TAXWISE

Doing Business Guide

Latvia 2015

www.taxwise.lv

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General information

WHY LATVIA

Facts and figures

Geography

The Republic of Latvia is located on the eastern coast of the Baltic Sea at the crossroads of northern and eastern Europe. Latvia has land border with Estonia (~343 km) in the North, Russia (~276 km) in east, Belarus (141 km) in south-east, Lithuania (453 km) in South and maritime border with Sweden on West. Latvia's total coast lane is 498 km. Latvia has three large ports – Liepaja, Riga and Ventspils which are ice-free also in winter and seven smaller ports distributed along all coast border – Skulte, Mersrags, Salacgriva, Pavilosta, Roja, Lielupe and Engure. These smaller ports are with regional importance by mainly operating with timber export and sea product import. Riga and Ventspils ports operates as a tax-free zones, Liepaja is part of the special economic zone (SEZ). All these ports are linked with railroad and highway networks leading to any further desired direction. Latvia's climate is maritime continental. Country territory covers 64,589 km^2 and is populated by 1,986.1 thousand (at the beginning of 2015). Capital of Latvia is Riga located in centre of country at coast of Riga gulf.

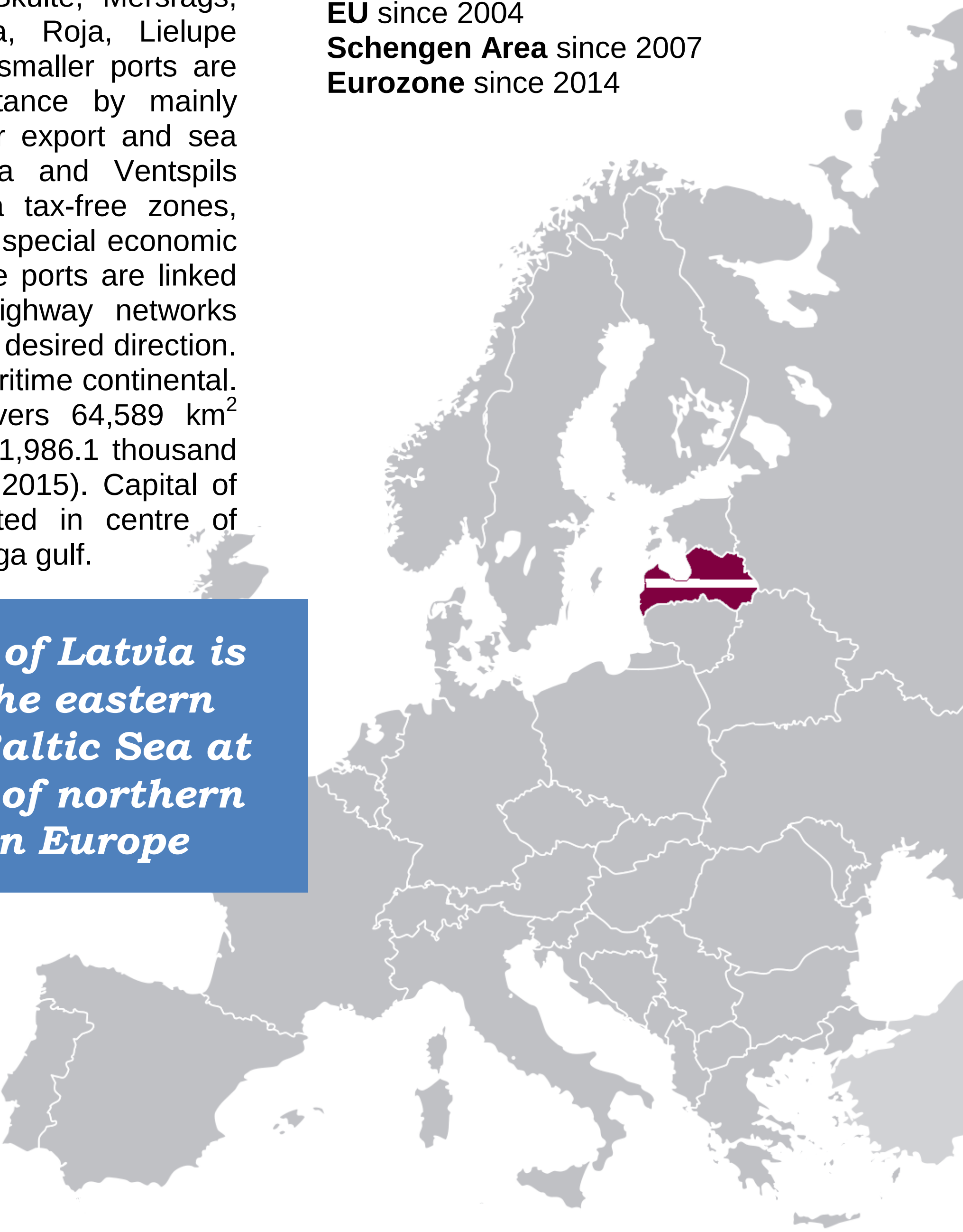
The Republic of Latvia is located in the eastern coast of the Baltic Sea at a crossroads of northern and eastern Europe

Governing

Political system:
Parliamentary republic
Capital:
Riga
Head of State:
President Mr. Raimonds Vejonis
Head of Government:
Prime minister
Ms. Laimdota Straujuma

Membership

WTO since 1998
NATO since 2004
EU since 2004
Schengen Area since 2007
Eurozone since 2014



Currency

As of 1 January 2014 Latvia has joined Eurozone and adapted to euro (EUR) as its national currency.

Language

Latvia has one official language: Latvian. However most of Latvian inhabitants know other languages such as English, Russian and German. Latvia's approximate structure of inhabitant language knowledge is as follows:

- Over 85% of Latvians speak Russian
- 70% of people under 40 speak English
- German, French and Scandinavian languages are also widely spoken

Business infrastructure

In Latvia there are plenty of options for infrastructure to choose from.

- With 3 ice free ports (and 7 small ones)
- Railway from West to East and from North to South reaching every region
- Airport connection to 80 destinations
- Available telecommunications in whole Latvia's territory as well as electricity and water supplies
- There is also a gas pipeline connected to several reservoirs in Latvia for transit and storage of Russian oil and gas resources

Government and Politics

Latvia is an independent democratic republic. The sovereign power of Latvia belongs to people who are represented by a unicameral parliament (Saeima) with 100 members elected for a four-year period. The Saeima elects the President for a term of four years.

The Cabinet of Ministers is the highest executive body of the country. The Cabinet of Ministers is formed by people who are invited by the President.

