TAX PROFILE, LATVIA

(published in BNAI's Global Tax Guide)

Jānis Taukačs and Alisa Leškoviča

SORAINEN
ESTONIA LATVIA LITHUANIA BELARUS

Estonia
Pärnu mnt 15, 10141 Tallinn
phone +372 6 400 900, estonia@sorainen.com

Latvia
Kr. Valdemāra iela 21, LV-1010 Riga
phone +371 67 365 000, latvia@sorainen.com

Lithuania
Jogailos 4, LT-01116 Vilnius
phone +370 52 685 041, lithuania@sorainen.com

Belarus
ul Nemiga 40, 220004 Minsk
phone +375 17 306 2102, belarus@sorainen.com

ISO 9001 certified
www.sorainen.com

KEY FACTS

Main tax rates

- Corporate tax rate: flat rate of 15%
- VAT standard rate: 21%, reduced rate 12%
- Personal income tax top rate: 25%

Population/GDP

Population: 2.02 million

GDP: USD 23.4 billion (approx EUR 16.45 billion) (estimated for 2010; 2011 figure not yet available)

Currency

Latvian lat, abbreviated here to LVL. The lat is pegged against the euro at a rate of LVL 0.702804 to EUR 1

Membership of economic groups

European Union (EU), World Trade Organization (WTO)

Major industries

Banking, tourism, transit services, forestry and woodworking, chemicals and pharmaceuticals, electrical and mechanical engineering and manufacture, textiles and clothing

Website of tax/finance authority

http://www.vid.gov.lv – Tax Authority: Latvian State Revenue Service

http://www.fm.gov.lv – Ministry of Finance

INTRODUCTION

Prior to 2010, Latvia had established a tax system that was fairly beneficial for companies and wealthy individuals but imposed a comparatively heavy burden on employment income, thus creating a long lasting debate regarding the fairness of the existing taxation policy. Latvia has also been affected by the global financial crisis with the result that structural changes have been made to its tax laws. In the main, these changes have created an even greater tax burden on individual taxpayers. No change has effectively occurred to these policies.

RECENT DEVELOPMENTS

From the beginning of 2010, Latvia has been required to reduce its expenditure and expand the tax base, because of its commitments in loan agreements with the EU and the International Monetary Fund. The low corporate income tax rate (15%) has been maintained but income previously exempt from personal income tax such as dividends and interest is now subject to tax and a capital gains tax has been introduced. The personal income tax rate has been increased and a residential property tax has also been introduced.

In an attempt to create a "low tax" environment to stimulate unemployed individuals to become self employed, a new taxation system based on paying a monthly license fee was introduced.

The low tax environment trend has continued with introduction for 2011 of a Micro Enterprise tax regime. Under this regime individual and limited shareholder (5) owner companies with an annual turnover of less than LVL 70,000 (approx EUR 99,601) pay a flat rate 9% on their quarterly turnover. Employees cannot exceed five in number and the monthly amount paid as net remuneration to an employee cannot exceed LVL 500 (approx EUR 711). The 9% covers all corporate and employment income taxes and social security contributions. In 2012, anti-abuse provisions were introduced to stop ordinary employment relationships being disguised through use of contract hiring of previous employees from a Micro Enterprise.

2011 saw reintroduction of a Large Project Investment incentive. Initially, under this incentive, investments in specified industry categories between LVL 5 million (approx EUR 7.1 million) and LVL 35 million (approx EUR 49.8 million) will receive a reduction in corporate tax payable equal to 25% of the amount invested. Qualifying investments over LVL 35 million will receive a reduction in tax payable equal to 15% of the amount invested. Allowable tax savings must be claimed within a 16 year period. In 2012, the initial required investment has been lowered to LVL 3 million (approx EUR 4.268 million).

A Financial Stability Duty was introduced in 2011. The duty for 2012 is levied at the rate of 0.072% of total year end liabilities (after certain adjustments) held by a Latvian registered credit institution or the Latvian registered branch of a foreign credit institution.

The Value Added Tax registration threshold remains at LVL 35,000 (approx EUR 49,828).

CORPORATE TAXES

General outline

A flat rate of 15% as of 1 January 2004 still applies at the time of writing.

