

LAW FIRM

GENCS VALTERS

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TAX & LEGAL NEWS FOR THE BALTIC STATES

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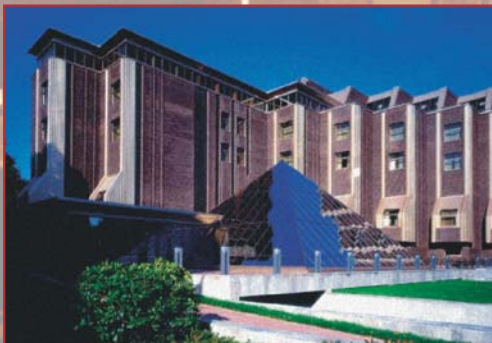
Latest Update on
Lithuanian Tax
changes

GENCS VALTERS LAW FIRM

is pleased
to announce
its arrival in Vilnius,
Lithuania

Seminar

"Expatriate Tax Planning 2009"



on March 11, 2009
at the
Reval Hotel Rīdzene,
Kronvalda
conference room,
18:00 – 18:45

/invitation enclosed/

*The Official
Opening reception
of office in Vilnius will
held on March 6, 2009 at 19:00
in Radisson SAS Astorija Hotel
Didžioji 35/2
01128 Vilnius, Lithuania*

/invitation enclosed/

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Changes in Latvian tax system

Due to slowdown of Latvian economy, especially in banking, construction and retail sectors, the Government of Latvia has drafted stabilization and growth rehabilitation program for Latvian economy. The program, which included several changes in the tax laws were submitted to the Parliament on the 10th of December in a package with the changes of the budget for year 2009. In accordance with the said, during the Parliament session on the 12th of December, relevant changes regarding VAT, excise and personal income taxation were swiftly passed. Below are stated the main alterations.



VAT

The most important changes have been adopted regarding VAT rates, thus in the law "On Value-Added Tax" stating that as of January 1, 2009, general VAT rate will be applied in amount of 21% thereby changing the current historical 18% rate which was in force since 1995. At the same time changes have been made regarding reduced 5% VAT – it has been doubled to 10%.

However, for several reduced 5% VAT positions as of January 1, 2009, general VAT will be applied in amount of 21%. Hence general VAT regulation *inter alia* will be applied on supplies of water in a centralised water supply system, sewerage services, collection, conveyance and disposal services for municipal waste, funeral services, supply of books and cartographic publications, subscriptions to commercial television and radio and newspapers, journals, bulletins and other periodicals. Except newspapers, journals, bulletins and other periodicals for which the transitional period has been determined until January 1, 2010 (applying reduced VAT in amount of 10%), for other positions VAT rate in amount of 21% will entry on force as of January 1, 2009.

Excise tax

Notwithstanding the changes in the law "On Value-Added Tax", several elaborations were passed in the law "On Excise Tax" thus changing relevant excise tax positions. For instance, for soft drinks the excise tax will be applied in amount of 4 LVL (approx. ~ 5,6 EUR) per 100 litres (instead of 2 LVL (approx. ~ 2,8 EUR), for coffee the excise tax will be applied in amount of 100 LVL (approx. ~ 143 EUR) per 100 kilograms (instead of 50 LVL (approx. ~ 71,5 EUR). The excise tax has been increased for alcoholic drinks either – for beer the excise tax has

been stated in amount of 4 LVL (approx. ~ 5,6 EUR) per 100 litres (instead of 2 LVL (approx. ~ 2,8 EUR) to), for wine and other fermented drinks – in amount of 40 LVL (approx. ~ 57 EUR) per 100 litres (instead of 30 LVL (approx. ~ 43 EUR), for other alcoholic beverages – in amount of 825 LVL (approx. ~ 1178 EUR) per 100 litres absolute alcohol (instead of 705 LVL (approx. ~ 1007 EUR). Similarly the changes in the excise taxation has been applied to diesel and petrol-oil, establishing the excise tax in amount of 234 LVL (approx. ~ 334 EUR) per 1000 litres (instead of 193 LVL (approx. ~ 275 EUR), to petrol that does not contain lead, establishing the excise tax in amount of 269 LVL (approx. ~ 384 EUR) per 1000 litres (instead of 228 LVL (approx. ~ 325 EUR) and to petrol that contain lead – in amount of 300 LVL (approx. ~ 428 EUR) per 1000 litres (instead of 297 LVL (approx. ~ 424 EUR).

