

March 3, 2021

To: Minister of Finance

Copy: Prime Minister of Latvia

AmCham commends the work of the government and the Ministry of Finance in shaping Latvia's tax policy.

Unfortunately, under the current tax system, foreign investors are unable to benefit from the tax convention if they pay dividends, therefore it creates unfavorable conditions for attracting foreign investment. In order to balance the existing tax system for both domestic and foreign investors, we propose amendments to the Law of Corporate Income Tax and the Law on Personal Income Tax, which will ease the tax burden on dividends paid to non-resident individuals. In our opinion, these amendments will improve Latvia's international competitiveness.

AmCham calls to balance tax burden for foreign investors

The current corporate income tax law in Latvia which came into effect in 2018 is disadvantageous for foreign individual investors and hurts Latvia's competitiveness compared to its Baltic neighbors.

Non-resident individual investors (or Latvian residents who are also subject to the tax obligations of another country, such as US citizens) are currently subject to effective economic double taxation on dividends paid by a Latvian company because tax treaty benefits cannot be applied by an individual investor. This hinders Latvia's ability to attract foreign investment compared to its neighboring countries.

With the goal to make the current system more balanced between resident and non-resident individual investors, we propose the following changes:

Allowing a reclassification of up to 10%¹ of the effective corporate income tax (CIT) paid by Latvian companies on the distribution of dividends as personal income tax (PIT) as an election to be made by taxpayers for tax treaty purposes.

The proposed changes are technical in nature and

- i. will not reduce the amount of tax paid into the Latvian budget;
- ii. will not impact the allocation of tax revenues between the state budget and municipal budgets;

¹ OECD BEPS Framework Pillar Two provides for Global Anti-Base Erosion (GloBE) rules, which will introduce a global minimum corporate tax rate set at 15%. The minimum tax will apply to MNEs with revenue above EUR 750 million. [Pillar Two Model Rules in a Nutshell \(oecd.org\)](https://www.oecd.org/tax/pillar-two/)

- iii. will allow non-residents to utilize double tax treaty benefits to reduce their tax burden from investments made in Latvia;
- iv. will make Latvia more competitive in attracting foreign investors.

I. BACKGROUND

1. AmCham invites the government to consider amendments to the corporate income tax regime, allowing a reclassification of up to 10%² of the effective corporate income tax (CIT) paid by Latvian companies on the distribution of dividends as personal income tax (PIT) as an election to be made by taxpayers for tax treaty purposes. The changes we are advancing will enhance the amount of tax revenue in Latvia (more investments, more companies, higher profits to tax at Latvia level).
2. The changes we are advancing are technical in nature and do not impact the aggregate tax rate/amount charged and will not negatively impact the budget. The proposed changes would make the current system level between resident and non-resident individual investors and ultimately make Latvia more competitive to attract additional foreign investment.
3. Since 2018, a higher corporate income tax (CIT) at the effective rate of 25% (or 20% as applied to the tax base divided by the coefficient of .8)³ is applied in Latvia in place of applying personal income tax (PIT) on dividends.
4. The changes of 2018 hurt Latvia's competitiveness in attracting investments into Latvia – especially investments into younger, earlier stage companies (like start ups), since such companies typically attract individual investors (angel investors, similar) since they would incur a higher tax burden on dividend income compared to an Estonian or Lithuanian company.
5. Non-resident individual investors have a significantly larger tax burden which cannot be alleviated by application of double tax treaties which ordinarily is the mechanism used to avoid double taxation on a cross border basis.
6. A non-resident individual investor cannot apply the provisions of an applicable double tax treaty as tax treaty provisions provide for reduction of tax solely on the taxation of dividends and not to the taxation of the profits of the company paying the dividends. Individuals also cannot benefit from the use of Article 10 (Dividends) of tax treaty provisions reducing tax withheld rate to 10%, 5% or even 0%.
7. A non-resident from a country with a traditional corporate income tax system may be subject to additional tax upon the receipt of dividends from a Latvian company, which creates a considerably higher tax burden on non-residents compared to residents of

² Ibid.

³ Article 3, 4 Enterprise Income Tax Law [Uzņēmumu ienākuma nodokļa likums \(likumi.lv\)](http://likumi.lv)

Latvia or Estonia which has a similar corporate tax system to Latvia.⁴ For example a US investor will end up paying an additional 20% tax on dividends received from a Latvian company in the US while a Spanish investors will end up paying an additional 19% on dividends received from a Latvian company because in both cases tax treaty benefits are not available to reduce the tax payable in their residence jurisdictions by amounts of tax paid in Latvia at the company level.

