

# Doing Business in Latvia

2009



## Contents

1. Introduction.....	2
2. Business environment.....	4
3. Foreign investment.....	7
4. Setting up a Business.....	10
5. Labour .....	13
6. Taxation.....	18
7. Accounting & reporting.....	27
8. UHY firms in Latvia .....	32
9. UHY offices worldwide .....	33

# 1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 70 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Latvia has been provided by the office of UHY representatives:

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Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at February 2009.

We look forward to helping you do business in Latvia.

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## 2. Business environment

Latvia is the central country of the Baltic States (Estonia, Latvia and Lithuania) and is located in North-eastern Europe on the east coast of the Baltic Sea, and is about the same size as Ireland. Most of the country is composed of fertile, low-lying plains, with some hills in the east. About 98% of the country lies under 200m elevation (640 ft.) and the highest point is 312m.

The climate is rather damp, with moderate winters. There are many rivers and lakes. More than half of the land is covered by forest, most of which is pine.

Other than peat, dolomite, and limestone, natural resources are scarce. Latvia has 531km (329 mi.) of sandy coastline, and the ports of Liepaja and Ventspils provide important warm-water harbors on the Baltic.

### Political system

According to the Constitution (Satversme), Latvia is a parliamentary republic in which the sovereign power belongs to the people, who are represented by a unicameral parliament (**Saeima**), with 100 members elected in general, equal, direct, secret and proportional elections for a four-year period.

The Saeima elects the **President** for a term of four years. The same person must not hold office as President for more than eight consecutive years.

The president represents the State in international relations, appoints the diplomatic representatives of Latvia, and also receives diplomatic representatives of other states. The President implements the decisions of the Saeima concerning the ratification of international agreements (Art.41 of the Constitution of the Republic of Latvia).

The President is the Commander-in-Chief of the Armed Forces of Latvia. During wartime, the President appoints a Supreme Commander. The President has the right to initiate legislation.

The candidate for the post of **the Prime Minister** who is invited by the President invites ministers to form the Government. When the candidate for the post of the Prime Minister submits to the Saeima the list of government ministers and the proposed government activity plan and

receives confidence vote by the Saeima, the Prime Minister and the Cabinet of Ministers start to fulfill their functions and exercise authority.

The Prime Minister determines the general direction of Government's activities and ensures coordinated and purposeful work of the Cabinet of Ministers. The Prime Minister leads the work of the Cabinet of Ministers and is responsible before the Saeima. The Prime Minister chairs Cabinet sittings and meetings of the Committee of the Cabinet of Ministers.

**Cabinet of Ministers** is a collegial institution, which adopts its decisions at the sittings of the Cabinet of Ministers.

Cabinet of Ministers, within the scope of its competence, considers policy planning documents, external and internal legal acts, orders of the Cabinet of Ministers, informative statements, national positions and official opinions of the State. Upon approval by the Cabinet of Ministers, all legal acts are published in the official newspaper "Latvijas Vēstnesis".

**Ministries** are top-level direct administration institutions that develop state policies and that are directly subordinated to a respective Member of the Cabinet of Ministers. There are the State Chancellery, 16 ministries, 2 secretariats of ministers for special assignments (in total, 19 top-level public administration institutions) in Latvia. The Corruption Prevention and Combating Bureau also has the status of a top-level institution; it is supervised by the Prime Minister and in charge of development and implementation of state policies for prevention and combating of corruption. 98 institutions are subordinated and 84 institutions – supervised by members of the Government, incl. 30 state agencies. Information about direct administration institutions is publicly available. Database of direct administration institutions is available in the Internet homepage of the Cabinet of Ministers.

### **The domestic market**

Population: 2.266 million inhabitants

Area: 64,589 square kilometers / 24,937 square miles

Capital: Riga

Language: Latvian (official), Russian (widely spoken), English and German (common)

Currency: Lat (LVL)

- Borders: Estonia (343 km), Russia (282 km), Belarus (167 km), Lithuania (576 km), Baltic coastline (494 km)
- Ports: Latvia's three major ports are Ventspils, Riga and Liepaja. Ventspils is the busiest port in the Baltic Sea region.

### **The economy**

The Latvian economy grew at a healthy pace from 1995 until the Russian economic crisis hit in 1998, which slowed growth temporarily. This resulted in negative fiscal and external account developments and noticeable contractions in GDP and industrial production. Towards the end of 1999 the economy picked up again, as the budget cuts recommended by IMF started to show their effect, and trade and FDI figures improved. In 2002, Latvia showed a rather enviable GDP growth rate of 6.1 per cent. Even stronger growth has occurred in the first quarter of 2003 (8.8 per cent). Current forecasts show a GDP growth of 7 per cent expected for the year 2003. If this growth rate is realized, Latvia will have posted one of the highest GDP growth rates in all of Europe.