Incentives for investors

Taxes

To optimize taxes of your business in Latvia you have opportunities to use Special Economic Zones, Holding Company Regime, loss carry forward, deduction of corporate income tax for large investment projects and beneficial depreciation ratio for new technological equipment.

Labour Related Incentives

There are agencies that help with vacancy registration and employee selection.

Procedure for pre-hiring training that predicts up to three month probationary period before hiring to assure candidate adequacy for position.

Employee qualification

Available courses for raising employee knowledge in particular sphere and teach new skills in terms of methods, tools and passing experience.

Funding options

For development and starting a new business there are several business incubators available.

Substantial financing grants are available in variety of key business activities including: vocational and other training, innovation, R&D. Value-added manufacturing and technology /knowledge transfer.

Latvia has four separate Special Economic Zones (three ports and one inland).

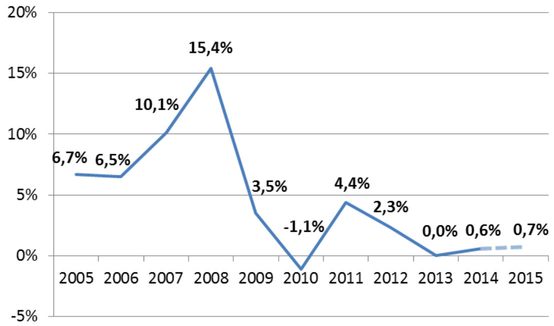
Economic indicators

To obtain impression about overall processes of Latvian economy from recent years and get an insight where it is going, we offer to look at the two main economic indicators: **Inflation rate** which directly affects value of unit earn in Latvia and **Gross Domestic Product (GDP)** what shows an overall direction of economy.

We offer to look at both of these data trends from year 2005 to completely cover recent economic crisis.

Inflation rate

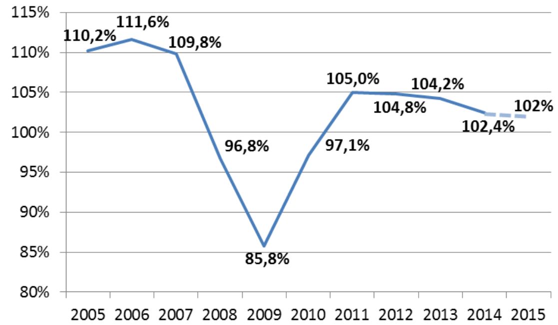
Average annual inflation rate in Latvia, % change from previous year



Up to year 2006 the economy was stable, but from 2007 the rapid increase of inflation started, which was synchronized with the global world crisis. By reaching its highest increase in 2008, it was followed with a drop of demand in the markets which made prices to drop by 1.1% in 2010. Since year 2011, after market equalized between the price and actual demand, Latvia has returned to steady growth of 0% – 4.4% annually. It is forecasted that in 2015 average prices will increase by 0.7%.

Gross Domestic Product

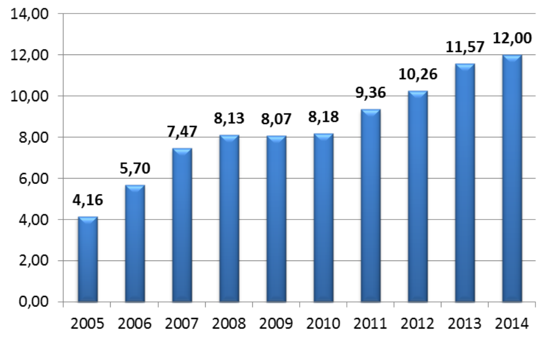
GDP growth rate, % change from previous year (previous year = 100%)



Up to year 2007 GDP grew steady, with approximately an annual 10% growth. Starting from 2007 GDP had huge decrease which lasted for the three consecutive years, with the biggest decline in 2009 – up to 85.8% in comparison to 2008. It only levelled back to steady growth from year 2011, with an annual growth rate 2.4% – 5% till 2014. It is forecasted that in 2015 GDP will continue to grow by 2%.

Foreign direct investment

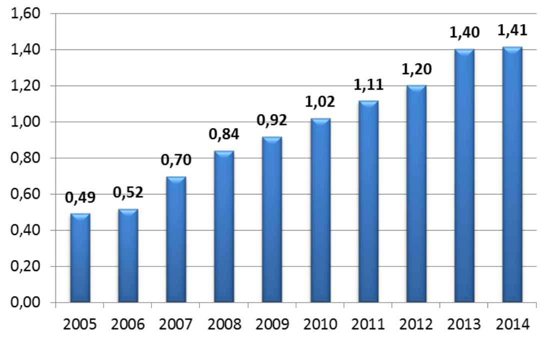
Total FDI in Latvia 2005-2014, Billion EUR



Latvia is a full member of the EU, European Economic Area (EEA) and Eurozone, what means there is free movement of capital without any restrictions and limits.

Latvia as development economy is attractive place for investments, with the main factors that are contribution to FDI inflow, such as, stable monetary policy, geographic location (between the EU and CIS countries) and well-developed infrastructure. Over recent years choice of investing in Latvia has only increased in numbers from 4.16 billion EUR back in 2005 to almost three times higher capacity of 12 billion EUR in 2014.

FDI in Latvian manufacturing industry (C) 2005-2014, Billion EUR



Historically, most of FDI flows had come from the EU Member States and Russia.

One of largest investors is Sweden which excels with its bank systems and impact on overall Latvian financial sector containing EUR 2.52 billion of all investments in 2014.

One of the most important sectors in Latvia is a manufacturing sector, which similarly increased three times from 0.49 billion EUR in 2005 to 1.41 billion EUR in 2014. Over the recent years, from 2005 till 2014, FDI in manufacturing accounted for approximately 9%-12% from total FDI in Latvia.

Largest Industries and economical sectors

In Latvia four leading manufacturing sub-industries has increased from year 2013 to 2014 – wood and wood product manufacturing increased by 7%, food product manufacturing by 2%, fabricated metal product manufacturing by 2% and non-metallic mineral product manufacturing by 1%. Negative impact on the manufacturing industry was left by the decline in the sub-industries, such as, manufacturing of machinery, equipment repair and installation services declined by 25%, manufacturing of apparel by 17% and in manufacturing of beverages by 11%.

In 2014 there was an increase in retail trade – by 4%, which includes the increase in the retail trade of automotive fuel – by 6%.

The construction industry in 2014, by comparison to 2013, has increased by 8.1%. This growth was mostly affected by the increase in – highway, street, road and railway construction, which increased by 21%, construction of residential buildings by 31%, construction of educational institutions by 88% and construction of industrial buildings and warehouses by 9%. The decline in sub-industry was mostly in the construction of main pipelines, communication and power lines, which decreased by 22%.

