Taxation and Investment in Latvia 2013

Reach, relevance and reliability

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1.0 Investment climate

1.1 Business environment

Latvia is a parliamentary democracy. Deputies are elected to the *Saeima* (unicameral parliament) under a system of proportional representation. The highest executive power lies with the Cabinet of Ministers, which is led by the Prime Minister. The role and functions of the executive power are stipulated in the constitution (*Satversme*) of the Republic of Latvia.

The Ministry of Economics is responsible for implementing Latvia's foreign trade policy with the EU, the World Trade Organization (WTO) and other international organizations. The Ministry is in charge of executing the export promotion policy, enforcing the internal market protection policy and fostering economic cooperation with other countries.

Latvia became an EU member state in 2004. Consequently, the business environment is governed by EU legislation, as well as Latvian domestic legislation and various international agreements. As an EU member state, Latvia is required to comply with all EU directives and regulations and it follows EU regulations on trade treaties, import regulations, customs duties, agricultural agreements, import quotas, rules of origin and other trade regulations. Trade also is governed by the rules of the WTO. The EU has a single external tariff and a single market within its external borders. Restrictions on imports and exports apply in areas such as dual-use technology, protected species and some sensitive products from emerging economies.

Latvia's membership in the WTO also entails certain obligations towards an open and well-functioning trade system. Internal EU trade currently constitutes about 75% of Latvia's foreign trade. Trade with third countries has undergone significant changes, including:

- Introduction of the common EU external customs tariff;
- Expansion of the external market as a result of the many free trade agreements concluded by the EU;
- Introduction of quantitative restrictions (quota) for imports of certain goods; and
- Application of EU market safeguards with respect to imports of certain goods.

Aided by its advantageous geographical location on the east coast of the Baltic Sea, Latvia is an important transit hub for east-west trade, and the new export-led economic model is expected to reinforce this role. Major exports include wood and wood products, machinery and equipment, metals, textiles and foodstuffs, while important imports include machinery, equipment, chemicals and fuels.

Price controls

Companies generally are free to set the prices of goods they sell, provided the Competition Law is not violated. This law prohibits the dominant market participant from establishing unfair purchase or sales prices or otherwise engaging in unfair trading practices.

Prices are controlled in the public utility sector, such as electricity, gas, heat supply, telecommunications, water, sewage and railways. Local municipalities also are authorized to regulate the provision of services in certain sectors, such as municipal waste management, water supply and sewage.

Intellectual property

The protection of intellectual property in Latvia is found in laws based on the legislation of EU member states and international conventions. Several state and nongovernmental organizations are involved in the administration, protection and enforcement of intellectual property rights, such as the Patent Office, the collective Copyright and Communication Consulting Agency/Latvian Copyright Agency, the Performers' and Phonogram Producers' Society and the Latvian Music Producers' Association. Authors' rights generally are protected under the Copyright Law. A copyright is in effect for the entire lifetime of the author and 70 years thereafter. A copyright belongs to the author as soon as the work is created, regardless of whether it has been completed.

No registration, special documentation or other formalities are required to prove the ownership of a copyright. Copyrights of works that have been edited or otherwise made known in a foreign state, in any material form, are recognized for foreigners in accordance with international agreements that binding on Latvia.

If an author has created a work while carrying out his duties in an employment relationship, the economic rights of the author may be transferred, in accordance with the employment contract, to the employer. If an employee creates a computer program while on a work assignment, all economic rights to the program belong to the employer, unless otherwise specified in the employment contract.

To obtain the right to use a work, the user must obtain permission from the holder of the copyright. The permission can be issued as a licensing agreement or a license.

Copyright holders may enforce their rights in court and criminal sanctions may apply for violations.

A patent is obtained from the Patent Office. Under Latvia's patent law, the creator's rights are protected if an application has been submitted to the Patent Office. These rights also are obtained by a person who has filed the first application in a state that is party to the Paris Convention for the Protection of Industrial Property, and who has, in accordance with the provisions of that convention, filed an application for the same invention with the Patent Office within 12 months. A registered European patent has the same legal effect as a Latvian patent.

Trademarks are registered and protected under the Law on Trademarks and Geographic Indications by registering the mark. Trademarks that are well known in Latvia are protected without registration. The registration is valid for 10 years from the application date and the registration may be extended. The law does not set a limit on the number of extensions but re-registration must be carried out in the year preceding the expiration of the patent.

1.2 Currency

Latvia's currency is the Lat (LVL). Latvia has fulfilled the Maastricht criteria necessary for joining the Eurozone, and the national Parliament has approved the law on adoption of the single Euro currency as from 1 January 2014.

The Bank of Latvia (central bank) implements a policy of a fixed national currency exchange rate (EUR 1 = LVL 0.702804), with the monetary base fully backed by the central bank's foreign exchange reserves. The bank is preparing the country for full-fledged participation in the Economic and Monetary Union (EMU).

1.3 Banking and financing

Both domestic and foreign banks offer banking services in Latvia. A single authority, the Financial and Capital Market Commission (FCMC), supervises the financial sector to ensure the overall stability of the financial and capital markets. The FCMC issues guidance on the activities of market participants, licenses participants and products in the financial and capital markets, and monitors compliance.

The legislative framework for banking in Latvia meets EU requirements, and in some areas is stricter. International Financial Reporting Standards (IFRS) have been fully recognized; the annual reports of the banks are prepared in accordance with IFRS and audited by internationally recognized auditing firms. Banking in Latvia is highly supervised and bank inspections are conducted more frequently than in other EU member states.

A bank licensed in another EU member state may establish a branch and provide financial services as set forth in the license issued by the foreign supervisory authority if the FCMC has received notification from the foreign supervisory authority about the branch's activities. A bank licensed in an EU member state may provide financial services in Latvia without establishing a branch after the foreign supervisory authority has transferred to the Latvian supervisor the business plan of the bank indicating the financial services it intends to provide.

Latvia has rules for measuring the performance of credit institutions and reporting requirements that conform to EU standards. It also has implemented the relevant EU directives on the prevention of money laundering, which requires customer identification and record-keeping on all transactions, identification of suspicious and unusual transactions, and reporting to the Board of Prevention of Legalization of Proceeds from Criminal Activities.