The Latvian economy is based on service industries including transportation and financial services and on light industry, e.g., wood, textiles, food processing. Most of the light industry sectors suffered due to the Russian crisis and turned Latvian trade increasingly towards Western Europe. In 1997 Latvia's exports to the CIS area were almost 30 percent of the total.

The year 2007 was a turning point in the macroeconomic development of Latvia. As a result of the measures under the inflation curbing plan adopted by the government, the growth that in the past few years was too vigorous is gradually moving towards more sustainable levels, whereas the already steep and still increasing inflation is mostly supported by excessive inflows of a variety of financing: credit resources from foreign parent banks, foreign direct investment, EU funding, workers' remittances from labour income abroad. With the pace of lending, excessively strong domestic demand and GDP growth gradually moderating, the first rebounding in inflation is to be expected in the second half of the year. The adoption of the Euro, projected no earlier than 2012 or 2013, would then reward the Latvian economy for having reduced its inflation levels.

### 3. Foreign investment

Since 1991, the Latvian Government has conscientiously instituted a number of reforms which led to an increase in the level of foreign investment.

Ever since Latvia regained independence, foreign direct investment has been a major driving force of the economy, showing steady growth with FDI stock doubling every 4-5 years. Currently ranked 6th among the new EU states for FDI stock per capita, Latvia continues to enjoy high recognition among both regional and global FDI contributors.

The main sources of foreign direct investment in Latvia have been, and remain neighboring countries in the Baltic Sea region which have been active in Latvia from the very beginning of the 1990s. Currently, investment from Germany, Sweden, Denmark, Finland and Estonia makes up more than 51% of total FDI stock, covering a variety of fields from finance, telecommunications and trade to fully export-oriented manufacturing.

The other group of more remote investing countries is led by the USA, Netherlands and United Kingdom, who tend to choose Latvia both as a market base for the Baltic region and as a favorable manufacturing location. Countries to the east, mostly Russia, have chosen Latvia for transit/value-added logistics operations for their main export commodities – oil products, chemicals and metals.

A large number of international financial services, telecommunication companies and retailers opened their branches in Latvia, thus bringing permanent direct investment into the country and creating a number of employment opportunities.

In general the attitude towards foreign investments in Latvia is favorable (in 2007 the volume of foreign direct investment received per year reached the amount of 1,116.9 mln lats), therefore most any form of foreign investments are freely permitted, for which the national regime is guaranteed – the same rights and obligations as those of Latvian merchants. There are no special laws regulating foreign investments in Latvia, but these investments are performed and protected under general law.



## **Principles of foreign investments**

Although from 1 January 2005 there is no unified law specifically regulating foreign investments, there are a number of principles reflecting the attitude of the State towards foreign investments apparent in the Latvian legal system.

### **Principle of equal protection**

Foreign investors can protect their rights and legal interests with all of the same means of legal protection afforded to local investors under Latvian laws and regulations. Bilateral treaties on reciprocal promotion and protection of investments entered into by Latvia sometimes provide particularly favorable provisions for protection of foreign investments.

### **Principle of equal treatment**

Foreign investors are treated the same way and they have the same rights and obligations as those of local Latvian merchants. The attitude of the state towards all the investors and merchants is equal irrespective of the country of origin of the capital. Bilateral treaties on reciprocal promotion and protection of investments entered into by Latvia sometimes provide particularly favorable provisions for treatment of foreign investors.

## **Forms of investment**

Even though there is no separate regulation of the forms for foreign investment in Latvia, the following forms for foreign investment can be derived from general regulation and practice:

- through foundation or acquisition in any other way of interest in a capital company (limited liability company or joint stock company) or partnership;
- by opening the branch of a foreign company in Latvia, through which a regular business activity can be performed on behalf of the foreign company;
- by purchasing securities or other kinds of financial instruments;
- by creating or acquiring different types of properties and other assets;
- by lending cash funds or transferring use of other types of assets owned by the foreign investor;
- Foreign investors can choose the most appropriate and beneficial form of investment at their own discretion.

## **Protection of Investments**

Latvian law prohibits State and local government institutions to treat foreign investors differently from other persons or to make decisions that are unfavorable specifically for foreign investors, without other legal grounds to do so.

Discrimination against foreign investors is prohibited. Any loss or damage incurred as a result of such discriminating treatment is to be compensated under procedures stipulated by law.

Foreign investments into movable or immovable property, like any other property rights, are protected by the Constitution of the Republic of Latvia (the "Satversme"). The Constitution of the Republic of Latvia provides that the expropriation of property for public purposes is only permitted in exceptional cases on the basis of a separate law and for fair compensation. This means that the State is not entitled to expropriate foreign investments nor to fail to provide fair compensation in case of expropriation by taking into consideration the total value of investments.

All disputes with respect to foreign investments are settled in Latvia under general procedures or in compliance with international treaties entered into by Latvia, including the Convention passed in 1965 *On the Settlement of Investment Disputes between States and nationals of other States*.

