TAX POLICY IN LATVIA FROM 2018

DIRECT TAXES | INDIRECT TAXES | OTHER CHANGES

On 28 July 2017, the Parliament approved a tax reform that includes number of draft laws thus several changes of the tax policy of Latvia enter into force as of 1 January 2018. Herewith, we offer a summary of the most important tax law updates.

NEW CORPORATE INCOME TAX

As of 1 January 2018, a new Corporate Income Tax Act (CIT Law) foresees a new payment scheme of corporate income tax (CIT) as well as extends a range of taxpayers i.e., partnerships and all co-operative societies will also become CIT tax payers.

CIT taxable base

The new CIT payment scheme foresees tax deferred contributions until profit is distributed or diverted in another form to the expenditure that does not ensure development of economic activity of taxpayer. Consequently, the new CIT Law provides a different CIT base calculation compared with the current CIT Law.

As of year 2018, the CIT taxable base will be composed of distributed profits and conditionally distributed profits.

Distributed profit includes:

1) calculated dividends including exceptional dividends
2) expenses aligned with dividends (applicable to a profit of cooperative society, private company or farm or fish farming enterprise and payment of profit share of partnership and non-resident permanent establishments
3) conditional dividends i.e., a reduction of share capital that was previously raised from undistributed profit for which CIT was not paid as per the new payment scheme, it also applies to cases when company gets liquidated or CIT tax payer registers as a microenterprise tax payer.

Similar to the current CIT Law, also the new tax law provisions provide exemption on dividends received from a taxpayer who is a CIT tax payer in his/her country of residence. In addition, if amount of dividends received exceeds the amount calculated in the taxation period which is included in the CIT taxable base, the difference will be entitled to transfer to the next taxation periods.

The conditionally distributed profit generally includes CIT adjustments for which the taxable income of the CIT cannot be reduced according to the current system. The most important adjustments are:

1) non-related expenses to economic activities (i.e., fines, costs for over-limit fuel consumption rates, donations, expenses for representation car, leisure activities of employees)
2) write-offs of doubtful receivables
3) increased interest payments to non-financial institutions, or "*thin capitalization*" (a limitation on ratio of own equity and leverage capital ratio of 4 to 1 is retained, as well as a new restriction on interest payments in excess of EUR 3 million per year)
4) loans granted to a related person
5) transfer pricing adjustments etc.

Moreover, the new CIT Law provides a possibility not to include the expenses of representation and staff sustainability among CIT tax base which do not exceed 5% of the total pre-tax year gross payroll fund when state social insurance payments are paid and if the costs are reported separately from other expenses. Expenditure on staff sustainability includes motivation and team building activities, catering facilities costs etc.

As regards *loans to related parties*, the new CIT tax law foresee that CIT taxable amount includes loans to shareholders or “sister companies’’ distributed as of 1 January 2018. Loans distributed by a ‘’parent company’’ or to permanent establishment abroad are not included in the CIT taxable base. Furthermore, the CIT taxable amount does not include a loan in the same amount received by a company from a non-related person or undistributed profit is not presented in the balance sheet at the beginning of the accounting year when the loan was granted.

Tax rate

The CIT rate is set at 20% as per the new law. However, it should be noted that prior applying the tax rate, the taxable amount should be adjusted using a coefficient of 0.8.

A coefficient of 0.8 is applied to determine the gross CIT (net) amount of paid dividends or other tax objects. Consequently, the effective tax rate will be 25% (rate 20/80).

Payments to non-residents

The new CIT Law in practical terms takes over CIT procedures laid down in relation to taxation of non-residents, taxable objects and possibility to apply current exemptions.

The differences in tax rates are:

- for management and consultancy services - 20%;
- alienation of immovable property in Latvia - 3%;
- all type of payments and dividends to low tax / duty-free countries / territories - 20%.

The tax object is no longer a fee for use of property.

While more favourable conditions are set in tax conventions, still provisions of the tax convention apply.

In case the CIT has not been withheld from payments, a payment obligation remains to a paying agent and the CIT tax due must be increased by a tax from income of non-resident i.e., the amount paid is divided by a coefficient of 0.8 and multiplied by relevant tax rate.

