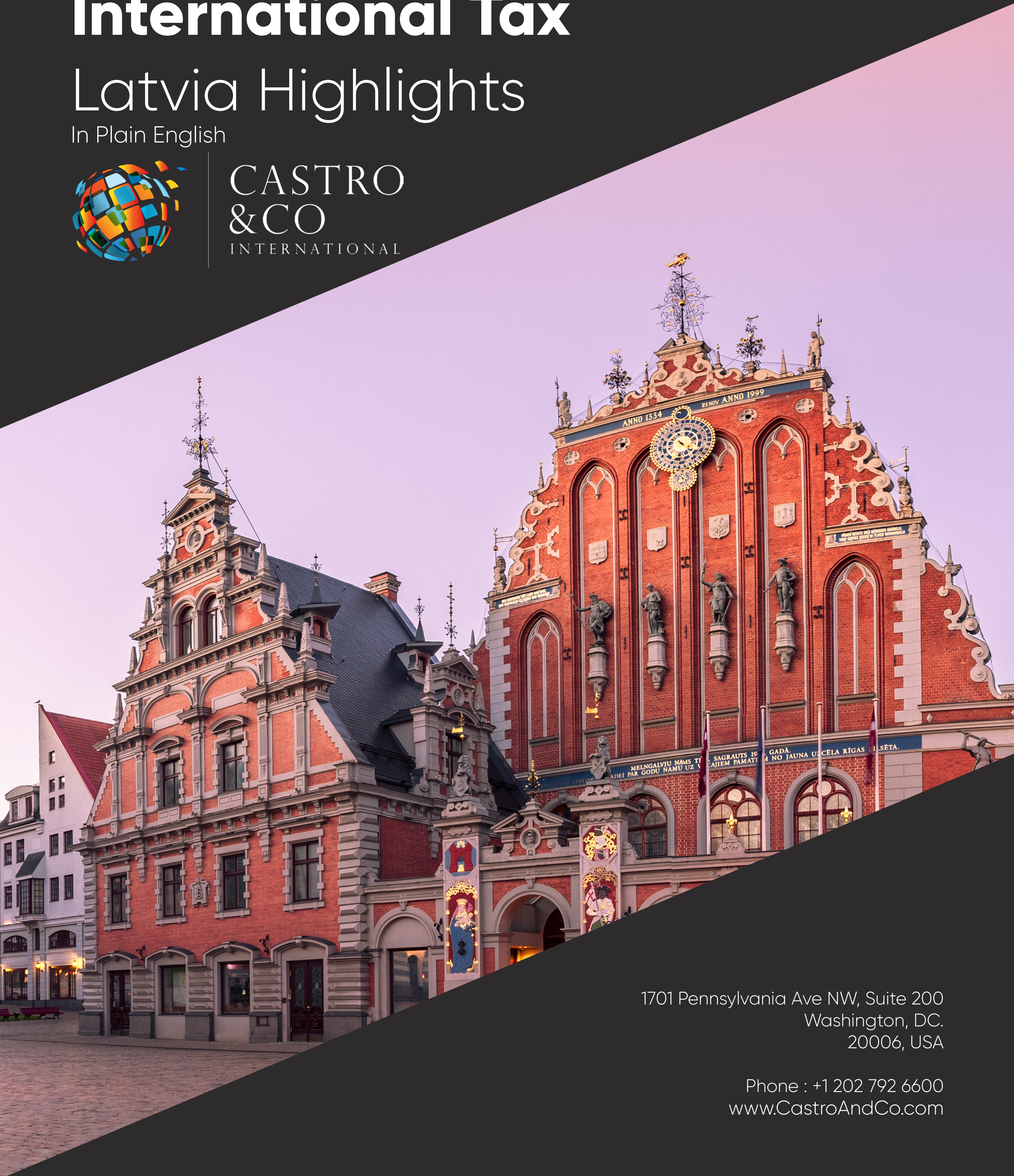
International Tax

Latvia Highlights

In Plain English

CASTRO &CO INTERNATIONAL



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Investment basics:

Currency – Euro (EUR)

Foreign exchange control – No

Accounting principles/financial statements – National standards (following IAS) and IFRS. Financial statements must be prepared annually.

