of a progressive tax. However, the Constitutional Court concluded that, on the one hand, the surtax was levied only on the personal annual income which exceeded the annual value of the minimum wage – and, therefore, there was a minimum of progressiveness of the surtax. On the other hand – and this was considered decisive – the idea that the tax system must be considered as a whole, which meant that the surtax and the personal income tax should be analysed together. In these terms, the Court judged that ‘the joint consideration of the surtax and the personal income tax and its aggregate effect on the financial sphere of taxpayers ensures the existence of a sufficient index of progressiveness on the whole system’.³² The flat rate of the surtax diminishes the level of progressiveness of the system but, once again, it was considered to remain within the ‘margin of appreciation’ of the legislature and did not ‘grossly violate’ the constitutionally mandated progressiveness.

During its analysis, the Constitutional Court also took into account the temporary and exceptional nature of the surtax, and the fact that it was designed to meet the ‘extraordinary needs’ of public finances.

Personal income tax brackets reduction

The personal income tax code provides for a tax table, with the tax brackets (the rates and the correspondent levels of personal income) used to determine the amount of a specific tax due. The 2013 Budget law reduced the number of tax brackets from the previous 8 to 5 and generally increasing the tax rates applicable to each specific range of taxable income.

³¹ Decision 187/2013 (*State Budget 2013*) point 109.

³² Decision 187/2013 (*State Budget 2013*) point 110.

The constitutionality of these amendments was challenged once more on the basis of Article 104(1) of the Constitution, more specifically the requirement of progressiveness of the personal income tax, and that it must 'pay due regard to the needs and incomes of households'.

In order for a tax to be progressive its tax rate must increase as the taxable base amount increases. A progressive tax distributes its effect on income in such a way that the rate progresses from low to high and the average tax rate is less than the marginal tax rate. The objective is to reduce the tax incidence of people with a lower ability to pay, as progressive taxes shift the incidence increasingly to those with a higher ability to pay. A progressive personal income tax is, therefore, viewed as a result of equality and social justice demands and is linked with the ability-to-pay principle – everyone should only bear taxes in accordance with one's ability to pay.

In legal terms, the requirement of progressiveness of the personal income tax is considered by the Court as undetermined and susceptible of various degrees of implementation by the legislature.³³ Despite this wide range of admissible implementation measures, the Constitutional Court maintains its power to review whether the tax law respects the constitutional requirement of progressiveness. This requirement is regarded as a means to reach the constitutional mandate binding on the whole tax system of promoting a fair distribution of wealth. Hence, the constitutionally imposed progressiveness is such that should bear the potential to reduce income inequality. This means, for instance, that a flat rate tax is forbidden by the Constitution, even if it does not cover a minimum subsistence level of per capita income.

The Court considered the amendments to the Personal Income Tax Code to be consistent with the Constitution, despite the reduction of the general level of progressiveness. According to the Court, the system maintains a 'sufficient sensibility to the different income levels', the tax-free level is proportionally higher in low-level incomes and there is a 'notable degree of progressiveness'. Furthermore, there are still a 'considerable number' of tax brackets, with progressive tax rates, which 'sufficiently differentiate the various income levels'.³⁴

The Court does not deny that the reduction of the number of tax brackets and the increase of tax rates means that significantly different levels of income will be under the same tax rate. This means that these amendments entail a reduction of the general progressiveness of the tax system. However, according to the Decision a progressive personal income tax still exists and it is not 'obviously unsuitable' to reach the goal of promoting a fair distribution of wealth. The Constitution is understood as imposing a progressive personal income tax – but not a specific degree of progressiveness.

³³ Decision 187/2013 (*State Budget 2013*) point 98.

³⁴ Decision 187/2013 (*State Budget 2013*) point 98.

