

## Latvia

**Uve Zosars, Edgars Koskins, Janis Taukacs, Alisa Surko**

**Sorainen, Riga**

### Key facts

#### Main tax rates

Corporate tax rate: Flat rate of 15%

VAT/GST standard rate: 21%

Personal income tax top rate: 23%

#### Population/GDP

Population: 2,260 million

GDP (2008): USD 8,08b in the last quarter of 2008.

#### Currency

The Latvian Lat (LVL). The Lat is pegged to the EURO at a rate of LVL 0.0702804 to EUR 1.

#### Membership of economic groups

Member of European Union

#### Major industries

Banking, tourism, transit services, timber.

#### Website of tax/finance authority

[www.vid.gov.lv](http://www.vid.gov.lv) – Tax Authority: Latvian State Revenue Service

[www.fm.gov.lv](http://www.fm.gov.lv) – Ministry of Finance

## Introduction

The Republic of Latvia has established a tax system that is fairly beneficial for companies and wealthy individuals. The tax system, however, imposes comparatively heavy burden on employment income, thus, creating a long lasting debate regarding a fairness of the existing taxation policy. To mention some of the lucrative taxation aspects in Latvia: low corporate income tax rate (15%), tax free distribution of dividends to individuals and limited taxation of capital gains derived by individuals.

## Recent developments

Taking into consideration that views expressed by many international experts that the Latvian economy is experiencing disastrous times are much grounded and true, the Latvian tax revenues are rapidly falling. For that reason the Latvian government is balancing between two goals which are difficult to meet simultaneously: warming up economy and raising tax revenues. Thus, recently new incentives in the corporate income tax were introduced: deemed interest deductions for promoting re-investment of profits and replacement of fixed assets policy to avoid gains derived from selling the old assets. Also the government reduced a personal income tax from 25% to 23%. On the other hand, the Government introduced increased VAT rate of 21% (previous one – 18%). Also it is planning to introduce personal income tax on dividends, capital gains and gifts and property taxation of private dwellings.

## Corporate taxes

### General outline

From a flat rate of 25% on 1 January 2002, the Latvian corporate income tax rate was progressively reduced to a flat rate of 15% which commenced on 1 January 2004. A 15% flat rate is still applicable at the time of writing.

In general, the Corporate Taxation system is relatively simple incorporating European Union Directive requirements and offering limited additional incentives in addition to a low basic tax rate.

Because of the world's general financial downturn Latvia will receive significant loans from the International Monetary Fund and other lenders. At the time of writing, Latvia has agreed as part of the loan conditions to introduce changes to increase its taxation revenues however a change in the basic rate of corporate tax was not mentioned.

### 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 operations a company pays a monthly prepayment of tax based on its prior year taxable income. The tax prepayment amounts can be reduced if revenues fall below that of the previous year.

Companies that operate in Special Economic Zones or Free Ports can receive reductions in corporate income tax 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. Deemed 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.

The calculated taxable tonnage income is subject to a tonnage tax rate of 15%. Tonnage tax payers do not pay corporate income tax and corporate income tax rebates are not applicable to them. An election to be a tonnage taxpayer cannot be revoked for 10 years.

In regard to deductible expenditure, there is a general provision in the law which states that expenses that are directly related to the conduct of economic activity are tax deductible. However, the following are some expenses specifically excluded from being allowable expenses.

Gifts and benefits in cash or kind provided by employers to employees or the employee's family members which are not remuneration for work services, costs related to the development of social infrastructure facilities belonging to a tax payer and donations or gifts to other persons, amounts of guarantees, which a taxpayer as a guarantor is required to pay in accordance with a guarantee, other deductions from profit or from turnover made by the taxpayer on his or her own initiative and such other expenses that are not economically related to economic activity of the taxpayer.

For taxation purposes depreciable fixed assets are divided into 5 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. Operating, leasing and depreciation expenses associated with "representational" motor vehicles exceeding LVL 30,763 (EUR 43,772) in value are non deductible.

From 2009 to 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 does not have a specific capital gains taxation regime and as a general rule capital gains and losses are included in the taxable income of a company. There are limited exemptions such as the disallowance of losses on the sale of depreciated fixed assets that have been sold to related parties and limited allowances for losses from the sale of non-publicly traded securities.

However, as part of Latvia's recent agreement with the International Monetary Fund (IMF) and other lenders it was agreed from 2010, to introduce a 10 percent tax rate on all capital income (interest, dividends, royalties, rental income, realized nominal capital gains on shares and realized nominal capital gains on immovable property). Under certain conditions the sale of a primary residence owned by an individual will be exempted. Previously some of the above income was subject to income tax exemptions.

### Position of losses

As of January 1 2009 losses may be carried forward for 8 years (previously 5). Companies operating in accordance with the Regional Development Law can carry forward losses for 10 years. Losses may not be carried back.

There are specific rules regarding the continued use of existing losses in cases where ownership of an entity changes or there is a reorganisation such as a merger.