Taxation period

In general, a taxation period will be a calendar month. Consequently, the CIT tax declaration will have to be submitted and the tax must be paid each month until the 20th of the following month.

The CIT declaration cannot be submitted for a tax period where the CIT taxable object will not be formed. However, regardless of whether the CIT taxable base has been or not formed during the reporting year, a taxpayer will have to submit a declaration of the last tax reporting period along with the annual report.

Undistributed profit or loss of previous year

The transitional provisions of the new CIT Law provide that undistributed profit presented in the balance sheet at 31 December 2017 will not be applicable to the CIT tax as per new law.

The CIT Law also retains a possibility to cover part of tax loss incurred in previous taxation periods until 31 December 2017 for a limited duration (i.e., next 5 years including 2018).

Submission of tax declarations and advance payments during 2018

It should be noted that the CIT declaration for the period from 1 January 2018 will have to be prepared in accordance with the new CIT law provisions not only for taxpayers which taxation period matches a calendar year, but also to taxpayers which reporting year for 2017 ends in 2018.

Since a different CIT tax model is being introduced, taxpayers which reporting year does not match with the calendar year, will have to submit an interim financial report and CIT declaration for a period until 31 December 2017 in accordance with the current CIT regulation. For the period from 1 January 2018 until the end of the reporting year, a single CIT declaration will have to be prepared in accordance with the new CIT law.

Also, for other taxpayers which reporting year coincides with the calendar year, a single CIT declaration will be required for the period from January to June 2018.

The new CIT law does not provide a tax advances payment except during transitional period until 30 June 2018, taxpayers will have to pay advance payments of CIT each month.

CHANGES OF PERSONAL INCOME TAX LAW

Personal Income Tax (PIT) rates for paid employment income and estimated non-taxable minimum

Starting from 1 January 2018, a progressive PIT tax rate has been introduced. It foresees the following:

- 20% should be applied for income not exceeding EUR 20 000 per year (or EUR 1 667 per month)
- 23% - for income exceeding EUR 20 001 to EUR 55 000 per year (or EUR 1 667 - EUR 4 583.33 per month)
- 31.4% for income exceeding € 55 000 per year (or more than € 4 583.33 per month).

For example, if an employee has a gross monthly salary of EUR 2 000 for income share up to EUR 1 667 a 20% tax rate should be applied and remaining part of EUR 333, 23% should apply. However, if the monthly gross salary is EUR 5 000, a part of income of EUR 1,667, 20% of the PIT will be withhold while the remaining part of EUR 3 333 - 23% since for salary earned during the tax year a 31.4 % tax rate will not be applied. The tax on annual income of more than EUR 55 000 per year will be calculated in a recapitulative order when submitting the annual income declaration.

When determining taxable income thresholds, non-taxable income is not included.

If a payroll tax book is not submitted at a place of employment, the salary tax rate will be 23% regardless of monthly income.

As it stands now, the amount of non-taxable income will depend on the total amount of income earned. It is foreseen that for income above EUR 1 000 per month a non-taxable minimum income will not be applied in general.
A non-taxable minimum income not exceeding EUR 1000 per month will be defined on the basis of person income forecast calculated by the State Revenue Service (SRS) and the national minimum ceiling based on the total income. The information about the employee's monthly non-taxable minimum forecasted by SRS via the Electronic Declaration System is noted to an employer by 1 January and 1 August each year.

Tax rates of other type of income

In 2018, the PIT will be 20% from a capital regardless of the type of income. The 10% of the PIT rates is maintained only for income from sale of forest, scrap metal and the lease of own property without registering as an economic operator and 15% for the income of seasonal agricultural workers.

The PIT is not required for a payment from dividends if CIT is paid. If a company pays dividends to a natural person from previously undistributed profits (i.e. until 31 December 2017), a tax rate is 10% the first two years (2018 and 2019).

SOLIDARITY TAX

Total solidarity tax rate for income exceeding the national maximum amount of state social insurance contributions (SSIC) is 35.09%. According to the law, by 2018 most of the tax paid will be contributed to tax payer pension and health insurance and only 10.5% of it will be credited to the State Treasury's PIT account.

