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## Who's deciding your tax bill?

The government

You

# Corporate Income Tax

## New tax rebates

The new amendments to the law "On Corporate Income Tax" will come into force on January 1, 2006. According to the amendments the tax holiday allowance equal to 40% of the total investment for companies engaged in investment exceeding LVL 10 million (EUR 14.2 million within 3 years) is abolished from January 1, 2006. However, a new tax rebate is introduced for new technological equipment. The acquisition value of assets will be increased multiplying it by ratio mentioned below before calculation of depreciation. For fixed assets, acquired starting with 2006, ratio 1.5 will be applied, in 2007 - 1.4, in 2008 - 1.3, in 2009 - 1.2 and in 2010 - 1.1. Therefore, this depreciation will be higher than before, but payable tax less.

For example, if the value of fixed assets is 20000 LVL, then in usual situation at depreciation rate 40% per year, depreciation is 8000 LVL, but applying the ratio, the depreciation is 12000 LVL. A new technological equipment for producing is defined as "a working machinery carrying out entire of certain successive technological operations, resulting in change of characteristics of product in increasing the value of the working object", as well as auxiliaries for these machineries. Such equipment may comprise machinery, textile production units or production lines. If fixed asset will be alienated during the five years from acquisition, prior depreciation shall be added to taxable income within the current year. It is planned that this rebate will be in force until year 2010.

## Writing-off debts

The new rules provide possibility to write-off bad debts, which does not exceed 0.2% from company's annual turnover. Taxpayer shall prove to the tax authority that it tried to collect the debt providing evidences such as correspondence with the debtor. In addition, it shall be proved that costs of recovering the debt are higher as the amount of the debt itself.

## Interest

Deductible interest for corporate income tax is the smallest of the following: a) interest calculated by multiplying 1.2 times the average short term credit interest rate set by the Central statistical bureau within the last month of the taxation year; or b) proportionally ratio of difference of debt against 4 times of equity within the first month of the taxation year.

New restrictions for deducting interest payments will be applicable for all types interest payments for all debts as well as for other payments which according to the economical substance are interest payments independently from their legal type.

# Value added tax

## **Reduced penalties**

If a company misses VAT payment term, the company shall pay late payment interest (0.05% for every late day) and increase in tax debt principal (calculated according to the refinancing rate - at the moment 4.5% -set by the Bank of Latvia).

The new rules provide reducing of penalty from 100% to 10% in cases when input VAT was deducted earlier - in period when company was not entitled to deduct tax.



## **Deduction of VAT in rising of capital cases**

European Court of Justice in May 26, 2005 has passed a judgment in *Kretztechnik (C-465/03)*, in result of which the companies intending to issue shares as a part of the increasing of share capital, will acquire substantial financial gain. This judgment may substantially impact other projects related with the increasing of the share capital, for example, issue of the bonds (debentures) or other securities.

### **1. Questions of the European Court of Justice**

The European Court of Justice has been requested, does the value added tax received by the companies rendering services related with the issuing of shares (for example, legal and bookkeeping services), is deductible and does the issue of the shares shall be considered a supply of services within the meaning of Article 2(1) of the Sixth Directive.

In various EU Member States there are different opinions on the mentioned question. For example, in Austria, Germany and United Kingdom the simple acquisition and holding of shares is not considered as a economic activity. The issue of shares of a taxpayer with

a purpose to reinforce its capital, in order to perform its economical activity, shall be regarded as a taxable transaction within the meaning of Article 2(1) of the Directive. Therefore in these states the deduction of VAT, to be paid for services related with the issue of shares, is blocked.

The VAT in its substance is established to be neutral to the entrepreneurship. A company performing the taxable transactions (supply of goods or services) receives a VAT from its customers. In turn for the received goods and services the company may deduct the paid tax, if the goods or services are connected with the economic activity of the company. In the same time there are services and goods non - taxable with VAT and respectively the VAT is nondeductible

as the input tax. If a company performs supplies both taxable and nontaxable, the input tax shall be deducted proportionally.

Those EU Member States so far blocking deduction of VAT based it on fact, that the issue of new shares is not a VAT taxable transaction. Therefore the VAT paid for the received services connected with the issue of new shares is referable to the nontaxable transactions and shall not be deducted as the input tax. From the mentioned follows that a company issuing new shares is supplying services to the persons acquiring these shares. Thus the paid VAT is non returnable.

### **2. The ruling of European Court of Justice- the VAT is deductible**

The Advocate General and the European Court of Justice has pointed that a company by issuing new shares is planning to increase its assets, acquiring additional capital, whilst granting to the new shareholders the rights to part of the capital thus increased.

The aim of the company- the issuer of the shares- is to raise capital and not to provide services. Regarding payment



of the sums necessary for shareholders for the increase of capital a payment is not of consideration but an investment or an employment of capital. From the mentioned follows that a company issuing new shares in connection with the commencement of quoting of shares, is not supplying services for consideration within the meaning of Article 2(1) of Sixth Directive. The company enters the capital market to finance its commercial activity foreseen in the charter, but not to commence the commercial activity of trading securities. Besides the issue of new shares, which are securities representing intangible property - cannot be regarded as a supply of goods for consideration within the meaning of Article 2(1) of that directive.

