LAW FIRM
VALTERS GENCS

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TAX & LEGAL NEWS IN LATVIA

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Law Firm Valters Gencs educates schoolchildren about legal professions

Law Firm Valters Gencs takes part in education program to introduce schoolchildren with professions they are interested in. This time our law office was involved in such event in Hansa Primary School on February 27th, 2007. About twenty schoolchildren of grades from 1st to 4th were interested in legal professions such advocate, judge, prosecutor, investigator, notary and other.

The made-up case – 2nd grade girl Evelina made black eye to 3rd grade boy Robert and took away his cellular phone – was examined with great interest. Starting from detailed investigation procedures to find the evidence – witnesses, blood-stains and movie record from camera of near gas station – and finally with court hearing and possible direction of little Evelina to colony for minor lawbreakers. Even possible corruption and necessity for judge to perform ethically was considered. Little ones of the Hansa Primary School proved themselves being the sharp knives in the drawer and abilities to become good lawyers in future.

Tax changes in Latvia 2007

Personal income tax in Latvia is set at 25% flat rate. There been several attemps to introduce progressive tax system but without a sucess untill in the parlament majority is liberal parties. A few years ago corporate income tax was decreased to 15%, however, small enterpreniers felt discriminated with teh requirement to pay 25% personal income tax as owners of the companies would be able to distibute tax free dividends and to have effective tax rate only 15%. Changes passed recenly with 2008 intriduces also reduced flat rate for personal income tax 15% for sole enterpreners, consultants and pro-viders of professional services such as doctors, architects, actors, managment of real property, brokers and engineers.

Exempt income

Amendments in the law On personal income tax (came into force on January 1, 2007) determines to exempt from personal income tax certain individual income.

Income from deposits in banks registered in Europe Economical zone is not taxable, before only income from banks registered in Latvia or EU member states were exempt. Income received as insurance reimbursement which is paid by insurance companies founded in EU or Europe Economical zone countries is exempt. Further, income from EU or Europe Economical zone countries state and municipality securities as well as mortgage bonds is not taxable.

Exempt income is not applicable to non-residents except to EU or Europe Economical zone residents which earns more than 75% of income in Latvia and is not used tax allowances in Latvia or similar allowances in his residence state.

Remuneration for board members

Amendments clarify that income received as a board or council member in Latvian company or European companies (*Societas Europaea)* is taxable without reference if income is paid from Latvian company or company which is not registered in Latvia.

Payments to private pension funds

Payments to EU or Europe Economical zone based insurance companies for health, accident and life (without accrual); not exceeding 10% (but not more than 300 lats) of annual taxable income paid by employer is exempt income. Starting with year 2007 non taxable limit is increased from 180 lats to 300 lats per year.

Corporate income tax

Withholding tax

The law On corporate income tax recent changed provides that withholding tax in amount of 10% should not be withheld from dividends paid to European Economic Zone (EEZ) countries if company receiving dividends owns 15% of capital and voting rights at least 2 years.

Amendments specify that responsibility to withhold tax from dividends rose from public shares paid to non-resident is to holder of security account.

Taxation of securities

Amendments specify rules determining that income from EU and EEZ securities which are in public circulation will not be included in taxable income.

Thin capitalization

Think capitalization rules are not applies anymore to interest paid by for loans, lease to credit institution registered in Latvia, EU or EEZ, as well as Latvian residents.

Receivable dividends

Amendments cancel requirement for resident company to own 10% in company paying out dividends. Taxable income of resident company should not be increased by dividends receivable from EU or EEZ country companies starting from taxation year beginning year 2006. Taxable income of permanent establishment should not be increased by dividends receivable from non-resident companies from EU or EEZ countries.

Group relief

Companies within corporate income tax group are allowed to transfer losses to profitable group companies in this way leveling tax burden. Starting from taxation year beginning year 2006 it is allowed to transfer losses between companies located in Latvia, EU or EEZ. Before, it was allowed to transfer losses only between Latvian resident companies.

Tax relief for donations

Changes in law determine additional criteria when tax relief for donation is not applicable. If receiver of donation provides activities for reimbursement where at the result of these activities donator (or related company, person or relative of donator) gets benefit, tax relief is not applicable.

Latvia: 2006 Year in Review

Significant tax developments in Latvia during 2006 included changes to the penalty regime, new tax holidays, amendments to the rules for interest and bad debts, and an expansion of the tax treaty network.

Tax Penalties

The previous penalty regime was in effect for 10 years. During the mid-1990s, penalty levels were set at 100 percent to 200 percent of the tax owed, plus the refinancing rate. The penalty regime had to be updated to reflect market changes and to introduce more transparency.

The new regime will be implemented in 2007, replacing the high penalties with a system that is more flexible. Fines will be lower, and taxpayers may be able to further reduce them. The initial penalty will be 30 percent if the assessed deficiency is less than 15 percent of the total tax owed. The rate climbs to 50 percent if the deficiency exceeds 15 percent of the tax owed. If the taxpayer has a similar deficiency within the next three years, a 100 percent penalty will apply. The rate jumps to 150 percent for additional violations.

Unpaid taxes, penalties, and late charges must be paid within 30 days, or the tax authorities may initiate insolvency procedures.

Tax Holidays

The rules for Latvia's tax holidays changed in 2006. Previously, companies with domestic investments exceeding LVL 10 million (approximately €14.2 million) over three years could claim an allowance equal to 40 percent of the amount invested.

