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HOW TO COME OUT FROM THE SHADOW

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The tax specialists of the Riga Office Mr Janis Taukacs and Mr Edgars Koskins comment on the draft conception developed by the Ministry of Finance on possibilities of introducing a fixed income tax for small businesses, specially for newspaper *Grāmatvedības avīze* (*Accounting Newspaper*).

The purpose of the conception is to reduce obstacles for commencement of the operating activities to those persons who do not have special accounting and taxation knowledge, thus furthering the economic activity in Latvia. In developing the conception, the experience of foreign countries (int. al. member states of the EU) in simplified calculation and application of income tax has been taken into account. The Cabinet of Ministers is offered to choose one of the two definitions of a small business included in the conception. The both definitions for the purposes of calculating personal income tax define small business as a natural person registered as a performer of the operating activities, sole trader, sole proprietorship (also farms and fishing farms). The definitions differ only regarding the criteria that may not be exceeded when applying a simplified procedure of calculating income tax. The conception offers three ways of simplified establishment of personal income tax, which can be applied to the both definitions of a small business. Additional information (in Latvian): <http://www.fm.gov.lv/page.php?id=1388>

Nonconformity with VAT

From my point of view, the idea by itself is useful. State effort to simplify the procedure of accounting keeping and the taxation system might only be welcomed. However, the concept of the Ministry of Finance to date is incomplete and needs a great deal of job. First of all, a word should be said for defence of my colleagues. As a lawyer, one should say that, the state has dealt with the solution of the problem using systematic approach. What do we have? Today, there are lawyers, which are registered as self employed persons, and there are lawyers working as LLC. "The good guys" pay individual income tax in the amount of 25%, "the bad guys" pay corporate income tax in the amount of 15%. The Attorneys-at-Law in this situation are forced to be "the good guys" – we have an opportunity to work only in the status of self-employed person. From my point of view, this question has to be solved within the concept in some way. However in real life I see, that the Ministry of Finance pretends not to be the part of this problem – the developed system of simplified taxation does not take into account nor lawyer, nor accountants, nor auditors, nor consultants.

In addition one more issue: it is not clear from the concept, how it is planned to solve the problem with the value added tax. This problem will arise by the nature of things.

One should follow the logic of the Ministry of Finance. On the one hand, with the turnover less than ten thousands, "small entrepreneur" has "bonus" – the simplified system of the bookkeeping and lower tax rate in comparison with the existing 25%. On the other hand, because of the administrative (bookkeeping) mismatches, he/she lose and opportunity to deduct the pretax on VAT, being, in this respect, in less favourable condition in comparison with the VAT payer.

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How to come out from the shadow

On the first look, one has to agree, that the idea is beautiful and grateful – to support small business in the country. However, when one goes into details, it becomes unclear, where is the meaning of the idea? To make life more simple to those, who work, or to withdraw from the shadow those not paying taxes? If the essence of the idea is to attract from the shadow economy: builders, lockmasters, plumbers, tailors and etc., then, perhaps, the perspective to pay the low tax rate and to carry out the particularly simplified system of bookkeeping, and to force them to start paying at least some taxes. In this case, from my point of view, in the further work on the concept it is necessary to work through "chain" individual income tax – the social security contributions in greater detail. Taking into account that today all these "small entrepreneurs" do not have any social security, - if an accident, for example, shall occur and all of them are at risk to become "out of business". It is not clear, why the concept excludes lawyers and accountants. The accountants, for example, while serving a number of companies, from each having approximately LVL 50 per month. Why not to simplify life for them? Or for lawyers working in the rural area?

It is not clear, where the numbers, according to which "small enterprises" will define from. For example, the net-turnover in the amount of LVL 45 thousands in the taxation year. Someone, from the developers of the concept, can explain to me, why an individual capable of creating an annual turnover of LVL 45 thousand is less capable, then lawyer, which has an annual turnover of LVL 9 thousand? Moreover the ways of individual income tax definitions does not stand any critics. The authors, in the beginning, are saying that they want to simplify the system – an option with 2% to 5% from the turnover, which are paid as tax, in accordance with this statement, - and later offer the second option, with combinations, bases and linkages to specified fields. By the means of reading of this single statement, one's head starts to ache.

If the state wants, that those, who never paid taxes, will start paying taxes, the taxation system has to be simple and clear! The advantages of paying taxes in the eyes of entrepreneurs have to be undisputable – low rates, simple bookkeeping, "clean" balance, which opens an opportunity to obtain loans in the banks for the low percentages, social securities and etc.

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