## 4. Setting up a Business

Company formation in Latvia is governed by a new Commercial Code effective 1 January 2002. Influenced by German law, the Code brings Latvian commercial law in line with European Union directives, and simplifies commercial law particularly by reducing the number of available business vehicles from 13 to 5. Protection of creditors' and minority shareholders' interests has been given greater attention especially where reorganization of the company or the reduction of capital takes place. The Code is explicit about the liability of company managers and for the first time provides detailed rules for dissolution, liquidation and reorganization of commercial partnerships and companies.

The Commercial Law regulates the general basis of business activity. There are certain fields of business activity, for example, banking and insurance which are regulated by separate laws.

Main types of company in Latvia:

- limited liability company (SIA)
- joint stock company (A/S)
- branch office
- representative office.

There are no restrictions on the ownership of Latvian companies by foreign investors. The overwhelming majority of Latvian businesses are launched as limited liability companies.

In order to be a legal entity and to undertake business activities all companies must be registered with the Latvian Registry of Companies and also as taxpayers with the State Revenue.

A company is formed by filing certain prescribed documents with the Companies' registry. The registration procedure would normally be carried out on behalf of the foreign investor by lawyers or other professional advisers.

Documents have to be filed with the Registry in Latvian. Documents in other languages have to be translated and notarized. All company documents filed with the Registrar are open to public inspection at a nominal charge.

Latvian company law calls for the creation of a three-tier governing structure:

- the shareholders' meeting
- the management board
- the supervisory board (optional for limited liability companies).

At least half of the members of the management board must be domiciled in Latvia.

Both limited liabilities and stock companies have legal personality distinct from that of their shareholders. Shares in a company represent a portion of corporate capital and entitle the holder to a proportional right to corporate assets on dissolution. There is no minimum or maximum amount of shares that a company is allowed to issue, unless otherwise specified in the incorporating documents. "One shareholder" companies are also permissible under Latvian law.

#### **Main features of limited liability company (SIA)**

- The most common business vehicle in Latvia.
- Minimum share capital is 2000 LVL (about 2800 EUR), at least half to be paid up before registration with the Commercial register and another half in the period of half a year from registration of company. Share capital can be paid up also with property contribution. Property contribution in order of its value can be evaluated by founders themselves or there is necessary evaluation of property expert approved by Register of Enterprises of Republic of Latvia.
- Minimum number of Members of the Board is one. The member of administrative institution can be any person without reference to his domicile.
- State duty is 100 LVL (about 71 EUR)
- 24 LVL (about 34 EUR) for publication of record in Commercial Register in official newspaper.

#### **Main features of a joint stock company A/S**

- Popular form for larger companies that wish to raise public capital.
- Minimum share capital is AS is 25 000 LVL (about 35 572 EUR), and minimal share capital must be paid up fully in currency till

submitting of registration application. Share capital can be paid up with a property contribution only after registration of the company and in order prescribed by founding agreement. In Latvia for particular stock companies depending of their type of activities there exist different requirements to minimal amount of equity capital which is necessary to be paid up before founding, for example for stock exchange stock companies it is 142 288 EUR.

- Founders have to appoint the Board and Council. The member of the Board and Council can be any person without reference to his domicile. Minimal number of the Board is one and for Council- three members.
- State duty is 250 LVL (about 355 EUR).
- 24 LVL (about 34 EUR) for publication of record in Commercial Register in official newspaper.

#### **The main features of a branch office**

- The share capital is not necessary.
- The owner has to appoint person who acts on behalf of the branch.
- Foreign-owned branch taxed at same rate as Latvian company.
- Reporting and audit requirements are same as for Latvian companies.
- State duty is 20 LVL (about 28 EUR).
- 16 LVL (about 22 EUR) for publication of record in Commercial Register in official newspaper.

#### **The main features of a representative office**

- The share capital is not necessary.
- Representative offices are not allowed to perform commercial activity.
- The owner has to appoint person who acts on behalf of the branch.
- State duty is 20 LVL (about 28 EUR).

## 5. Labour

### **Employees' rights and remuneration**

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

An employment contract must be concluded in writing and must contain the following mandatory provisions: the term of the contract (if entered into for a specified period of time), work place, position of the employee, general description of contracted work, the amount of remuneration and time of payment, working time, duration of annual paid leave, term for giving notice of termination, information on applicable collective agreements and working procedure regulations. An employment contract can include also other provisions, which the parties deem to be necessary.

An employment contract may not include provisions which are contrary to applicable laws and regulations or collective agreement and which worsen the legal status of an employee.

As a general rule an employment contract must be concluded for an indefinite period of time. In separate cases, an employment contract may be entered into for a specified period in order to perform specified short-term work or work of a seasonal nature. An employment contract entered into for a specified period of time may not exceed a term (including extension of the term) of two years. If upon the expiry of the term of an employment contract neither party terminates the contract, an employment contract for an indefinite period shall be deemed to be concluded.

