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The Foreign Investors Council In Latvia Position On Tax and Tax Administration

1. Executive Summary

The Foreign Investors Council in Latvia (FICIL) position is that the Government should improve the tax system in order to encourage the business activities during the economic slowdown. The FICIL recommends ensuring an effective tax system, which supports and encourages the business activities in Latvia and ensures consistent tax revenues to the state budget.

The FICIL suggests that the Government should implement changes in laws and regulations focusing on improvement of the tax legislation – review current rules, make amendments, implement new rules in order to improve the business environment and to harmonise the Latvian tax system with the European Union regulations. The FICIL believes that the aforementioned changes will result in business development and promote the recovery of Latvian economy.

2. Recommendation/Suggestions

1. To further develop the corporate income tax system.
2. To implement amendments and optional provisions for the Law on Value Added Tax as well as we support reinstating of the reduced VAT rate to the hotel accommodation services and printed books.
3. To reinstate the ceiling for the maximum amount of social security contributions.
4. To abolish or at least reduce the excise tax rate for non-alcoholic ready-to-drink beverages.
5. To implement gradual increase of the natural resource tax rate for specific natural resources' groups and for producers implement a moratorium on the tax increase till 1 January 2012 on CO2 emissions.
6. To further develop the Law on Personal Income Tax and implement taxation of capital gains.

3. Rationale

Corporate Income Tax

Short to medium term goals/1st priority

1. To allow accumulated tax losses to be carried forward and set off against next year profit for an unlimited time period.
2. To allow depreciation of goodwill for tax purposes.
3. Bad debt provisions should be tax deductible for all companies, write-off criteria for tax deduction of bad debts should be updated, simplified and applicable in practice for all companies, including leasing companies. Editorial changes in the Law on Corporate Income Tax regarding deduction of bank loan write-offs should be made to ensure that write-offs are unanimously treated as a tax deductible item.

Long term goals/2nd priority

1. To make changes to allow the current year tax loss to be carried back and set off against prior

- year profit for a period of up to a maximum of three years.
2. To abolish 10%/5% withholding tax on interest payments between related parties.
 3. To abolish 2% withholding tax on sales proceeds from sale of real estate located in Latvia and sale of shares in companies holding real estate in Latvia.

Value Added Tax

Short to medium term goals/1st priority

To implement provisions related to deferral of value added tax (VAT) payment on imports, recovery of VAT on bad debts, VAT grouping and to provide an option to apply VAT on real estate. To ensure more transparent and understandable application of the Law on Value Added Tax on the sale of collaterals. Listed provisions would improve Latvian economy as follows. Deferral of VAT payment on imports would suspend VAT payment till submission of regular monthly VAT declaration. The norm would stimulate transits and exports of goods and services and free up company assets. The norm would also encourage customs clearance on the Latvian Boarder and would also increase the amount of customs duty paid on the boarder; would reduce administrative costs tax administration due to decrease of repayment of overpaid input VAT as well as decrease of adjustment to customs declaration. Whereas recovery of value added tax on bad debts would improve company cash flows and value added tax grouping would encourage the creation of service centres in Latvia.

Long term goals/2nd priority

To simplify the VAT system and prolong time of VAT payment to small size companies. To make amendments to the Law on Value Added Tax by excluding the possibility to avoid value added tax payment on large initial transactions which currently is made possible by vague wording of the Law on Value Added Tax regarding value added registration requirement of reaching or exceeding LVL 10 000.

Social Security Contributions

To reinstate ceiling for the maximum amount of social security contributions.

The abolition of ceiling for the maximum amount of social security contributions provides short-term positive effect on the revenues of the state social security budget. The long-term effect on the state social security budget will be negative – the expenses for pension, sick benefits, maternity and paternity benefits will increase as a result additional budget expenses will arise. The tax burden for the employers increase and Latvia becomes less attractive to the foreign investors.

FICIL do not support the proposed reduction of the social security contribution payments form 8% to 2% to the 2nd pension level scheme.

Excise Tax

Excise tax on national excise products

To abolish or at least reduce excise tax on non-alcoholic ready-to-drink beverages. The excise tax on non-alcoholic beverages is national tax; not required or harmonised in the EU. On February 2009 the excise tax on non-alcoholic drinks was doubled which makes negative impact on the output of the soft drink producing sector, employment sector, competition with Lithuania and Estonia market, tax revenues and foreign investments. The output in the soft drink producing sector and related sectors (transport, retailing) is reducing. The employment in the soft drink and related sectors is reducing facilitating the unemployment benefits increase. The excise tax changes create uncertainty and send the negative signals to the

foreign investors.

Excise tax on tobacco products.

Short to medium term goals/1st priority

1. Avoid any further raise of excise duty as:
 - Price of cigarettes has significantly increased during past years;
 - Duty unpaid market has enlarged.
2. Determine a priority of State Revenue Service to ensure all necessary control arrangements that prevents duty unpaid cigarette supplies from Russia and Belorussia.

Long term goals/2nd priority

Change the structure of excise tax rate:

- Gradually increase specific rate of excise tax, accordingly reduce ad valorem excise tax rate;
- Apply specific rate of excise tax only;
- Cancel the cigarette price restriction.

Simplify the excise administration requirements for aviation fuel supplies at the international airport:

- Simplify the processing of consignment documents by the State Revenue Service (permit this outside their working hours);
- Simplify the requirements for supplies and registration of documents.

Natural Resources Tax

To implement a moratorium on the tax increase till 1 January 2013 on CO2 emissions for producers. For the following resource groups: limestone, clay, sand, gravel, gypsum, peat the tax increase should be postponed till 1 January 2012. As of 1 January 2012 the tax increase on the latter mentioned natural resources' groups should be gradual reaching 10% tax increase per six months till the moment when the amount of the tax reaches an appropriate level, which would be estimated taking into consideration circumstances specific to Latvia and Europe.

Personal Income Tax

1. To update the Law on Personal Income Tax.
2. To implement taxation of capital gains and further reduce personal income tax rate for employment income. The tax rate applicable to capital gains should correspond to the difference between the standard tax rates of personal income tax and corporate income tax.
3. To expand the list of allowable deductions of up to 20% of gross taxable income and include also education expenses and interest paid for real estate loans.

Tax Administration

1. To ensure better communication between tax authorities and tax payers.
2. To allow a possibility for companies to request an advance ruling regarding future transactions, which currently in practice is not possible.