The court stated, that in the present concrete case within the concerned operation the costs of the supplies acquired by that company in connection with the operation concerned form part of its overheads and are, as such, component parts of the price of its

products being sold. Factually such services have direct and immediate link with the economic activity of the taxable person. The Kretztechnik performed the supplies of medical equipment fully VAT taxable, therefore it was entitled to deduct all the VAT.

### 3. The application of the judgment in Latvia

In Latvia the Article 6 Para 1 Clause 17 of the law On the Value Added provides that the financial transactions including issue of securities are not VAT taxable. According to the mentioned judgment the Article 7 (1) and (2) of the Sixth Directive 77/388/EEC entitles to deduct all VAT imposed to the costs of the tax payer for various services received within the issue of shares insofar as the transactions performed during the economic activity of this tax payer are taxable transactions. The mentioned shall be applied also in Latvia. The Article 15 Para 4 of the

Administrative procedure Law provides that in applying the legal norms of the European Union (Community), institutions and courts shall take into account European Court of Justice Judicature (case law).

Therefore the judgment of the European Court of Justice may be used in the Administrative court to ground the rights of a company to the deduction of VAT. This judgment of the European Court of Justice may support those companies which will decide to expand their business by issuing new shares. It shall be noted, that the result of that judgment will raise less interest in the companies rendering financial services as well in the banks as their services are not VAT taxable.

The companies suffered from the locking of VAT deduction by some of EU Member States, also Latvia, shall use to return the paid VAT. Thus there may rise situation that those Member States including Latvia so far blocking deduction of VAT will be obliged to repay considerable amounts which were hold using the gaps of EU law.

## Completion of privatization

Recently the parliament has passed the Completion of the Privatization of the State and Municipal Property and Use of the Privatization Vouchers Law entering into force in September 1, 2005.

The privatization is one of the ways how to acquire, the company, the land or building belonging to the state or municipality or shares or other property of the state or municipality in a private company, next to the ordinary alienation procedure. There is still a number of large - scale companies in Latvia which state's shares may under a question of privatization, such as telecommunication company "Lattelekom". The law exempts only some of companies not to be privatized- such a state monopoly electricity

company "Latvenergo", the post company etc.

The law provides the final deadline for the application on the privatization. A person or legal entity may submit the application respectively to the municipal council or Privatization Agency (which is responsible for state property) until the August 31, 2006.

The law sets the threshold for privatization or property compensation vouchers which may be used as a partial payment mean next to the money for the privatized property. A voucher is dematerialized security, assigned by the state. These vouchers are still being sold in the security market. However the government is entitled to decide that in a privatization of a specific

state company the vouchers could not be used.

The Privatization Agency shall prepare the decision on privatization within 2 months and the government shall pass it within 4 months from the reception of the application.

Other novelty comparing to the previous procedure is that the authority shall evaluate if the property proposed to be privatized is necessary for the performance of state administration functions or commercial activities of state or municipality as provided by the State Administration Law. The authority is entitled to refuse the privatization only if the respective property is required for the state or municipality for the mentioned purposes.



# Confidentiality in credit institutions of Latvia



Recently the amendments to the Credit Institution Law in Latvia of 1995 have been passed specifying the regulations for Latvian banks on the disclosure of information on clients and their transactions.

## General principle

The general principal is that a credit institution shall guarantee the confidentiality of the identity, accounts, deposits and transactions of clients. The credit institution shall provide the information regarding the accounts and the transactions conducted by clients to themselves and to their authorized representatives.

## Disclosure of information

The law provides also exemptions from the principle of confidentiality. There are certain state institutions to which a credit institution is obliged to disclose information on clients in specific procedure set by the laws. The information shall be provided to the (i) Financial and capital market Commission; (ii) Money laundering Prevention Service, if a transaction conforms to at least one of the elements included in the unusual transactions list or due to other circumstances there is cause for suspicion of money laundering (iii) courts within the framework of cases being considered and only upon the decision of the judge; (iv) to investigation institutions (police etc.) or prosecutor office only upon the

acceptance by judge of district court; (v) state security and defense institutions upon the acceptance by Chief Judge of Supreme Court or a judge assigned by him; (vi) Corruption Prevention and Combating Bureau; (vii) court bailiffs; (viii) State Treasury and State Audit Office; (ix) Tax Authority, if a customer who is tax payer has not submitted to the Tax Authority the declarations or tax calculations, or has not paid taxes, or during the audit the violations of book-keeping or tax laws have been established, or if the respective credit institution is a payer of savings to the client; (x) sworn notary in inheritance cases.

## International exchange of information

A credit institution shall provide the information on clients and their accounts also to the foreign court or investigation institution or the foreign banking surveillance authority, or the foreign bank of correspondence within the procedure set by the respective international agreements.

The new amendments provides more specific regulatory framework of keeping and providing confidential information in credit institutions in Latvia.

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