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Parliament Passes Microenterprise Tax Law on First Reading

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COUNTRY DIGEST

Parliament Passes Microenterprise Tax Law on First Reading

Latvia's Parliament on June 10 will conduct a final reading of a draft law on microenterprise tax. The legislation, which was approved in a first reading on April 29, is expected to enter into force on July 1.

The draft law provides for a preferential tax on microenterprises — specifically, individual merchants, individual enterprises, farms, other natural persons who are registered as performers of economic activities, and limited liability companies.

The microenterprise tax combines into a single payment:

- mandatory state social insurance contributions and the state entrepreneur risk fee for employees of the microenterprise;
- the enterprise income tax if applicable; and
- the owner's personal income tax on earnings derived from the economic activity of the microenterprise.

To be eligible for microenterprise tax treatment, applicants and all members of the enterprise must be natural persons; the enterprise's turnover within a calendar year cannot exceed $121,440; the enterprise cannot employ more than five people; and the employees' income cannot exceed $870 per month.

Qualifying enterprises may apply to the State Revenue Service until December 15 each year and will be subject to the microenterprise tax from January 1 of the following year. A microenterprise tax payer may not opt out of the tax regime before the tax period is over. Microenterprises that do opt out of the regime may not reelect to use the microenterprise tax regime for five years.

Currently, the draft law calls for a fixed tax rate of 20 percent on a microenterprise's yearly turnover, but the Ministry of Economics has proposed reducing the rate to 12 percent. For each additional employee exceeding five, 2 additional percentage points will be added to the tax rate. Also, a 30 percent tax rate will apply to any portion of turnover that exceeds $121,440. If the monthly income of an employee exceeds $870, a tax rate of 50 percent will apply to the excess. The tax is paid four times a year on the turnover for each quarter.

The provisions of the draft law could give rise to several different tax situations. For example, if a microenterprise has five employees with income of $870 per month and the turnover within a calendar year is $121,440, the microenterprise will pay a 20 percent (or possibly 12 percent) tax on the turnover. If the same microenterprise has six employees, the tax rate is 22 (or possibly 14) percent.

Further, if the turnover per calendar year is $138,778, an amount that exceeds the limit by $17,338, the 20 (or 12) percent tax rate will apply to the first $121,440, but a 30 percent tax rate will apply to the $17,338 excess. However, if one employee receives $1,216, an amount that exceeds the limit by $346, a 50 percent rate would apply to the excess.

A spouse or other immediate relatives of the owner of a microenterprise may be employed without establishing a labor relationship; however, the owner and relative can still pay state social insurance jointly. ◆

♦ *Valters Gencs, Law Firm Valters Gencs, Riga*