Increase in the cargo turnover contributed to the rise of the transport industry in 2014, i.e. by 7% in automotive and by 5% in sea transport sub-industries. Sub-industry of passenger transport by road remained at the level of the year 2013.

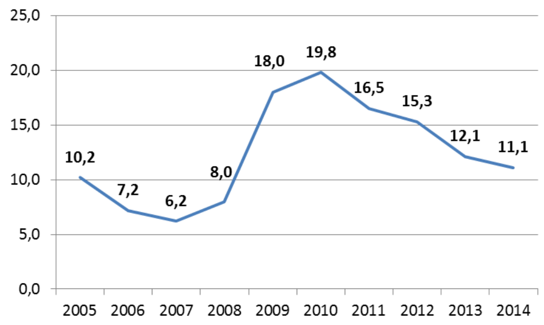
Changes of GDP in 2014 by industry

Industry	Industry structure at current prices, %	% change from previous year (2013) at constant prices
Wholesale and retail trade (G)	14.0%	+2.2%
Real estate activities (L)	12.9%	-0.7%
Manufacturing (C)	12.2%	-0.3%
Transportation and storage (H)	9.6%	+3.2%
Commercial services (MNS)	9.1%	+1.4%
Construction (F)	6.7%	+8.1%
Information and communication (J)	4.7%	+1.3%
Financial and insurance activities (K)	4.3%	+4.7%
Other manufacturing (BDE)	4.2%	-2.5%
Other industries	22.3%	n.a.

Employment market

According to official statistics, at the 2nd quarter of 2015 the number of people employed was 870,800 (age 15-64) and unemployment rate was 9.9%. The level of unemployment varies greatly between regions (with higher unemployment on east side and lower in the capital – Riga).

Unemployment rate in Latvia 2005-2014 (age 15-64), %



In Latvia minimum monthly wage is determined by law – EUR 360. The average monthly gross wage in 2014 was estimated to EUR 765.

In 2014 the majority of workforce operated in the industry of trade, accommodation and food service activities (G, I) 18.3% of total persons employed and in the manufacturing, mining and energy industry (B, C, D, E) 15.6% of total persons employed.

Employment regulations and laws

Employment relationships are mainly governed by the Employment Code (*Darba likums*). There are special laws enforcing rules for labour conflicts, trade unions and employers' organizations, as well as collective employment.

According to the Employment Code, an employment contract has to be written. However, a non-written contract will be considered in force if at least one party has fulfilled the provisions of the contract. Some mandatory conditions, like working hours and salary, have to be included in the provisions of the contract.

State Labour Inspectorate

The State Labour Inspectorate (*Valsts darba inspekcija*) is authorized to supervise employment relationships and the safety of labour and the industry equipment.

Business Entities

Broadly, a foreign investor should select between limited liability company, public limited company, branch (permanent establishment) or representative office. However, the limited liability company is the most preferred for the business activity and representative office is used if the foreign entity carries out only auxiliary activities in Latvia.

Limited Liability Company (LLC)

LLC ('SIA' in Latvian) is a private limited liability company, which is the most commonly used form of business in Latvia. Share capital can be paid in cash or contributed in kind. The minimum share capital value is EUR 2,800 and at least a half of it has to be paid in cash. Until applying for registration in the Register of Enterprises at least a half of the share capital has to be paid, the remaining part must be paid within one year's time from the date the company has been registered in the Register of Enterprises.

Limited Liability Company with reduced share capital

Limited Liability Company with reduced share capital is a company whose share capital value is between EUR 1 and EUR 2,799. Before applying for registration share capital has to be signed and paid, in addition, until applying for the company registration it must be paid up in cash.

The company must meet the following requirements of the Commercial Law:

- The number of founders of the company should not exceed five individuals
- The number of shareholders of the company should not exceed five individuals
- The board of directors should consist of one or more members, and they all have to be shareholders of the company
- Each shareholder can be only a member of a single limited liability company with reduced share capital

Every year limited liability company with reduced share capital should create a minimum reserve by making a deduction of at least 25 % of the year's net profit. The statutory reserve, based on shareholders meeting can be used to:

- Increase the share capital
- Cover losses of annual report, if they are not covered by the previous annual report
- Cover losses of previous financial year if they are not covered by the annual report

Public Limited Company (Joint-stock company)

Public limited company ('AS' in Latvian) is a public company and its shares can be publicly-traded. Share capital of a public limited company cannot be less than EUR 35,000. If the share capital is set above EUR 35,000, then by applying for registration the entire share capital has to be signed, but the paid up share capital has to be not less than the statutory minimum share capital (EUR 35,000) and not less than 25 % of the signed share capital (the rest is paid up no later than in one year's time from the date of signing the Founding Agreement).

NB! The public limited companies, depending on the type of their activity, have different minimum amounts of share capital (for example, the financial sector (banking, insurance, non-bank lending)).

Residence permits

According to amendments to Immigration Act, foreign investors may apply for a Latvian temporary residence permit for the period up to 5 years.

The following advantages and benefits foreign investors obtain by having Latvian temporary residence permit:

- Freedom of movement within the Schengen Agreement Member States (no need to obtain a visa of Member State to travel)
- Latvian temporary residence permit does not require for a person to reside permanently or to reside for a certain period of time during the calendar year in comparison with the other Members of Schengen area
- Temporary residence permit for investors is valid up to 5 years (restored annually)
- Investor's family (spouse, minor children and wards) are also eligible to obtain temporary residence permit
- Favourable economic environment – secure banking system, labour (able to speak Russian and/or English), infrastructure for business development and management to both West and East from Latvia

Investor may apply for a temporary residence permit for a period **up to 5 years** if:

(1) He/she has acquired and owns one or more properties located in the Republic of Latvia with the total value of the transactions not less than EUR 250,000 if following conditions are met:

- He/she does not owe and never had real estate tax debts
- The transaction value has been paid up by non-cash payment
- The property has been acquired from Latvian legal entity, which is registered in Latvia, EU, EEA or the Swiss Confederation, or individual, which is a Latvian citizen, Latvian non-citizen, EU citizen or a foreigner with a valid Latvian residence permit
- By the time of acquisition the total cadastral value of the purchased properties is not less than EUR 80,000. In case total cadastral value is less than provided above, the total value of properties market value should not be less than EUR 250,000, which is determined by certified real estate expert
- He/she, upon requesting the first temporary residence permit, pays five percent of the property's value in to the State budget
- Property does not contain agricultural or forest land

(2) He/she has contributed into share capital of Latvian entity by increasing it or the contribution has been made upon establishment of Latvian entity and it is at least:

- EUR 35,000 given that entity employs no more than 50 employees, annual turnover or value of the assets does not exceed EUR 10 million and in the financial year pays altogether not less than EUR 40,000 in taxes to state and municipal budget
- EUR 150,000 given that entity employs more than 50 and annual turnover or value of the assets is more than EUR 10 million

(3) He/she has subordinated liabilities with a credit institution of the Republic of Latvia in the amount of not less than EUR 280,000 and the term of the transaction entered into with such credit institution is not less than five years and, upon requesting the first temporary residence permit, he/she pays EUR 25,000 into the State budget.