Above mentioned changes entred into force as of January 1, 2009.

Personal income tax

Regarding personal income taxation, there have been transformed rules in the law "On Personal Income Tax", stating that the personal income tax rate will be applied in amount of 23%, instead of current 25% rate. Similarly to the other above mentioned taxation changes reduced personal income tax will entry on force as of January 1, 2009.

It is believable that given changes is not the last instrument in a way to put more tax burden on consumption from the one hand, and to reduce tax expenses for employers from the other hand. However, it is unpredictable to foreseen what consequences will cause these changes that may pretend to be called as the most unexpected and the most rapidly passed during the last 15 years.

Personal Income Tax

Finally there have been made amendments in the law "On Personal Income Tax" in respect of a withholding tax from dividends paid to residents of other EU or EEA Member States. Previously this law created an uncertainty among taxpayers whether a tax shall be or shall be not withhold from dividends paid to individuals – residents of other EU or EEA Member States. The European Commission even initiated an infringement procedure, but the government's position was that there is no withholding tax to such dividends and it is just a problem of ambiguous wording of the law. However, with those amendments in the law the wording of the law is improved and now it is clear that there is no withholding tax from dividends paid to residents of other EU or EEA Member States except those dividends which are paid by companies – residents of Latvia which are not corporate income tax payers or are using any corporate income tax relief.

In order to try to slow down the real estate market in Latvia in May 2007 there were made amendments in respect of non-taxable income. At that time the law provided that the income from alienation of the real estate which has been in person's possession less than 12 months is non-taxable but then in May 2007 it was decided that there shall be introduced some restrictions which could help to slow down real estate market. Therefore this exemption was abolished and instead of that it was settled that income from alienation of the real estate will be not taxable if it would have been in person's possession more than 60 months and last 12 months have been the person's registered place of living. In all other case the income from alienation of the real estate was settled as taxable income.

However in November 2008 this above-mentioned restriction has been abolished and the old rules about 12 months have been introduced back into the law.

In addition to this it has been also provided that the interest rate paid for mortgage in order to obtain this real estate may be deducted from taxable income, previously it was not allowed.

The new amendments also provide that if the taxpayer receives an income from abroad where the taxation period is different than in Latvia then such taxpayer is allowed to submit a tax return within 2 month from the date when the tax return shall be submitted in the respective foreign country. Generally in Latvia the tax return shall be submitted till 1st of April.

Corporate Income Tax

With an aim to create an incentive for owners of companies not to distribute profits by paying dividends but instead of it to invest in the development of company by increasing equity there are introduced amendments in the law "On Corporate Income Tax" which will provide that in order to facilitate such behaviour it will be allowed to reduce taxable income for the amount which is calculated by multiplying undistributed profit in the pre-taxation period with average interest rate of the taxation period settled by the Latvijas Banka (Central Bank of Latvia) for credits issued to non-financial companies. It will be applied to the profit gained after 1st January 2009.

Capital taxation in Latvia – update

At the end of November there have been made number of amendments in regard to personal income tax and corporate income tax.



With an aim to facilitate the investment into the assets of company it is settled that the taxable income may be reduced by such income which is gained from alienation of the asset if within 12 months before or after the alienation date functionally similar asset is acquired. This tax relief will be not applied to art works, antiques, jewellery, cars, water vehicles, aircrafts, motorcycles etc.

The loss carry forward period from five years have been extended to eight years. However, it will be done gradually. In 2009 it will be six years, in 2010 seven years but eight year period will come into force on 1st January 2011.

With an aim to stimulate air companies to renew and to enlarge the lease of aircrafts used in the international air traffic it is settled that payments to non-resident for the use of aircraft used in the international traffic will be not considered as royalties or lease and the withholding tax will be not applied.

It shall be noted that on 12th of December 2008 the Parliament together with Economic Stabilisation Plan has approved also new and very crucial amendments in the tax area, especially regarding value added tax and personal income tax. As soon as the final wording of those amendments will be published we will inform you.