The 'Taxa adicional de solidariedade' – Solidarity Surcharge

The 2013 Budget law also increased the tax rate applicable to the top tax bracket of personal income tax – with what was called a 'solidarity surcharge'. It was considered a temporary and extraordinary measure. Bearing that in mind and given what was said regarding the requirement of a progressive personal income tax, the Constitutional Court found the surcharge not unconstitutional in the *State Budget 2013* decision.³⁵

The reduction of itemised deductions

The 2013 Budget Law also reduced the number of itemised deductions (expenses that reduce an individual's taxable income), and the value of the deductions that could be made. The reductions meant that health, education, housing or senior care expenses (for instance) could lower the taxable income in a lesser degree.

The Constitutional Court was asked if these reductions were compatible with the ability-to-pay principle and the constitutional rule that personal income tax 'shall pay due regard to the needs and incomes of households' (Article 104(1) of the Constitution). The ability-to-pay principle – which, in short, means that one should pay taxes in accordance with one's ability to pay – is not specifically laid down in the Portuguese Constitution, but there is consistent case law and legal theory supporting that it is intrinsically linked with the equality principle and the equity of the tax system.

The Constitutional Court accepted that this amendment to the tax code signified the increase of the tax due and a decrease of the correspondence between taxable income and real personal income, thus disregarding the ability-to-pay of families and households.

However, the Court took into consideration the context of the amendments to the tax code – the general rise of taxation and a higher tax-paying effort demanded to all tax-payers, especially the ones with higher incomes. The ability-to-pay principle was also regarded by the Constitutional Court as a general principle and standard of the tax system, which does not lead to a single precise value or number of itemised deductions due in each case. In light of those considerations, the Constitutional Court considered the amendments not unconstitutional in the *State Budget 2013* decision.³⁶

The contribution imposed on sick and unemployment benefits

The 2013 Budget law also imposed a 'contribution' of 5 per cent on sick benefits and of 6 per cent on unemployment benefits. The Constitutional Court was asked

³⁵ Decision 187/2013 (*State Budget 2013*) point 100.

³⁶ Decision 187/2013 (*State Budget 2013*) point 103.

if the ‘contribution’ was in accordance with the Constitution – especially with the equality principle (because the beneficiaries were in a different, vulnerable position in relation to other workers) and the constitutional provisions that guarantee every worker’s right to material assistance, the right to assistance and fair compensation for victims of workplace accidents or occupational diseases and also the right to the protection of citizens in sickness as well as unemployment and in all other cases of a lack of or decrease in means of livelihood or ability to work (Articles 59(1)(e)(f) and 63(3) of the Constitution).

Firstly, the Court needed to determine if the ‘contribution’ was a statutory reduction of benefits or a tax. In fact, the ‘contribution’ was directly deducted from the benefit, as if the benefit to which the beneficiary is entitled was reduced in that amount. That fact that the ‘contribution’ was a fixed rate, invariable, and not progressive, without any exemptions (for instance, in relation to the monetary value of the benefit), seemed to indicate that the Court was facing a measure that did not fit in the tax universe, but a reduction in the amount of benefits.

However, the Court qualified the ‘contribution’ as a parafiscal tax equivalent to social security contributions – but levied on the beneficiaries of the benefits. Therefore, it did not have to comply with the constitutional rules governing taxes. The Court admitted that the establishment of a contributory requirement on the active beneficiaries themselves is not entirely in accordance with the contributory scheme of the Portuguese social security system – every worker must pay a social security contribution and, in return, has the right to be the beneficiary of social security protection – but considered that this change was not sufficiently relevant to alter the nature of the taxpaying capacity principle. The Constitutional Court qualified it as a deviation from this principle in that it was a new way to finance social security, but found it did not called into question the constitutional right to social security.

The Court went on to determine if the new rules, which burdened social security beneficiaries who were in a vulnerable position, were consistent with the proportionality principle.

Once again the Court found that the constitutional right to social security, established in Article 63, ensures the workers right to material assistance in case of sickness or involuntary unemployment and commands the legislature to create a social security system, but this right did not cover the quantitative amount of the benefit in question. The change would only be unconstitutional if the legally imposed reduction of the benefit was such that it could no longer be considered a benefit resulting from the contributive social security system. Such was not the case.