In general, the corporate taxation system is relatively simple, incorporating EU Directive requirements and offering limited additional incentives in addition to a low basic tax rate.

Corporate tax rates

The basic rate of tax is a flat 15%. Taxable income is determined by starting with the annual financial statement profit or loss result of the company and making specified taxation adjustments to this figure.

After its first year of operation, a company pays a monthly prepayment of tax based on its previous year's taxable income. Tax prepayments can be reduced if revenues fall below the previous year's.

Companies that operate in Special Economic Zones or Free Ports can receive reductions in corporate income tax payable of up to 80%.

A tonnage tax regime is an option allowing Latvian registered companies to elect to have their taxable profits from certain shipping activities determined at fixed income rates based on the "net tonnage" of the ship(s) used in these activities rather than the actual business results from using the ship(s).

"Net tonnage" means the measure of the useful capacity of a vessel as certified by its International Tonnage Certificate. Notional income amounts are linked to various levels of a ship's net tonnage which are then multiplied by the number of days the ship(s) are used.

Calculated taxable tonnage income is subject to a tonnage tax rate of 15%. Tonnage taxpayers do not pay corporate income tax and corporate income tax rebates do not apply to them. An election to be a tonnage taxpayer cannot be revoked for ten years.

With regard to deductible expenditure, a general provision in the law states that expenses directly related to the conduct of economic activity are tax deductible. However, the following are some of the expenses specifically excluded as allowable expenses.

The value of gifts and benefits in cash or kind provided by employers to employees or an employee's family members which are not recorded as remuneration for employment services, costs related to development of social infrastructure facilities belonging to a taxpayer (multiplied by 1.5) and donations or gifts to other persons, amounts of guarantees which a taxpayer as a guarantor is required to pay under a guarantee, other deductions from profit or from turnover made by the taxpayer on their own initiative and other expenses not economically related to the economic activity of the taxpayer.

From 2011, employers operating company cars are required to pay a mandatory monthly deemed employee fringe benefit tax per vehicle owned, calculated on the capacity of the motor. If the employer can substantiate through GPS records that the vehicle has not been used by employees for private purposes, a refund can be requested.

For taxation purposes, depreciable fixed assets are divided into five groups with buildings and structures being depreciated at a standard 5% rate, railway rolling stock and technological equipment, sea and river fleet vessels, fleet and port technological equipment, power equipment at 10%, computing devices and related equipment, including printing devices, information systems, software products and data storage equipment, means of communication, copiers and related equipment at 35% and other fixed assets at 20%, except for oil exploration and extraction platforms together with the equipment necessary for their functioning located on such platforms, oil exploration and extraction ships which have a 7.5% rate.

The amount of deductible depreciation is calculated using the declining balance method and the above rates are doubled with the exception of motor vehicles, where a multiple of 1.5 is applied to give an effective rate of 30%. Operating, leasing, and depreciation expenses associated with “representational” motor vehicles exceeding LVL 30,763 (approx EUR 43,772) in value are nondeductible.

Until 2013, the current law allows the purchase or manufacturing cost of new production technology equipment to be increased by a factor of 1.5 for depreciation purposes.

Capital gains taxes

Latvia now has a limited capital gains taxation regime applying to individuals but as a general rule capital gains and losses incurred by a company are included in the taxable income of the company. There are limited exclusions such as disallowance of losses on sale of depreciated fixed assets sold to related parties..

From 2013, losses from the sale of securities (including shares in any company) must be added back to taxable income. On the other hand, gains from the sale of securities are exempt from tax, except if they are shares in a company registered in a nil or low tax jurisdiction as listed in Latvian law.

Position of losses

From 2012, taxation losses which arose prior to and including the 2007 tax year can be used for the following 8 years. Tax losses arising in the 2008 and later tax years now have no limit as to when they can be used.

Specific rules govern continued use of existing losses in cases where ownership of an entity changes or a reorganisation such as a merger or demerger occurs.

Losses may also be transferred within a tax group as discussed below.

Group treatment

A group exists for taxation purposes where there is a principal entity and one or more subordinate entities. The entities making up the group must be tax resident in Latvia, the European Economic Area (EEA), or in a country with which Latvia has a double taxation treaty (DTT). A permanent establishment of a subordinate entity can also qualify as a part of the group.