Most recent tax amendments in Estonia



Income tax

It was finally confirmed on the 12th of December that the annually planned reducing of the income tax shall be amended. The new legislation applicable from the first of January 2009 set out following personal and corporate income taxation rates:

Personal - 21% during 2009, 20% during 2010, 19% during 2011 beginning from 2012 18%

Corporate - 26,58% (21/0,79) during 2009, 25% (20/0,80) during 2010, 23,46% (19/0,81) during 2011, beginning from 2012 (18/0,82) 21,95%

An interesting turn took the intention to introduce the requirement of corporate income tax advance payments calculated on the basis of taxable incomes from three previous years. The original plan to implement the mentioned system has by the time of writing this been abolished in its entirety due to arising legal contradictions.

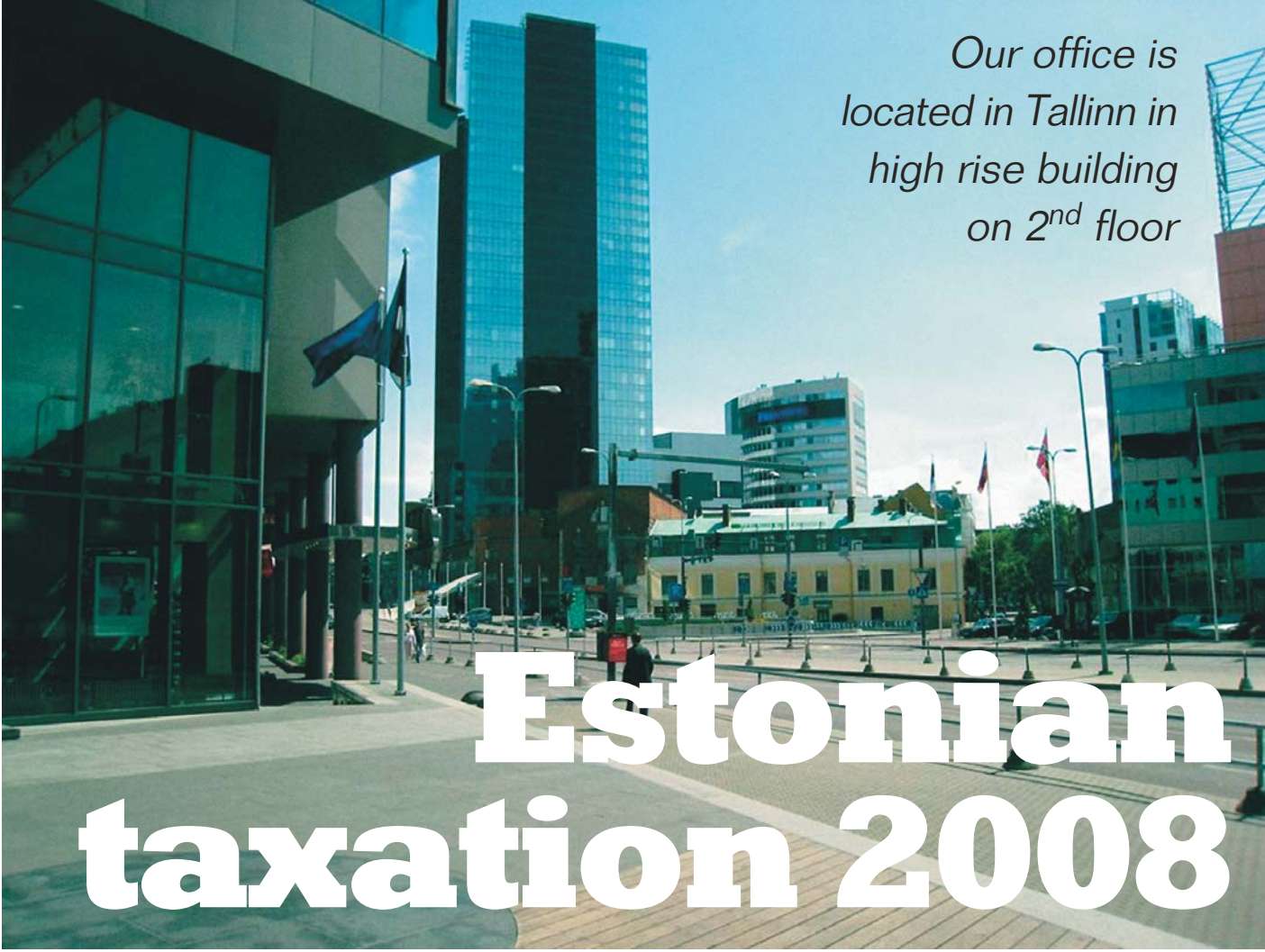
VAT

Difficult financial situation of the state forced the government not only to relinquish the promised income tax reduction, but also raise the VAT of several products and services that in the past have been subject to reduced VAT taxation. VAT was raised from 5% to 9% on books and work exercise-books used as learning materials, periodic publications, accommodation services as well as medicinal products, contraceptive preparations, sanitary and toiletry products, and medical equipment or medical devices intended for the personal use of disabled persons within framework of the Social Welfare.

A lot more drastic is considered a raise from 5% to 18% regarding handling of hazardous waste, funeral items and services and organization of concerts and performances on the territory of Estonia. The latter one caused an especially strong criticism as while Estonian citizen will be deprived from the major part of entertainment (which shall most probably be relocated to Latvia and Lithuania) the companies responsible for organization will have to fight for survival under occurring tax pressure.

State fees

Finally it is definitely worth noticing that in order to cover constantly growing budgetary deficiencies state fees regarding Traffic Register procedures have been raised. Onetime fee amounts have been increased 50% in average whereas for example raise of vehicle registration fee reached 90%. Yet the raise can be considered somewhat expected and proportional bearing in mind the approaching introduction of car tax.



*Our office is
located in Tallinn in
high rise building
on 2nd floor*

Estonian taxation 2008

Problematic rise of land tax

One of the most significant and definitely most debated amendments implemented in 2008 included raise of the land tax in Tallinn municipality. In order to comprehend the matter, one should be aware of that the land tax in Estonia is the only major tax under the influence of municipalities, which have a relative autonomy to decide over the rates of taxation. The rates of the land tax are set by the Parliament within the range of 0.5-2.5% from the assessed value of the land. The rate in Tallinn municipality was raised on the first of January 2008 from moderate 0.6% to somewhat drastic 1.5% causing a hurricane of protests, opinions and media publicity.