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 job involving irregular hours. A five-day work week is specified for employees, although if the nature of the work makes a five-day week impossible, an employer, after consultation with the employee representatives, may designate a six day working week. 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

representatives, 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 for by a collective agreement or an employment contract.

Employees can defend their interests directly or indirectly through the mediation of representatives. Employees' representatives can be trade unions or authorized employees' representatives elected by the employees. Within the scope of one company it may be the case where a part of the employees are represented by a trade union and another part by elected representatives.

### **Wages and benefits**

The official minimum wage in 2009 is LVL 180 per month. Employers are not required to provide fringe benefits to other employees.

### **Pensions**

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

- All persons making social insurance contributions fall within the first tier. Current contributions are used for payment of old-aged 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 through private pension funds.

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 accident or occupational disease, disability, illness, maternity and additional costs in the event of death of the insured of the person supported by him or 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.

Foreign nationals employed by foreign companies are subject to a 31.10% national social insurance contribution from the 184<sup>th</sup> day of their stay in Latvia, unless their employment contact in Latvia does not exceed 12 months. Resident employers must pay national social insurance on a monthly basis; contributions from employees of foreign companies must be made and reported quarterly. Voluntary contributions can also be made.

### **Termination of employment**

An employment contract can be terminated in the following cases:

- by notice of termination by the employee
- by notice of termination by the employer
- upon expiry of the term (if the contract is entered into for a specified period of time)
- upon mutual agreement between the employee and the employer
- at the request of a third person or court judgments in criminal matters
- death of the employer – natural person, if employment relationships are personal
- death of the employee.

### **Employment of foreigners in Latvia**



Since Latvia's accession to the EU, the procedure for employing an EU citizen in Latvia has been simplified, because a separate work permit is no longer necessary.

Thus, an EU citizen can be employed in Latvia and he or she can enter into a 49 employment contract, if he or she legally resides in the territory of Latvia. In the case of a long-term employment relationship, if the EU citizen wishes to stay in Latvia for more than 90 days within a six month period, he or she must register with the Office of Citizenship and Migration Affairs and receive a residence permit.

To employ a person in Latvia who is not an EU citizen, a work permit must be received from the Office of Citizenship and Migration Affairs. The work permit can be issued to a foreigner based on a visa (stays in Latvia for less than 90 days within a six month period), the residence permit (stays in Latvia for more than 90 days within a six month period) or asylum seeker's personal identification documents. An employee is permitted to employ a foreigner only in the profession, occupation or position indicated by the work permit of such foreigner. In order to receive a work permit, various documents must be submitted to the Office of Citizenship and Migration Affairs according to each particular situation.

### **Labour protection**

According to the provisions of the Labour Protection Law, an employer has the duty to provide labour protection in the whole company. An employer is responsible for the safety and health of employees at work. All the costs related to labour protection shall be covered by the employer, except for separate cases as required by law.

An employer has the following general labour protection duties:

- setting up of the work environment in such a way as to avoid work environment risks or to reduce the impact of unavoidable work environment risks;
- preventing the causes of work environment risks;
- adapting the work to the individual, mainly as regards the design of workplaces, work equipment, as well as in respect of the choice of work and production methods paying special attention to alleviating monotonous work and work at a predetermined work-rate and to reducing negative effects on employee health;

- taking into account technical, hygiene and medical developments;
- developing a coordinated and comprehensive system of labour protection measures;
- giving priority to collective labour protection measures in comparison with individual labour protection measures;
- preventing the impact of work environment risks on the safety and health of those employees for whom in accordance with regulatory enactments special protection has been specified;
- performing employee instruction and training in the field of labour protection;
- co-operating in the field of labour protection with employees and authorized representatives.

## 6. Taxation

The Law on Taxes and Fees, originally adopted in February 1995, sets out the general principles of taxation in Latvia.

The overriding principle used in the application of tax laws is that, in cases where matters are regulated by a specific law, the specific law (e.g. VAT, corporate income tax) will apply over and above the general Law on Taxes and Fees.

Latvian tax system consists of direct and indirect taxes.

Currently the following direct taxes are in effect:

- corporate income tax
- personal income tax
- social insurance payments (social tax)
- real estate tax.

The below listed are currently effective indirect taxes:

- VAT
- excise tax
- customs duty
- gambling tax
- natural resources tax.

### **Corporate income tax**

Companies established or registered in Latvia, permanent establishments of nonresidents and any other entity deriving business income in Latvia are subject to corporate income tax at 15%. Taxable income is calculated based on the profit or loss as calculated in the annual income statement adjusted for non-taxable and non-deductible items as provided by the tax law.

Corporate income tax is regulated by the Law on Corporate Income Tax, passed on 9<sup>th</sup> February, 1995 with subsequent amendments. Corporate income tax payers are:

- residents: domestic enterprises, which carry on business activity, public and religious organizations, and institutions financed from the state budget or local government budgets, which obtain income from economic;
- non-residents: foreign enterprises, companies, natural persons and other persons - non-residents;
- permanent establishments of non-residents.