STATE SOCIAL INSURANCE COMPULSORY CONTRIBUTIONS (SSIC)

The Law "On State Social Insurance" has been supplemented by a new type of social insurance i.e., health insurance which shall be subject to all employees. Thus, in order to ensure rights for entitlement of health care services of insured persons declared in the law, the rates of SSIC are increased, and in 2018 the mandatory contribution rate if the employee is insured for all types of social insurance will be 35.09% of which 24.09% will be paid by an employer and 11% by employee.

In addition, it is envisaged that royalty distributors will be obliged to calculate and pay the SSIC to beneficiary of royalties for a pension insurance to the state budget. The SSIC rate is 5% of the amount of the agreed royalties.

CHANGES OF MICRO-ENTERPRISE TAX LAW

By 2018, a status of micro-enterprise taxpayer will obtain only economic operators which turnover in a calendar year will not exceed EUR 40 000 (currently EUR 100 000). In addition, there are also restrictions on employment i.e., a natural person as employee can engage only in one micro-enterprise.

The amendment to the Law provides a transitional period for persons who were employed by micro-enterprises 31 December 2017.

VALUE ADDED TAX

As of 1 January 2018, a range of transactions applicable to a specific value added tax (VAT) regime or reverse tax liability will be extended.

In the future, the special regime will also apply to game console supplies, building materials and constructions (construction products), metal products and related services, as well as to a wide range of household electronic equipment and hardware supplies (refrigerators, washing machines, etc.). Only non-cash payments are allowed for all transactions as per special tax regime.

The VAT registration threshold has also been reduced, thus economic operators will have to register as VAT payers if value of taxable transactions exceeds EUR 40 000 in the previous 12 months (currently EUR 50 000).

EXCISE TAX

As of 2018 excise duty rates for most excise goods will be increased with the view to compensate budget deficit estimated for the next year due to the reduction of payroll tax rates. Changes of excise tax rates are available the SRS web page: https://www.vid.gov.lv/en/excise-duty-rates

Excise tax rates have not changed only for fermented alcoholic beverages up to 6°, cigarettes, fuel oil and marketed fuel, as well as natural gas, soft drinks, coffee and liquid for electronic cigarettes.

LOTTERY AND GAMBLING TAX

As of 2018, the gambling tax rate for roulette, card and dice games (per table) is increased from EUR 18 000 to EUR 23 400 per calendar year and gambling tax rate for video games and slot machines increased (for each gaming machine) per a calendar year from EUR 3 204 to EUR 4 164.

LAW "ON TAXES AND DUTIES"

In accordance with amendments to the Law "On Taxes and Duties" by 2018, the rights of SRS's to request security deposit are increased, as well as a range of cases where the SRS is entitled to publish information on the SRS website without requesting taxpayer's right to enable companies to verify their business partners:

- Information on employers which average monthly salary is at or below the minimum monthly salary in the country
- Information on taxpayers who have been subject to administrative penalties for violation of payroll regulations ("*envelope salary*" payments)
- Information about taxpayers who have not submitted tax declarations or informative statements to tax administration within terms specified in the Law or specific tax regulations
- Information on a taxpayer' official who is or was an official at a commercial company and in result of his / her performance of duties circumstances for suspension of economic activity of a commercial company occurred.

In addition, credit institutions and payment service providers are obliged to inform the SRS annually on clients - natural persons (residents of Latvia) which debit or credit turnover of one account exceeds EUR 15 000 in the previous year.

LAW ON ASSISTANCE ON PAYMENT OF DEPOSITS AND PENALTIES

From 1 October 2017, the Law on Assistance on Payment of Deposits and Penalties to tax payers have entered into force. It foresees that taxpayer paying basic tax debt shall be ceased of penalties within 21 days after payment of the full amount of tax debt. The assistance will apply to all taxes administered by the SRS except a real estate tax that has been incurred before 1 June 2017. Also, taxpayers which have been granted extension of the tax payment period will be eligible for assistance.

The companies that have been subject to suspension or exclusion from VAT register in event of irregularities, court decision declaring insolvency proceedings, taxpayer's official included in the register of risk persons or if taxpayer address is listed in risk address register are not eligible for the support.

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