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 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 the transferring and receiving entities must be submitted with their Latvian tax declarations and foreign accounts must be restated in accordance with Latvian accounting standards.

### Withholding taxes

**Table (1) shows the various withholding tax rates**

Country	Dividends	Interest (2)	Royalties (3)
	Individuals,	Qualifying	
	companies	Companies(1)	

	(%)	(%)	(%)	(%)
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 Rep.	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
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
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
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
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
(1)	The reduced treaty rates will often apply if the non-resident company owns at least 25% of the capital (or sometimes the voting rights) in the Latvian company; no holding period is required. Other conditions can be applicable to obtain a reduced rate.			
(2)	Only applies if the interest is paid to a related party. Interest paid by a Latvian registered credit institution to a related party is subject to 5% under the domestic law.			
(3)	The 5% rate is in the main applicable to the use of industrial, commercial or scientific equipment.			

### 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 in regard to tax residency.

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

### Position of non-resident companies

Non resident companies are taxable in Latvia if they maintain a permanent establishment in Latvia. In regard to withholding tax payable on the sale of Latvian immovable property (2% of the total sale price), this is now also applicable to the sale to a Latvian entity by a non resident, of shares in a company whose assets directly or indirectly consist 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 European Union or a European Economic Area member country. This can also apply to payments to the permanent establishments of qualifying companies if these are also tax resident in the European Union or European Economic Area

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 be applicable or a reduced rate of 5% is applicable if share ownership is at least 10% or 25% of the payer.

### *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 the 10% rate will reduce to 5% if the interest is paid to a related entity (including a permanent establishment) that is registered in the European Union. From 1 July 2013 there will be no withholding tax imposed on interest paid to a related entity that is registered in the European Union.

The above exemptions can also apply to interest payments received or made by European Union resident's permanent establishment if certain conditions are met.

### *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 tax treaties payments for the right to use industrial, commercial or scientific equipment is considered a royalty. Latvian law now specifically excludes payments for the right to use airplanes located in Latvia from Latvian withholding tax.

A company registered in a Latvian Special Economic Zone or Free Port can obtain a reduction of up to 80% of the withholding tax applicable to Dividend, Royalty and Management and Consulting Fee payments made by it to foreign entities.

## **Indirect taxes**

### **VAT/GST: main and reduced rates, exemptions**

The standard rate of VAT is 25%, which is applied to almost all entities that reach or exceed a *de minimis* level of LVL 10,000 (app. EUR 14,230). VAT is reported on a monthly basis.

On some occasions VAT is applied at the reduced rate of 10%. The reduced VAT rate is applicable to medical devices, infant food, various newspapers and magazines, public transportation, utilities and some other items.

### **Other indirect taxes**

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

Latvia also applies environmental tax which is called natural resources tax. The natural resources tax is applicable to entities which are involved in polluting activities, extraction of natural resources, selling or consuming for their own business needs goods that are hazardous to environment (e.g. electrical and electronic equipment), registering in Latvia transport vehicles and other activities.

## **Personal taxes**

### **Domicile and residency requirements**

An individual is deemed a resident of Latvia (and thus fully taxable) if:

1. they permanently reside in Latvia; or

2. they stay in Latvia for 183 days or more in a 12-month period; or
3. they are Latvian citizens, who are employed in a foreign state by the Latvian government.

### **Main rates and bands**

Individuals are subject to the personal income in a flat rate of 23%. Individuals who derive their income from a business of which he/she is the sole proprietor (self-employed person or individual entrepreneur) or is a partner in a partnership are subject to personal income tax in a flat rate of 15%. Those individuals who are registered as self-employed persons with the tax authorities, providing that they have no employees and business income did not exceed LVL 10,000 in the previous taxation year, or most likely will not exceed LVL 10,000 during the taxable year, may opt to pay the personal income tax in a fixed amount which might vary from LVL 5 to LVL 500 depending from the amount of business income derived.

An individual who derives his/her income from employment relationship in principle is supposed to pay personal income tax (salary tax) in the amount of 23% of almost all direct or indirect income he/she received due to employment relationship (including salary, bonuses, lump-sum payments, remuneration from previous employment). However, there are several exceptions to the above rule. Thus, expenses related to the employment duties, apartment costs in case of appointment of the employee to other place of work, compensation of personal car costs attributable to the work duties, expenses of business trip, education expenses, as paid by the employer are not subject to personal income tax. The other benefits in kind are generally taxed at fair market value.

As of November 2007, the legislation lists some factors, the presence of any of which is to be considered as indication that the individual should be taxed as an employee, not self-employed person, and thus is subject to salary tax in the amount of 23% instead of 15%.