Resident companies are taxed on their worldwide income; nonresidents are subject to tax on their business income earned or sourced in Latvia.

Corporate income tax applies to all types of business income, including business profits, dividends, interest income, royalties and rental income.

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

Dividends from domestic subsidiaries and qualifying EU/EEA companies are exempt from tax. If a partnership distributes business income to a foreign partner, it must withhold tax at 15%.

The taxable period for corporate income tax corresponds with the annual accounting period, and it normally coincides with the calendar year. The tax return must be filed within four months after the end of the financial year (generally 15 May of the year following the tax year). However, companies must make monthly advance payments based on the previous year's profits.

### **Personal Income Tax**

The Law on Individual Income Tax was adopted in 1993 and sets out the taxation level of individuals' personal income.

Expatriates are liable for Latvian taxes depending on their tax residency. Latvian residents are taxable on their worldwide income. Consequently non-Latvian residents are liable for the income they receive in Latvia.

According to national legislation, an individual is regarded as a resident of Latvia, if:

- the permanent place of residence is Latvia;
- the person resides in Latvia for 183 days or longer in any given 12-month period beginning or finishing during the taxation year; or
- the person is a citizen of the Republic of Latvia employed abroad by the Latvian government.

Overall, people who do not meet the criteria referred to are considered to be non-residents of Latvia for tax purposes.

Individuals who are not considered to be residents during the year before taxation payments are due are considered to be residents from the date they entered Latvia during the taxation year.

Individuals who are not considered to be residents during the post-taxation year are not considered to be residents for that period of the taxation year after the date that they left Latvia; if during that period they had closer collaboration with another country than with Latvia.

Closer collaboration with another country may be confirmed by ownership of property in that country, contributions to that country's social security system, or the fact that the expatriate's family is residing in a foreign country.

#### **Taxation of Latvian residents**

Latvian residents are liable for personal income tax that is withdrawn at source and remitted to the tax authorities at a flat rate of 23%.

#### **The taxable income of residents is calculated as in the Table, below:**

Calculations as from January 2009

Gross income	1,000
Less: personal allowance	90.00
Less: allowance for dependants	63.00
Less: (on a monthly basis) social security tax of 9%	90.00
Less: (on an annual basis) deductible expenses incurred in the course of obtaining intellectual property rights	
Less: (on an annual basis) deductible expenses for health care and education (maximum LVL150 (EUR215) per person and LVL150 (EUR215) per dependent)	
Less: (on an annual basis) donations to qualifying organisations	

Equals: taxable income	757.00
Times: tax rate of 23%	174.11
Equals: income after taxes	735.89

Exempt income

Personal income tax-exempt income in Latvia is listed below:

- dividends paid by Latvian or other EU companies
- income from deposits in banks registered in Latvia
- lottery wins, if the amount does not exceed expenses incurred on them, maximum LVL500
- income from the sale of personal property, excluding the sale of real estate held for a period less than 12 months
- compensation paid by an employer to an individual (final consumer), provided the individual purchases a certain amount of goods from that company
- insurance benefits received – except compensation payments for life, health or accident insurance if premiums were paid by the employer – upon expiration or breach of agreements
- income derived from Latvian State or municipality bonds
- certain business travel expenses
- a number of government benefits.

#### **Taxation of non-residents**

Personal income tax paid in a foreign country may be accredited against tax payable in Latvia, but not more than 25% of the income taxed abroad. To credit foreign paid tax, reports from foreign tax authorities must be submitted to the Latvian tax authorities. Allowances and deductions are not permitted for non-residents.

Expatriates who have received remuneration abroad and stayed in Latvia for more than 183 days within any 12-month period starting or ending within a year, or who have received a Latvian residence permit, must file a Latvian individual income tax declaration, except where tax treaty exemptions are applicable.

Some guiding principles on how to become fully taxable in Latvia and how to obtain personal tax exemptions in home countries:

### **Social Insurance Payments (Social Tax)**

The Law on State Social Insurance, passed in 1998, sets out the application of mandatory statutory social insurance payments to salaries. Social insurance payments are made to the combined budget. Social insurance payments are collected from: resident employers, employees of Latvian companies, resident employees employed by non-residents, resident expatriates assigned to work in Latvia, and self-employed individuals.

Taxable income subject to social tax is any income derived from work under contract in Latvia and that is subject to personal income tax.

The duty of an employer is to withhold social tax on a monthly basis at the rate of 24.09% of gross income. The total tax that must be paid is 33.09%, therefore the employee must contribute a payment of 9%.

The self-employed (as well as I and II disability group) rate of social insurance payments is 30.48%. Residents working for non-resident employers pay the same amount of taxes as if they were working for residents.

The administration of insurance premiums is the duty of the State Revenue Service (SRS). It issues a social insurance payer registration certificate, with reporting dates listed, to each company.