A subordinate entity must be at least 90% owned by the principal entity or through cross ownership by other entities within the group.

Taxation losses incurred by one member of the group in a taxation period can be transferred to another group member in the same taxation period if both companies (or a permanent establishment of a qualifying group company) are registered in Latvia or one is registered in the EEA or a DTT country and both companies have been members of the group for the full tax year and have the same tax year end date. Both entities must be subject to tax and, if subject to Latvian law, must not use tax holidays and must have no outstanding tax obligations. Foreign losses can only be transferred to a Latvian entity if they cannot be first used in the foreign jurisdiction.

Latvian registered companies forming part of a group must file separate tax declarations.

Copies of the audited accounts of transferring and receiving entities must be filed with their Latvian tax declarations and foreign accounts must be restated in line with Latvian accounting standards.

WITHHOLDING TAXES

Table 1 shows the various withholding tax rates.

Position of resident companies

Companies incorporated in Latvia or entities that should have been incorporated or registered because of their business activities in Latvia are deemed to be resident and fully liable to tax in Latvia. Latvia has no central management and control test with regard to tax residency.

Income earned by a Latvian tax resident company from activities outside Latvia is also taxable in Latvia.

Position of nonresident companies

Nonresident companies are taxable in Latvia if they maintain a permanent establishment in Latvia. With regard to withholding tax payable on the sale of Latvian immovable property (2% of the total sale price), this now also applies to sale to a Latvian entity by a nonresident of shares in a company whose assets directly or indirectly consist of more than 50% of immovable property located in Latvia.

DIVIDENDS, INTEREST AND ROYALTIES

Dividends

Dividends are subject to a general 10% withholding tax rate. No withholding tax is imposed on dividends paid to qualifying companies that are tax residents of the EU or a EEA member country and meet certain conditions such as their registration type and taxes they pay in their jurisdiction. This can also apply to payments to the permanent establishments of qualifying companies if these are also tax resident in the EU or EEA and also pay certain specified taxes similar to Latvia's corporate income tax or are tax resident in Latvia.

Where the above exemption does not apply and a shareholder is tax resident in a tax treaty country, then depending on the Treaty, the standard 10% rate can apply or a reduced rate of 5% applies if share ownership is at least 10% or 25% of the payer.

From 1 January 2013, all outgoing dividends (with the exception of dividends paid to nil or low tax jurisdictions as listed in Latvian law) will no longer be subject to Latvian withholding tax. Also, from 1 January 2013, all incoming dividends (with the exception of dividends paid from nil or low tax jurisdictions as listed in Latvian law) will no longer be subject to Latvian corporate income tax.

Interest
Interest withholding tax is only payable if both parties are "related". The general rate is 10% with a 5% rate applicable to interest paid between a Latvian registered commercial bank and a foreign related entity.

From 1 July 2009, a 5% rate applies if interest is paid to a related entity (including a permanent establishment) registered in the EU. From 1 July 2013, no withholding tax will be imposed on interest paid to a related entity registered in the EU. Paying and receiving entities must also meet qualifying conditions.

These exemptions can also apply to interest payments received or made by a EU resident's permanent establishment if certain conditions are met.

From 1 January 2014, no withholding tax will be imposed on outgoing interest payments with the exception of interest paid to entities located in nil or low tax jurisdictions as listed in Latvian law.

Royalties
A general 15% rate applies to the right to use copyright in literary and artistic works, which also includes film and audio works.

A 5% rate applies to all other rights to use intellectual property. Under some of Latvia's double taxation treaties, payments for the right to use industrial, commercial, or scientific equipment are considered a royalty. Latvian law now specifically excludes from Latvian withholding tax payments for the right to use aircraft located in Latvia.

From 1 July 2013, no withholding tax will be imposed on royalties paid to a related entity registered in the EU. Paying and receiving entities must also meet qualifying conditions to be exempted from the withholding tax. From 1 January 2014, no withholding tax will be imposed on royalty payments with the exception of royalties paid to nil or low tax jurisdictions as listed in Latvian law.