8. Compared to other Baltic countries (Estonia and Lithuania) the current corporate tax system with respect to the payment of dividends puts Latvia at disadvantage in competing for investors. Lithuania has a traditional corporate tax system which allows for better tax treatment with respect to non-resident investors as tax treaty benefits can be applied. Estonia, which has a similar corporate tax system to Latvia, has a more efficient regime in case regular dividends are paid out reclassifying 7% of the corporate income tax paid on distributions as personal income tax allowing a non-resident investor to apply tax treaty benefits to this part of tax. (see attached Appendix 1 comparison chart.)
9. The current system with respect to the taxation of dividends encourages use of holding companies and other more complex, less transparent structures to reduce the tax burden as a clear direct investment/ownership of shares by non-resident natural persons/investors is less attractive from a tax perspective.
10. Evaluating the results of the tax reform implemented in 2018, the Fiscal Discipline Council concluded that the reform has not achieved one of the main goals - an increase in tax revenues against GDP, as well as a sufficiently rapid growth of the tax base.⁵ As a result, it is necessary to find a means to increase tax revenue. It is necessary to encourage attracting additional foreign individual investors, encourage the distribution of dividends and make Latvia more competitive among its Baltic

⁴ Example:

LatCo is a Latvian registered limited liability company.

25% shares are owned by a US investor investor A,

25% shares are owned by a Spanish investor investors S and

50% shares are owned by a Latvian investor, investor L.

LatCo pays out EUR 40,000 in dividends.

LatCo pays corporate income tax (CIT) in Latvia of EUR 10,000.

Investor A must pay additional personal income tax in the US at a rate of 20%. Treaty benefits cannot be applied. Tax burden for Investor A is approx. EUR 4500 (not taking into account FX rates)

Investor S must pay additional personal income tax in Spain at a rate of 19%. Treaty benefits cannot be applied. Tax burden for Investor S is approx. EUR 4400.

Investor L does not pay additional income tax in Latvia on the receipt of the dividends. Tax burden for Investor L is EUR 2500.

⁵ CIT losses as a result of the tax reform in 2018 reached 142.8 million euros (0.49% of GDP), but in 2019 423.4 million euros (1.37% of GDP). <https://www.fdp.gov.lv/lv/media/2988/download>

neighbors. Currently, Latvia lags far behind its neighbors in attracting foreign direct investments.⁶

11. Allocation of the amount of tax collected (CIT of 25% compared to CIT of 15% and PIT of 10% on dividends distributed) among budget line items is purely a technical issue which can be addressed easily. According to the Law on the On the medium-term budgetary framework for 2022, 2023 and 2024, and the Law on the 2022 budget, revenues from personal income tax are allocated 75% to the State Budget and 25% to municipal budgets.⁷ The proposed amendments would not require changing this proportion, nor would they result in more revenue being allocated to municipal budgets. There are two possible ways of addressing any concerns:

- a) taxpayer (CIT payer) and non-resident recipient of dividends make an election (tick the box) for tax treaty purposes only to treat 10% of the current 25% effective corporate tax rate as personal income tax withholding for treaty purposes only; or
- b) tax amounts reclassified from CIT to PIT with respect to non-resident investors remain in the initial “bucket” or classification of tax for purposes of allocation of tax revenues between the state budget and municipal budgets.

12. Enterprise Income Tax Law and Personal Income Tax Law would require amendments to allow for the election and establish the process for making the election to reclassify a part of CIT as PIT for tax treaty purposes on the tax paid on distribution of dividends to non-residents.

AmCham calls policy-makers to review and amend the existing laws and regulations in order to make Latvia more competitive in attracting additional foreign investment.

⁶ In 2020 OECD data indicates that FDI in Latvia was less than one third of the amounts in our neighboring countries of Estonia and Lithuania. [FDI in Figures - October 2021 \(oecd.org\)](#) Table 1 page 8

⁷ [Par vidēja termiņa budžeta ietvaru 2022., 2023. un 2024. gadam \(likumi.lv\)](#) and [Par valsts budžetu 2022. gadam \(likumi.lv\)](#)