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

There are standard allowances for each dependant (children, an employed spouse, etc) in the amount of LVL 63 per month for 2009, and non taxable minimum in the amount of LVL 90 per month (LVL 1,080 per year) for 2009. The amounts of allowances above are decided each year by the government of Latvia. If a resident individual derives his/her income from both business activities and employment relations, the above allowances may be allocated proportionally to each way of income. If the allocated allowance exceeds the relevant part of the income, the excess allowances may be deducted from the other part of the income.

Apart the above allowances, the taxable income can be decreased by certain expenses, including life and health insurance premiums, contributions to approved private pension funds and donations to certain organizations (20% of a person's taxable income), as well as certain medical and educational expenses incurred by taxpayer and his/her family members (LVL 300 per year per each person).

Certain types of income are tax exempted, including income from inheritance, gifts from individuals, child support and maintenance, dividends paid by most of the EU, EEA and Latvian companies, interest and other income from deposits and investments in credit institutions in Latvian and the EU, certain social benefits, from agricultural production and rural tourisms if the income does not exceed LVL 4,000.

### *Dividends*

Dividends paid to resident individuals by companies established in Latvia, the EU or EEA are tax exempted, providing that distributing company is not exempted from corporate income tax (or similar tax in the residence state of the company) and does not enjoy any reliefs from the corporate income tax granted under Latvian or the EU, EEA laws. If the distributing company is exempted or enjoys reliefs from corporate income tax, the dividends paid to individuals are subject to tax in a flat rate of 10%.

### **Social security/national insurance payments**

Employees and self-employed persons are obligated to make social security insurance payments. The taxable base for an employee is his/her gross salary subject to individual income tax. The payments, generally, must be withheld by the employer and levied at a rate of 33.09%, where 9% are withheld from an employee's salary and 24.09% are paid by an employer.

The tax base for a self-employed person is his/her income derived from business activities to an extent determined by him/herself. The minimum annual taxable base, however, cannot be less than LVL 2,160 for 2009.

Foreign employee who is employed by foreign employer must pay the social security insurance payments beginning with the 184<sup>th</sup> day of his/her presence in Latvia.

## **Transfer pricing and anti-avoidance rules**

### **Transfer pricing rules (documentation requirements, APAs, etc.)**

Under Latvian law, the three transactional transfer pricing methods (i.e. comparable uncontrolled price, cost-plus and resale method) prevail. Two profit-based methods (i.e. 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.

There is no provision for an Advance Pricing Agreement as such. Taxpayers can obtain binding rulings from the Latvian State Revenue Service regarding taxation issues. It is understood these are more in regard to the application of a given pricing methodology rather than a request for an approved set of specific prices.

If a taxpayer does not agree with the value the Latvian taxation authorities have given to a related party transaction 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 as being between related parties must be reported in an attachment to the annual corporate income tax declaration and provide full details of the parties, the type of transaction, the transaction values and the pricing method used.

There are no specific documentary requirements regarding substantiating the pricing method used and the value(s) determined. However, if during an audit the Latvian State Revenue Service requests to see the documentation supporting the pricing of the transaction this must be provided within 30 days.

### **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 non deductible interest results from either or both the calculations, taxable income is increased by the largest amount calculated.

(i) 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.

(ii) Second calculation

Taxable income is to be increased for interest paid by an amount that is proportional to the amount by which the average amount of the principal payable during the year exceeds a multiple of 4 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 that are not reflected in the profit and loss statement.

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

### **Controlled Foreign Company (CFC) rules**

Latvia has no Controlled Foreign Company rules.



## **Tax treaties**

Latvia currently has 47 treaties predominately with EU and OECD nations.

## **Miscellaneous taxes**

### **Taxes on payroll**

Employers are required to pay 24.09% of an employee's gross salary as an employer 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.

A 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 bankrupting. The current duty per employee is LVL0.25 (EUR 0.35) per month.

### **Taxes on capital**

There is no tax on capital in Latvia. There is a small registration fee payable when shares are transferred. When there is a change 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**

Currently a flat 1% tax is 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. Under current law the 1% rate will be payable up to December 31 2010. From January 1 2011, a base rate of 0.4% of the cadastral value will be payable but municipalities can impose an additional amount that does not exceed 0.6% of the cadastral value.

However, in accordance with the IMF loan agreement, from 2010 it is also proposed to increase real estate and property taxes, which are currently significantly below the OECD average. At the time of writing it has been stated that this will be achieved by removing exemptions in order to broaden the tax base and one of the exemptions that may be lifted is the residential property exemption.

## **Other taxes**

### **Real property tax**

The real property tax is levied at a rate of 1% from the cadastral value on an annual basis. Notable exemptions from the tax are private dwellings and buildings used for agricultural purposes.

### **Lottery and Gambling Tax**

The taxation object of the 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. Similarly also slot devices are taxed.

The taxation object of the lotteries tax is the revenue generated by the sale of tickets: lotteries – 8% from the revenues received from the sale of tickets or "momentary" lotteries – 10% from the revenues received from the sale of tickets.

In addition all gambling activities are subject to substantial stamp duties that are applied depending on a concrete gambling activity.

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

