News

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November

4/2017

EFFECTS ON BUSINESSES FROM UPCOMING TAX REFORMS

Year 2018 will come with some significant tax reforms in Latvia and Estonia affecting businesses of all size. Latvia is introducing 0% tax rate on reinvested profit, Estonia is lowering the income tax rate for regular profit distribution and other measures to improve the competitiveness of each country are taken. To give a better insight in the upcoming tax reforms, LEADELL law offices have prepared comparative overview of the most important changes.

TAX FOR REINVESTED PROFITS

One of the main changes in Latvia that will come into effect on 1st January 2018 is the 0% corporate income tax (CIT) rate on reinvested profit. The aim of the tax reform is to motivate entrepreneurs to keep the money in the company. It should improve the capitalization and facilitate the fund raising for further development of the company. It is also anticipated that 0% rate would improve attraction of foreign investments, as it would greatly facilitate cash flow during the investment period. This system already is working in Estonia. While, in Lithuania there are similar initiatives under consideration; however, no specific decisions are made yet. At the moment, in Lithuania a standard CIT in amount of 15% applies also on reinvested profits. Nevertheless, some significant differentiated CIT rates in Lithuania should be highlighted - entities whose average number of employees does not exceed 10 and whose income over the taxable period does not exceed EUR 300 000 is usually taxed at a rate of 5%. The same rate of 5% is applied for agricultural companies. Moreover, the participation exemption is applied in Lithuania which means that dividends received by a Lithuanian entity from Lithuanian or foreign entities where the Lithuanian entity that receives dividends continuously (for at least 12 past months, including the moment of distribution of dividends) owns more than 10% of voting shares (interest) usually is not subject to the income tax.

With the new CIT regime, a new taxation period of one calendar month is introduced in Latvia and Estonia. The taxation period in Lithuania is 1 fiscal year. In addition to that, all three Baltics states provide a different calculation coefficient for the taxable base, which is 0.85 in Estonia, 0.8 in Latvia and 0.86 in Lithuania.

PROFIT DISTRIBUTION

Amended tax regulations will apply in Latvia and Estonia also in case company decides not to invest its profits back in the company, but rather to pay dividends to shareholders. In Latvia the tax rate will be increased from 15% to 20%, but in Estonia on the contrary - a lower income tax rate of 14% will be available for regular profit (amounts that are lower or equal to the average divided profit of previous three years) distributions. The profit distributions exceeding regular profit amount are still charged with the standard 20% rate. In Lithuania the general tax rate applicable to profit distribution is 15%.

0% corporate income tax rate on reinvested profit in Latvia.

Reduction of tax rate for regular profit distribution in Estonia is a major move. The amendments were elaborated to motivate entrepreneurs to distribute the profit of previous tax periods and keep the profit

	LV	LT	EST
Corporate income tax for reinvested profits	▪ 0%	▪ 15%	▪ 0%
Taxation period	▪ 1 calendar month	▪ 1 fiscal year	▪ 1 calendar month
Charged amount subject to rate	▪ 0.8	▪ 0.85	▪ 0.86

A lower income tax rate of 14% in Estonia for regular profit distributions.

distribution active also in the forthcoming periods. As a result of these amendments, it becomes more useful for companies to distribute profit throughout years as stable as possible since the tax liability will be significantly lower in such a case. It should also increase the competitiveness of Estonia in comparison to the rest Baltic countries and make Estonia more attractive to investors.

	LV	LT	EST
Tax rate in case of profit distribution to legal entities	▪ 20%	▪ 15%	▪ 14%* ▪ 20%**

*for regular profits
**when exceeding regular profits

The same rate as it is for legal entities will be applied also to natural persons for profit distribution in Latvia. In other words, 20% rate will be applied and no additional personal income tax shall be due. However, in Estonia and Lithuania additional taxation is applicable. In Estonia the profit charged with 14% rate and distributed to a natural person is subject to an additional 7% income tax withholding by the company paying out the dividends. In Lithuania the profit is charged with 15% rate and natural persons are also charged with additional 15% of personal income tax. Accordingly, Latvia for shareholders – natural persons should be in a more favorable position by the given lower tax rate.

	LV	LT	EST
Tax rate in case of profit distribution to natural persons	▪ 20%	▪ 15% + 15%	▪ 14% + 7%

NON-REFUNDABLE AND LONG-TERM TAXABLE LOANS

Adopted amendments will also affect the lending among related companies. Estonian government attempts to guarantee a better inflow of income tax by taxing non-refundable or long-term loans that have been given by a subsidiary to a parent company or another company functioning on a higher rank in the chain of companies, also to a so-called sister company, and the loans exceeding the total amount of loans taken by this company and the contributions made into the equity. The same model is also introduced in Latvia with the amendments coming into effect on January 1st, 2018. Such system is already working in Lithuania. The aim of the said amendments is to prevent hidden take-out of profit from companies. Before the amendments companies used to pay the profit without any income tax to the parent company, calling it a loan. In practice this means that loan is given for an extremely long period or the term of payment is extended several times. Actual interest rate is hardly ever paid from the loan but it is added to the amount of loan. The enforcement of these amendments should end such behavior and guarantee that the transactions for taking out profit in the future would be charged with the standard income tax rate.

Reduced corporate income tax rate of 5% available to small companies and agricultural companies in Lithuania.

TO SUM UP:

- Latvia is becoming more attractive for investors by introducing 0% CIT rate on reinvested profits.
- Estonia will have the lowest CIT rate of 14% for regular profit distributions for legal entities.
- Profit distribution to natural personas in Latvia will not be taxable with personal income tax.
- Lithuania is more attractive for small and agricultural companies with the reduced CIT rate of 5%.
- No more hidden profit takeout in form of long term loans to related companies.