According to the Court,

the fulfilment of the constitutional protection program of citizens in sickness and unemployment depends, in each historical moment, on financial and material

factors, and it is the task of the legislature to determine the list of situations that require protection and the content of the corresponding social right.³⁷

Besides that, the ‘contribution’ should be viewed together with other amendments, which increased benefits in certain cases and is a temporary, exceptional measure.

Nevertheless, the Constitutional Court judged the ‘contribution’ unconstitutional because of the absence of a protective clause that could safeguard the lower benefits. In fact, the ‘contribution’ would be applied to all benefits, including the ones already on the statutorily imposed minimum. This was considered inconsistent with the proportionality principle by the Court, because it is unreasonable to burden the most vulnerable of the beneficiaries (which are already, by definition, in a vulnerable situation).³⁸ The absence of a protective clause also meant that the ‘contribution’ could be considered to be inconsistent with the ‘right to a minimum dignified existence’ present in the Court’s case law as a result of the constitutionally imposed respect for the human dignity. Therefore, the Constitutional Court found that

[w]hile one may not doubt the reversibility of concrete rights and subjectively grounded expectations, one cannot fail to recognize that, even in a state of economic emergency, there should always be a caveat regarding the essential core of minimum guarantees already put into effect by the general legislation governing entitlement to benefits in the contingencies of sickness or unemployment, so it [the contribution] may be considered contrary to the constitutional protection of a decent existence.³⁹

The measures were re-enacted in 2014, although a safeguard of a minimum amount of income was added to the legislation. However, it was once again declared unconstitutional by the Court in the *State Budget 2014* Decision. The Constitutional Court stressed that it does not deem reasonable, even in a context of economic crisis, the imposition of further burdens on the life conditions of citizens already affected by disease or unemployment. The contributions demanded are not a first sacrifice, but an additional decrease in the disposable income, aggravating a precarious situation and hindering even more the autonomy of the social security beneficiaries.

CONCLUSIONS

The constitutional case law on austerity measures that affect fundamental rights and freedoms touches on a range of different subjects. The impact of the

³⁷ Decision 187/2013 (*State Budget 2013*) point 91.

³⁸ Decision 187/2013 (*State Budget 2013*) point 93.

³⁹ Decision 187/2013 (*State Budget 2013*) point 94.

unconstitutionality rulings should not undermine four relevant facts: firstly, that the Court has cleared a significant part of austerity legislation allegedly encroaching on fundamental rights; secondly, the margin of discretion of the legislature has played a significant role on the Court's reasoning by way of deferring to the legislature's choices; thirdly, the situation of financial distress and the country's legal obligations under international and European Union law have been acknowledged by the Court as a relevant element of constitutional interpretation; fourthly, and perhaps more importantly, the unconstitutionality rulings have not been grounded on the violation of specific fundamental rights *per se*, but on the breach of well-established constitutional principles, common to all constitutional states, such as equality, legal certainty and the protection of confidence and legitimate expectations.

This last aspect may also point in another direction: if the normative degree of protection afforded to the rights in the unconstitutionality decisions had been directly deduced from the individual rights, as enshrined in the Constitution, its modification through a reform of the text could be easily achieved (one should bear in mind that despite the rigidity of the Portuguese Constitution, the reform procedure is not terribly burdensome and it largely depends on a consensus between the two major political parties). Since that protection was grounded on fundamental principles, it is virtually impossible to modify the constitutional framework that was used to uphold the Court's decisions.

Furthermore, the protection of fundamental rights through general principles may also be regarded as the necessary means to accommodate the conflicting views of the judges. We must remember that the Constitutional Court's judgments were mostly majority decisions and not unanimous rulings (except in rare cases, such as the *Pensions Convergence* decision), where dissenting and concurrent opinions are allowed. It is fair to presume that on the matter of rights protection a consensus drawn from general principles is easier to reach than an agreement on the obligations imposed by the more specific provisions of the Constitution upon the legislature. This conclusion is reinforced if we take into account that the decisions on austerity measures have had more and more dissenting and concurrent opinions every time: as years go by, it seems that the differences in the reasoning between the judges have been exacerbated. Bearing this in mind, it seems that grounding the rulings on basic constitutional principles has proved a judicious way of reaching an agreement.