(4) He/she purchases interest-free State securities dedicated to a specific purpose with the nominal value EUR 250,000 and pays EUR 250,000 into the State budget.

Corporate income tax rate

The relatively low rate of corporate income tax (15%) makes Latvia attractive as a country for setting up a HC as only very few countries in EU provide lower rate.

Holding Companies

Latvia has already been selected by a number of multinationals groups as a location for their shared service centres (finance, IT, back-office functions) due to certain non-tax attributes (location in EU, available English speaking labour), and mainly due to the fact that it is considered as being far-less expensive location if compared with more developed economies. To create Latvia's recognition as a location for Holding Company (HC), Latvian parliament has passed substantial amendments into corporate tax legislation aiming to compete with other commonly known Holding Companies jurisdictions in Europe.

Latvian Holding Company regime applies fully as from 2014. It is simple, with low compliance costs, easy to manage and does not require complex planning. This article will summarize the key tax and non-tax attributes that Latvia can provide and which are important when considering potential locations for a Holding Company.

HC is usually defined as a company that owns shares in other company or companies. HC's are often used by multinational groups to centralize the management function, to improve the treasury management (e.g. via cash pooling and allocation of profits) or to hold important assets (e.g. trademarks, licenses, and similar property). HC can also be a key component to increase a company's tax efficiency and, in fact, usually the tax benefits are considered as a decisive factor for creating a HC. Thus the investors decision is usually based on the set of tax and other considerations.

A "Wish List" of an attractive location for a HC usually includes the following tax- attributes:

- Low corporate income tax rate
- Access to strong network of double tax treaties and EU Directives
- No income tax on dividends, interest and royalties received by HC
- No income tax on capital gains
- No withholding tax (WHT) on dividends, interest and royalties paid to a HC
- No WHT on outgoing dividends, interest and royalties paid by HC
- No local stamp duties, capital duties or similar taxes
- Anti-haven rules
- Tax efficient exit

As from 2013/2014 Latvia's tax laws provide most of these tax attributes as discussed further.

Corporate income tax rate

The relatively low rate of corporate income tax (15%) makes Latvia attractive as a country for setting up a HC as only very few countries in EU provide lower rate.

EU directive and double tax treaties

Under the terms of the EU parent/subsidiary directive, if a HC owns at least 10% of capital of another EU company, no WHT is levied on dividends paid by the subsidiary to its parent company. To qualify for the exemptions provided by the EU directives, tax residence in EU is required. Companies should be subject to taxation in their jurisdiction and should agree with the legal form as prescribed for each country.

Currently, Latvia has concluded 58 double tax treaties (DTT), with another 12 in approval process, which provide favourable WHT rates on payments made by entities outside EU. Most of the DTT ensures that WHT levied by the subsidiary does not exceed 5% on dividend payments provided that Latvian HC owns at least 25% of capital of another company. The WHT rate on interest payments made to Latvian HC shall not exceed 10% based on provisions of DTT, while WHT on royalties are limited to 10%.

Tax credit in Latvia can be claimed on foreign WHT suffered via reduced tax payments in Latvia.

Income tax on dividends, interest and royalties received by Latvian HC

Since the main purpose of the HC is improvement of capital flow, the most important tax issue is availability of participation exemption (i.e. tax free dividends) rules. As from 1 January 2013 all dividends are exempt from taxation in Latvian HC but with the exception of dividends received from entities in tax haven countries which are subject to 15% corporate income tax. To apply exemption there are no restrictions on minimal shareholding or a holding period or shareholding.

Capital gains

Gains on the disposal of shares are exempt from corporate income tax. If loss is incurred upon sale, it will not be deductible. To apply exemption, there are no restrictions on minimal holding period or shareholding. The exemption, however, does not apply on gain from sale of shares in entities located in tax haven countries. The latter gains are subject to regular corporate income tax rate at 15%.

Similarly, gains on disposal of securities quoted on the regulated markets of the EU or EEA countries and investment certificates in EU and EEA open-end investment funds are exempt from taxation in Latvia. Thus Latvian company could be used for trading of such securities as a profit from such activities is exempt from taxation in Latvia.

Gains on the disposal of other investments are taxed at regular corporate income tax rate of 15%. Thus it is recommended that such assets are disposed via sale of shares.

Repatriation of profit

To create an attractive tax regime in Latvia, WHT on payments made by Latvian entities are gradually removed:

- There is no WHT on dividends paid to foreign entities
- There is no WHT on interest payments made to foreign entities, if it's within the limits that are set in Latvian legislation
- And there is also no WHT on royalty payments made to foreign entities

The exemption from WHT on dividends, interest and royalties is not applied on payments made to entities in tax haven countries. These payments will be subject to 15% WHT. If dividends or interest are paid to individuals (residents or non-residents) then personal income tax is deducted at 10% rate.

Local stamp duties, capital duties or similar taxes

Unlike other countries, Latvia charges no stamp duty on share capital payments, apart from small stamp duties to the Enterprise Registry. Sale of real estate however is subject to 2% stamp duty, which (in case of non-residential building) is capped at EUR 42,686. Planning options are available to minimize the amount of stamp duty.

Controlled foreign corporation, thin capitalization

Latvian corporate income tax law does not provide CFC rules as only actual income is taxed and not consolidated profit.

Certain HC jurisdictions have thin capitalization rules pursuant to which too high debt to equity ratio may prevent the HC from being deemed a structure to which the participation exemption rules apply. Latvian laws also impose the debt-equity ratio which is fixed at 4 to 1. The interest exceeding the gearing level is treated as non-deductible, but does not affect participation exemption rules. Furthermore, thin capitalization rules do not apply to loans borrowed from banks and financial institutions.

Anti-haven rules (applicable to *offshore companies*)

Historically Latvia has established list of tax-haven countries and territories, which now comprises 65 locations and include most of tax haven countries and locations with certain exceptions. The payments to residents located in these countries and locations are subject to 15% WHT. WHT however does not apply, if specific permission is granted by the tax authorities or if goods of origin of tax haven country have been purchased.

