

IN THIS ISSUE:

1. Latvia: 2007 Year in Review

2. The New Insolvency law

3. European Union Funding 2007 – 2013

Latvia: 2007 Year in Review

There were several amendments to personal and corporate income tax legislation in Latvia in 2007. The year also brought new developments in Latvia's tax treaty network.

Following is a summary of the main changes to the personal and corporate tax regimes and an update on Latvia's new and pending tax treaties.

Real Estate

Latvia's Parliament on May 17 approved amendments to the Personal Income Tax Law that affect income derived from sales of real property and capital gains on shares held, directly or indirectly, in a company with Latvian real estate assets in excess of 50 percent. The changes took effect on June 12.

Previously, income from sales of shares and real property that was held for at least one year was exempt from personal income tax. If the property or shares were held for less than a year, the applicable personal income tax rate was 25 percent.

Under the new rules, the 50 percent threshold for companies with Latvian real estate assets applies to a current or previous year and is measured by the balance sheet value at the beginning of the tax year.

To determine indirect ownership, shareholdings both in Latvian and foreign companies or parties are taken into account.

The new rules establish that a sale of immovable property that has been in the possession of a person for more than five years, starting from the day the property is registered in the Land Register – or for more than 12 months if the property is the person's place of residence – and that is not declared as a second address is not subject to personal income tax.

However, the old rules still apply for a three-year transition period (until July 1, 2010) under the following circumstances:

- if the owner's property rights were already registered in the Land Register as of June 12, 2007;
- if the owner's property rights were not registered in the Land Register as of June 12, 2007, but such registration will be completed by December 31, 2008;
- if the owner's property rights were not registered in the Land Register as of June 12, 2007, because of a dispute over ownership, but a court has issued a decision accepting the owner's claim statement; or
- if the owner's property rights were not registered in the Land Register as of June 12, 2007, but a decision has been made to restore the owner's property rights.

Corporate Income Tax

Also effective from June 12 was an amendment to the Law on Enterprise Income Tax that excludes from tax-deductible business expenses the purchase price of "representative cars" (cars valued at more than LVL 25,424 (approximately €36,450), excluding VAT). Depreciation and expenses (including interest) related to representative cars also are not deductible.

**Expatriate tax planning seminar**

organized in Riga, on March 12, at 18:00 – 18:45 followed by buffet in Reval Hotel Ridzene (Reimersa Street 1) Kronvalda room. To book for the seminar, please, fill the fax back form or call Amanda at +371 67240090 or e-mail us at amanda.revalde@gencs.lv

Income Tax Treaties

Latvia's long-awaited treaty with Austria, along with its treaty with Macedonia, entered into force in 2007. Both treaties' provisions will apply from January 1, 2008.

The new treaties with Austria and Macedonia state that nonresident construction companies will not have permanent establishments in Latvia if their activity there lasts less than nine months.

In the treaty with Austria, the dividend withholding rate is set at 5 percent if the minimum holding is at least 25 percent. In the treaty with Macedonia, only a 10 percent holding is required for the 5 percent rate to apply. In all other cases, both treaties provide for a 10 percent dividend withholding rate.

The withholding rate on interest is 10 percent in the treaty with Austria and 5 percent in the treaty with Macedonia. Moreover, the treaty with Macedonia stresses that interest does not include any income that may be treated as a dividend.

Regarding royalties, both treaties provide for taxation at source. In the treaty with Macedonia, the royalty rate is set at 10 percent for payments for the use of, or the right to use, cinematographic films and films or tapes for radio or television broadcasting, and 5 percent in all other cases. In the treaty with Austria, the royalty rate is 5 percent for the use of industrial, commercial, or scientific equipment, and 10 percent in all other cases.

It should be mentioned that the two treaties use different approaches to resolve cases of dual residency by a person other than an individual. In the treaty with Austria, such issues will be resolved by way of a mutual agreement procedure. Moreover, if the competent authorities are unable to reach an agreement, the person will not be recognized as a resident of either contracting state and will not be eligible for treaty benefits. However, in the treaty with Macedonia, a person (other than an individual) with dual residence will be deemed to be a resident in the contracting state where it derives such status under domestic law.