The financial center of Latvia is the capital, Riga.

1.4 Foreign investment

Reforms in Latvia have strengthened the private sector, created macroeconomic conditions favorable for growth and helped to improve the business environment, thus attracting the attention of international investors worldwide.

The Investment and Development Agency promotes business development by facilitating foreign investment and working to increase the competitiveness of Latvian entrepreneurs in both domestic and foreign markets.

Latvia has signed bilateral agreements on the mutual promotion and protection of investments with a number of countries, including: Armenia, Austria, Azerbaijan, Belgium, Belarus, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Georgia, Hungary, Iceland, India, Israel, Italy, Kazakhstan, Korea, Kuwait, Lithuania, Luxembourg, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, Singapore, Slovakia, Spain, Sweden, Switzerland, Taiwan, Turkey, UK, Ukraine, US and Vietnam. These agreements prescribe standard treatment for investments and profits related to foreign persons, together with protection from potentially harmful consequences caused by state institutions interfering with foreign investments and profits.

1.5 Tax incentives

A “substantial investment” tax incentive regime provides corporate income tax relief. The regime, which is designed to attract new investment, applies to long-term investments in manufacturing, telecommunications, computer programming facilities, storage and transport auxiliary works. The relief is 25% of the amount of the investment up to LVL 35 million (approximately EUR 50 million), and 15% of investments exceeding this amount. The following requirements must be met to qualify for the relief:

- The minimum amount of the investment must be LVL 3 million (about EUR 4.3 million);
- The investment must be made within five years from the date the Latvian government approves support for the project;
- The investment must be made in one of the specified state-supported industries;
- The investment must result in a new business line or the modernization/expansion of an existing business line (e.g. manufacturing of a new product, changing a manufacturing process, etc.);
- The investment must be made in unused manufacturing technological equipment, telecommunications and computer programming equipment, or buildings and construction; and
- The investment must be in the course of the investor’s business and related to the business activities of the investor.

There are four free zones in Latvia: the Riga and Ventspils Free Ports and the Liepaja and Rezekne Special Economic Zones (SEZ), established in 1997 for a 20-year period to encourage Latvia’s participation in foreign trade, attract investment, develop production and services, and create new jobs. Licensed companies operating in these areas are entitled to reductions in direct and indirect tax rates. Incentives include:

- An 80% rebate of corporate income tax on income derived by licensed companies from business activities within the zone (however, the tax relief may not exceed 25%-70% (depending on the criteria in the law) of the investment value);
- An 80% rebate of withholding taxes on royalties and management fees; and
- The ability to carryforward losses, a rebate of real estate tax, etc.

A company must sign an agreement with the free zone to qualify for the incentives and obtain a license to carry out business activities in the zone.

The Liepaja SEZ is located in the port city of Liepaja on the south-west coast, and covers nearly two-thirds of the city territory, including the port, industrial areas, the airport and the former navy base, Karaosta.

The Rezekne SEZ is situated in the city of Rezekne in the south-east part of Latvia, near the Russian border. This SEZ is designed to help diversify investment away from Riga to a relatively undeveloped area, but has only limited impact, although wood processing enterprises, one of the priority sectors, are developing successfully. The output of Rezekne enterprises mainly targets eastern markets.

The Riga Free Port is located near the capital and is open year round for navigation. The Free Port is expanding, with the goal of becoming one of the leading ports in the Baltic region and providing effective distribution, warehousing and acquisition services.

The Ventspils Free Port, an ice-free port, is the leading port on the Baltic Sea and among the top 15 European ports in terms of cargo turnover. The Ventspils Free Port has the largest crude oil and oil product trans-shipment terminal and the largest liquid chemicals trans-shipment terminal in the Baltic Sea Region, and the second largest potash trans-shipment terminal in the world. The port has a highly developed infrastructure linked to the crude oil and oil product pipeline system and railway network of Russia and other members of the Commonwealth of Independent States.

1.6 Exchange controls

The Latvian government does not have any controls on the import, export, use or exchange of foreign currency in Latvia. Lats may be exchanged for any convertible currency in banks and exchange bureaus. The Bank of Latvia grants cash exchange licenses to Latvian companies, provided the founders and owners of the enterprises have a good reputation.

The Bank of Latvia has adopted the Regulation for Buying and Selling Cash Foreign Currency, and Recommendations to Currency Exchange Bureaus for Developing Procedures for Identification of Suspicious and Unusual Transactions. The recommendations also require that such enterprises identify customers in cases established by the Law on the Prevention of Laundering of Proceeds Derived from Criminal Activities.

2.0 Setting up a business

2.1 Principal forms of business entity

The following forms of business entities are available in Latvia: individual merchant, general partnership, limited partnership, limited liability company and joint stock company. The European Company (*Societas Europaea*, or SE) and the European Economic Interest Grouping also are available, the latter providing an opportunity for Latvian individuals and legal persons to join international partnerships with members from other EU member states.

An individual merchant is an individual who is registered as a merchant with the Commercial Register. An individual merchant is fully liable for his debts.

A general partnership is a partnership with the purpose of carrying out commercial activities, and in which two or more persons are united under a common business name, on the basis of a partnership agreement. The partners in a general partnership are jointly liable for the obligations of the partnership with all their assets.

In a limited partnership, at least one of the partners is a limited partner, who is liable for the obligations of the limited partnership to the extent of his contribution; the general partners are liable for the partnership debts with all their assets.

The share capital of limited liability and joint stock companies is divided into shares or stock. These are the most popular forms of investment vehicle. Both entities have all the rights of a juridical person. In practice, the most common business form is the limited liability company, because it requires fewer organizational formalities and less statutory capital.

Companies from two or more EU member states are permitted to merge to form an SE or create an SE holding company or branch. A company may convert an existing firm to SE status without liquidating. One advantage of an SE is that it is possible to move headquarters to another EU member state with minimal formalities.