Such a progression hit particularly hard on low income and retired citizen living in highly valued residential areas, who were suddenly faced with almost tripled

annual tax invoices. The land tax exempt regarding retirees was raised respectively to an annual amount of 700 EEK, but that only in case the land owner posses over 200m² of estate. Thus some of the senior citizen living in 65m² flats in the central Tallinn experienced a sudden shock being forced to pay 3000 EEK compared to 1320 EEK in 2007.

The Social Democrat party with its head and the mayor of Tallinn Edgar Savisaar met waves of criticism towards their land tax resolution. Estonian Central Homeowners' organization has turned to administrative court in order to determine the legality of land tax decision and its accordance with Estonian constitution, whereas in the beginning of May the intensions to apply with this question to Estonian Chancellor of Justice were confirmed. Secretary-General of the organization, Taavi Madiberk, provided that they

support the idea that every state shall in any case be able to finance itself, but hurried to emphasize that the means of such financing should not deprive citizen from their constitutional rights of ownership, especially not to force them to give up crucial home property.

The resolution has without a doubt cast a shadow on constantly weakening Social Democrats' authority, who have difficulties with shifting the blame. Savisaar asserted that he would be ready to relinquish the rise if the Reform Party would in their turn give up the rise of alcohol and petrol duties as well as VAT rates. Definitely worth to mention is the exclamation of the Prime Minister and the leader of the of Social Democrats' nemesis Andrus Ansip who, in his typical annoyed manner, put the blame on Tallinn municipality citizen for electing an improper town council.

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Cars' enthusiasts, beware!

Another issue that brought along an amount of controversy was Social Democrats' launching of the proposal for introduction of a car tax in Estonia. This initiation announced in the beginning of May was, according to Estonian Taxpayers Association, considered almost as cynical and careless as previously mentioned rise of the land tax in Tallinn. In addition to that the coalition of Social Democrat

As any other matter among recent financial decision, the car tax has also a political battle background. The car tax may from some perspective be seen as a Social Democrats' response to Reform Party's intentions to increase the excise tax on fuel in order to reduce consumption and thus pollution. Not completely surprisingly the plan has been by opposed by Social Democrats and one third of IRL coalition. Besides political opposition, Lasse Lehis, the head of the Estonian Taxpayers

breach of the article 5 of the Directive, as income tax payable on profit distributions constituted a withholding tax. Despite several confusing judgments of the European Court of Justice and initially unnecessary nature of introduced amendments, the result of innovations shall remain and withholding tax with regard to dividend distribution shall be abolished.