In both treaties, there is a small amendment in the definition of immovable property. The treaty with Austria includes in that definition any option or similar right to acquire

immovable property, while the treaty with Macedonia includes any agreement granting a right to purchase or sell immovable property or a similar right with regard to immovable property. The extension of the definition encompasses the same idea in both treaties but is expressed with different wording.

For capital gains, the treaty with Austria provides that income derived from the alienation of shares in a company whose assets consist mainly of an immovable property will be treated as capital gains and taxed accordingly.

Both treaties state that activities by a nonresident involving the exploration or exploitation of the seabed and its subsoil and their natural resources in a contracting state will create a permanent establishment in that state if the activities are carried on for a period or periods exceeding, in the aggregate, 30 days in any 12-month period.

Both treaties also contain extended nondiscrimination provisions for nonresidents, as well as for taxes of every kind and description. Exchange of information provisions also are extended to nonresidents, although the exchange of information will apply only to taxes covered by the treaties.

It should be noted that Austria was one of the EU member states with which Latvia did not have an effective tax treaty. Therefore, the Austria-Latvia treaty has been long awaited in the business community.

There are two more EU member states with which Latvia still does not have effective tax treaties – Italy and Cyprus. The treaty with Italy is already signed and has been ratified by Latvia's Parliament, but it has not come into force because it has not yet been ratified by Italy. Treaty negotiations with Cyprus are still continuing.

Latvia's Ministry of Finance in 2007 concluded treaty negotiations with Albania, Bosnia and Herzegovina, and Morocco, and is continuing negotiations with Tunisia and Cyprus.

It should be noted that although Latvia did not begin work to conclude tax treaties until 1992, it already has quite a large treaty network. As of this writing, it has held negotiations with 57 countries, initialed tax treaties with 55, and signed 47. Of the 47 treaties that have been signed, 44 have entered into force. Latvia's treaty network is expected to continue to grow each year.

The Main Tax Changes in the Tax Area for 2008

Personal Income Tax

Till 1st January 2008 there were differences in taxation between an individual who are engaged in a business activity and taxation of companies. It was a discrimination of two different types of taxpayers who are both doing the same activity but are taxed at the different levels – an individual at 25% rate but company at 15% rate. With the amendments in the law this difference has been removed. Since 1st January 2008 the law provides that an individual who is engaged in a business activity may choose to pay a fixed income tax. The rate of such tax depends from the amount of income gained by this taxpayer.

In other cases the tax rate for individuals who are engaged in a business activity is set at 15% with certain restrictions.

In regard to personal income tax it should be mentioned that from 1st January 2008 the new non-taxable minimum is 80 lats but the minimum salary 160 lats.

Immovable Property Tax

The most substantial changes in the area of immovable property tax area are that from 1st January 2008 immovable property tax rate will be 1% from its cadastral value. In addition to that the law provides with a restriction which settles that if there are no changes in the usage of such property the amount of the immovable property tax in 2008, 2009, and 2010 must not exceed not more than 25% of the amount of immovable property tax calculated in the previous tax period. Such restriction is due to the fact that the State Land Service has made an update for a basis of immovable property cadastral value in 2007 which substantially raised tax burden of immovable property tax payers.

Since 1st January 2011 the immovable property tax rate will be 0,4% from the property's cadastral value. Municipalities will have the rights to increase the tax rate up to 1%. The abovementioned restriction will not apply anymore. ■■

The New Insolvency law

Since 1st January 2008 there have come into force the new Insolvency Law. The new law establishes some substantial changes in this area.

As first substantial change there should be mentioned insolvency criteria for legal entities.

Firstly, it is foreseen that the company will be deemed to be insolvent when applying compulsory measure of execution it was not possible to execute the judgement of the court about the a debt recovery from a debtor.