Principal business entities – These are the private limited liability company (SIA), joint stock company (AS), general and limited partnership and branch of a foreign company.

Corporate taxation:

Residence – A company is considered tax resident if it is incorporated in Latvia (i.e. registered in the Company Register).

Basis – Residents are taxed on worldwide income. Nonresidents are taxed only on Latvian-source income. Permanent establishments (PEs) of foreign companies are taxed in the same way as resident companies, although certain restrictions apply to payments made to a head office.

Taxable income – Corporate income tax is levied only when profits are distributed; reinvested profits are not subject to tax.

Profit distributions include declared dividends and interim dividends, payments similar to dividends, hidden profit distributions and deemed profit distributions such as nonbusiness expenses, excessive interest payments, loans made to related parties, transfer pricing adjustments, nonqualifying bad debts and liquidation proceeds.

Taxation of dividends – Dividends and other distributions of profits are subject to corporate income tax at the level of the payer (see "Taxable income," above).

The corporate income tax applies at the time the dividend is declared, and no further tax is due at the time of payment.

Capital gains – Capital gains on sales of property are taxed only when there is a profit distribution. Capital gains from the sale of shares are exempt from tax, provided certain conditions are satisfied (see "Holding company regime," below). A nonresident's income from the sale (or from the contribution into share capital) of real estate located in Latvia, or the sale of a company's shares where more than 50% of its assets consists of Latvian real estate, is subject to a 3% withholding tax.

Losses – Corporate income tax applies only to distributed profits, and any financial losses decrease the distributable amount.

Tax losses accumulated through 2017 can be carried forward to reduce up to 50% of taxable distributed profits through 31 December 2022.

Rate – 20% on the gross amount of the distribution. Certain expenses deemed to be profit distributions (see "Taxable income." above) are subject to tax at an effective rate of 25% on the amount of the expense.

Surtax – No

Alternative minimum tax – An alternative minimum tax of EUR 50 applies.

Foreign tax credit – A foreign tax credit is available for tax paid abroad, but the credit is limited to the lower of the foreign tax paid or the Latvian tax attributable to the foreign income.

Participation exemption – Redistributions of dividends received from resident and nonresident payers will not be subject to corporate income tax in Latvia where the following conditions are satisfied: (i) the payer of the underlying dividends to the redistributing entity pays corporate income tax in its country of residence or the dividends have been subject to withholding tax in the distributing jurisdiction; (ii) the payer is not from a black- list country; and (iii) the dividends are not treated as a tax-deductible expense in the payer's country of residence.

Holding company regime – Capital gains from the sale of shares held for at least 36 months are exempt from tax, provided certain conditions are fulfilled. The exemption does not apply to capital gains from sales of shares of companies located in black-list jurisdictions.

Incentives – A rebate of up to 80% of corporate income tax on profit distributions and real estate tax is available for licensed entities located in special economic zones and free ports. The rebate has been approved as compatible with the EU state aid rules.

Start-up companies are entitled to make fixed monthly payments equal to two minimum compulsory state social insurance contributions per employee, instead of paying full payroll taxes. Start-up company status is granted by a state-formed commission according to criteria specified in the legislation.

Withholding tax:

Dividends – Latvia does not levy withholding tax on dividends, except for dividends payable to persons resident in black-list jurisdictions, which are subject to a 20% withholding tax.

Interest – Latvia does not levy withholding tax on interest, except for interest payable to persons resident in black-list jurisdictions, which is subject to a 20% withholding tax.

Royalties – Latvia does not levy withholding tax on royalties, except for royalties payable to persons resident in black-list jurisdictions, which are subject to a 20% withholding tax.

Technical service fees – Latvia does not levy withholding tax on technical service fees.

Branch remittance tax – No

Other – Consulting and management fees paid to a nonresident company are subject to a 20% withholding tax, unless the rate is reduced under a tax treaty.

Withholding tax is payable at the time the payment is made.

Other taxes on corporations:

Capital duty – No

Payroll tax – Employers are required to withhold personal income tax and remit the amount to the tax authorities on a monthly basis. The following rates apply:

20% on income up to EUR 20,004 per year; 23% on income over EUR 20,004 per year; and 31.4% (consisting of personal income tax and solidarity tax) on income over EUR 62,800 per year. The above brackets are multiplied by 1/12 to calculate the amount to be withheld from monthly income.