Employees must be registered by the 5th day of the following month after an employment contract has been signed. Resident employers must submit statements of social insurance contributions till the date set by the SRS.

### **Real Estate Tax**

The Law on Real Estate Tax was passed in 1997. Under this law, taxable entities are individuals, legal entities and non-residents that own or possess real estate in Latvia.

The real estate tax rate is 1.0%. From 1 January 2008, the basis for taxation will be the cadastral value. The first year after completing the construction of a building for business purposes is exempt from real estate tax if the building was completed after 1 January 2001.

### **Value Added Tax**

According to the Law on Value Added Tax (VAT), adopted in 1995, VAT must be charged on any supply of goods or services, on the import of goods, as well as on self-consumption. VAT rates are 21%, 10% and 0%.

The supply of goods is the transfer of their ownership to another entity so entitling the latter to dispose of the transferred possession. The first sale after completion of the construction of a building is also regarded as the supply of goods.

The supply of services is a transaction based on activities carried out by an entity for a consideration. They include the activities of self-employed individuals, the transfer (sale) of any obligations, rights or intangible assets, obligations to refrain from activities or to accept any activity, as well as the lease of goods. Personal (self)-consumption is the supply of one's own goods and services to an entrepreneur, his family members, employees or other persons free of charge.

VAT Rate of 10%

The rate of VAT at 10% came into effect on 1 January 2009. It is applied to pharmaceuticals, veterinary medicines; infant products, certain water-supply and utility services.

### **Zero-rated Supplies and Exemptions**

Pursuant to the law, the following groups of supplies and services are subject to the 0% VAT rate:

- export of goods if documents show that the goods are to be transported outside the EU;
- services which are related to export of goods outside the EU;
- services which are defined as 'not supplied within Latvia';
- goods and services related to the maintenance and service of international transportation;
- on the basis of reciprocity, services and goods related to diplomatic and consular officers enjoying immunity;
- certain services, if the recipient is a non-resident, such as assignment, transfer or grant of intellectual property rights; services related to advertising and public relations; legal, accounting, audit, consulting, interpretation, expert, engineering, market research, and management services, services of patent offices; data processing;
- exchange of know-how, supply of information; supply of staff, except education and training services; leasing except real estate and vehicles; telecommunication services; broker agency services.



A number of goods and services are exempt from VAT, e.g. certain services with an educational value or cultural function, the sale of shares and not-newly constructed real estate, lotteries as well as land.

The 0% VAT rate for intra-community supplies is applied if the recipient of goods is an EU entity which is registered in its home country's VAT register and transport documents demonstrate that the goods were actually delivered. The 0% rate is also applied to intermediaries who re-sell goods to end consumers within EU countries. Reports on such intra-EU supplies must be submitted to tax authorities quarterly.

### **Excise Tax**

Pursuant to the Law on Excise Tax, adopted in October 2004, excise tax rates are as follows by:

- Soft drinks (LVL4 per 100 litres)
- Coffee (LVL100 per 100 kilograms)
- Beer (LVL1.45 per 100 litres for each % proof, but not less than LVL4)
- Wines and other fermented drinks (LVL40 per 100 litres)
- Alcoholic beverages up to 15 proof (LVL42 per 100 litres)
- Alcoholic beverages between 15-22 proof (LVL70 per 100 litres)
- Other spirits and alcoholic beverages (LVL825 per 100 litres)
- Cigarettes (LVL 22.5 per 1000 cigarettes)
- Cigars (LVL11 per 1000 cigars)
- Tobacco (LVL23 per 1000 grams)
- Petrol, diesel (LVL234-300 per 1000 litres)
- Active rates as on 1st February 2009.

### **Customs duty**

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.

### **Gambling Tax**

According to the Law on Gambling and Lottery Taxes, adopted in 2005, gambling and lottery tax is levied on business entities that have been issued gambling licences. The cost of a licence is LVL 300,000 and for every next year LVL25, 000. A totalisator gambling service licence costs 30 000 annually.

Gambling tax is payable annually for each gambling facility and machine. For example, each roulette table is subject to LVL9,600 gambling tax, each slot machine up to 2280, depending on whether it is situated in a casino, another gambling venue or not, and each bingo venue with up to 100 seats LVL12 000, up to 200 – LVL18 000, up to 300 – LVL24, 000 and more than 300 – LVL36, 000. Telephone gambling games must pay 10% of their revenue in tax.

Lottery tax at 8% is imposed on the sale of lottery tickets, except instant lottery tickets, which attract 10% tax.

Starting from January 2007, it is prohibited to set up and operate slot-machines outside casinos and licensed gambling venues.

### **Natural Resources Tax**

According to the new Law on Natural Resources Tax, adopted in 2005 and enforced in 2006, natural resource tax is payable by individuals or legal entities or associations who under the respective licence (if such is required under law) perform any of following actions:

- In the territory of Republic of Latvia (or continental shelf) acquire any taxable natural resources.
- In the territory of Republic of Latvia (or continental shelf) makes taxable pollution
- Import environmentally non-friendly goods or packaged goods for distribution in the customs territory of the Republic of Latvia
- In the Republic of Latvia, distributes locally produced, environmentally non-friendly goods or packaged goods.