A company registered in a Latvian Special Economic Zone or Free Port can obtain a reduction of up to 80% of withholding tax applicable to dividend, royalty and management and consulting fee payments made to foreign entities.

INDIRECT TAXES

VAT/GST: main and reduced rates, exemptions

The standard rate of VAT in 2012 is 21% (22% – up to 1 July 2012). Entities that reach or exceed a VATable transaction level of LVL 35,000 (approx EUR 49,800) during a taxation year must register for VAT. VAT is reported monthly, quarterly or half yearly depending on the prior year's VATable turnover.

On some items VAT applies at a reduced rate of 12%. The reduced VAT rate applies to medical devices, infant food, various newspapers and magazines, public transport, utilities, and some other items. Electro energy will be subject to 22%.

Latvia has incorporated into its law the changes required by recent Directives issued by the

European Commission that apply from 1 January 2010.

Other indirect taxes

Latvia applies excise duties on alcoholic beverages, tobacco, oil products, non alcoholic beverages, and coffee.

Latvia also applies an environmental tax called natural resources tax. Natural resources tax applies to entities involved in polluting activities, extraction of natural resources, selling or consuming for their own business needs goods hazardous to the environment (for example electrical and electronic equipment), transport vehicles registered in Latvia, and other activities.

PERSONAL TAXES

Domicile and residence requirements

An individual is deemed a resident of Latvia (and thus fully taxable) in any of the following situations:

- They permanently reside in Latvia.
- They stay in Latvia for 183 days or more in a twelve month period.
- They are Latvian citizens employed in a foreign state by the Latvian Government.

Main rates and bands

In 2012, individuals are subject to personal income tax at a flat rate of 25%. Individuals who derive their income from a business of which they are sole proprietor (self employed person or individual entrepreneur) or a partner in a partnership are also subject to personal income tax at a flat rate of 25%. Individuals registered as self employed persons with the tax authorities and who have no employees and whose business income did not exceed LVL 10,000 (approx EUR 14,229) in the previous taxation year, or most likely will not exceed LVL 10,000 during the current taxable year, may opt to pay personal income tax at a fixed amount which might vary from LVL 5 (approx EUR 7) to LVL 500 (approx EUR 711) depending on the amount of business income derived.

Individuals who perform certain specified services or activities can also register as self employed and pay a fixed monthly license fee which includes both their personal income tax and social security obligations.

Individuals deriving their income from an employment relationship are in principle required to pay personal income tax (salary tax) amounting to 25% of almost all direct or indirect income they receive due to that employment relationship (including salary, bonuses, lump sum payments, remuneration from previous employment). However, there are several exceptions to this rule. Thus, expenses paid by an employer related to employment duties, apartment costs in the case of posting of an employee to another place of work, compensation of personal car costs attributable to work duties, expenses of business trips, and education expenses are not subject to personal income tax. Other benefits in kind are generally taxed at fair market value.

Income derived may be decreased by certain deductible expenses and allowances, unless an individual has opted to pay fixed tax from business income derived.

Standard allowances are available for each dependant (for example, children, an employed spouse) of LVL 70 per month for 2012, and a nontaxable minimum of LVL 45 (approx EUR 64) monthly (LVL 540 (approx EUR 768) yearly) for 2012. These allowances are decided each year by the Latvian Government. If a resident individual derives income from both business activities and employment relations, the above allowances may be allocated proportionally to each type of income. If the allocated allowance exceeds the relevant part of income, excess allowances may be deducted from the other part of income.

Apart from the above allowances, taxable income can be decreased by certain expenses, including life and health insurance premiums, contributions to approved private pension funds, and donations to certain organisations (20% of a person's taxable income), as well as certain medical and educational expenses incurred by a taxpayer and their family members (LVL 150 (approx EUR 214) yearly for each person).

Certain income previously classified as exempt income is now subject to tax. A 10% tax now applies to dividend and interest income and a 15% tax applies to capital gains. Under certain conditions, the sale of an individual's primary residence may be exempt. Gifts from specified relatives remain exempt but gifts over LVL 1,000 (approx EUR 1,420) yearly received from unrelated individuals will be taxable.

Income from agricultural production and rural tourism is exempt if not exceeding LVL 2,000 (approx EUR 2,850).