Businesses also can establish as a European Economic Interest Grouping (EEIG). Companies (even non-EU companies if the vehicle is a subsidiary in an EU country) that want to start working with a Swedish company, but do not want to commit to a formal joint venture may set up an EEIG. The grouping functions much like a partnership in that the income is taxed in the hands of the member companies. At least two of the companies involved must be from different EU member states.

Formalities for setting up a company

To set up a company in Latvia, the founder(s) must prepare and sign the company's articles of association, form the company's governing bodies, subscribe for the share capital, pay the relevant fees and register the company with the Registry of Enterprises. The registration application must be signed by all founders and be notarized.

Entries made in the Commercial Register are promulgated by publishing an announcement in the official newspaper, *Latvijas Vēstnesis*, and simultaneously in electronic form in the official database, *Lursoft*.

Forms of entity

Requirements of an LLC and a JSC

Capital. *LLC*: An LLC can be established with a minimum statutory capital of LVL 2,000, while a micro LLC can be founded with a minimum statutory capital of LVL 1. The shares of an LLC may not be publicly traded. *JSC*: The minimum statutory capital of a JSC is LVL 25,000; higher amounts are required to establish banks, insurance companies and currency exchanges. The establishment of a branch of a foreign bank is subject to the approval of the Bank of Latvia. Only JSCs are allowed to make public share offerings.

Founders and shareholders. *Both*: An LLC and a JSC can be formed by one or more individuals or legal persons. A nonresident may be the sole owner.

Board of directors. *Both*: A board of directors, appointed by the supervisory council, may consist of a single individual or two or more individuals, unless the company's shares are publicly traded, in which case there must be at least three board members. All board members must be individuals and a member of the supervisory board may not also be a member of the board of directors. The supervisory council is responsible for supervising the board of directors. The council, elected for a five-year term, must have at least three, but no more than 20, members. There are no restrictions on a foreigner accepting the position of director or member of the council.

Management. *Both*: The administrative bodies of a company are the meeting of shareholders and the board of directors, as well as the supervisory council (the latter is mandatory for JSCs). The supervisory council represents the interests of shareholders and supervises the activities of the board of directors.

Taxes and fees. *Both*: The standard state fee for registering an LLC is LVL 100 and LVL 250 for a JSC. The fee must be paid before the application is submitted, and this can be done in any banking institution.

Type of shares. *LLC*: The capital of an LLC is divided into shares, which must have a par value of a whole number of LVL. All shares must confer the same rights; preference shares or different classes of shares are not permitted. *JSC*: The shares of a JSC may be registered or bearer, and may be ordinary, preference or employee shares.

Branch of a foreign corporation

Branch offices are regulated by the Commercial Law and may be established by foreign or local companies. Branch offices must be registered with the Commercial Register.

A branch of a nonresident company is treated as a separate Latvian taxpayer and is subject to the same reporting and audit requirements that apply to domestic companies. A branch for tax purposes is treated as an independently operating entity subject to certain adjustments for transactions carried out with the head office. The head office is fully liable for the activities of its branch.

As a general rule, a branch of a nonresident company is taxed the same as a subsidiary. There is no separate branch profits tax.

Representative office

A representative office also may be established by a foreign company, but a representative office may not engage in commercial activities and it does not have the status of a separate legal entity, although it can be active in advertising and promoting the business of the head office.

2.2 Regulation of business

Mergers and acquisitions

Mergers and acquisitions in Latvia generally are governed by the Commercial, Civil and Competition Laws. The Commercial Law regulates the reorganization of companies, such as mergers, divisions or restructurings, and sets forth general rules for the transfer of shares and assets. The main principles regarding transactions, contracts, and the rights and obligations of the parties are governed by the Civil Law. Mergers are subject to the Competition Law if the combined turnover of the participants during the previous financial year exceeded LVL 25 million and the combined market share of the market participants involved in the merger exceeds 40%. These rules apply in the following cases:

- The merger of two or more independent market participants;
- The amalgamation of one market participant into another market participant (acquisition); or
- Where one or more individual(s) already exercising a decisive influence over a market participant acquires all or part of the fixed assets of another market participant or the right to utilize a decisive influence over another market participant.

The Competition Council monitors and ensures compliance with the Competition Law. Market participants covered by the law must submit advance notification to the Council to obtain permission to merge.

Other laws also may affect mergers and acquisitions, including the Financial Instruments Market Law, which imposes additional requirements on companies listed on stock exchanges.

Merger and division transactions are described in detail in the Commercial Law. An acquisition is a process in which a company transfers all of its assets to another company. In a consolidation, two or more companies transfer all of their assets to a newly founded company. Consequently, all rights and obligations of the acquired company (or companies) are transferred to the acquiring company, the acquired company (or companies) cease(s) to exist without liquidation and the shareholders of the acquired company (or companies) become shareholders of the acquiring company.

If an undertaking or an independent part of it is transferred, the purchaser usually acquires a part of a company's assets. All claims and other rights included in the undertaking or its part are transferred to the purchaser. The buyer and seller are jointly liable for all obligations that become due within five years after the transfer.

The Commercial Law does not impose any restrictions on the alienation of a company's assets, but the company's articles of association may contain additional rules, such as requiring prior consent of the shareholders' meeting or the council of the company.

Mergers with a Community dimension fall within the competence of the European Commission. The EU has jurisdiction over mergers in two situations:

1. Where the combined aggregate worldwide turnover of all of the undertakings concerned is more than EUR 5 billion and the aggregate EU-wide turnover of each of at least two of the undertakings is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover in a single member state; and
2. Where the aggregate global turnover of the companies concerned exceeds EUR 2.5 billion for all businesses involved, aggregate global turnover in each of at least three member states is more than EUR 100 million, aggregate turnover in each of these three member states of at least two undertakings is more than EUR 25 million and aggregate EU-wide turnover of each of at least two of the undertakings is more than EUR 100 million, unless each achieves more than two-thirds of its aggregate EU-wide turnover within one and the same state.

If a merger normally would not fall within the purview of the European Commission, the affected companies may ask the Commission to review it if they would otherwise be obliged to notify three or more member states. The Commission proceeds as a "one-stop shop" only if none of the relevant member states objects within 15 days.