Law on Packaging was adopted on 2002. Tax on the packaging of products is calculated on every unit of packaging. The number of packaging units should be specified by accounting documentation and a document listing standard packaging units, or by a supplier's statement, or by agreement on obtaining the goods, or by a cargo waybill approved by a customs authority, or by the consumption of standard packaging units.

If the taxpayer is not aware of packaging type and size, an opinion should

be obtained from the Latvian Packaging Certification Centre.

Tax is imposed on the following packaging types: glass (tax rate in 2007 - LVL0.16, 2008 - LVL0.20, 2009 - LVL0.25 per kg), polymers (2007 - LVL0.40, 2008 - LVL0.60, 2009 - LVL0.65), metal (2007 - LVL0.24, 2008 - LVL0.45, 2009 - LVL0.70), pulp and other natural-fibre raw materials, paper, cardboard (2007 - LVL0.05, 2008 - LVL0.15, 2009 - LVL0.30), laminates with polymer or metal components are taxed according to which component makes up the major proportion in the material.

Tax relief may be granted to a taxpayer who finances projects aimed at reducing environmental pollution, up to the total of the sum invested, or implements a voluntary programme for the management of packaging waste, or participates in an emission-quota-trading system.

### **Special Taxation Regimes**

There are four special economic zones (SEZ) across the country, three of which are situated in the free ports of Ventspils, Riga and Liepaja, and the fourth being an inland zone in the city of Rezekne, eastern Latvia, close to the Russian and Belarus borders. The basic facilitating package available for companies establishing within these zones includes rebates on real estate tax, on corporate income tax on income derived within the zone, on withholding tax for dividends, management fees and payments for use of intellectual property and on VAT. However, it should be taken into consideration that these rebates may not exceed 50% of the amount invested.

Tax holidays are granted by the Authority of each Special Economic Zone or Free Port for companies located in their territory and carrying out entrepreneurial activities only in the territory of that special economic zone or free port.

Such activities as the location of the administrative institutions outside of the territory of a special economic zone or free port, the conduct of negotiations and the concluding of contracts outside of the territory of a special economic zone or free port, the transit of goods from or to the territory of a special economic zone or free port, and other activities not having the nature of the execution of a goods-money transaction are not considered to be an entrepreneurial activity outside of the territory of a special economic zone or free port.

## **7. Accounting & reporting**

### **General information**

The Law on Accounting and the Law on the Annual Accounts of Undertakings are the basic laws regulating bookkeeping and financial reporting in Latvia. The Law on Certified (sworn) Auditors regulates the professional activities of persons carrying out auditing and related services.

### **Legislation**

The Law on Accounting and the Law on the Annual Accounts of Undertakings are based on the 4th and 7th European Union Directives. Latvian accounting principles are being brought into line with the international standards applicable in their respective fields.

### **The Law on Accounting**

This Law sets out the basic principles and rules to be followed in accounting records and stocktaking.

The Law applies to all enterprises and non-profit organizations registered with the Enterprise Register of the Republic of Latvia, regardless of the type of commercial transactions they carry out, or of the type of ownership. It also applies to the permanent establishments (subsidiaries, departments) of foreign-owned enterprises registered with the Enterprise Register of the Republic of Latvia, to all institutions and organizations which are financed from state and municipal budgets, to all public organizations, associations, foundations with limited numbers of participants, religious organizations and trade unions.

### **The Law on the Annual Accounts of Undertakings**

This Law applies to all enterprises and non-profit organizations that are registered with the Enterprise Register of the Republic of Latvia, irrespective of the type of commercial transactions they carry out or of the type of ownership. The law defines which companies must prepare annual reports and which are exempt from this requirement. The law does not apply to farms, fishery farms or to individual businesses where the annual income from business transactions is LVL200, 000 (EUR285, 000) or less at the beginning of the reporting year. In addition, the law does not apply to banks, to credit institutions and insurance companies, nor to private

pension funds, all of which are regulated by special acts passed by Parliament.

### **The Law on Certified (Sworn) Auditors**

This Law sets out the legislative basis for the professional activities of persons qualified to provide auditing services. The law explains the rights and obligations of individual certified auditors and companies providing these services. In addition, the Law elaborates the principles and activities of the Latvian Association of Certified Auditors.

### **Accounting and annual financial reporting**

#### **Accounting records**

According to current legislation, company accounts must clearly present the transactions and financial results of the company, and give a true and fair view of its financial position. The records shall be kept in such a manner as to enable any person qualified in accounting to clearly identify the financial position of a company, the business transactions made during a given period of time, and to ascertain both the beginning and the sequence of each transaction.