Besides changes considering application of withholding tax there are several other areas in corporate taxation that shall alter their appearance in January 2009. Yet here it would be quite appropriate to pinpoint the fact that the core of the system where the profits are subject to taxation only upon their distribution shall remain. Period of the taxation on the other hand shall be extended from the current period of one month to more widely acceptable annual taxation.

Among other noteworthy amendments, the changes regarding taxation of liquidation incomes, payments made for redemption and return of shares as well as capital reductions will take place. Such incomes that are currently subject to personal income tax shall be treated as dividends or any other profit distribution and shall thus be taxed on the corporate level. Tax exempts shall be granted to the excess of the amount of previous monetary and non-monetary contributions to the equity of the company. The amendment was considered necessary in order to eliminate less favorable position of permanent establishments of foreign companies. Shareholders' double tax relief will be provided.

Furthermore, new corporate tax legislation will include the requirements of advance payments calculated on the basis of taxable incomes from three previous years. Such advance payments shall take place twice a year. Upon filing of a tax return the advance payments will be credited against the tax liability. It is also important to observe that during the period of 2009-2012 specific transitional provisions shall be applied.

Observing the matter it is important to notice that Estonia and Lithuania are currently the only countries in Europe that do not have a car tax.

party, Reform Party and IRL initiated the plan to double the fringe benefit rate which is paid by companies for corporate cars being used for private purposes. The cars subject to tax would be those generating power over 139kW and the monthly tax rate would amount roughly 2000-5000 EEK. Very few concrete statements have since then been provided, but even though the Minister of Finance of Estonia Ivari Padar claims nothing has been finalized, the general expectations have turned to face the fact that there will be a CO2-based car tax introduced in Estonia in 2009.

Observing the matter it is important to notice that Estonia and Lithuania are currently the only countries in Europe that do not have a car tax. Thus it may definitely seem an inevitable idea during the times of transnational crisis to start thinking about consequences of pollution while filling the gapes of deficient state budget. Quite optimistic calculations expect in accordance with different sources the amount between 600 mln and 1 bln EEK to be collected by the state.

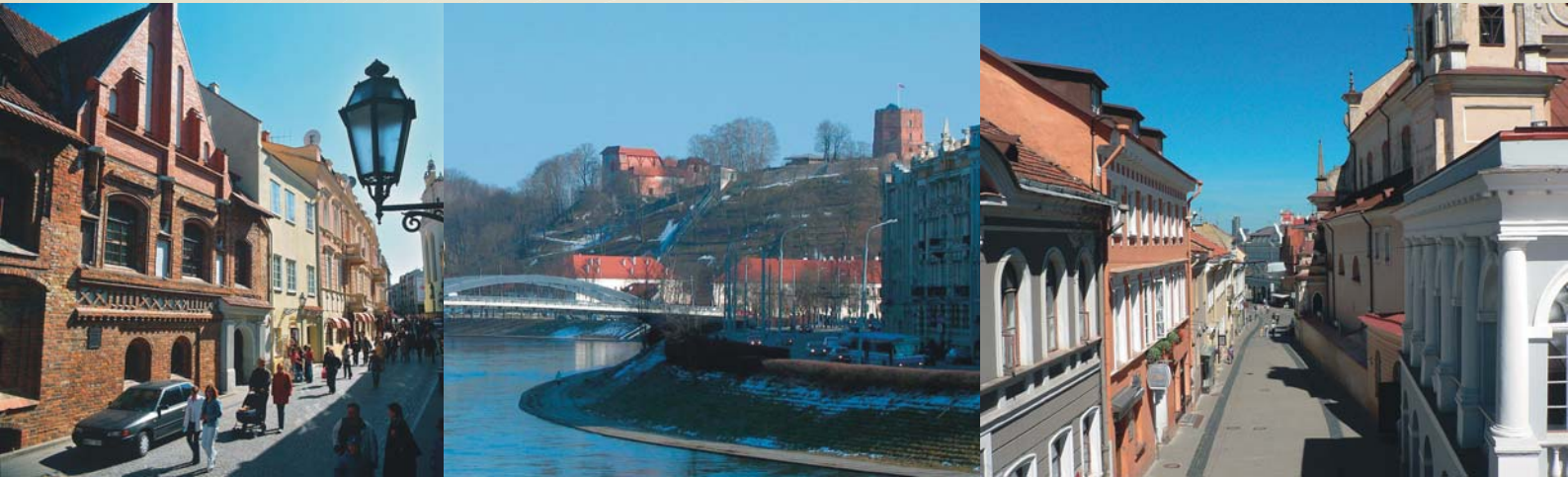
Association, provided some harsh criticism towards car tax mentioning the fair treatment of all taxpayers and denial of double-taxation as well asserted that people will simply start registering cars in the neighboring countries. Finally worth noticing are the results of research of Tallinn's paper Pealinn showing that 65.5% of the respondents were against the implementation whereas 52% of them were completely reluctant.