Social security/national insurance payments

Employees and self employed persons must make social security insurance payments. The taxable base for an employee is their gross salary subject to individual income tax. Generally, payments must be withheld by the employer and levied at a rate of 35.09%, where 11% is withheld from the employee's salary and 24.09% is paid by the employer.

The tax base for a self employed person is their income derived from business activities to a self determined extent. However, the minimum annual taxable base cannot be less than LVL 2,400 (approx EUR 3,415) for 2012.

A foreign employee employed by a foreign employer must pay social security insurance payments beginning with the 184th day of their presence in Latvia.

TRANSFER PRICING AND ANTI AVOIDANCE RULES

Transfer pricing rules (documentation requirements, APAs, etc)

Under Latvian law, three transactional transfer pricing methods prevail, that is: comparable uncontrolled price, cost plus, and resale method. Two profit based methods (that is: transactional net margin method, and profit split method) are available if the first three methods are not sufficient for determining the arm's length price.

New transfer pricing documentation rules have been introduced specifying the documentation required to support the transfer price applied to a transaction, if annual turnover exceeds LVL 1 million (approx EUR 1.4 million) and a related party transaction exceeds LVL 10,000 (approx EUR 14,200). These changes also provide for advance pricing agreements to be issued if the actual or proposed transaction exceeds LVL 1 million per annum. These agreements are provided for a fee.

Taxpayers can also obtain binding rulings from the Latvian State Revenue Service regarding general taxation issues. These are provided without charge.

If a taxpayer does not agree with the value the Latvian taxation authorities have given to a related party transaction (no APA exists), they can seek an independent valuation from the Transaction Evaluation Commission. The Commission's decision can be appealed to a court by both the taxpayer and the Latvian State Revenue Service.

All transactions between related parties and transactions deemed between related parties must be reported in an attachment to the annual corporate income tax declaration, with full details of the parties, the type of transaction, the transaction values, and the pricing method used. Transactions with entities located in nil or low tax jurisdictions as listed in Latvian law are deemed related party transactions.

Anti avoidance provisions

There are no general anti avoidance rules in Latvia. In regard to certain transactions, a substance over form approach can be adopted which can result in the nature of a transaction being reclassified or ignored. Latvia has recently uncovered a number of large scale money laundering, fictitious invoicing, and carousel type schemes.

Thin capitalisation/other interest deductibility rules

The Latvian thin capitalisation rules are as follows: the maximum amount of annual deductible interest is determined by making two separate calculations. If an amount of nondeductible interest results from either or both calculations, taxable income is increased by the larger amount calculated.

First calculation

Under the first calculation, the amount of interest allowable is determined by multiplying the principal amount outstanding during the year by 1.2 times the average short term interest rate for the last month of the taxation period as determined by the Latvian Statistics Commission. This is then compared to the actual interest paid.

Second calculation

Taxable income is to be increased for interest paid by an amount proportional to the amount by which the average amount of the principal payable during the year exceeds a multiple of four times the company's equity as stated in its annual accounts at the beginning of the year, which is then reduced by any amounts that are long term investment revaluation reserves or other reserves not reflected in the profit and loss statement.

If a taxpayer's accounts do not reflect equity amounts, only the first method is used.

Financial and Insurance institutions are not subject to the rules and nor is interest paid to specified lenders.

Controlled Foreign Company (CFC) rules

Latvia has no Controlled Foreign Company rules.

Tax treaties

Latvia currently has 50 treaties, predominantly with EU and OECD nations.

MISCELLANEOUS TAXES

Payroll taxes

Employers are required to pay 24.09% of an employee’s gross salary as the employer’s social security contribution. Current law has removed the previous income ceiling limiting the amount of salary on which an employee and employer must pay social security contributions.

State insolvency risk duty is payable by an employer. The purpose of the duty is to fund unpaid salaries in the event of an employer going bankrupt. Current duty per employee is LVL 0.25 (EUR 0.35) monthly.

Taxes on capital

There is no tax on capital in Latvia. A small registration fee is payable when shares are transferred. When a change occurs in the ownership of immovable property between unrelated individuals and corporate entities, a 2% duty (LVL 30,000 or EUR 42,686 maximum) is payable in a sale situation and in a gift situation a 3% duty (LVL 50,000 or EUR 71,143 maximum) is payable.

