

MINISTRY OF FINANCE  
REPUBLIC OF LATVIA

# Tax Reform in Latvia

2017, August



# Reasons for Tax Reform

National Development  
Plan:  
**average annual GDP  
growth of at least 5%**

In 2015, the Gini coefficient  
for Latvia was 35.4, which is  
one of the highest in the  
European Union  
Government Action Plan:  
**to reduce income inequality  
for employees**

Government Action Plan:  
in 2018 the **total amount  
of taxes revenues**  
approaching 30% of GDP

Government Action Plan:  
**the efficiency of the SRS  
increases** – costs for one  
collected euro in 2016 was  
0.0157 euros, in 2018 will  
be 0.0130 euros

Government Action Plan:  
**reduce the size of the  
shadow economy** : from  
23.6% of GDP (2015) to  
21% of GDP (2018)



# Tax Policy Changes as a Complex Solution





# Labor Tax Reform





# Personal Income Tax (PIT) (I)

## 1) Introduction of progressive income tax system (exception - income from capital and capital gains)

Incomes, EUR per year	2017	2018
Bellow 20,000 EUR per year	23%	20%
From 20,000 to 55,000 EUR per year		23%
Above 55,000 EUR per year		31.4%*

\* The third PIT rate (31.4%) will be calculated only in annual tax return, but during a year the tax will be paid as Solidarity tax (rate 10.5%) for revenue above 55,000 euro per year (it will be transferred to PIT revenues as payment for third PIT rate). SSC from incomes above 55,000 euro per year is not be paid.

## 2) Increasing the differential non-taxable minimum

	2017	2018	2019	2020
Maximum differential non-taxable minimum, EUR per month	115	200	230	250
Minimum non-taxable minimum, EUR per month	60	0	0	0
Incomes till which maximum non-taxable minimum will be applied, EUR per month	400	440	440	440
Incomes till which non-taxable minimum according to formula will be gradually decreased, EUR per month	1 100	1 000	1 100	1 200



## Personal Income Tax (PIT) (II)

### 3) Increasing of allowance for dependents

	2017	2018	2019	2020
Allowance for dependents, EUR per month	175	200	230	250

### 4) Increasing of non-taxable minimum income for pensioners

	2017	2018	2019	2020
Non-taxable minimum income for pensioners	235	250	270	300

5) Raising of minimum monthly wage from 380 in 2017 to **430** euro in 2018

6) PIT rate for income from capital and capital gains – 20% (exception – dividends taxed by CIT)



## Social Security Contributions (SSC) (I)

In order to increase financing of health care services from 2018 SSC rate will be increased by 1 percentage point, of which 0.5% for the employer and 0.5% for the employee.

	2017	2018
SSC rate, of it:	34.09%	35.09%
Employer rate	23.59%	24.09%
Employee rate	10,5%	11%

Revenues will be transferred to budget for health care expenditures.



## Solidarity Tax

- is applied to income that exceeds the maximum amount of the object of the State social insurance mandatory contributions (social contributions) – 55 thousand € in 2018
- tax rate is the same as social contributions rate determined by Law On State Social Insurance (Article 18) – in general an employer's rate will be 24.09% and an employee's rate 11% in 2018
- tax revenue (in 2016 and 2017 transferred to state budget as a whole) starting with 2018 shall be transferred to:
  - state budget for financing health care services – 1 percentage point;
  - state funded pension scheme on behalf of payer (2<sup>nd</sup> pillar) – 6 percentage points;
  - pension scheme of the private pension fund on behalf of payer (3<sup>rd</sup> pillar) – 4 percentage points;
  - local government budget and state budget as a part of Personal Income tax – 10.5 percentage points;
  - the rest – state pension special budget as a solidarity input



# Labor Tax Changes Impact on Wage Recipients

Employee without dependents

Gross income, euro per month	Net income in 2017	Benefit (in comparison with 2017)		
		2018	2019	2020
Minimum wage	288 €	+58 €	+64 €	+68 €
600 €	436 €	+20 €	+26 €	+31 €
800 €	571 €	+13 €	+20 €	+25 €
1000 €	705 €	+7 €	+14 €	+20 €
1200 €	841 €	+13 €	+13 €	+13 €
1400 €	979 €	+18 €	+18 €	+18 €
2000 €	1392 €	+22 €	+22 €	+22 €
4000 €	2770 €	+8 €	+8 €	+8 €

