

Latvia

Enterprise income taxation



Latvia



Latvia is along with Estonia and Lithuania one of the three so-called "Baltic Republics". The country has a low population density which is distributed over an area as wide as Northern Italy, it has just under two million inhabitants concentrated mainly in the capital Riga which is the main logistics and airport hub of the all three Baltic Republics. Latvia has been a member of the European Union since 2004, a member of the Eurozone since 2014 and an OECD member since 2016.

Strengths of the Country are first of all the low cost of skilled labour force mainly thanks to a high quality level of both school and university and professional training.

In recent years, the Latvian government has made important investments in the field of high technology, placing it among the most technologically advanced countries in Europe, moreover, many bureaucratic obstacles of the past have been eliminated while the times of civil justice have been reduced in order to attract foreign investments and to make it one most "business friendly" countries of the world.



Enterprise Income Tax (EIT)

Latvian enterprise income tax (EIT) law provides for tax exemption of reinvested profits and the taxation of corporate profits only when they are distributed, this method is called of the “remittance-basis” (or cash-based taxation). In other words, corporate tax is not due any more on profits as they arise, instead a tax exemption is applied on all reinvested earnings and tax is payable only when the company declares their dividends or when they make other payments equivalent to dividends or when they distributes their earnings in other forms like fringe benefits. Both natural and legal persons who receive such dividends are exempted from Latvian income tax and no withholding tax on distribution is applied either, it follows that corporate profits in Latvia do not suffer any economic double taxation as they are taxed only once at the level of the first entity generating them. For the purposes of Double Tax Treaties, even if the profits are taxable only at the time of distribution, the Latvian EIT is regarded among the Member States of the European Union not as a withholding tax on dividends, but as a real corporate income tax and this is valid also for the purpose of the application of the EU Parent-Subsidiary Directive.



The Enterprise income tax (EIT) is applied on profits only at the time of their distribution. As long as the Latvian company retains them corporate profits are not included into the taxable base for EIT purposes.

The corporate tax rate on distributed profits is 20%

The main advantage of cash (or deferral) tax system lays in the possibility to defer the payment of EIT on corporate profits by retaining them or alternatively by reinvesting them also in the acquisition of shareholding in other companies both in Latvia and abroad.



Also dividends received by individuals both resident and non-resident of Latvia are exempt from tax. The EU principle of free movement of capital together with the principle of "non-discrimination" provides that all shareholders are treated equally, therefore the dividends that Latvian residents receive from foreign companies are also exempt from tax provided that the profits have been taxed in the source country; this condition is commonly called the "subject-to-tax test. This provision represent a significant incentive for foreign investors considering bringing their tax residence to Latvia in order to obtain tax savings on their investments since they pay no tax on dividends they receive from any other foreign country therefore Latvia is a country where it is possible to be shielded from taxation on profits repatriated from foreign investments.

Latvia's corporate tax regime is a great advantage for those looking for flexibility in terms of choosing whether or not to distribute profits or whether to reinvest them.

The Latvian law provides some anti-avoidance rules which aim to dissuade taxpayers from artificially extracting profits by means other than dividends in order to avoid paying tax, by including in the taxable income:

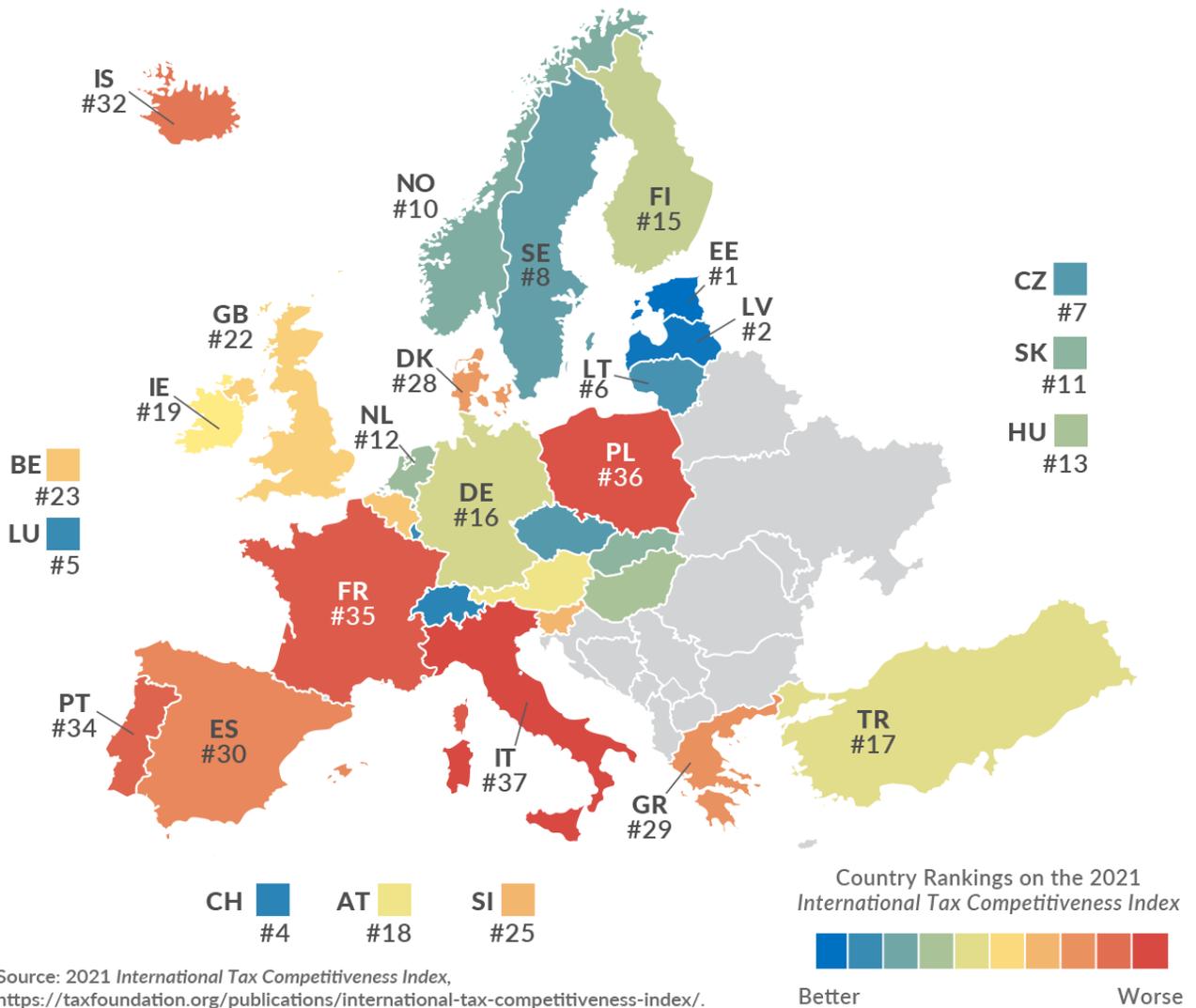
- non-business costs, entertainment costs exceeding 5% of total wages, part of the cost of company cars;
- the cds. "fringe benefits" to employees;
- interest payments to non-financial corporations and individuals exceeding certain thresholds are assimilated to distributions; in line with European legislation the deductibility of interest expense has a threshold of the debt/equity ratio of 4:1 and the 30% of the EBITDA (earnings before interest tax depreciation and amortization) for interest exceeding €3 million;
- the cds. adjustments or the adjustments made by the tax authorities of the transfer prices are assimilated to distributions;
- liquidation fee.



Also loans to related persons are treated as dividend distributions and are subject to EIT unless they qualify for a specific exemption. The exemptions apply to:

- loans granted by parent companies to direct subsidiaries;
- loans issued by a company for its overseas permanent establishment;
- loans from agricultural or forestry cooperative societies to members for commercial activities;
- loans issued by non-profit companies and included in the opening balance sheet of the current fiscal year;
- short-term loans (12 months).

European OECD Country Rankings on the 2021 International Tax Competitiveness Index



Source: 2021 International Tax Competitiveness Index, <https://taxfoundation.org/publications/international-tax-competitiveness-index/>.

TAX FOUNDATION

@TaxFoundation

The "International Tax Competitiveness Index" report published by the OECD for 2021 ranks Latvia at the second place among OECD member countries for tax competitiveness moreover to date Latvia has signed over sixty bilateral international Double Taxation Agreements to avoid international double taxation.