Full list of tax havens is prescribed by the Cabinet of Ministers Regulations of 26 June 2001 No. 276 and is available here.

Tax efficient exit

If foreign investor decides to close the Latvian operations, there is no specific exit taxes payable. Sale of Latvian HC is neither subject to Latvian WHT nor capital gains tax. However, if Latvian real-estate company is sold (more than 50% of its assets value is real estate in Latvia), 2% WHT may apply. This WHT may be effectively avoided by prior planning.

If the operations of Latvian entity are transferred to other country, transfer-pricing aspects of the transaction should be considered to eliminate potential disputes with the tax authorities.

Advance rulings and clarifications from the tax authorities could be obtained within a month for free of charge.

Advanced transfer pricing agreements are also available from the tax authorities for a fixed fee of EUR 7,114.

Non-tax attributes

The desired non-tax attributes for a HC location would usually include:

- Sound standing in the international and business community
- Politically and economically stable environment
- Ease of incorporation and closure of operations
- Minimal reporting requirements (accounting, consolidated accounts, audit)
- Minimal substance requirements and administration costs
- Approachable location
- Availability of well qualified and trained workforce at competitive salaries

Further some of these attributes applicable in Latvia are discussed.

Political and economic environment

Although Latvia suffered a lot from the global crisis, it showed remarkable ability to balance its economy and achieve stable growth. This is accompanied with introduction of euro as from 2014, invitation to join OECD and positive ratings issued by international credit rating agencies (e.g. Standard & Poor's, Moody's).

Incorporation / closure

Latvian laws do not have specific HC rules, for establishment and operation of the HC the same rules apply as for the regular companies.

The activities of the HC are carried out through either limited company, which usually is established for business operations or public limited company, which are usually established to satisfy specific business requirements (e.g. banks, insurance companies and certain other businesses required to be registered as public companies) or because the entity intends to trade shares publicly.

Setting up a HC in Latvia requires a minimum share capital of EUR 2,800 and no great expense is involved in its ongoing maintenance. Incorporation is easy and can be carried out within a week.

Reporting requirements

Latvian companies need to apply local accounting standards, which are generally in line with IFRS. Accounting registers should be maintained in euros as from 2014.

Statutory audit is required only for companies if at least the following two criteria are exceeded:

- Balance sheet of EUR 400,000
- Turnover of EUR 800,000
- Average number of employees – 25

Summary

As from the above, Latvia can be considered as a reasonable location for a HC due to the attributes discussed above together with minimal substance requirements, availability of advance rulings and advanced pricing agreements, low maintenance costs. The fact that Latvia is not well-known location for HC's in some cases may considered as advantage as may lead to less scrutiny by the tax authorities in other jurisdictions.

Latvian HC regime can be particularly useful for the following activities:

- For holding shares in a company, which intends to be sold without taxation
- As platform for new investments, especially if several investors are involved with minority shareholdings and each having its HC
- For centralizing management and back-office functions to benefit from 15% income tax rate
- For cash pooling and centralizing financing
- As a tax-free platform for trading with or investing in listed securities traded in stock exchange located in EU or European Economic Area

Tax system

The acts and regulations of Latvian tax system are subject to rather frequent changes and amendments. Accordingly, businesses and individuals are required to keep up and comply with all the effective changes. Further is given a general tax facts and rates in 2015. Customs duties, excise tax, natural resource tax, electricity tax, lottery and gambling tax and motor vehicle operating tax are not covered in this review.

Corporate Income Tax

Tax rate and base

The general corporate income tax (CIT) rate applied on taxable income is 15%. Companies registered in Latvia (i.e. registered with Register of Enterprises) and permanent establishments of foreign entities are subject to CIT on their worldwide income. Companies registered outside Latvia are subject to CIT on their Latvian-source income. CIT is imposed on annual profit before taxes adjusted under provisions of the CIT Act. Taxation period is 12 months, which may not correspond with the calendar year.

How to calculate taxable profit

The following adjustments (most common but not entire as stipulated under CIT Act) to taxable profit should be made according to provisions of the CIT Act.

Expenses not related to economic activities

Expenses that are not related to operating activities of the company are not deductible for CIT purposes and a coefficient of 1.5 shall be applied.

For example (the list provided is not definitive):

- expenses that could not be personalized and are incurred for the benefit of taxpayer's owners and employees (e.g. trips, entertainment events, trips using company car for non–business purposes)
- Donations and gifts to other persons
- Costs of guarantees paid under guarantee agreement

Depreciation of fixed assets

Financial depreciation should be added to taxable income and tax depreciation of fixed assets is deductible at the following rates provided under CIT Act:

- 10% for buildings, structures and perennial plants
- 20% for railway rolling stock and technological equipment, marine and river fleet vehicles, fleet and port technological equipment and energy equipment
- 70% for computing facilities and their equipment, including printers, information systems, computer software products, as well as data storage and communication equipment, photocopiers and their facilities
- 40% for other fixed assets except those mentioned below
- 15% for oil exploration and extraction platforms together with facilities necessary for functioning and oil exploration and extraction vessels

For light vehicles, motorbikes, marine and river fleet vehicles and aircraft (excluding operative vehicle, a special light vehicle, a light vehicle equipped to transport disabled persons in wheelchairs and a new light vehicle used as demonstration cars by an authorized vehicle trader) calculation of depreciation shall be separate for each fixed asset applying a rate of 30%.

There are special principles for calculating tax depreciation for biological assets and new technological machinery acquired for manufacturing purposes.

Intangible investments are depreciated according to the straight-line method. In general, concessions are written off in 10 years, but patents, licenses and trademarks in 5 years.

Interest payments

Non-deductible interest payments are determined as follows:

- Taxable income is increased by interest payments which exceeds the amount calculated by multiplying the annual weighted average interest rate of loans to non-financial enterprises (published by Latvian Bank) with 1,57
- Taxable income is increased by interest payments in proportion to the extent to which the average amount of obligations in the taxation period exceeds an amount equal taxpayer equity (which is reduced to a revaluation reserve of long-term investments and other reserves, which are not formed as a result of profit sharing) multiplied by four

If taxable income should be increased according to both criteria, then it is increased by largest amount.

These restrictions for interest deduction do not apply to loans, which are obtained in credit institutions registered in Latvia, EU and EEA, as well as in countries Latvia has concluded a tax convention with.

Capital gains

Gains on the disposal of shares are exempt from corporate income tax. If loss is incurred upon sale, it will not be deductible. To apply exemption, there are no restrictions on minimal holding period or shareholding. The exemption, however, does not apply on gain from sale of shares in entities located in tax haven countries. The latter gains are subject to regular corporate income tax rate at 15%.