Family with two children

Gross income, euro per month	Net income in 2017	Benefit (in comparison with 2017)		
		2018	2019	2020
Minimum wage x 2	657 €	+108 €	+108 €	+108 €
600 € x 2	953 €	+38 €	+63 €	+80 €
800 € x 2	1222 €	+26 €	+51 €	+70 €
1000 € x 2	1490 €	+14 €	+40 €	+60 €
1200 € x 2	1762 €	+27 €	+39 €	+47 €
1400 € x 2	2038 €	+36 €	+48 €	+56 €
2000 € x 2	2865 €	+43 €	+55 €	+63 €
4000 € x 2	5621 €	+15 €	+27 €	+35 €

Non-taxable minimum and allowance for dependents changes

200 € in 2018

230 € in 2019

250 € in 2020

Minimum wage changes

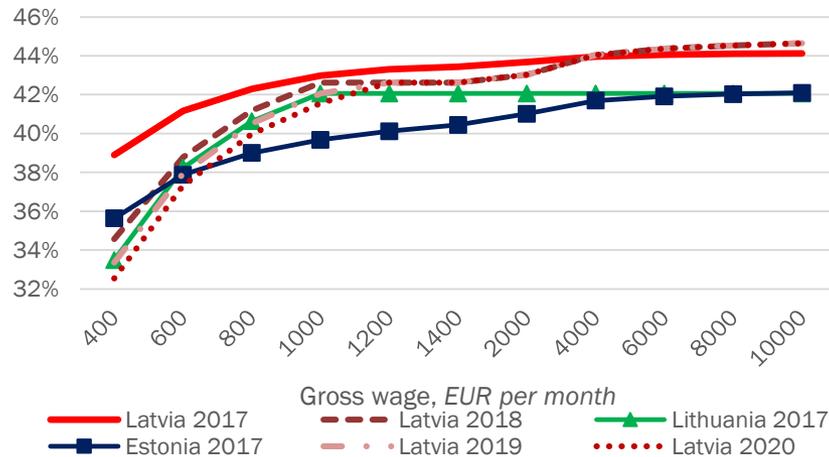
380 € in 2017

430 € in 2018-20

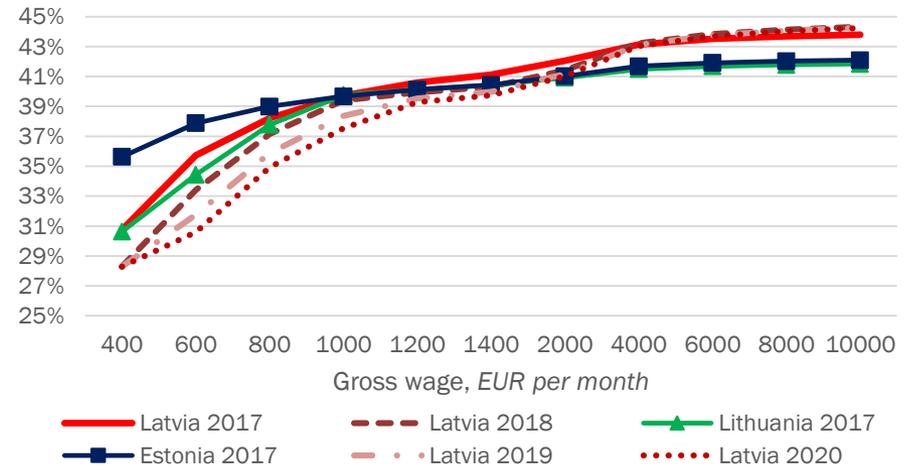


# Labor Tax Wedge in Baltic States

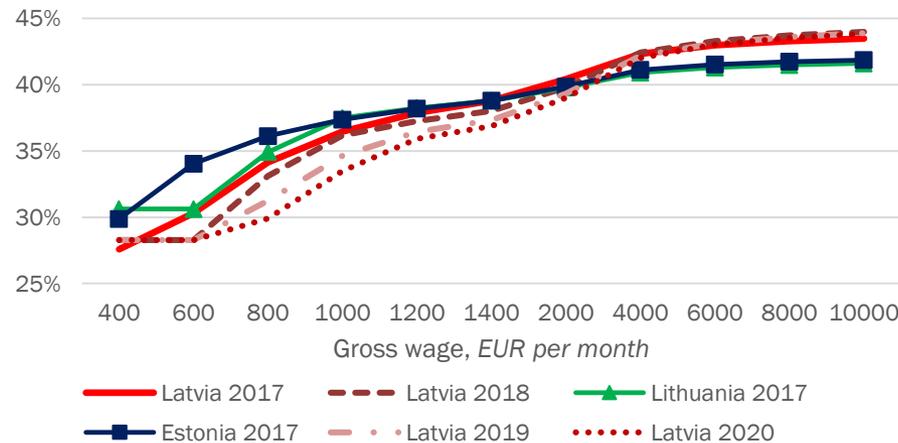
**Tax Wedge**  
(employee without dependants)



**Tax Wedge**  
(employee with one dependant)



**Tax Wedge**  
(employee with two dependants)





# Performers of Economic Activity (I)

**The same progressive income tax system as for labor incomes.**

**Determination of the expenses of economic activity (EA):**

- A taxpayer is entitled to include in the expenses of EA the expenses related to EA in the amount **not exceeding 80%** of the total annual revenue of performer of EA.
- Types of expenses of EA, which may be included in the expenses of EA in full amount:
  - 1) salary and SSIMC of employer, including Solidarity tax (that performer of EA pays for its employees);
  - 2) real estate tax;
  - 3) depreciation of fixed assets;
  - 4) compensation for tenants regarding the release of living premises and the cancellation of tenancy agreements (in relation to the capital repair of living premises or the reconstruction the premises for the performance of EA).
- !!! The amount of limitation of the expenses of EA is not applied to the payers for the first taxation year (registration of EA is carried out) and the next taxation year, as well as for the taxation year, in which EA is terminated or the liquidation process is completed.
- !!! Losses of EA of the taxation year shall be covered in a chronological order from the taxable income of EA of the following three taxation years.