TAX FOUNDATION

Subscribe

Donate

2021 International Tax Competitiveness Index Rankings

Country	Overall Rank	Overall Score	Corporate Tax Rank	Individual Taxes Rank	Consumption Taxes Rank	Property Taxes Rank	Cross-Border Tax Rules Rank
Estonia	1	100.0	3	1	9	1	15
Latvia	2	85.1	2	5	27	5	9
New Zealand	3	81.3	28	6	6	2	22
Switzerland	4	78.4	10	15	1	35	2
Luxembourg	5	76.5	25	20	4	13	5
Lithuania	6	76.5	4	7	24	7	23
Czech Republic	7	75.5	8	4	35	6	12
Sweden	8	72.9	9	18	16	8	14
Australia	9	71.3	29	17	7	4	24
Norway	10	70.6	11	13	18	15	11

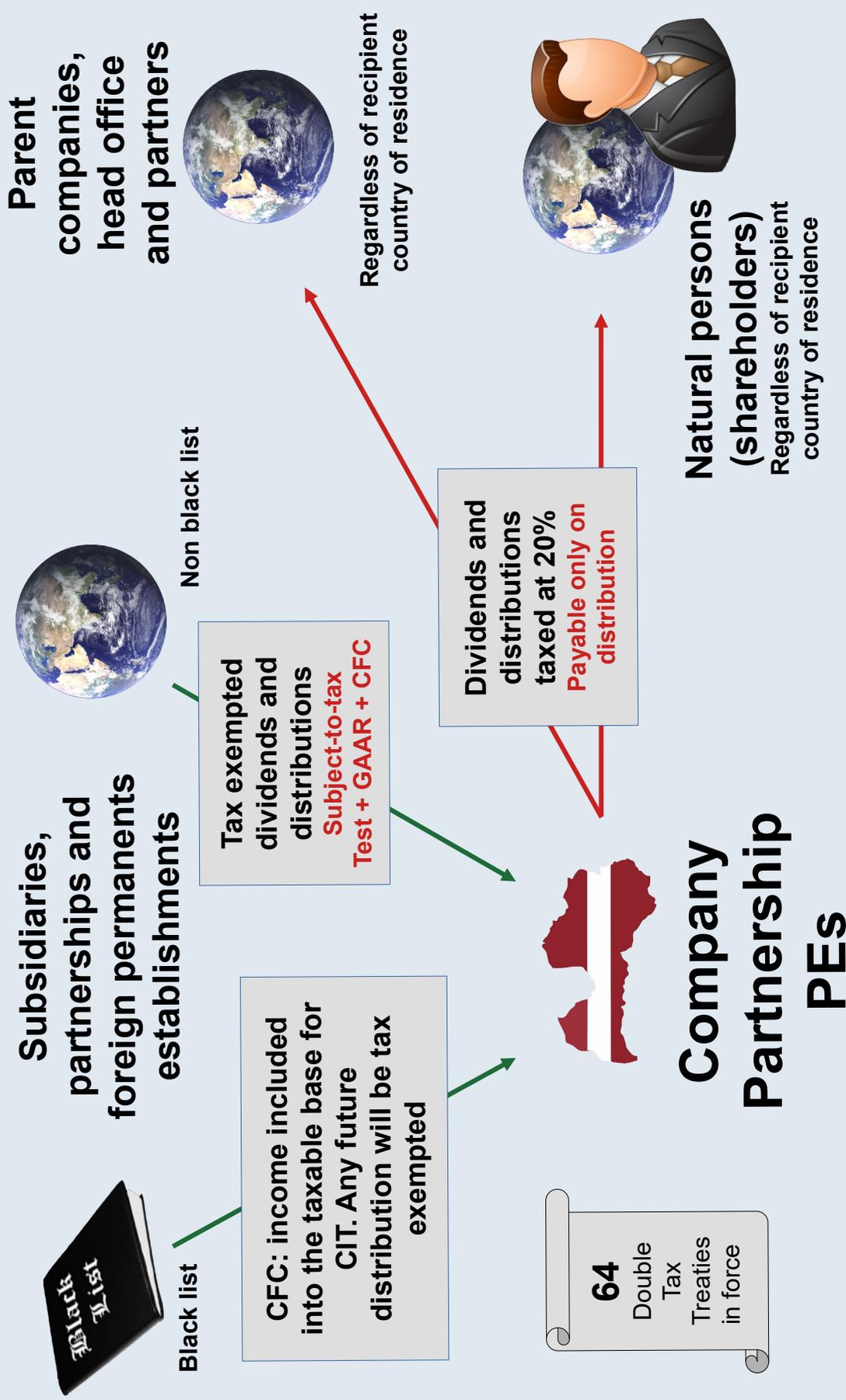
The tax period in Latvia is monthly and declarations for direct tax purposes are due only in the case of distributions or presumed distributions. An advantage for foreign subjects deriving from investment in Latvia is also constituted by the fact that the country is one of the few signatories of the "Multilateral Treaty for the Abolition of Legalizations" therefore every legal document does not require any legalization.