Similarly, gains on disposal of securities quoted on the regulated markets of the EU or EEA countries and investment certificates in EU and EEA open-end investment funds are exempt from taxation in Latvia. Thus Latvian company could be used for trading of such securities as profit from such activities will be exempt from taxation in Latvia.

Gains on the disposal of other investments are taxed at regular corporate income tax rate of 15%. Thus it is recommended that such assets are disposed via sale of shares.

Bad and doubtful debts

Taxable income may be reduced by the amount of bad debts if conditions provided by CIT Act are met.

Taxpayer is entitled for deferred CIT payment on provisions for doubtful debts. Provisions for doubtful debts cannot exceed 20% of taxable income. In order to use the relief certain conditions must be met. Taxable income shall be increased by the provisions that are not written off in the given period of time.

Representation costs

Under CIT Act the representation costs are costs for establishing and maintaining the prestige of the company at the level of publicly accepted standards. The Act provides examples of representation expenses and these include public conferences, receptions and meals with clients, and expenses for acquiring small value items representing the company (i.e. which generally means items with the company or product logo). Tax authorities tend to claim that the list of samples is exhaustive. Taxable income of the taxpayer should be increased by 60% from the amount of representation costs used.

Loss carry forward

Tax losses incurred till the year 2007 (including) can be carried forward up to 8 years. Losses incurred starting from the year 2008 can be carried forward for unlimited period of time.

As of 1 January 2014 group relief was excluded.

Other Executive car

Under CIT Act an executive car is described as a passenger car with up to eight seats excluding the driver's seat, the value of which exceeds EUR 50,000 (excl. VAT) and which is not an operational means of transport or a special passenger car (ambulance, caravan or hearse), or a passenger car, which is specially equipped in order to transport disabled persons in wheelchairs, or a new passenger car, which is utilized as a demonstration car for an authorized car dealer.

Following restrictions are imposed under the CIT Acton executive car:

- No tax depreciation is calculated
- Any costs (maintenance, leasing, etc.) incurred must be added back to taxable income for CIT purposes (without coefficient of 1.5 applied)

Please note that there is different taxation rules stipulated to taxpayers whose operations are related to car rental.

Related party transactions

Transactions with related non-resident parties and associated Latvian entities forming the group (direct and indirect 90% ownership) must comply with arm’s length principle. Transactions with companies established in tax havens are regarded as transactions with a related company. In case due to related party transactions (with price different from market) taxable profit is reduced or even a loss increased, taxable profit of Latvian entity must be adjusted in compliance with market prices considering the actual difference.

Penalties and fines

In general, penalties (e.g. ones assessed by State Revenue Service), fines and contractual penalties are not deductible for CIT purposes. Tax return submission and tax payment CIT return is submitted together with annual report within a month after its approval but not later than 4 months after the reporting year end.

The submission period of annual report and CIT return for large companies (as stipulated by Act on Annual Reports, i.e. balance sheet value – EUR 1,400,000, turnover – EUR 3,400,000 and average number of employees – 250) or parent companies which have to prepare consolidated annual report according to Acton Consolidated Annual Report, is seven months after the reporting year end.

The CIT is due within 15 days after the submission of tax return.

Newly established companies may make advance CIT payments in first reporting year or for the period till submission of the annual report on a voluntary basis. There are no advance payments for entities registered with State Revenue Service as a microenterprise tax payer.

In any other case, the advance payments have to be made on or before 15th date of each month. Advance payment is calculated according to CIT liability of previous reporting year. Any reliefs are not taken into account for advance payment determination purposes.

In case turnover has decreased significantly and it is expected to continue to decrease during the financial year, taxpayer may submit an application to State Revenue Service in order to reduce the advance payment.

Taxpayer is entitled to make quarterly advance payments on or before 15th day of month following quarter if in previous financial year monthly advance payments did not exceed EUR 711.

Withholding Tax

Currently, Latvia has concluded 58 DTT, with another 12 in approval process, which provide favourable WHT rates on payments made by entities outside EU. Most of the DTT ensures that WHT levied by the subsidiary does not exceed 5% on dividend payments provided that Latvian HC owns at least 25% of capital of another company. The WHT rate on interest payments made to Latvian HC shall not exceed 10% based on provisions of DTT, while WHT on royalties are limited to 10%.

Tax credit in Latvia can be claimed on foreign WHT suffered via reduced tax payments in Latvia. As from 1 January 2013, no WHT is levied on dividends paid by Latvian company to non-residents. However, this rule does not apply for dividend payments to companies established in tax havens.

Interest and royalties

As of 1 January 2014, WTH is not applied for Latvian company's interests (if it's within the limits that are set in Latvian legislation) and royalties paid to abroad companies, excluding those, which are located in tax haven territory.

Management and consulting fees

10% WHT is levied on management and consulting fees. It is possible to obtain exemption from 10% WHT under the provisions of DTTs, provided that certain administrative procedure is complied with before making the payment.
5% WHT is levied on payments for the use of property (both movable and immovable) situated in Latvia.

Gains on disposal of real estate

2% WHT is levied on proceeds to a non-resident from disposal of real estate located in Latvia. Latvian company is obliged to deduct WHT. Meanwhile no WHT should be applied on disposal of real estate when both contracting parties are non-residents.

Under CIT Act if real estate constitutes more than 50% of company's assets (at the beginning of the financial year) then it is considered as the disposal of real estate property and therefore attracts 2% WHT.

Payments to tax havens

Historically Latvia has established list of tax-haven countries and territories, which now comprises 65 locations and include most of tax haven countries and locations with certain exceptions. The payments to residents located in these countries and locations are subject to 15% WHT. WHT however does not apply, if specific permission is granted by the tax authorities or if goods of origin of tax haven country have been purchased.

Full list of tax havens is prescribed by the Cabinet of Ministers Regulations of 26 June 2001 No. 276 and is available here.

Administrative requirements

In order to apply the provisions of the tax treaty and avoid/reduce WHT, there should be evidence that the tax treaty provisions may be applied. In particular, non-resident has to obtain a valid residence certificate prior Latvian company makes the payment. If that is not done (i.e. there is no residence certificate at the Latvian company's disposal), Latvian company has to apply WHT from the total amount of payment to non-resident. Nevertheless, this tax may later be recovered by non-resident by submitting a special request.

As noted above, it is possible to avoid the WHT based on the DTT rules subject to availability of residence certificate. The payments may be done by Latvian company without deducting WHT only when the residence certificate is approved by non-resident's tax authority and Latvian State Revenue Service.