# Performers of Economic Activity (II)

## Determination of depreciation of fixed assets

*Rules from section 13 of the law «On Enterprise Income Tax» shall be integrated in the law «On Personal Income Tax» and in Regulations No.899 issued by the Cabinet.*

### Acquired fixed assets after December 31, 2017:

- depreciation of fixed assets is written off, if its purchase price exceeds **1000 euro**,
- A taxpayer shall be entitled to choose one of two mentioned methods:
  - **reducing balance depreciation** (depreciation of the taxation year in per cent), or
  - **linear depreciation** (productive time in years) method,
- A taxpayer shall be entitled to change the procedure for depreciation chosen not more often than **once in 10 years**.

### Acquired fixed assets until December 31, 2017:

- A taxpayer shall be entitled to choose one of two mentioned methods:
  - continues to apply the procedure for depreciation applied until December 31, 2017 (Section 13 of the law «On Enterprise Income» (in force until December 31, 2017)), OR
  - chooses the above mentioned procedure for depreciation under which **the double amount and coefficient determined for the rate is not applied**.
- A taxpayer shall not be entitled to change procedure for depreciation of fixed assets after choosing one method.



## Performers of Economic Activity (III)

For performers of economic activity and self-employed the SSC rate and object will be determined as follows:

- ✓ if a taxable income exceeds 430 € per month – according to the current procedure, namely, freely determined object of contributions, but not less than the amount of minimum salary (in 2018 – 430 € per month) and rate – current (31,13%) (depending on the status of the self-employed person), but SSIMC in the amount of 5% shall be paid (for pension insurance) for the difference between the freely selected object of contributions and the actual taxable income of economic activity;
- ✓ from the taxable income not exceeding 430 € per month, contributions to NDC scheme (1st pension pillar) shall be made at least in the amount of 5%.