Monopolies and restraint of trade

Historically formed monopolies dominate the state-regulated sectors in Latvia and some services are provided under conditions of a natural monopoly. Although the electric, gas and rail markets gradually are being opened up to competition, these markets currently are dominated by large companies.

The Competition Law includes EU standards, whereby a market participant who has a dominant position is prohibited from abusing this position in Latvia. The Competition Council is responsible for ensuring compliance with the law.

2.3 Accounting, filing and auditing requirements

Financial statements must be submitted annually. The annual report must be audited by a sworn auditor if two of the following criteria are exceeded: (1) total assets of at least LVL 250,000; (2) net sales of at least LVL 500,000; and (3) the average number of employees is at least 25.

Accounting must be done in Lats and the exchange rates of the Latvian central bank should be applied to transactions in other currencies. Bookkeeping is based on requirements in the Law on Accounting, but it contains only general regulations. Records should be kept in Latvian currency or be readily translated in the event of an audit by the tax authorities.

Local GAAP has been developed, but application is not mandatory. Local GAAP is to a large extent similar to IFRS and IAS, which are used mainly as guidance and mandatory only for banks and insurance companies.

3.0 Business taxation

3.1 Overview

In addition to corporate income tax, companies doing business in Latvia are subject to value added tax (VAT), real estate tax, customs and excise duties, social security contributions and a natural resources tax.

A holding company regime applies as from 1 January 2013, under which dividend income and capital gains on share transfers are tax exempt. As from the same date, withholding tax on dividends paid to companies outside the EU/EEA is abolished.

Latvia has implemented most EU directives, including the parent-subsidiary and merger directive, and currently applies an eight-year transition period (until 1 July 2013) to implement the interest and royalties directive. Latvia also has implemented the EU savings directive, which requires the exchange of information between tax administrations when interest payments are made in one EU member state to an individual resident in another member state. Latvia is a party to the EU arbitration convention, which provides for disputes with the tax authorities to be referred to an advisory commission, subject to waiver of rights of appeal under domestic law provisions.

The Ministry of Finance develops financial policy, and coordinates and organizes implementation of policy, in addition to carrying out other functions.

The general tax rules in Latvia are found in the Law “On Taxes and Duties” and the Law “On Corporate Income Tax”.

Latvia Quick Tax Facts for Companies	
Corporate income tax rate	15%
Branch tax rate	15%
Capital gains tax rate	15%
Basis	Worldwide income
Participation exemption	Yes
Loss relief	
− Carryforward	Indefinite
− Carryback	No
Double taxation relief	Yes
Tax consolidation	No, but loss surrender available
Transfer pricing rules	Yes
Thin capitalization rules	Yes
Controlled foreign company rules	No
Tax year	Calendar year or fiscal year
Advance payment of tax	Yes
Return due date	Within 4 or 7 months of end of fiscal year
Withholding tax	
− Dividends	0%
− Interest	5%/10%
− Royalties	5%/15%
− Branch remittance tax	No
Capital tax	No

Social security contributions	24.09% of employee salary
Real estate tax	Varies
Natural resources tax	Varies
VAT	21%

3.2 Residence

A corporation is resident if it is established and registered – or required to be established and registered – in Latvia.

3.3 Taxable income and rates

Resident companies are taxed on their worldwide income; nonresidents are subject to tax on income earned or sourced in Latvia. Nonresident companies operating through a permanent establishment (PE) in Latvia are subject to tax on income derived by the PE in Latvia, as well as income independently derived abroad by the PE.

The corporate income tax rate on resident companies, PEs of nonresident entities and other entities deriving business income in Latvia is 15%.

Taxable income defined

Taxable income is calculated based on the profit or loss as calculated in the annual income statement adjusted for nontaxable and nondeductible items as provided by the tax law. Corporate income tax is levied on all types of business income, including business profits, dividends, interest income, royalties and rental income.

As noted above, a new holding company regime applies as from 2013, under which dividends received are exempt from corporate income tax, unless the dividends are received from companies located in black list countries or territories (see 3.6 for countries included on the black list). Dividends paid by a Latvian resident company to a nonresident are exempt from withholding tax, regardless of where the recipient is resident, and regardless of the extent of the participation or holding period. The exemption does not apply, however, when the dividends are paid to a company located in a black list country or territory.

Business income derived by investment funds, general and limited partnerships, as well as co-operative societies, is taxed only in the hands of the investors and partners.

Deductions

Expenses directly related to the business of a company and, thus attributable to the generation of taxable income, are deductible for tax purposes.

Deductible expenses include interest (subject to the thin capitalization rules), royalties, employee remuneration, directors' fees, service and management fees and R&D costs. Certain expenses that are not directly concerned with the business of the company may be deducted (e.g. representation expenses), but the deduction is limited to 40% of the expense. Certain expenses are nondeductible, generally because they are not "directly" related to the business of a company, e.g. expenses for recreational activities of owners and employees, expenses for private travel, gifts, credits and loans turned into gifts for employees, as well as penalties, fines and interest for late payments of tax.

Tax relief is granted for "substantial investments" (see above under "Tax incentives").

Limits are imposed on the deductibility of expenses incurred by a PE, such as rent, interest or for services, including management and consulting services and technical assistance, paid to the head office.

Depreciation

Fixed assets used for business purposes generally may be depreciated using the declining balance or the straight-line method.

Under a special tax depreciation regime for new manufacturing equipment, which applies until the end of 2013, the acquisition value of new manufacturing equipment for tax depreciation purposes is multiplied by 1.5. The increased rate also applies to patent and trademark development costs if a new patent and/or trademark is registered.

Intangible assets, such as concessions, patents, licenses and trademarks may be amortized using the straight-line method. Concessions are amortized over 10 years, and patents, licenses and trademarks over five years provided they do not expire earlier. Copyrights, goodwill and other intangible assets may not be amortized for tax purposes.

R&D expenses may be written off in the year the costs are incurred.

If fixed assets are leased without an option to purchase (e.g. an operating lease) and are to be returned to the owner at the end of the lease, or if a lease agreement provides for the reconstruction, improvement or renovation of fixed assets, the lessee may write off the amount of such costs in equal parts over the remaining period of the lease. If the lessor compensates the lessee for such expenses, the amount of the reimbursement must be included in the lessee's taxable income.