The measure of value must be a monetary unit of the Republic of Latvia, and Latvian must be used as the language of accounting. If a partner in the economic entity is a foreign private individual, or a legal entity (registered company), a second language, agreed upon by the parties and acceptable to the auditors, may be used. The accounting records and all the confirming documentation must be stored in Latvia. Each entry in the accounting ledger must be confirmed by a document justifying that entry. A justifying document should contain: the name of the company; the company's registration number; the name, number and date of the document; a description and justification of the transaction; units (quantities, sums) and the signatures of persons responsible for the execution of the transaction and the accuracy of the information presented. The Cabinet of Ministers has passed regulations with additional requirements for specific types of supporting documentation, such as the presence of the company seal, etc. The information and data to be included in an annual report are not considered to be business secrets of the company. All other information included in the accounting records is deemed to be confidential. A company's confidential information shall be disclosed to the auditors, to the tax administration reviewing declared taxes, as well as to other state institutions, in accordance with the procedures provided for by legislation.

The reporting period shall cover 12 months. Usually, the beginning and the end of an accounting period corresponds to the calendar year, however, this period could differ if the minutes of a company shareholders' meeting so provide. Companies forming a group shall have the same accounting period.

The reporting period may be altered. The change must be justified and explained in the notes to the annual report. A newly formed company may have a longer or a shorter accounting period for the first year, but it may not exceed 18 months. The reporting period shall not exceed 12 months if it is changed for an already existing company. The reporting period may also be shorter than 12 months when a company terminates its activities, or changes the beginning of its reporting period.

### **Reporting requirements**

The annual report consists of financial statements and a management report. Financial statements, to be complete, consist of a balance sheet, a profit or loss statement, a cash flow statement, and a statement of changes in equity, with explanatory notes as necessary. The annual report shall give a true and fair view of the company's assets, and of its liabilities and financial position, profit or loss and cash flows, and must be prepared in Latvian.

The monetary unit of the Republic of Latvia shall be used as a measure of value.

The annual report shall be prepared in accordance with the following policies:

- 1) Going-concern assumption – the company will continue as a going concern.
- 2) Consistent use of the same valuation methods from year to year.
- 3) Items shall be valued in accordance with the principles of prudence, i.e.:
  - The annual report reflects only that part of the profit generated up to the date of the balance sheet.
  - All incurred liabilities and losses, both current and those for the previous years, must be taken into consideration, even if discovered within the period after the date of the balance sheet but before the preparation of the annual report.
  - All financial impairments and depreciation during the reporting year have to be taken into consideration,

irrespective of whether the financial result was a loss or profit.

- 4) All income gained and expenses incurred during the reporting year have to be taken into consideration irrespective of the payment date or the date the invoice was issued or received. Expenses shall match the revenues for the reporting period.
- 5) Assets and liabilities must be valued separately.
- 6) The opening balance must match the previous year's closing balance.
- 7) Business transactions must be recorded taking into account their economic content and substance, not the legal form.

These reporting conditions may be disregarded in exceptional cases. Any such deviation shall be explained in the notes, indicating its effect on the assets, liabilities, financial position and the operational results of the company.

### **Consolidated reporting**

Consolidated reporting is regulated by the Law on Consolidated Financial Statements. The parent company has to prepare a consolidated annual report if, for two successive years, figures for the parent company together with its subsidiaries have exceeded any two of the following criteria:

- Total assets: LVL 1 million (EUR 1.4 million)
- Net turnover: LVL 2.4 million (EUR 3.4 million)
- Average number of employees in the reporting year: 250

The preparation of the consolidated annual report requires the application of the same accounting principles to all companies within the group in order to reflect their business transactions in the same manner. If the accounting principles applied in a subsidiary differ from those applied by the parent company, adjustments must be made to the subsidiary's records when producing the consolidated annual accounts. If it is not possible to adjust the records, this shall be pointed out and explained in the consolidated annual report. Furthermore, the proportion of the subsidiaries applying different accounting principles in the consolidated annual accounts must be indicated.

### **Statutory audit of financial statements**

In the event that the company exceeds two of the criteria listed below, the annual reports must be audited by a certified auditor or by a firm of certified (sworn) auditors, duly elected by the shareholders:

- Total assets: LVL 250 000 (EUR 356 000)
- Net turnover: LVL 500 000 (EUR 711 000)
- Average number of employees in the reporting year: 25

A company must submit a copy of the annual report and the auditor's report (if the company is audited) to the State Revenue Service, and to the Enterprise Register no later than one month after the annual report is approved, and no later than four months after the end of the reporting year. The time period between the submission of the above-mentioned documents, and the end of the reporting period shall not exceed seven months where the following criteria are exceeded:

- Total assets: LVL 1 million (EUR 1.42 million)
- Net turnover: LVL 2 million (EUR 2.8 million)
- Average number of employees in the reporting year: 250



## 8. UHY firms in Latvia

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## 9. UHY offices worldwide

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