Tax & Legal Alert

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Tax and Legal Alert provides the latest information on changes in Latvian legislation.

In this issue: the latest amendments to Latvian tax laws taking effect on 1 January 2009.

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Amendments to tax laws taking effect on 1 January 2009

Several amendments to tax laws took effect on 1 January 2009 in Latvia:

- value added tax standard rate was raised from 18 percent to 21 percent,
- the reduced VAT rate was increased from 5 percent to 10 percent,
- personal income tax was lowered from 25 percent to 23 percent,
- the minimum monthly wage was raised from LVL 160 to LVL 180,
- tax-exempted minimum monthly income – from LVL 80 to LVL 90.

The latest amendments to the Latvian VAT Act came into force on 23 December 2008 which anticipate that the low rate of 10% apply only to medicines and specialised baby food, domestic public transport services, medical devices and goods, as well as heating, electricity and natural gas supplies to households.

10% rate will also apply to newspapers and magazines for one year period (2009), after which 21% rate will be applied.

Instead of 5%, the rate of 21% will apply to veterinary medicines, water supply, sewerage and household refuse collection services, commercial television and commercial radio broadcasts, books and maps, admission charges to sporting events and cinema shows, hotel accommodation, hairdresser's and undertaker's services, as well as firewood supplies and simplified renovation services to households.

Other taxes

The government decided to raise excise tax for all excise goods from 1 February 2009.

The other bill planned states that from 1 January 2011 the sale of development land will attract the standard rate and defines development land as a piece of land that meets the relevant statutory uses and is covered by a permit issued under construction law for building development, engineering communications or access roads.

Amendments to corporate income tax law

Incentives for shareholders to reinvest profits in companies

In future, the law will encourage shareholders to invest profits in the development of their company, rather than take them out in dividends. Businesses will be able to reduce their taxable income by a notional amount of interest that a taxpayer would have to pay on a loan equal to his prior-year undistributed profit. This adjustment is calculated by multiplying the annual weighted average rate of interest on loans in lats issued to non financial Latvian businesses as determined by the Bank of Latvia for the tax period, and undistributed profits from previous periods beginning after 31 December 2008.

Residence certificate

According to the new amendments, to be able to pay out dividends to an EU or EEA resident free of tax, or to pay interest and royalties subject to a reduced rate of withholding tax under section 3(4) of the CIT Act and paragraphs 46 and 47 of the transitional rules, the company paying the dividend must hold at the time of payment a certificate issued by the tax authorities of the shareholder's country of residence. The certificate must confirm the shareholder's compliance with paragraph (2) or (3) of section 1(19) of the CIT Act, or that the recipient of interest or royalties complies with section 1(19.1). The certificate is valid for five years from the date of issue, provided the payee meets statutory criteria during this period.

Loss carry forward

To support companies investing considerable amounts in business development and suffering resultant tax losses over a long period, the loss carry forward period is to be extended from five to eight years from the tax period beginning in 2010.

According to the transitional rules, in tax periods beginning in 2008 and 2009, taxpayers will be able to offset losses they were entitled but unable to offset in 2007 through lack of taxable income. This means that losses of 2002 can be offset in subsequent eight years, i.e. up to 2010 (inclusive), assuming a 12 month tax period that remains unchanged.

Pleasant surprises

Expenses incurred in carrying an employee from home to work and back qualify as business expenses if the nature of his job prevents him getting to work or back home by public transport (e.g. work at night).

The law also states that taxable income can be reduced by expenses incurred in setting up a new specialised job for a physically or mentally disabled person, provided the new job exists for at least two years.

To support airlines that lease aircraft to renew their fleet, there is no withholding tax on rental payments to non residents for rented aircraft flying international routes.

Deferred tax on asset replacements

Latvia, like some other EU countries such as the UK, will permit a deferred payment of tax on profits arising on the sale of a replaced asset in order to encourage manufacturing companies to replace inefficient and outdated plant and machinery.

The amendments provide that if a company acquires a functionally similar asset within 12 months before or after the old equipment is disposed of, then any income (profit) on the disposal of the old equipment is ignored in this tax period, i.e. the profit is deductible from taxable income. Tax payment is deferred until the new equipment is sold, because taxable income from its sale should be calculated by reducing its acquisition cost and thus increasing taxable income by profit on the sale of the old equipment. This tax payment can also be postponed if the new equipment is again replaced (which is likely to happen if the company continues in business).

Functionally similar are assets of the same class that provide a similar use or the new asset produces a better result than the old one.

This provision does not apply to works of art, antiques, jewellery, investment properties, long term investments held for sale; motorcycles, watercraft, aircraft, and light passenger vehicles.

Depreciation of new plant and machinery

To encourage purchases of new production equipment, the amendments extend the period of coefficients launched in 2006 to increase the tax value of assets for capital allowances. Before the amendments, the law stated that the value of plant purchased in 2009 would be increased by a coefficient of 1.2, and 1.1 would apply to equipment bought in 2010. The amendments state that the tax value of equipment acquired over the period from 2009 to 2013 can be increased by a coefficient of 1.5.

Please note that if such equipment is disposed of within five tax periods after its acquisition or creation, then taxable income must be increased by the difference between capital allowances and depreciation, and tax is payable on the tax relief claimed in previous years. So, in this situation the use of a coefficient results in the tax payment being deferred until the period in which the asset is disposed of, rather than being reduced as would be the case if the taxpayer held the equipment longer than five years.

Amortisation of intangible investments

To encourage the registration of patents and trademarks in Latvia, the creation or acquisition costs of intangible investments may be increased by a coefficient of 1.5 if such investments result in a trademark or patent being registered after 31 December 2008.