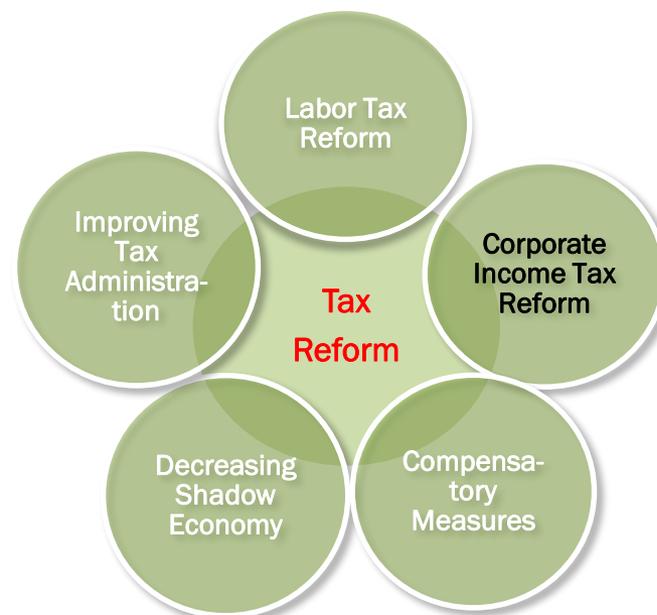


## Recipients of Royalties

- For the recipients of royalties, in addition to the current SSC model (by not reducing current social security), 5% SSC rate from the payers resources (for pension insurance) shall be determined for the royalties, which will be withheld at the moment the royalties is paid out. The amount withheld shall be transfer to the NDC scheme (1st pillar).
- Concerning heirs of copyrights – current procedure remains, namely, SSC are not due.



# Corporate Income Tax Reform





# Corporate Income Tax (CIT)

## Main elements:

- CIT is payable on distributed profits (including deemed profit distributions);
- No CIT is payable on undistributed profits;
- CIT is payable on net amount of expenditures not related to business activity;
- CIT rate is 20% on the gross distributed amount or 20/80 on the net income; In case of dividends distributed to individuals no personal income tax (PIT) apply;
- CIT taxable period is one month.



## CIT base

- ✓ Dividends
- ✓ Liquidation quota
- ✓ Expenses not related to economic activity, incl., expenses for acquisition and maintenance of the representation vehicle
- ✓ Transfer pricing difference
- ✓ Payments made to non-residents, from which CIT was not withheld (if was to be withheld)
- ✓ Doubtful-debts written-off, in case law enforcement measures are not carried out – artificial forgiveness of debts
- ✓ Cession of debts (to related persons or at value not corresponding to the market value)
- ✓ Disproportionate interest payments (thin capitalisation rule)
- ✓ Loan to related persons – deemed profit distribution

# Expenses that are not Related to Economic Activity



Expenses that are not directly related to a taxpayer's economic activity.

✓ Such expenses include:

- expenses for relaxation, entertainment activities for owners or employees and other benefits;
- deductions from profits, turnover or other base quantity – upon a taxpayer's initiative or an order of a shareholder;
- gifts, credits and loans converted to gifts;
- donations;
- value of assets used for other purposes, acquisition costs or remaining value of this asset, maintenance costs of this asset;
- representation and personnel sustainability expenses > 5% of the salary fund of the pre-taxation year, for which state social insurance mandatory contributions made;
- fine, contractual penalties and amounts of deficits or plundering not indemnified, amounts of deficits exceeding limits;
- transactions – evaluated through economic substance over legal form.



# CIT Special Provisions

- Donations to public benefit organizations (PBO)
- Flowing through dividends
- Holding regime
- Representation expenses
- Transition periods
- Investment projects/ special economic zones/ accumulated losses

# Donations to Public Benefit Organisations (PBO)



- ✓ Taxpayer who has donated to PBO\* is entitled to use one of three alternative incentive models:
  - 1) not to include the donated amount in CIT applicable base of the taxation period but not more than 5% from profit of previous reporting year after taxes; or
  - 2) not to include the donated amount in CIT applicable base of the taxation period but not more than 2% from the total gross wage calculated for the employees (with paid state mandatory social insurance contributions) in the previous reporting year; or
  - 3) to decrease CIT which is calculated for the dividends in the reporting year. Decreasing - 75% from the donated amount but not exceeding 20% from the calculated CIT amount for the calculated dividends

\* As well state institutions or to the State capital companies, carrying out the state culture functions delegated by the Ministry of Culture

# CIT- Flowing Through Dividends/ Holding Regime/ Representation Expenses/ Transition period

- Flowing through dividends – the CIT is not applicable, if the income from which the dividends have been paid has already been subjected to CIT or withholding tax.
- Holding regime - the exemption for income from alienation of shares has been maintained, in case if holding lasts for a period of at least 36 months.
- Representation expenses - not subject to CIT, provided they do not exceed 5% of the total gross wage calculated for the employees.
- Transition period – profits made in the previous years (until 2018) are not subject to the new CIT at 20% rate, regardless when such profits are distributed. If distributions are made to individuals, the 10% PIT rate apply during the first two years, and the 20% PIT rate after such transitional period.