The residence certificate is valid for five years from the date when the Latvian State Revenue Service approves it. In practice there are cases when foreign tax authorities refuse to approve Latvian residence certificate form and issue the certificate in their own format. Such residence certificate would be valid only for one year and also certain minimum information is required.

It is possible for a non-resident to apply for tax refund in case Latvian company has withheld tax at a rate provided under CIT Act. In order to reclaim tax, non-resident within 3 years after the payment shall file residency certificate and application for refund with Latvian State Revenue Service.

Value Added Tax

New VAT Act has been introduced as from 1 January 2013. Standard rate – 21%, reduced rate –12%. Domestic taxpayer may not register in the State Revenue Service as a VAT taxpayer, if the total value of taxable goods and services rendered during the previous 12 months does not exceed EUR 50,000. Unregistered taxpayer threshold for the purchase of goods within the EU is EUR 10,000 per year. If, however, taxpayer renders services to customers outside Latvia or receives services from parties outside Latvia and the place of supply of services is deemed to be country where the customer has established its business then Latvian taxpayer should register for VAT purposes before rendering/receiving such services. There are no registration thresholds for non-resident company performing taxable transactions in Latvia (effectively non-resident company should register before carrying out taxable activities in Latvia), except if EU taxpayer is engaged in the distance sales for which registration threshold in previous or current calendar year must not exceed EUR 35,000 (does not apply to excisable goods).

Taxable transactions Standard rate (21%) applies for the following transactions (as an example):

- Supply of goods and related transactions
- Provision of services and related transactions
- Supply of goods within EU
- Import of goods
- Purchase of new vehicle made by any person within EU territory

Reduced rate (12%) applies for the following types of goods and transactions (as an example):

- Supply of pharmaceuticals and medical devices (their parts and accessories)
- Supply of specialized food products intended for infants
- Transportation services of passenger and luggage in Latvia
- Supply of study books and original literature books
- Supply of newspapers, journals and other periodicals
- Accommodation services
- Supply of thermal energy, wood and firewood to inhabitants for household consumption
- Import of specific goods and acquisition of such goods in the EU territory as stipulated by VAT Act

Supply of goods and services for which the place of supply is deemed to be outside Latvia and if such supplies have been subject to VAT if taken place in Latvia are exempt with credit (entitling to recover input tax).

Zero-rated transactions (as an example):

- Export of goods and supplies of goods that are not released for free circulation within the customs warehouses and free zones
- Distribution of goods to fiscal representative for further export
- Supplies of goods to taxable recipient of other member state provided that goods are delivered to another EU member state
- Supply of new vehicle to any person of other member state
- Import of goods provided that certain permission is obtained

- Provided services, which are (as an example):
    - Directly relates to exports of goods, including such whose customs procedure started in another member state
    - Directly relates to transit traffic
    - Services in free zones and customs warehouses related to goods, that imported into the European Union from third countries or third territories and are not released for free circulation
    - International passenger traffic, as well as passengers traffic to other member states and brokerage services by selling these tickets, if passenger crosses the border of the Republic of Latvia, as well as luggage transportation, which the passenger carries with him, and transportation of the vehicle with which he travels
- Distribution and transport by ships and aircrafts, supply of spare parts and fuel to ships and aircraft
- Export of goods from Latvia to non-EU country

Following transactions are exempt from VAT, without entitlement to recover input tax (as an example):

- Postal services
- Medical services
- Mandatory health checks
- Dental care services, services provided by dental technicians and dental hygienists
- Social welfare, occupational and social rehabilitation, social assistance and social work services
- Services of state-accredited educational institutions
- Cultural events (theatre and circus, concerts, exhibitions for children, art events and charity events, visits to state-recognized museums, libraries, zoo and exhibitions)
- Insurance and reinsurance services
- Financial transactions (lending and loans; deals with loan guarantees; services related to deposits and current accounts, and the involvement of other repayable funds, cash and non-cash payments; and other)
- Gambling and lotteries
- Sale of used immovable property (specific rules applies)

Reporting period

Monthly:

- When taxable transactions exceed the value of EUR 50,000 during the pre-taxation year or the taxation year
- When goods are supplied within the EU territory, for which apply 0 percent interest rate, according to VAT act
- If the person provides services in the other country of the EU
- For VAT group and fiscal representative

Quarterly:

- For a registered taxpayer in the taxable year, if previous criteria (for monthly reporting period) are not met and the value of taxable transactions during the pre-taxation year exceeds EUR 14,228.72, but does not exceed EUR 50,000

In a half-year:

- For taxable person if the value of taxable transactions during the pre-taxation year does not exceed EUR 14,228.72 and if previous criteria (monthly and quarterly reporting period) are not met

VAT returns and its appendices must be filed within 20 days after the end of the tax period using the Electronic Declaration System.

VAT is payable within 20 days after the end of the tax period.

Personal Income Tax

Tax rate and base

An individual (resident for tax purposes in Latvia) is taxed on his worldwide income. Certain expenses (e.g. educational and medical) as well as social security contributions, personal allowance (EUR 75 monthly) and allowance on dependents (EUR 165 monthly for each registered dependent) may be deducted from taxable income.

Non-resident is taxed on his Latvian source income and is not entitled to any deductions or allowances, except when he/she (resident of EU/EEA member state) has derived more than 75% of his total income in Latvia in the tax year. Deduction may be applied if similar relief has not been applied in his/her residence country. The following Personal Income Tax (PIT) rates are levied on provided sources of income:

- Salary – 23% in 2015, calculated and paid by the employer (starting from 2016 – 22%)
- Income on commercial activities – 23% in 2015 (starting from 2016 – 22%)
- Income on capital (e.g. dividends, interest) – 10%
- Income on capital gains (e.g. sale of shares, real estate) – 15%
- Monthly patent fees depending on economic activity – from EUR 43 to EUR 100
- Fixed income tax from certain business activities–5%

Latvian PIT Act provides extensive list of non-taxable income (e.g. insurance benefits, gambling winnings, inheritance and scholarships).

As from 1 January 2013, CFC rules (direct and indirect 25% ownership) has been introduced and are applicable on any legal establishment (company, trust, partnership) in tax havens provided that shares of it are not publicly listed in EU/EEA member states.

Tax residence

Under domestic rules, individual is considered Latvian tax residents if he has a permanent residence in Latvia or if he stays in Latvia for 183 days or more in any 12 month period.

Tax treaty rules applies to determine tax residence of individual in case Latvia has an effective tax treaty with that country and individual is considered tax resident in both countries.

Tax return submission and tax payment

The taxation period of PIT is one calendar month (if there is an employment relationship) or one calendar year (in other cases). Both resident and non-resident individuals should file their PIT return between 1 March and 1 June following the year in which their income has been gained. The tax assessed should be paid no later than 15 days after the PIT return has been submitted. If the tax due exceeds EUR 640 it is possible to divide payment into three instalments due on or before 16 June, 16 July and 16 August.