Reserves/provisions

Although there are no rules permitting tax-free reserves, certain types of companies are permitted to deduct contributions allocated to specific provisions and reserves (e.g. credit institutions can deduct contributions to their statutory deposit insurance funds and provisions made for doubtful debts, insurance companies can deduct allocations to special technical reserves.

Losses

Losses arising in 2008 and thereafter may be carried forward indefinitely (losses arising in prior years may be carried forward for eight years). However, where there is a change in the control of a company, the carryforward of existing losses will be forfeited unless the company continues the same business activities for the subsequent five years. If a company merges, the absorbing company (under certain conditions) may utilize the losses of the absorbed company.

Latvia permits a group of companies to surrender losses to other companies in the group. For purposes of the group relief rules, the parent companycan be a Latvian or another EU/EEA legal entity. To qualify for the loss relief, the parent company must own directly or indirectly at least 90% of the capital of the subsidiary and both companies must have been members of the same group for the entire tax period and not be exempt from tax. In addition, the annual accounts of both companies must be audited and neither company can have any outstanding tax debts.

The carryback of losses is not permitted.

3.4 Capital gains taxation

Capital gains on the sale of property are calculated as the difference between the net tax value of property and the sales price. Such gains are subject to tax at a standard corporate rate of 15%.

Under the new holding company regime, as from 2013, capital gains derived from the alienation of shares (other than shares in companies located in black list countries and territories) are exempt from corporate income tax (and losses are not deductible). There is no minimum shareholding or holding period to qualify for the exemption and "shares" for these purposes means shares in private or listed entities, etc.

3.5 Double taxation relief

Unilateral relief

Latvia generally applies the credit method to avoid double taxation, both unilaterally and in its tax treaties. The credit may not exceed an amount equal to the tax calculated in Latvia on the foreign-source income. To apply the unilateral method, sufficient supporting documentation of the tax incurred abroad must be available; i.e. a document provided by the foreign tax authorities evidencing the amount of foreign taxable income and tax paid.

Tax treaties

Latvia has a solid tax treaty network, the aim of which is to eliminate double taxation and provide for reduced rates of withholding tax on dividends, interest and royalties. The treaties generally follow the OECD model treaty, providing for relief from double taxation on all types of income, limiting the taxation by one country of companies resident in the other and protecting companies resident in one country from discriminatory taxation in the other. Latvia's treaties also adhere to the internationally agreed exchange of information requirements.

To claim treaty benefits, the payer must have a residence certificate from the foreign recipient entity, preferably in the format prescribed in Latvian legislation.

Latvia Tax Treaty Network			
Albania	Finland	Lithuania	Serbia
Armenia	France	Luxembourg	Singapore
Austria	Georgia	Macedonia	Slovakia
Azerbaijan	Germany	Malta	Slovenia
Belarus	Greece	Moldova	Spain
Belgium	Hungary	Montenegro	Sweden
Bulgaria	Iceland	Morocco	Switzerland
Canada	Ireland	Netherlands	Tajikistan
China	Israel	Norway	Turkey
Croatia	Italy	Poland	Ukraine
Czech Republic	Kazakhstan	Portugal	United Kingdom
Denmark	Korea (R.O.K.)	Romania	United States
Estonia	Kyrgyzstan	Russia	Uzbekistan

3.6 Anti-avoidance rules

Transfer pricing

Transfer pricing rules apply to transactions between related parties, whether resident or nonresident. Thus, if goods or services are sold to a related company below market price, or purchased from a related company or a related person above market price, the taxable income of the Latvian taxpayer may be adjusted by the tax authorities based on the effective market price. There are no special documentation requirements, but the OECD guidelines may be applied to substantiate a transaction price.

Under Latvian law, three transactional transfer pricing methods prevail: the comparable uncontrolled price, cost plus and resale methods. Two profit-based methods (i.e. the transactional net margin method and the profit split method) may be used if the first three methods are not sufficient for determining the arm's length price.

Taxpayers are required to document certain transactions with affiliated entities and substantiate the transfer prices. The documentation requirements apply to resident companies and PEs of foreign companies if the company's annual turnover exceeds LVL 1 million and transactions exceeding LVL 10,000 are carried out with:

- Related persons (companies) that are foreign enterprises;
- Related persons (companies) that are part of the same tax group;
- A company or co-op that is exempt from corporate income tax or that benefits from corporate income tax relief;
- Related individuals; and

- Other companies or individuals that are located or established in tax havens.

The documentation must be retained by the taxpayer for five years (to be provided to the tax administration within a month upon request) and must contain the following:

- General overview of the industry;
- Organizational and legal structure of the related parties;
- The taxpayer's tax strategy;
- Information on the business process;
- Description of the services or products and transactions;
- Description of the transfer pricing methodology; and
- Financial analysis of comparable transactions between unrelated companies or an analysis of comparable prices in unrelated party transactions.

Thin capitalization

Latvia's thin capitalization rules restrict the deduction of interest payments. A company may not deduct interest expense incurred on payments made to another entity (whether or not a Latvian entity) that exceed the lower of the following amounts:

- Interest exceeding 1.2 times the average annual short-term credit rate; and
- A 4:1 debt-to-equity ratio. Thus, even if the interest is at a "market" rate, the deduction will be limited if the debt-to-equity ratio exceeds 4:1.

These restrictions do not apply to interest payments made to credit institutions established in Latvia or another EU member state, or to interest payments to the state treasury, a member of the group of the Nordic Investment Bank or the World Bank.

Controlled foreign companies

Although Latvia does not have CFC legislation, payments made by residents of Latvia to entities or individuals registered or domiciled in low- or zero-tax countries and territories included on the government's black list are subject to a special withholding tax of 15%. The tax authorities may exempt payments from this requirement if certain conditions are satisfied.

General anti-avoidance rule

There are no general anti-avoidance rules in Latvia, with the exception of transactions made with entities located in jurisdictions on a black list. Such transactions are deemed to be transactions with related parties and, therefore, the transfer pricing rules apply. A 15% withholding tax is levied on all payments to countries from these jurisdictions.