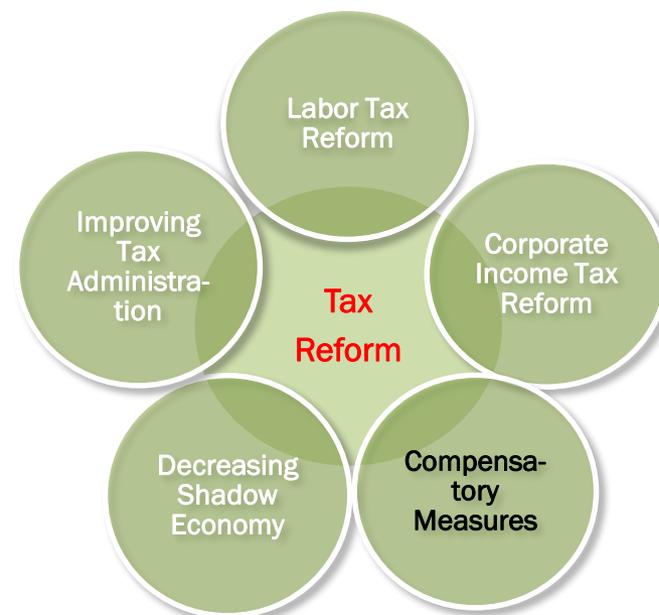


## CIT – Investment Projects/ Special Economic Zones/ Accumulated Losses

- The CIT allowance for Cabinet of Ministers approved investment projects is maintained for projects to be approved within a specified period after their submission.
- The 80% CIT allowance for companies operating in Special economic zones and Freeport's is maintained also under the new CIT regime.
- CIT payable on dividends may be reduced in the amount of 15% of tax losses accumulated in the previous years (until 2018). Such reduction is applicable during the first five years, starting from 2018.



# Compensatory measures





# Compensatory Measures

Increasing PIT rate  
from capital (10/15%  
=> 20%)

Increasing excise  
duties rates

Increasing gambling  
tax rates (30% for  
gaming machines and  
tables; PIT for wins  
over EUR 3,000)

Restriction of MET  
activity (turnover EUR  
100,000 =>  
EUR 40,000)

Restricting PIT eligible  
expenses



# Excise Duty on Tobacco Products

Product	01/07/ 2017	01/07/ 2018	01/07/ 2019	01/07/ 2020
<b>Cigarettes:</b>				
specific tax, per 1000 items	67.0	74.6	78.7	78.7
ad valorem, %	20%	20%	20%	20%
Minimum excise duty level per 1000 cigarettes	99.0	109.2	114.7	114.7

Estonia	Lithuania
01/01/ 2017	01/03/ 2016
63.5	58.68
30%	25%
104.98	85.0

Product	01/01/ 2017	01/01/ 2018	01/01/ 2019	01/01/ 2020
<b>Cigars and cigarillos, per 1000 items</b>	58	73	88	95.20
<b>Smoking tobacco, per 1000 grams:</b>				
fine cut smoking tobacco	62	66	70	75
other smoking tobacco	62	66	70	75
<b>Other tobacco product (tobacco leaves, heated tobacco), per 1000 grams</b>	62	66	70	75

Estonia	Lithuania
01/01/ 2017	01/03/ 2016
211	29.54 (per 1000 g)
71.15	54.16
71.15	54.16
71.15	54.16