There is also no general wealth tax or inheritance tax.

Taxes on property

From 1 January 2010, a flat 1.5% tax has been imposed on the cadastral value of land and buildings which do not constitute residential property or are otherwise exempted. The tax is calculated and collected by municipalities.

Commencing 1 January 2011, increased residential building/apartment tax has been introduced with the following progressive rates (a LVL 5 (approx EUR 7) minimum is payable):

- 0.2% – for cadastral value not exceeding LVL 40,000 (approx EUR 57,000);
- 0.4% – for cadastral value from LVL 40,000 to LVL 75,000 (approx EUR 107,000);
- 0.6% – for cadastral value exceeding LVL 75,000.

Local municipalities currently have the power to grant taxation reductions to specific categories of individuals.

However, from 1 January 2013, local municipalities will be able to impose property tax ranging from 0.2% to 3.0% in accordance with regulations that must be issued by the municipality no later than 1 October of the prior tax year. If this is not done the rates of tax will apparently remain as they are currently in the law.

OTHER TAXES

Lottery and gambling tax

The taxation object of gambling tax is the gambling operator – a company, gambling venue location, and gaming equipment. For example, roulette and cards and dice games are taxed annually for each table operated. Slot devices are taxed in a similar way.

The taxation object of lotteries (including “instant” lotteries) tax is 10% of revenue generated by the sale of tickets.

In addition, all gambling activities are subject to substantial stamp duties applied depending on the particular gambling activity.

Gambling taxes and stamp duties are deductible for the purposes of calculating corporate income tax.

Table 1 *Tax treaty withholding rates*

Country	*Dividends*		*Interest*[a]	*Royalties*[b]
	Individuals, companies (%)	*Qualifying companies*[c] *(%)*	*(%)*	*(%)*
Albania	10	5	5/10	5
Armenia	15	5	10	10
Austria	10	5	10	5/10
Azerbaijan	10	5	10	5/10
Belarus	10	10	10	10
Belgium	15	5	10	5/10
Bulgaria	10	5	5	5/7
Canada	15	5	10	10
China	10	5	10	10
Croatia	10	5	10	10
Czech Republic	15	5	10	10
Denmark	15	5	10	5/10
Estonia	15	5	10	5/10
Finland	15	5	10	5/10
France	15	5	10	5/10
Georgia	10	5	10	10
Germany	15	5	10	5/10
Greece	10	5	10	5/10
Hungary	10	5	10	5/10

[a] Only applies if interest is paid to a related party. Interest paid by a Latvian registered credit institution to a related party is subject to 5% under domestic law.

[b] The 5% rate mainly applies to use of industrial, commercial, or scientific equipment.

[c] Reduced treaty rates will often apply if a nonresident company owns at least 25% of the capital (or sometimes the voting rights) in a Latvian company; no holding period is required. Other conditions may apply to obtain a reduced rate.

Iceland	15	5	10	5/10
Ireland	15	5	10	5/10
Israel	15	5/10	5/10	5
Italy	15	5	10	5/10
Kazakhstan	15	5	10	10
Korea	10	5	10	5/10
Kyrgyzstan	10	5	5/10	5
Lithuania	15	0	0	0
Luxembourg	10	5	10	5/10
Macedonia	10	5	5	5/10
Malta	10	5	10	10
Moldova	10	10	10	10
Morocco	10	6	10	10
Netherlands	15	5	10	5/10
Norway	15	5	10	5/10
Poland	15	5	10	10
Portugal	10	10	10	10
Romania	10	10	10	10
Serbia	10	5	10	5/10
Singapore	10	5	10	7.5
Slovakia	10	10	10	10
Slovenia	15	5	10	10
Spain	10	5	10	5/10
Sweden	15	5	10	5/10
Switzerland	15	5	10	5/10
Tajikistan	10	0/5	7	5/10
Turkey	10	10	10	5/10

Ukraine	15	5	10	10
UK	15	5	10	5/10
USA	15	5	10	5/10
Uzbekistan	10	10	10	10