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Position Paper on Tax Policy and Tax Administration

1. Executive Summary

A tax policy that is well thought out and administered effectively is vital to FICIL members as it can support the competitiveness of the business and improve the attraction of Latvia for foreign investments.

FICIL would like to contribute its view and recommendations regarding the new tax policy and suggestions for improvements in tax administration, highlighting three priorities.

1 Priority – quality and predictability of tax system – FICIL is of the opinion that the implementation of the new tax reform as soon as with 2018 would impair its quality and recommends postponing the go-live date at least to 2019.

2 Priority – shadow economy – FICIL highlights that the volumes of shadow economy in Latvia are still high and recommends improvements in coordination of law enforcement institutions and more effective application of penalties.

3 Priority – tax administration – FICIL is of the opinion that further improvements are needed for clarity and ease of tax law application and recommends to expand on the explanations work, for Tax Administration to focus on electronic data controls, and to review the remuneration system at Tax Administration for attraction of highly qualified employees.

2. Recommendations

1 Priority - quality and predictability of tax system

The fact that the new tax system is being progressed in a way to implement it as soon as 2018 would not allow for sufficient quality and consideration. The Law on Corporate tax is being drafted anew and within so short deadlines that will prevent full evaluations and commenting.

FICIL is of the opinion that an initiative of this scale and long-term impact must first and foremost be of high quality. It is important that companies are not facing new changes within one or two years from the introduction of the new system. The frequency of law amendments is a direct indicator of the quality of the law. Furthermore, change of tax system is a great opportunity to simplify the application and administrative burden, which should be used.

FICIL recommends to postpone the implementation of the tax reform and introduce it no sooner than 2019, carefully considering the transitional rules.

It is also important that the new tax principles remain stable for a long term. After reorganizing the system for a completely different corporate tax model, it should remain in force for ten years or more.

The results of this Priority can be measured by setting a goal to achieve higher ratings at Doing Business¹ and Global Competitiveness report² (where Latvia is ranked 14 and 49 respectively) – in three years time to increase the score for 'effect of taxation on incentives to invest' from 3.3 to 4.5 (according to Global Competitiveness report) and to decrease the time for tax administration by 20% (from 168,5h to 135h according to Doing Business).

2 Priority – shadow economy

As before, FICIL considers shadow economy to be a top priority along with all activities related to its decrease. Although Latvia has been able to gradually decrease the volumes of shadow economy over the last few years, it is still the highest among Baltic states and it is larger than the averages in EU. In 2016 Latvia achieved a 20,3% estimate of shadow economy (percentage from GDP), which is a decrease by one percent point since last year¹.

The new tax policy principles also include a variety of activities for fighting the shadow economy and this area is considered to be vital for a successful implementation of the tax reform.

FICIL views the following topics important for further decrease of shadow economy.

- Focused and coordinated work of law enforcement institutions
- More strict penalty system and more effective application of penalties
- Balanced tax policy – a gradual and sustainable tax rate increase, considering the purchase power and risks of illegal trade

The results of this Priority can be measured by setting a goal to improve the ratings in The Centre for Sustainable Business at SSE Riga research – in three years time to achieve the lowest volume of shadow economy among the Baltic states at no more than 15%, while in five years time to achieve the average ratings of old EU countries at no more than 12%.

3 Priority – tax administration

Tax administration contains various aspects, combination of which contribute to the satisfaction with the tax system in Latvia and appreciation of the work of Tax Administration. This area still needs significant improvements. It is an area that has been highlighted in the new tax policy principles as well, and the Tax Authority has stated that its vision and mission for 2017-2019 is to become a trusted partner and to administer fairly and effectively.

The most important aspects of tax administration are clear rules and ease of compliance. FICIL recommends to:

¹ Tālis J. Putniņš & Arnis Sauka, The Centre for Sustainable Business at SSE, Shadow Economy Index in the Baltic States 2009 – 2016

http://www.sseriga.edu/download.php?file=/files/events/sseriga_shadow_economy_index_2009_2016.pdf

- Expand the explanations of tax law in a convenient and easy form;
- Ensure consequent and publically available explanations on more complicated cases or when the interpretation changes;
- Support small and new companies by offering simple accounting and tax calculation software;
- Focus control activities on electronic data and analysis;
- Set materiality thresholds for activities of the Tax Authority, depending on the amounts of taxes involved;
- Review remuneration system for Tax Authority employees to attract highly qualified professionals.

The results of this Priority can be measured by setting a goal to improve the trust rating of Tax Authority when compared to other state and public institutions. The research² is being carried out by the Research Centre SKDS and as of now the Tax Authority is ranked 11th out of 14 institutions. We would suggest a target of TOP3 of most trusted institutions for the Tax Authority.

3. Rationale for Recommendations

Taxes are an area of special importance to maintain and improve the competitiveness of Latvia in the region. In the above-mentioned researches ratings of Latvia have been comparatively stable in the last years, but to achieve the main goal of NAP 2020 – an economical breakthrough – and to improve the ratings, a well-considered and brave further action is needed.

The implementation of the new tax policy is an especially good time to focus both on the quality of the tax system, and to review the usefulness of the principles employed before. The way how this will be carried out will be of utmost importance and will influence investors' decisions regarding Latvia for a long time to come.

² Please see [http://www.fm.gov.lv/files/files/A.Kaktins_Sabiedr%20un%20nodokli%20\(13.12.2016\).pdf](http://www.fm.gov.lv/files/files/A.Kaktins_Sabiedr%20un%20nodokli%20(13.12.2016).pdf)