Real estate tax – The local authorities levy a real estate property tax, in an amount equal to 1.5% of the cadastral value of land and buildings. A 3% tax is levied on agricultural land not in use.

Social security – Employment income is subject to social security contributions at a rate of 35.09% of an employee's gross salary (24.09% as the employer's portion, and 11% from the employee's salary). The contributions must be paid on monthly basis and reporting requirements apply. Nonresident employers must register with the tax authorities or, in certain situations, authorize employees to register and settle payments on behalf of the foreign employer. The amount of annual income subject to social security contributions is capped at EUR 62,800, but income above the threshold is subject to solidarity tax at 25.5% (borne partly by the employer and partly withheld from the employee's salary).

Stamp duty – Stamp duty is levied on registration of real estate by a legal entity. The rate is 2% of the higher of the sales price or the cadastral value. No duty applies on reorganizations and a 1% rate applies to contributions in kind.

Transfer tax – No

Other – If an employee's salary exceeds the social security cap of EUR 62,800, the excess is subject to solidarity tax, which applies at the same rates and according to the same principles as social security contributions.

Anti-avoidance rules:

Transfer pricing – Latvia's transfer pricing rules generally follow OECD transfer pricing guidelines. Transfer pricing documentation requirements apply to Latvian corporate taxpayers as set out below.

Mandatory preparation of a master file (without submission) is required if the total annual value of related party transactions exceeds EUR 5 million. The master file must be submitted to the tax authorities where (i) annual turnover exceeds EUR 50 million and the total value of related party transactions exceeds EUR 5 million or (ii) the total value of related party transactions exceeds EUR 15 million.

A local file must be prepared where the total annual value of related party transactions exceeds EUR 250,000 and submitted to the tax authorities where such transactions exceed EUR 5 million.

A taxpayer must retain documentation substantiating the arm's length nature of a transaction for five years, and the documentation must be provided to the tax administration within one month following a request or annually if the relevant thresholds are met.

Penalties of up to 1% of the value of related party transactions for which the taxpayer is obliged to prepare transfer pricing documentation may be imposed for significant violations of the transfer pricing documentation preparation or submission requirements, capped at a penalty of EUR 100,000 per transaction.

Latvia has adopted country-by-country reporting requirements.

Thin capitalization – Under the thin capitalization rules, interest payments are included in the taxable base where (i) the debt:equity ratio exceeds 4:1 or (ii) the interest payment exceeds both EUR 3 million and 30% of EBITDA (earnings before interest, tax, depreciation and amortization). The inclusion in the taxable base is the larger amount resulting from these two calculations.

Thin capitalization rules do not apply to interest payments made to EU/European Economic Area (EEA) credit institutions or to credit institutions resident in a country that has concluded a tax treaty with Latvia, or for EU/EEA public debt securities.

Controlled foreign companies – A controlled foreign company (CFC) regime is introduced as from 1 January 2019, in accordance with the EU Anti-Tax Avoidance Directive. An entity is treated as a CFC where a Latvian taxpayer either alone or together with its associated enterprises holds a direct or indirect participation of more than 50% of the capital or voting rights or is entitled to receive more than 50% of the profits of the entity. A PE always is treated as a CFC.

The Latvian taxpayer must include in the tax base undistributed income of the CFC arising from artificial arrangements that have been entered into for the essential purpose of obtaining a tax advantage.

An arrangement or series of arrangements is regarded as artificial to the extent that the entity or PE either would not own the assets or would not have assumed the risks necessary to generate the income if it were not controlled by a company that conducts the significant executive management people functions relevant to those assets and risks.

The CFC rules do not apply if the CFC's profit does not exceed EUR 750 000 and the income derived other than from the sale of goods and services does not exceed EUR 75,000.

Disclosure requirements – No

Other – A 20% withholding tax is imposed on payments to entities located in black-list jurisdictions (see "Withholding tax," above), although exemptions may be possible for acquisitions of goods and EU/EEA public bonds.