According to Regulations of the Cabinet of Ministers, the following are considered low- or no-tax countries and territories:

Latvia Black List Jurisdictions/Territories			
Alderney	Dominica	Liberia	São Tomé and Príncipe
Andorra	Ecuador	Liechtenstein	Seychelles
Anguilla	Gibraltar	Macau	St. Helena
Antigua & Barbuda	Grenada	Maldives	St. Kitts & Nevis
Aruba	Guam	Marshall Islands	St. Lucia
Bahamas	Guatemala	Mauritius	St. Pierre and Miquelon
Bahrain	Guernsey	Monaco	St. Vincent and the Grenadines

Barbados	Hong Kong	Montserrat	Tahiti
Belize	Isle of Man	Nauru	Tonga
Bermuda	Jamaica	Netherlands Antilles	Turks & Caicos
British Virgin Islands	Jersey	New Caledonia	United Arab Emirates
Brunei	Jordan	Niue	Uruguay
Cayman Islands	Kenya	Panama	US Virgin Islands
Cook Islands	Kuwait	Qatar	Vanuatu
Costa Rica	Labuan	Samoa	Venezuela
Djibouti	Lebanon	San Marino	

3.7 Administration

Tax year

The taxable period for corporate income tax corresponds with the annual accounting period, and it normally coincides with the calendar year.

Filing and payment

Small and medium-sized companies must file a tax return within four months after the end of the financial year and large companies must file within seven months.

Advance payments of corporate income tax must be made on a monthly basis by the 15th of the month based on the profits of the previous year. The final payment of tax must be made within 15 days of filing the annual return.

Interest and penalties apply for failure to file a timely or for filing an incorrect return. A company may file an amended return or an adjustment to a tax assessment within three years after the required payment date.

Consolidated returns

Latvian law does not contain any provisions allowing for the filing of a consolidated return, but it does permit a group of companies to surrender losses to other companies in the group (see above under “Losses”).

Statute of limitations

The statute of limitations is three years from the end of the tax period in which the tax return was due, unless the tax authorities are conducting an audit or criminal activities are suspected.

Tax authorities

The State Revenue Service (SRS) is the institution responsible for the administration of tax in Latvia. The responsibilities of the SRS include:

- Recording and registering taxpayers and taxable objects;
- Collecting tax and duties and other payments;
- Conducting audits; and
- Carrying out information exchanges as the competent authority for Latvia.

Rulings

The Latvian tax authorities may provide a binding advance ruling on the tax consequences of a proposed transaction, but it is a difficult and seldom used procedure.

3.8 Other taxes

No

4.0 Withholding taxes

4.1 Dividends

As from 1 January 2013, there is no withholding tax on dividends regardless of whether the recipient is an EU/EEA resident company or a resident in a third country, unless the recipient company is resident in a black list jurisdiction, in which case a 15% withholding tax applies.

4.2 Interest

A 10% withholding tax applies to interest paid by Latvian resident companies to associated nonresident companies; the rate is 5% if paid by a commercial bank to an associated nonresident company. The rate may be reduced under a tax treaty.

Under the transitional rules for implementation of the EU interest and royalties directive, a 5% tax will be withheld from interest paid by Latvian resident companies to associated EU companies. The rate will be reduced to 0% as from 1 July 2013.

The withholding tax on interest will be abolished as from 1 January 2014.

4.3 Royalties

Royalties paid to a nonresident are subject to a 5% or 15% withholding tax (depending on the type of royalty), unless the rate is reduced under a tax treaty.

Under the transition rules in the EU interest and royalties directive, Latvia is permitted to apply a 5% withholding tax regarding associated EU companies. The rate will be reduced to 0% as from 1 July 2013.

The withholding tax on royalties will be abolished as from 1 January 2014.

4.4 Branch remittance tax

Latvia does not impose a branch remittance tax.

4.5 Wage tax/social security contributions

An employer in Latvia is required to pay social security on behalf of its employees. The combined social security rate is 35.09% of the employee's gross income (11% paid by the employee and 24.09% by the employer). Reduced rates apply for special categories of employees. Social security contributions cover old age pensions, unemployment, work accidents, disability, maternity and illness.

4.6 Other withholding taxes

Rental payments made to a nonresident for the use of property in Latvia are subject to a 5% withholding tax.

Management fees are subject to a 10% withholding tax unless the nonresident is entitled to an exemption under a tax treaty and the nonresident does not have a PE in Latvia.

5.0 Indirect taxes

5.1 Value added tax

Value added tax (VAT), which is levied on the sale of goods, the supply of services and imports, is based on the EU directives. The standard rate is 21%, with a reduced rate of 12% applicable to certain goods and services. Certain exports and related supplies are zero-rated and some supplies (e.g. medical services, rentals of apartments, and banking and insurance services) are exempt.

A Latvian company may register for VAT immediately after it is registered with the Commercial Register. A company is obliged to register if the total value of its VAT-taxable transactions reaches or exceeds LVL 35,000 during the preceding 12 months. Foreign entities (from the EU or elsewhere) that carry out VAT-taxable transactions in Latvia must register for VAT purposes before commencing transactions, irrespective of the amount of the transactions, unless the reverse-charge method applies.

If input VAT exceeds output VAT, the VAT payer may request a refund. Subject to certain conditions, a refund may also be granted to a foreign entity that has paid Latvian VAT on goods or services purchased in Latvia.

The tax period is the calendar month, with some exceptions. VAT payers must submit the VAT return within 15 days after the end of the tax period.

Latvia allows for the establishment of a VAT group, which may consist of companies that are members of the same concern and Latvian branches of foreign companies, provided the company in question is also a member of the same concern as the other members of the VAT group. Once an election is made to set up a VAT group, the group must be maintained for at least 12 months. A VAT group is considered a single taxable person with its own VAT registration, with one member of the group filing the group's VAT returns. Transactions between members of a VAT group are outside the scope of VAT.

5.2 Capital tax

Latvia does not levy capital tax.