# Excise Duty on Alcoholic Beverages

Product	01/03/ 2017	01/03/ 2018	01/03/ 2019	01/03/ 2020
Wine, per 100 litres	78	92	101	111
Fermented products (not exceeding 6 per cent of alcohol content), per 100 litres	64	64	64	64
Fermented products (exceeding 6 per cent of alcohol content), per 100 litres	78	92	101	111
Intermediate products (not exceeding 15 per cent of alcohol content), per 100 litres	78	92	101	111
Intermediate products (from 15 to 22 per cent of alcohol content), per 100 litres	130	150	168	185
Other alcoholic beverages (ethyl alcohol), per 100 litres of absolute alcohol	1450	1670	1840	2025
Beer, per hectolitre/degree of alcohol of finished product	4,5 <sup>1</sup>	6.8 <sup>3</sup>	7.4 <sup>5</sup>	8.1 <sup>7</sup>
Beer, per hectolitre/degree of alcohol of finished product	2,25 <sup>2</sup>	3.4 <sup>4</sup>	3.7 <sup>6</sup>	4.05 <sup>8</sup>

Estonia		Lithuania	
01/02/ 2016	01/07/ 2017	01/03/ 2016	01/03/ 2017
111.98	123.18	77.89	164.67
48.55	77.44	30.96 (till 8.5 %)	65.46 (till 8.5 %)
111.98	123.18	77.89	164.67
239.12	263.03	96.65	185.82
239.12	263.03	136.37	264.52
2172	2389	1352.69	1665.0 4
8.30	15.52	3.36	7.11
4.15	7.76	3.36	7.11

06.09.2017



# Excise Duty on Mineral Oils

Product				Estonia	Lithuania
	01/01/ 2016	01/01/ 2018	01/01/ 2020	01/02/ 2017	01/01/ 2016
Unleaded petrol, per 1000 litres	436	476	509	512	434.43
Leaded petrol, per 1000 litres	455.32	594	594	512	579.24
Diesel fuel (gas oil), per 1000 litres	341	372	414	493	330.17
Kerosene, per 1000 litres	341	372	414	330.10	330.17
Liquefied petroleum gas (LPG), per 1000 kg	206	244	285	193*	304.10
Diesel fuel (gas oil) used for agricultural works, per 1000 litres	50	55.8*	62.1*	133	21

\* From 1 July

\* The excise duty for LPG in Estonia came into force on 01.07.2017.



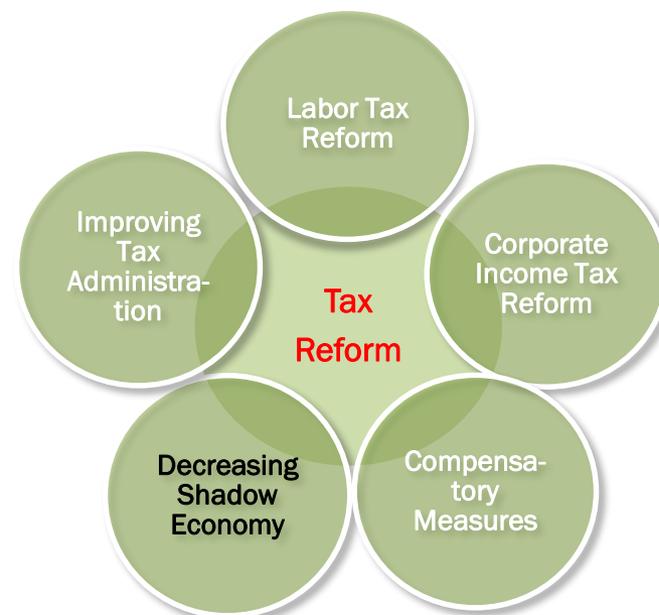
## Eligible Expenses for PIT

By determining the amount of eligible expenses, the percentage, as well as summary limitation of the eligible expenditure shall be applied.

Eligible expenses	Current limitation of expenses	Limitation of expenses as of 1 January 2018
Social security contributions (SSC)	None	None
Solidarity tax	None	None
Contributions to private pension funds	10% from the annual taxable income	Total amount of expenses shall not exceed 10% from the annual taxable income, but not more than 4 000 € for a taxation year
Payments of life insurance premiums	10% from the annual taxable income	
Donations and gifts	Total amount of expenses shall not exceed 20% from the annual taxable income  215 €	Total amount of expenses shall not exceed 50% from the annual taxable income, but not more than 600 € for a taxation year, it is allowed to attribute the educational and medical treatment expenses to the income of the following 3 taxation years
Donations to political parties		
Expenses for the use of educational, medical and medical treatment services by a taxpayer and its family members	215 €, it is allowed to attribute expenses to the following 5 taxation years	
Expenses of authors of works of science, literature and art, discoveries, inventions and industrial models	From 15% to 40%, depending on the type of activity	25% and 50%, depending on the type of activity