Amendments within corporate income taxation from 2009

Estonian Parliament has recently passed several amendments to the corporate income tax which shall be applicable from the 1st of January 2009. Reflected in the Law on Changing the Income Tax Act (RTI, 16.04.2008, 17, 119), the latest modification shall target first of all at the compliance with the Council Parent-Subsidiary Directive (90/435/EEC). Before joining the EU in 2004 Estonian legislation was considered to be in



Latest Update on Lithuanian Tax changes



Profit tax

As of January 1st, 2009 profit tax for companies has been increased to 20%.

However, 50% of reinvested profits shall not be taxed. The companies will be allowed to invest non-taxed profit into long-term assets for production of new products or services, increase of capacity, implementation of new processes and technologies. Investments into replacement of production assets with new similar assets shall not be deemed as investment project.

Tax on dividends

20% rate shall also be applied as tax on dividends. Furthermore use of certain exemptions (no tax on dividends when the shareholder has been controlling more than 10% in the company for more than 12 months) shall be limited. The exemption shall not be applied to dividends from companies that have enjoyed 0% rate on profits or other profit tax benefits.

Since any personal income by residents will be taxed by additional 6% healthcare insurance tax from 1st of January - residents shall pay 26% total tax on dividends.

VAT

Since start of 2009, value added tax rate has been increased from 18% to 19%. Also preferential rates (5%) for all product groups have been cancelled except for books and non-periodic informational publications (for which it has been raised to 9%). Preferential rate for compensated medicaments and heating shall apply until July and September 2009 respectively.

Preferential VAT rate of 5% for publications (newspapers, magazines) has been cancelled and normal rate of 19% shall apply. However, subscriptions made until beginning of 2009 shall be taxed by old 5% rate.

Personal income tax

Since 1st of January, personal income tax rate has been reduced by 3 percentage points to 21%. This rate shall include 6% healthcare insurance tax – without it personal income tax would be 15%. Previously this tax has not been specified separately.

As before, income from transfer of property shall not be taxed if the property has been held for more than 3 years. Income from sold property shall also not be taxed if a person has lived in it for more than 2 years. If the person has lived less than two years in the property, but the person shall use sale proceeds to acquire new property for living during one year, sale income shall not be taxed.

Most personal income tax exemptions have also been cancelled. It will no longer be possible to use exemptions on interest for acquired real estate, acquired computers and education fees (for second higher degree). Exemption for loan interest on acquired real estate shall continue to apply for loans taken before 2009, however for only one property.

Calculation of non-taxable income amount has also been changed. For persons with income not exceeding 800 Litass per month non-taxable amount shall be 470 Litass. If income exceeds 800 LTL, non-taxable amount shall be decreased by 20LTL for every 100LTL above the 800LTL, meaning that for persons earning more than 3150 Litass per month, non-taxable amount shall not be applied.

Social insurance tax

From the start of 2009, the list of income taxed by social insurance tax has been extended. This tax shall be applied to royalties, remuneration of sportsmen and artists. However rates for these persons shall increase gradually – they will pay reduced rates in 2009 and 2010, while full rates shall apply in 2011. In 2009, for royalties the employer will have to transfer additional 7% to state insurance and the employee an additional 1%.





Our firm this year the same as last year sponsored Swedish "Santa Lucia" concert organized by the Swedish Embassy, featuring "Santa Eugenia Vokalensemble".



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