That program was replaced with a tax rebate for new technological equipment, which operates inconjunction with the depreciation rules. For fixed assets that qualify as technological equipment, the annual depreciation expense is multiplied by a ratio to determine the tax rebate. For 2006 the ratio was 1.5. If the asset is valued at LVL 20,000 and the normal depreciation is 40 percent, or LVL 8,000, the deduction, including the tax holiday rebate, is LVL 12,000 (8,000 multiplied by the ratio of 1.5). The ratio will be lowered each year. The rebate will be available until 2010.

Bad Debts

New tax rules permit taxpayers to write off bad debts as a deductible expense if the bad debt does not exceed 0.2 percent of the company's annual turnover. Taxpayers must show that they attempted to collect the debt and that the estimated cost of recovering the bad debt is as high as the debt itself.

Interest

Latvia's corporate income tax regime now limits the amount of interest expense deductible by businesses. The deduction is the smaller of two figures: 1.2 times the average short-term credit rate set by the Central Statistical Bureau over the last month of the tax year, or the difference between the debt and a multiple (four times) of the company's equity, as measured in the first month of the tax year. The interest rates for 2006 fluctuated for each quarter, ranging from 6.7 percent to 7.8 percent.

The new restriction applies for all types of interest expense, including other payments that have the same economic substance as interest regardless of their legal form.

Personal Income Tax

In 2006 it was debated whether the government should keep the current capital gains exemption for personal income tax purposes. The exemption applies to capital gains from the sale of real property held more than 12 months, and other kinds of property. (For prior coverage, see *Tax Notes Int'l*, Oct. 16, 2006, p. 178.) Also debated was the proposed cut in personal income tax rates from 25 percent to 15 percent.

Dividends received by Latvian residents are not taxed, and the effective tax rate for distributed profits is 15 percent, which reflects the corporatelevel tax. The personal income tax rate is 25 percent, so taxpayers have an incentive to take compensation in the form of tax-free dividends rather than salary.

Tax Treaties

New treaties with Greece and Georgia took effect in 2006, and new treaties with Azerbaijan, Israel, Luxembourg, and Serbia and Montenegro will take effect in 2007. Following Montenegro's split from Serbia in June 2006, the Latvia-Serbia and Montenegro treaty will apply only to Serbia. From a business perspective, Latvia's most significant tax treaties are with Israel and Luxembourg.

7th annual tax seminar "Tax planning 2007" was held on March 7, 2007 in Park Hotel Ridzene jointly with the Swedish Chamber of Commerce. The seminar covered issues of personal, expatriate and company taxation in relation to personal income tax, corporate income tax as well as social fees. The slides for the seminar are available under **www.gencs.lv**

International Tax

On March 6, 2007 the Latvian government adopted amendments to the rules of the Cabinet of Ministers on the procedures for the application of tax relief under international tax treaties for the avoidance of double taxation and the prevention of fiscal evasion. The amendments came into force on March 10, 2007.

1. Tax relief in Latvia

Before the recent amendments only a residence certificate issued in Latvia and confirmed by both the Latvian and the non-resident's state tax authority had to be presented in order to qualify for tax relief in Latvia.

The new amendments determine that tax relief can be applied if the non-resident's state tax authority considers the residence certificate issued in Latvia insufficient, and issues a document with the following information:

- The recipient's name and surname (title for companies), address, passport or registration certificate number and date of issue;
- confirmation from the recipient's state tax authority that the recipient is a resident of that state according to the tax treaty concluded between both countries;
- the taxation year to which issued certificate is related.

The certificate can be issued in foreign languages, but one of the languages should be English.

This certificate is only valid for one year from the moment of issue.

A residence certificate issued in Latvia and confirmed by both tax authorities is valid for 5 years however.

2. Tax relief if non-resident does not have permanent establishment

If a non-resident according to the tax treaty does not have a permanent establishment in Latvia, in order to qualify for any applicable tax relief, the non-resident has to submit an application to the tax authority for a tax relief certificate conferring the right to not register a permanent establishment in Latvia. The certificate application has to be confirmed by the tax authority from the other state. The certificate application has to be submitted to the Latvian tax authority in 3 copies within 10 days of the commencement of business activities in Latvia.
Taking into account previously mentioned certificate application has to be filled and submitted to the tax authority in recipient's state before business activities are started in Latvia that it could be submitted to the Latvian tax authority within 10 days after commencement of activities in Latvia. Latvian tax authority will confirm this certificate application within 30 days after receiving it.

In case if recipient's tax authority does not confirm above mentioned certificate application confirmation part could be substituted by document issued by the recipient's state's tax authority. This document should consist of information mentioned in point 1.

3. Tax relief for pensions

3.1. Pensions for EU member state residents

Tax relief determined in the tax treaties for pensions for EU member state residents, will be assigned only after receiving certificate E202. This certificate confirms residency state for social tax purposes for individuals.

3.2. Pensions for resident of countries with which Latvia has concluded agreement about social security

Latvia has concluded agreement about social security with Ukraine.
Tax relief which follow from social security agreement will be applied after confirmation of residency.

4. Residence certificate for Latvian residents-individuals

If Latvian resident receives income from other country and this income is not taxable or is taxable according to the smaller tax rate, certificate issued by the Latvian tax authority could be used. Certificate contains information that individual according to the tax treaty is resident of Latvia
Certificate is issued according to the registered residence place.

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