# Decreasing of Shadow Economy





# Combating of the shadow economy

2018

Improvement of the supervision of the taxation of individuals by imposing an obligation on credit institutions and payment service providers to provide information on a individual if his account turnover exceeded EUR 15 000 in the previous year

Promoting information disclosure and public participation by publishing information on taxpayers who fail to comply with their statutory obligations

Improvement of the registration stage of commercial companies by limiting the registration of dummy entities in the Enterprise Register

Fine increase of interference in taxes and other payments for the authorization of electronic devices and equipment in the software, as well as distinguishing between responsibility for machinery and equipment control tape failure to store

Introducing a VAT reverse charge mechanism for supplies of construction products, hardware, household electronic appliances, household electrical equipment and game consoles and extension of this mechanism to all construction services

Reducing the threshold for decoding the VAT declaration from EUR 1,430 to EUR 150, only for transactions with registered taxable persons

Disclosure of information on employers who pay average salaries that are lower than state minimal wage

Disclosure of information on employers who are penalized for paying "envelope wages"

Disclosure of information on taxpayers who failed to comply with submitting tax returns on time

Reduction of the VAT registration threshold from EUR 50,000 to EUR 40,000

# Detailed information in the construction industry



**1** Registration of working hours at building sites as of 1 October, 2017



**2** The **COMMON** electronic database will operate as of 1 January, 2019 (the data will be provided by main building contractors and subcontractors)

## Electronic working hours have to be registered:

- On the new building sites of third category
- On the building sites if the costs of constructions exceeds 1 million euro

## The following data to be registered in the electronic system:

- Natural persons, working (on the basis of an employment contract) on the building site
- On the persons staying on the construction site, if they do not have an employment contract)
- on the contract between the main building contractor and the customer



# Combating of the shadow economy

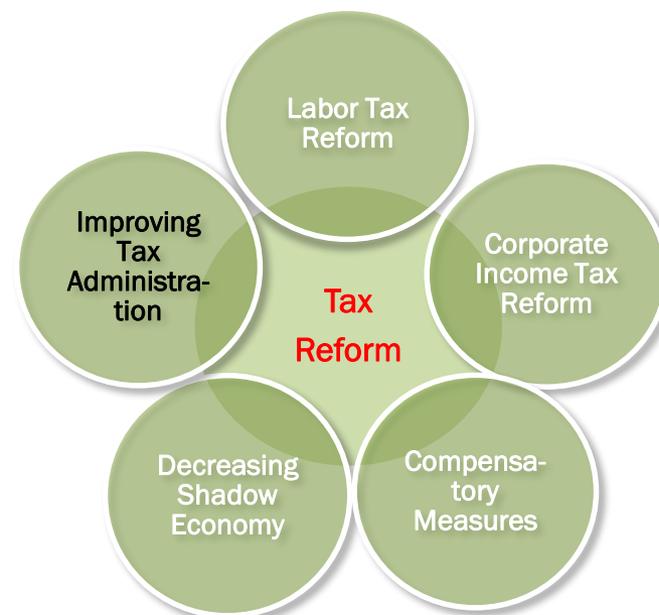
2019

Promoting information disclosure and public participation by publishing a summary of the decision on data compliance or tax audits (audits) for legal entities

Improvement of the tax control process by developing a regulatory framework for the digitization of tax monitoring



# Improving Tax Administration





# The promotion of payment of tax debt

**Purpose** – to alleviate the tax debt burden of the taxpayers, and to increase the budget revenues

## The principal debt to be alleviated

a) in case of a natural person – a tax debt on the date of the application submitted to the State Revenue Service

b) in case of a legal person – a tax debt on 1 June, 2017

- Division the term for the payments of principal debt in instalments for a period of up to 24 months
- Extinguishing of the late payment charge and penalties after paying off the principal debt
- The procedure starts on 1 October, 2017, and ends on 31 December, 2019