5.3 Real estate tax

Real estate tax is paid by domestic and foreign companies that have a title (registered with the Land Registry) or legal possession of real estate in Latvia. The local authorities levy a real property tax equal to 1.5% of the cadastral value of land and buildings. A 3% tax is levied on agricultural land not in use.

5.4 Transfer tax

The sale of property or a real estate company by a nonresident to a Latvian resident is subject to a 2% withholding tax.

5.5 Stamp duty

Stamp duty is levied on the registration of property by a legal entity. The rate is 2% of the higher of the sales price or cadastral value, capped at LVL 30,000. Different rules apply to reorganizations and contributions in kind.

5.6 Customs and excise duties

Customs duty is imposed on goods imported in Latvia from countries outside the EU upon their release for free circulation. The duty is based on the common customs tariff applicable in all EU member states. In general, the rates are calculated as a percentage of the customs value of the goods (e.g. 0%, 12%) or on a volume basis (fixed rate per unit). The tariff may differ depending on the country of origin of the product.

Excise duty is imposed on oil products, alcoholic and non-alcoholic beverages and tobacco products. The duty is calculated either as a percentage of the value of the goods or on a volume basis (fixed rate per unit). Latvia's excise duty legislation is in accordance with EU rules. Duty payments may be suspended if goods are moved between excise warehouses of EU member states. The duty becomes due when the goods are released for free circulation.

5.7 Environmental taxes

Natural resources tax is levied on taxpayers engaged in extractive activities or first selling packaged goods. The rates depend on the item and certain exemptions are available.

5.8 Other taxes

Tax on lotteries and gambling

The tax on lotteries and gambling is levied on businesses that have a license to organize and run lotteries and gambling games. In addition to the tax, a duty or license fee also must be paid.

6.0 Taxes on individuals

Individuals in Latvia are subject to a number of taxes, including income tax, real estate tax and social security contributions.

Latvia Quick Tax Facts for Companies	
Income tax rates	24%
Capital gains tax rates	15%
Basis	Worldwide income
Double taxation relief	Yes
Tax year	Calendar year
Return due date	1 April
Withholding tax	
− Dividends	10%
− Interest	10%
− Royalties	15%-40%
Net wealth tax	No
Social security	11%
Inheritance tax	No
Real estate tax	Varies
VAT	21%

6.1 Residence

An individual is considered a resident of Latvia for tax purposes if he/she a permanent place of residence in Latvia or is present in Latvia for 183 days or more in any 12-month period, or is a citizen of Latvia and is employed abroad by the Latvian government.

6.2 Taxable income and rates

Resident individuals are subject to tax on their worldwide income, while nonresidents are liable to tax only on their Latvian-source income.

Income is taxable in the year in which it is paid to the individual’s account or the year in which the individual otherwise has received control over the income.

Taxable income

Individuals are taxed on the following sources of income:

- Employment income, including bonuses and benefits (e.g. company-provided housing, company car, lunch vouchers, etc.);Income from the carrying on of a trade or business;
- Income from the provision of personal services;
- Director’s fees;
- Passive income, such as dividends, interest, rents and royalties;
- Benefits received from stock options, share purchase plans and other equity-based plans; and
- Pensions.

The following income is exempt:

- Daily allowances, mileage allowances and other reimbursements related to business trips and paid within the limits set by the Cabinet of Ministers;
- Insurance indemnities, except for indemnities paid on life insurance, medical expenses and personal accident insurance arranged by the employer for the benefit of the employee;
- Income from government bonds of Latvia or another EU member state; and
- Inheritance income, excluding copyright royalties, paid to heirs.

Employee pension insurance and endowment premiums paid by the employer to funds and insurance companies registered in EU/EEA member states can be tax-exempt for the employee up to 10% of the employee's gross annual salary. Non-savings life, health and accident insurance premiums paid by the employer for an employee can be tax-exempt up to LVL 300. These exemptions are applicable if a savings-based agreement is concluded for at least five years and a non-savings agreement for at least a year.

Deductions and reliefs

Latvian residents are entitled to a number of deductions in computing taxable income, including:

- Social security paid in Latvia and other EU member states;
- Expenses for medical treatment, vocational training and obtaining education;
- Health insurance premiums paid to insurance companies; and
- Contributions to Latvian private pension funds or other private pension funds registered in another EU/EEA member state that do not exceed 10% of the individual’s annual taxable income.

Additionally, resident individuals are entitled to a monthly nontaxable personal allowance of LVL 45 and an allowance of LVL 70 for each dependent.

Nonresidents who are residents of other EU/EEA member states that derive at least 75% of their total income in the tax year in Latvia can take the same allowances/expenses as Latvian residents.

Rates

The tax rate on income of a resident individual is 24%. Income from capital and dividends received from EU/EEA resident companies is subject to tax as follows: a 15% rate applies to capital gains (e.g. gains on the sale of shares or stock) and a 10% rate to other types of income from capital (dividends, securities and interest income).

The withholding tax rates applicable to nonresidents are as follows:

- Dividends: 10%;
- Income from participation in a partnership: 24%;
- Interest: 10%, except for interest from state or local government of Latvia, EU/EEA member states debt instruments;
- Royalties: 15% (for the use of a patent); and
- Income from rent of real estate: 24%.

Nonresident individuals owning real estate in Latvia may include gains derived from the sale of property in their annual taxable income and pay income tax of 24% on the profit or alternatively suffer a 2% withholding tax from the proceeds.

6.3 Inheritance and gift tax

Gifts from relatives are tax-exempt, but gifts in excess of LVL 1000 annually received from nonrelatives are subject to a 24% tax. Latvia does not levy an inheritance tax.

6.4 Net wealth tax

Latvia does not levy a net wealth tax.

6.5 Real property tax

Real estate tax is paid by individuals that have a title (registered with the Land Registry) or legal possession of real estate in Latvia. The local authorities levy a real property tax equal to 1.5% of the cadastral value of land and buildings. Residential property not used for commercial purposes is taxed at a rate ranging from 0.2% to 0.6%. A 3% tax is levied on agricultural land not in use.

The sale of property or a real estate company by a nonresident to a Latvian resident is subject to a 2% withholding tax.