A non-resident individual who performs employment in Latvia and receives income from an employer that is not resident in Latvia and does not have a permanent establishment in Latvia, is required to submit PIT return. PIT Act provides specific criteria for cases when non-resident is required to submit of PIT return.

If capital gains exceed EUR 711.44 a month, then a capital gains tax return must be filed on a monthly basis by the 15th day of the following month. If monthly capital gains are from EUR 142.30 up to EUR 711.44, a capital gains tax return must be filed on a quarterly basis by the 15th day of the following month. If monthly capital gains are less than EUR 142.29, a capital gains tax return must be filed on annual basis by the 15th January of the following tax year.

Social Security Contributions

Social security contributions (SSC) are levied on gross employment income and remitted to the Treasury on a monthly basis. Tax rate applied differs depending on the category of the taxpayer (e.g. disabled, at retirement age, self-employed). SSC are deductible for PIT purposes.

Total standard SSC at a rate of 34.09% are divided between employer (23.59%) and employee (10.50%). Different rates and paying procedures applies if the person is employed by an employer registered outside the EU/EEA or is self-employed.

Social Security Contributions

Total standard SSC at a rate of 34.09% are divided between employer (23.59%) and employee (10.50%)

All persons reached the age of 15 are subject to SSC in Latvia:

- Persons employed in Latvia by a Latvian, EU, Swiss Confederation or EEA employer
- Self-employed individuals
- Domestic employees at a foreign employer, if employee have a permanent residence in Latvia and the employer is registered in EU, Swiss Confederation or EEA (to whom in accordance with Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004, laws and regulations of Latvia are applicable)
- Foreign employees at a foreign employer, if employee does not have permanent residence in Latvia, but he/she stays in Latvia for 183 days or more in any 12-month period, that starts or ends in the taxation year

If the employer is registered in EU, Swiss Confederation or EEA, employer must register and pay SSC (34.09%) in Latvia. If the employer is a company registered outside EU, Swiss Confederation or EEA or in a country that has not concluded tax treaty with Latvia, the employee is fully responsible for compliance and paying taxes in Latvia.

If a non-resident is employed by a foreign company not registered in Latvia, it is the employee's duty to pay SSC at a rate of 31.46%.

Real Estate Tax

Real Estate Tax (RET) is payable by owner or person in legal possession of immovable property.

Immovable property include physical objects located in Latvia and which cannot be transferred without causing damage, i.e., land, buildings and engineering constructions. Certain property is exempt from RET in Latvia. The taxation period is a calendar year.

Municipalities are entitled to set tax rate by issuing binding rules. If not provided otherwise, following RET rates applies:

- 1.5 % of the cadastral value on buildings, land, and engineering constructions
- For buildings with functional use of living, as well as to groups of premises with similar functionality (garages, parking lots, basements, warehouses and household premises) if they are not used for business operations. And auxiliary premises of residential houses and garages which are owned by cooperative societies, associations and individual owners (except for garages for heavy machinery and agricultural machinery) provided that they are not used for business operations:
    - 0.2% of cadastral value, which does not exceed EUR 56,915
    - 0.4% of the part of cadastral value, which exceeds EUR 56,915, but does not exceed EUR 106,715
    - 0.6% of the part of cadastral value, which exceeds EUR 106,715
- 3% of the cadastral value on unprocessed agricultural land
- For buildings that are degrading the environment or are the threat to human safety, 3% applies to highest of the following values:
    - The cadastral value of the relevant land
    - The cadastral value of the structure

Corporate Light Vehicle Tax

Corporate Light Vehicle Tax (CLVT) is payable on a light passenger vehicle that is owned or held by a business and registered for the first time after 1 January 2005. There is a fixed monthly rate applied depending on the engine volume stated in the car registration certificate:

- EUR 27.03 for up to 2,000 cm^3
- EUR 42.69 from 2,001 to 2,500 cm^3
- EUR 56.91 for over 2,500 cm^3

For vehicles registered before 2005, CLVT is EUR 42.69 a month regardless of their engine volume.

Emergency vehicles, taxi, demonstration vehicles, car rental companies, vehicles that are exclusively used for business purposes and other light vehicles (as stipulated under the Law On the Vehicle Operation Tax and Company Car Tax) are exempt from this tax.

CLVT is remitted to the Treasury before an annual roadworthiness test for the months elapsed from the beginning of the calendar year including the month in which the test occurs. The balance of tax for the year is payable at next year's test.

CLVT is payable also on a car that is used under an employment contract, although company is not registered as holder at the Road Traffic Safety Office (RTSO). There are different tax (CIT, PIT and social contributions) consequences for company and individual (employee) depending on how vehicle is registered with RTSO and used (contractual) in company's daily operations.

Microbusiness Tax

Latvian entities can opt to pay Microbusiness tax (MBT) and therefore being exempt from CIT, PIT and SSC.

In order to become MBT payer, company shall comply with certain criteria:

- Participants are individuals
- Turnover up to EUR 100,000
- Number of employees up to 5
- Salary up to EUR 720
- Shareholders are only individuals and are deemed to be employees of the company
- Involved individuals and legal persons cannot be members of a partnership

Microbusiness Tax is calculated at a rate of:

- 9% for turnover that does not exceed EUR 7,000
- 9% for turnover between EUR 7,000.01 and EUR 100,000 (for the first three taxation years after acquisition of microbusiness taxpayer status)
- 12% for turnover between EUR 7,000.01 and EUR 100,000 (starting from the fourth taxation year after acquisition of microbusiness taxpayer status)

It is planned, that the rate of MBT for turnover between EUR 7,000.01 and EUR 100,000 will be:

- 13% rate in 2016
- 15% rate in 2017

In case MBT payer fails to comply with requirements it losses is special status as from next year, and is subject to increased MBT rate in current year calculated as follows:

- 2% are added to standard rate for each additional employee in case MBT payer's number of employees in a quarter exceeds 5
- 20% rate is applied on the excess of turnover over EUR 100,000
- 20% rate is applied on the excess of employees salary over EUR 720

MBT is remitted to the Treasury on a quarterly basis. MBT return has to be submitted on or before 15th day of month following quarter.

CONTACT US

If you have any questions in relation to this Guide, we will be happy to provide more Information!

AAT SIA
Matīsa st. 46 k-1 - 14
Riga, LV-1009,
Latvia

www.taxwise.lv

Arturs Breicis
Certified tax consultant
T: +371 28733751
E: company@aat.lv