How can a foreign shareholder make the most of the benefits of the Latvian tax system? In order to not be subject to economic double taxation and withholding tax on the repatriation of profits distributed by tax-free Latvian companies, it is advisable for the non-resident person to

- be tax resident of Latvia or alternatively of a country which applies the exemption regime without subsequently imposing tax at the time of distribution to individual shareholders and to obtain a shareholding in a resident company controlling the Latvian company, Estonia would serve to the purpose);
- partially replace equity financing, with loan financing (debt capital).

LATVIA: CORPORATE INCOME TAXATION





The Latvian “participation exemption regime” provides that income from the alienation of stock of shareholding is exempted from capital gains tax on condition that the Latvian company has held it for at least three years;

Latvian holding company regime

Latvian system of tax deferral applies not only to "active income" (income generated by the performance of a commercial activity), but also to "passive income" as income from interest, royalties and distributions from resident and foreign (not black-listed) entities. Dividends distributed to natural persons are exempt from Latvian EIT as they are subject to taxation only at the company level even if these dividends come from another entity, including a foreign one (excluded from "Black List" countries) provided that it has already included those profits in the taxable base tax in the Source Country (subject-to-tax test). The system of exemption from corporate income tax (EIT) of dividends distributed by other subsidiaries takes the name of "flow-through dividends". In order to benefit from the regime, it is required that the profits from which these dividends are generated have been subject to tax at the level of the foreign distributing company in the country of residence or that these dividends have been paid by another Latvian company and that the distributing company does not has undergone recent changes in its corporate structure.



Company governance

- Minimum capital of 2,800 euros, half of which must be paid up at the incorporation.
- The Latvian company must appoint a Board with administrative and legal representation duties. There are no restrictions on the appointment of non-residents to the Board.
- Member of the Board can be both a founding member and an "external" subject, founding members can be both natural persons and resident and non-resident legal persons.
- Accounting is monthly, but is provided only for operating companies (not for holding companies) or if the company acts as an employer.
- An auditor is provided only for those entities that simultaneously meet two of the following conditions:
 - annual turnover exceeding approximately 800,000 EUR;
 - the balance sheet total exceeds EUR 400,000;
 - the number of employees is 25 or more.
- A supervisory body (supervisory board) is optional.
- Possibility of setting up a LTD with reduced capital only by natural persons (no more than five). In the LTD with reduced share capital, only the founding members can be appointed to the Board.

The personal income tax

Latvia adopts a progressive system of personal income taxation. The lower tax rate of 20% applies to annual income up to €20,000 while a 23% rate now applies to annual income from €20,001 to €78,100 and 31.4% to income over €78,100.



- Net salary
- Contributions paid by the employer
- Contributions paid by the employee
- Personal Income Tax (PIT)

A flat rate of 20% is applied on capital income such as interest, on other income such as capital gains as well as on all dividends which have not been taxed in the “source country”, in that case taxpayer can elect to a tax credit for the foreign tax, the taxpayer will be required to give evidence that such income has been subject to taxation in the country of origin.

Royalties are subject to higher taxation (25%-40%) if paid to natural persons who do not act in the exercise of business, art or profession.





Lorenzo Ghigini
International Tax Affiliate of the CIOT
Certified Tax Adviser



LATVIAN
ASSOCIATION
OF TAX CONSULTANTS



LORENZO GHIGINI
INTERNATIONAL TAX AFFILIATE
OF THE CHARTERED INSTITUTE OF TAXATION

International
Tax Affiliate

RELIEVA
INTERNATIONAL TAX AND PROPERTY PLANNING

Contact us for more

information on +39 347 8031497

e-mail. info@relieva.eu - info@relievaconsulting.it