6.6 Social security contributions

Social security contributions are levied on both the employee and the employer. The general contribution is 35.09%, which consists of an employer portion of 24.09% and an employee portion of 11%. The employee contribution is withheld by the employer. Nonresident individuals employed by a Latvian employer only have to make social security contributions if they are present in Latvia for 183 days or more in a 12-month period. A foreign taxpayer employed by a nonresident employer for more than 183 days in any 12-month period to whom the EC social regulation does not apply and who does not permanently reside in Latvia is subject to social security contributions at a rate of 33.18%.

6.7 Other taxes

None

6.8 Compliance

The tax year for individuals is the calendar year.

Tax on employment income is withheld from the employment income and is paid to the budget by the employer. Individuals are generally required to self-assess and file an annual tax return by 1 April of the year following the tax year. Self-employed individuals are required to make quarterly advance payments of tax, which may be offset against the final income tax liability.

7.0 Labor environment

7.1 Employee rights and remuneration

The main act governing employment relations in Latvia is the Labor Law, which generally corresponds to EU requirements. All individuals are granted equal rights in employment relationships regardless race, color, gender, age, disability, etc.

Employment contracts must be in writing and set out items such as the term of the contract (if the contract is for a specific period), a description of the work, the employee's position, remuneration and time of payment, working hours, etc.

Working hours

Normal work hours may not exceed eight hours per day and 40 hours per week. In general, an employee must consent in writing for overtime work. Special requirements apply to night shifts or jobs involving irregular hours. A five-day work week is specified for employees, although where the nature of the work makes it impossible to comply with the regular daily or weekly work times for the relevant category of employees, the employer, after consultation with the employee, may prescribe an aggregated working time, which may not exceed 56 hours per week and 160 hours within a four-week period, unless otherwise provided by a collective agreement or an employment contract.

Employees are not required to work on public holidays. If it is necessary to ensure the continuity of the work, an employee may work on a holiday and have another day off or be paid appropriate compensation.

7.2 Wages and benefits

The official minimum wage in 2013 is LVL 200 per month and LVL 1.189 per hour. Employers are not required to provide fringe benefits to their employees.

Pensions

Latvia has a three-tier pension system: first tier (state compulsory unfunded pensions), second tier (state-funded pension) and third tier (private voluntary pension), which ensure financial stability of the system:

- All persons making social insurance contributions fall within the first tier. Current contributions are used for payment of old-age pensions to existing pensioners.
- The social insurance contributions of those who participate in the second tier are invested in the financial market through chosen fund managers and saved for the pension of the specific contributor.
- The third tier ensures the possibility for all individuals to create additional savings for their pension.

The old-age pension is calculated and granted in accordance with the Law on State Pensions. The "premature" old-age pension, taken before an individual reaches the statutory retirement age, is 80% of the full pension entitlement, but it may not be lower than 110% of the state social insurance benefit.

Social insurance

Social insurance covers the risk of lost employment as a result of age, unemployment, workplace accidents or occupational disease, disability, illness, maternity and additional costs in the event of death of the insured or a person supported by him/her. Social insurance benefits include state pension, unemployment, work accidents and occupational diseases, disability, maternity and sickness.

Compulsory social insurance contributions are determined by law and paid into a special fund that gives an insured person the right to receive social insurance services.

Resident employers must pay national social insurance on a monthly basis; contributions from employees of foreign companies must be made and reported quarterly.

7.3 Termination of employment

An employee may be dismissed for cause if the contract has a specified date for termination or if the business of the employer is to be liquidated. The amount of severance pay, if any, depends on the length of time the individual worked for the employer.

If the employer engages in a collective dismissal, it must first consult with the employee representatives.

7.4 Labor-management relations

Although collective agreements are not used frequently, and are largely confined to the enterprise level, trade unions have the right to insist on negotiating such agreements. Collective agreements can contain provisions regarding wage rates, working hours, holidays, benefits, workplace safety and other working conditions. Conflicts may be resolved either by special dispute commissions or in court.

7.5 Employment of foreigners

No work permit is required for EU/EEA citizens or any member of their family. Unless an exception applies, third-country nationals should obtain a work permit. Latvian legislation does not restrict the number of foreigners employed by Latvian companies.

According to government regulations, an offer by an employer for a foreign citizen (except for EU citizens) to work in Latvia must first be approved by the State Employment Service. The Office of Citizenship and Migration Affairs issues the work permit on the basis of an affirmative decision, in addition to visa or residence permits.

8.0 Deloitte International Tax Source

Professionals of the member firms of Deloitte Touche Tohmatsu Limited have created the Deloitte International Tax Source (DITS), an online resource that assists multinational companies in operating globally, placing up-to-date worldwide tax rates and other crucial tax material within easy reach 24/7.

Connect to the source and discover:

A unique tax information database for 65 jurisdictions including –

- Corporate income tax rates;
- Domestic withholding rates;
- Historical corporate rates;
- In-force and pending tax treaty rates on dividends, interest and royalties;
- Indirect tax rates (VAT/GST/sales tax); and
- Holding company and transfer pricing regimes.

Guides and Highlights – Deloitte's Taxation and Investment Guides provide an analysis of the investment climate, operating conditions and tax system of most major trading jurisdictions while the companion Highlights series summarizes the tax landscape of nearly 150 jurisdictions.

Tax publications – Global tax alerts and newsletters provide regular and timely updates and analysis on significant cross-border tax legislative, regulatory and judicial issues.

Tax tools – Our suite of tax tools includes annotated, ready-to-print versions of the holding company and transfer pricing matrices; controlled foreign company information for DITS countries; an R&D incentive matrix; monthly treaty updates; and expanded coverage of VAT/GST/Sales Tax rates.

Webcasts – Live interactive webcasts and Dbriefs by Deloitte professionals give you valuable insights into important tax developments affecting your business.

DITS is free, easy to use and always available!

http://www.dits.deloitte.com

9.0 Office locations

To find out how our professionals can help you in your part of the world, please contact us at the office listed below or through the "contact us" button on **http://www.deloitte.com/tax**.

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