Secondly, the debtor has not comply with any or several debt commitments which each or all together exceed 1000 lats and for which the date of payment has come, and if a creditor or creditors have handed out or delivered to the debtor's legal address a notification about his/their intent to submit an application for starting a process of insolvency and the debtor within three weeks after the date of handing out or

delivering of such notification has not paid the debt or has not raised any objections against this claim.

Thirdly, the debtor has not fully paid to employees salaries, compensation of damages due to an accident in a work place or a professional disease or has not made social security contributions within two months from the fixed payment day. If there is no payment day fixed in the employment contract, the payment day is the first working day of the next month.

Fourthly, the debtor is not able to settle his debt commitments for which the payment day has come and his debt commitments exceed his assets.

Fifthly, the company will be deemed to be insolvent when at the beginning of liquidation the financial statement will show that the debtor's assets are not sufficient in order to satisfy all reasoned creditor's claims or when such state of affairs turn out in the course of liquidation.

Finally, the debtor is not able to settle his commitments which were established in the action plan of judicial protection process.

The other substantial change in the law is that finally the law regulates insolvency issues in regard to individuals. Those new provisions provide that an individual may submit himself in a court an insolvency application if this individual does not have any possibility to settle his debt commitments for which the date of payment has come and those debt commitments exceed in total 50 minimum monthly salaries or due to provable conditions it will be not possible for this individual to settle his debt commitments for which the payment day will come within one year, and those debt commitments in total exceed 100 minimum monthly salaries.

The transitional provisions of the law provide that the old law will still apply to the insolvency processes which have been started before the new law came into force.

European Union Funding 2007 – 2013

It has been announced that from 2007 – 2013 there will be available 18 state aid programmes which funding in total will be 261,50 millions lats.

Those programmes could be divided in three subgroups: in the first subgroup there are programmes where the entrepreneur will receive funding himself. In the second subgroup, there are programmes where the entrepreneur in order to receive funding should cooperate with his colleagues, competitors and scientists. In the third subgroup's

programmes the entrepreneur will not receive any funding but he will be able to benefit from development of infrastructure and environment.

It is important to note that there are a lot of improvements in the whole process. Firstly, everybody remembers the long queues at the doors of the Investment and



Development Agency of Latvia where people spent many hours in order to submit their projects. Taking into account this experience it has been decided to replace queues with the set of criteria which will be used during the process of evaluation of the submitted projects.



This will allow to classify the projects according to their quality.

Secondly, there have been decreased the amount of documents which should be submitted together with the project. Thirdly, it is allowed to submit the project by post in registered letter or by e-mail using electronical signature. It means that there is no more the need for entrepreneurs who are situated outside Riga to come to Riga and to stand in the queues.

Fourthly, there will be possible in the several programmes to divide the funding in several payments. For example, if the project will last few years it will be possible to receive some part of funding while the project is in its` middle of the realization. It will be possible to have also advance payments.

Finally, it is foreseen that also the process of reports will be simpler. For example, if in the project there are many payments for small amount of money it will be enough to present a printout from a bank account.

As it was mentioned before there will be available 18 aid programmes, for example: the development of the new product or technology, the implementation of the new product in the manufacturing, the registration of the industrial property rights, the attraction of highly qualified employees, the support for a business activity with high added value, the entering in the external market and many other programmes.

It should be noted that almost for all the programmes there are the maximum amount of the money which could be assigned to the respective project as well as there are several business areas in the

some programmes which will not be supported at all. For example, in the programme of the development of the new product or technology there will be no funding assigned to the production of alcoholic drinks or tobacco products.

However, in our view it will be possible for almost everybody to find the programme which is more appropriate to his/her business interests.

NEWS



Gencs Valters Law Firm sponsored on December 15, 2007 in Riga Doms Christmas concert SANTA LUCIA chorus Olaus Petri Vocalis from Orebro (Sweden) and opera singer Inese Galante.



Newly employed

Ilona Bauda joined the firm in end of 2007. She before has occupied position of Deputy head of the tax convention department of the Tax policy department of the Ministry of Finance where she been from 2002. She has extensive experience in field of international taxation. She holds LL.M from the Riga Graduate school of Law.

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