Compliance for corporations:

Tax year – Calendar month and financial year

Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

Filing requirements – The tax return must be filed on a monthly (or in some cases, quarterly) basis by the 20th day of the following month. The tax also is due before the 20th day of the following month (or quarter, where applicable).

Penalties – Interest of 0.05% per day is imposed for the late payment of tax. Fines may be charged as a result of a tax audit, in the range of 10% to 300% of the tax due.

Rulings – Advance rulings and advance pricing agreements (APAs) may be obtained from the tax authorities to ascertain their opinion on the application of tax and transfer pricing rules. Advance rulings are binding only on the tax authorities; APAs are binding on both the taxpayer and the tax authorities.

Personal taxation:

Basis – Resident individuals are taxed on worldwide income; nonresidents are taxed only on Latvian-source income.

Residence – An individual is resident in Latvia if his/her permanent place of residence is in Latvia or if he/she is present in Latvia for 183 days or more in any 12-month period, starting from the date of arrival in Latvia.

Filing status – Each individual must file a return; joint filing for spouses is not permitted.

Taxable income – Taxable income includes income from employment, income from the exercise of a business and investment income.

Capital gains – Gains on the sale of an individual's capital assets (real estate, shares, etc.) are subject to a 20% tax. Gains on the sale of a private residence may be exempt. A nonresident individual's income from the sale (or from the contribution into share capital) of real estate located in Latvia, or the sale of a company's shares where more than 50% of the company's assets consist of Latvian real estate, is subject to a 3% withholding tax.

Deductions and allowances – Minor deductions and allowances are granted.

Rates – The following rates apply: 20% on income up to EUR 20,004 per year; 23% on income over EUR 20,004 per year; and 31.4% (consisting of personal income tax and solidarity tax) on income over EUR 62,800 per year. Capital gains and other income from capital are taxed at a 20% rate.

Other taxes on individuals:

Capital duty – No

Stamp duty – Stamp duty at 2% is levied on the higher of the sales price or the cadastral value when real estate is registered in the land register. Stamp duty also is levied on the registration of a mortgage.

Capital acquisitions tax – No

Real estate tax – The local authorities levy a real estate property tax equal to 1.5% of the cadastral value of land and buildings. The rate on residential property not used for commercial purposes ranges from 0.2% to 0.6%. A 3% tax is levied on unused agricultural land.

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – An 11% social security tax is withheld from employment income; the rate for self-employed persons is 32.15% (with the minimum base being EUR 430 per month). A nonresident individual employed by a nonresident employer for more than 183 days in a 12- month period (where the EU social security regulations does not apply) and who does not permanently reside in Latvia is subject to social security contributions at a rate of 32.72%.

Compliance for individuals:

Tax year – Calendar year

Filing and payment – The annual income tax return is due by 1 June following the tax year. The tax is due within 15 days after the tax return is submitted, but the actual tax payment may be divided into three installments. Tax on capital gains is paid on a quarterly or an annual basis. Wage tax, social security contributions and some of the tax on income from capital is withheld at source.

Penalties – Interest of 0.05% is imposed daily on late payments. Fines may be charged as the result of a tax audit, in the range of 10%-300% of the tax due.

Value added tax:

Taxable transactions – VAT is charged on supplies of goods and services, intra-Community acquisitions of goods and services and importation of goods and services. The general rules are in line with EU VAT directives.

Rates – The standard rate is 21%, with a reduced rate of 12% or 5% applying to certain goods/services. Some items are zero-rated, and others are exempt (e.g. financial and insurance services).

Registration – Persons whose taxable supplies (excluding imports) exceed EUR 40,000 in a 12-month period must register for VAT purposes. A foreign person engaged in business in Latvia is required to register on or before the date of the first taxable supply.

Filing and payment – The taxable period generally is the calendar month, although it may be quarterly for taxpayers with lower turnover. Returns must be submitted and tax paid by the 20th day of the month following the taxable period.

Source of tax law: Law on Taxes and Duties; Corporate Income Tax Law; Law on Personal Income Tax; Value Added Tax Law; Law on State Social Insurance; Regulations of the Cabinet of Ministers

Tax treaties: Latvia has concluded 62 tax treaties. Latvia signed the OECD multilateral instrument on 7 June 2017.

Tax authorities: State Revenue Service