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New Rules on Capital Taxation Take Effect

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COUNTRY DIGEST

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New Rules on Capital Taxation Take Effect

Latvia's amended Law on Personal Income Tax entered into force on January 1, bringing all forms of capital into the tax net except treasury bills and bonds issued by the government of Latvia and other EU and European Economic Area member states.

Capital gains and income from capital other than capital gains must be strictly separated because of varying tax rates and other dissimilarities.

Income From Capital Gains

A capital gain is the difference between the sales price of a capital asset and the value of acquisition, or, under the Commercial Law,[1] the difference between the liquidation quota and the value of the investment.

Income from capital gains is taxed at a 15 percent rate. The person who receives the income is solely responsible for tax payment and reporting to the State Revenue Service (SRS).

Income gained by a nonresident from the sale of capital assets (other than financial instruments) based in Latvia is taxed at a rate of 2 percent if the payer of the income withholds the tax at the place of payment.

To clarify how the capital gain is determined, the rules for capital assets, acquisition value, and setoff are explained below.

Capital Assets

Capital assets include:

- financial instruments such as stocks, shares, investments in private partnerships, and others as mentioned in the Financial Instruments Market Law;
- transferable securities such as certificates of shares in investment funds or mutual investment companies;
- debt instruments such as deposit certificates, short-term bonds, and other monetary instruments that are traded in money markets;
- real estate (including rights to acquire real estate), undertakings (in accordance with the Commercial Law[2]), and intellectual property; and
- income derived from transactions involving the sale of rights to acquire capital assets.

Capital Assets: Acquisition Value

The acquisition value depends on how the capital asset is acquired. There are several components to consider. If a capital asset is acquired by way of purchase, its value is the purchase price. Similarly, if a capital asset is acquired by way of a gift agreement or legacy, its acquisition value is the value prescribed in the gift agreement or the value of the capital included in the legacy.

The acquisition value is adjusted by costs related to the acquisition of the capital asset — any state taxes, loan interest (paid for the acquisition of the particular capital asset), and similar expenses — and costs related to the purchase of the security and its custody.

However, if not otherwise specified, any cost and income in the form of a good or service is to be valued in monetary terms at market prices that are in force at the moment when the income and costs are incurred.

If an agreement is concluded but the deal is broken or some part of the obligation is not performed and a person has received income that is not subject to repayment, it is deemed as income from capital gain and may be adjusted by costs related to the abandoned deal.

[1] Commercial Law article 328 (1): ''After the claims of creditors have been satisfied or the monies due them are deposited and the liquidation expenditures have been covered, the liquidator compiles a liquidation closing financial account and a plan for the division of the remaining property, in which a liquidation quota is determined.''

[2] Commercial Law article 18: ''An undertaking is an organizational economic unit. The undertaking includes both tangible and intangible things belonging to a merchant as well as other economic benefits (value), which are utilized by the merchant to perform commercial activities.''

Capital Assets: Setoff

If several capital assets are sold during a tax period, the capital gains are calculated during that same tax period. If the calculated capital gain is negative, it is ignored for tax purposes. However, if the capital gain from the sale of one capital asset is negative, but it is positive from the sale of another capital asset, the losses may be covered by the positive capital gain.

It should be noted that a person who receives income from capital in foreign countries is subject to income tax in Latvia regardless of whether the income is taxable in the place of payment of the income. If any tax is withheld in the place of payment, it may be set off as an expense against the income tax payable in Latvia, subject to any applicable tax treaties.

The new law does not describe exactly which costs may be covered by the capital gain. For example, if stock is acquired at different prices, it is not clear which acquisition price should be taken into account.

Non-Capital-Gains Income

Income from capital other than capital gain is taxed at a rate of 10 percent. The obligation to make tax payments is on the entity that disburses the income (for example, a bank in the case of an interest payment on a deposit, or a company in the case of dividends).

Under Latvian law, income from capital other than capital gain includes:

- dividends from company shares;
- stocks and income from other rights (not derived from debt obligations) to participate in distributions of profit and income from private partnerships;
- interest income and income related to interest income;
- income from investments in private pension funds; and
- income from life insurance agreements with savings accounts.

No adjustment for costs is permitted for capital income from dividends and interest income.

Day of Receipt of Income

The day income is deemed to be received is significant, especially for separating income received before and after January 1, 2010, when the new amendments came into force.

In general, the day when income is deemed to be received is the day when a person receives money or other assets. However, the day is set differently for income from capital gains or from capital other than capital gains.

Income From Capital Gains

If capital gains income is to be received during several tax periods, it is deemed to have been received in the tax period when it is actually received.

If the capital gains income is to be received in more than three tax periods (from the year of the sale agreement), the income is deemed to have been received in the first three tax periods. In that event, the outstanding amount is to be calculated in the taxable income during the third tax period regardless of whether the income is actually received.

In the case of a share swap (without any other consideration), the day of income is the day when the swapped shares are sold. The day of sale is the day when consideration is received or the day when changes are recorded in the commercial register. If consideration is received before changes are recorded, the day of income is the day when consideration is received.

Income From Capital

The day of receipt of income from capital is the day when the income is calculated. The same rule applies to dividends (that is, the day of dividend income, as well as the day of dividend income disbursement, is the day when the dividends are calculated). However, if dividends are calculated for publicly listed companies, the day of dividend income is the day when the dividends are paid. The custodian who settles with the shareholder is required to pay the tax into the state budget.

Reporting to State Revenue Service

There are changes regarding the reporting of capital and capital gains to the SRS as well. For both types of income, the tax is due 15 days after the income report is filed.

Income From Capital Gains

All income from capital gains should be reported to the SRS if income tax is not withheld at the place of disbursement. Nonresidents must report all income from capital gains received in Latvia if income tax is not withheld at the place of disbursement.

A resident taxpayer must report all unfinished transactions involving capital assets in Latvia and foreign countries; a nonresident taxpayer must report all such transactions involving sales of real estate in Latvia. The report must be submitted to the SRS once a year, no later than April 1 of the year following the tax period.

If income tax is not withheld at the moment income is paid, a report must be submitted by the 15th day of the month following the month when the income was received. If the income is less than LVL 500 per month, reporting can be done up to the 15th day of the month following the respective quarter.

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Income From Capital

If tax is not withheld at the place of disbursement, the taxpayer must report to the SRS any interest income received in January and February of 2010, and make the tax payment. The report must be submitted no later than March 31. ◆

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