Notifying tax authority of lending to individuals before 1 June (1) (3/21/17)

We have written earlier about situations where individuals are required to file their income tax return for 2016 with the State Revenue Service (SRS) before 1 June 2017. This is also the deadline by which the SRS must be notified of any loans made to individuals in past tax periods. This article explores loans that are treated as income and cases where loans must be reported to the SRS.

General criteria for loans and loan agreements

Under section 8.1(1) of the Personal Income Tax (PIT) Act, the general principle for treating a loan as income is very straightforward. A loan is treated as income if –

1. the individual is not borrowing for their trade or business, and
2. the loan is not repaid within six months after the repayment date stated in the loan agreement, subject to a cap of 66 months after the loan date.

In any case, multiple loans from a single lender totalling up to €1,500, loans from one or more lenders for payment of medical expenses, and loans to the spouse or relatives up to the third degree are not treated as income.

Whether a loan is treated as income or not, the PIT Act lays down a number of criteria also for the loan agreement. While the criteria listed below do not affect treating a loan as income, in cases where one is considered income, they will determine its PIT treatment. The general criteria governing any agreement for a loan to an individual (including employees and shareholders) are as follows:

1. The loan agreement must be in writing. If the loan comes from a non-Latvian resident that resides outside the EU/EEA, and Latvia does not have an effective double tax treaty with the lender’s country of residence, or if the lender is based or established in a tax haven, the loan agreement must be prepared as a notarial act.
2. The loan and its repayment must be by bank transfer (remember that from 1 January 2017 the Taxes and Duties Act lays down a number of restrictions on cash transactions if the transaction exceeds €7,200).
3. The repayment period set in the loan agreement is up to 60 months.
4. The company’s total lending to individuals must not exceed its shareholders' equity (according to its last approved financial statements).
5. The lender – an individual or entity – must have no tax debt on the loan date aged more than one month after the tax deadline specified in the relevant tax law.
6. The maximum loan must not exceed 30% of the borrower’s average monthly gross income with the lender over the last 12 months before the loan date multiplied by 60.
7. If the borrower – a shareholder – gains no income from the company, the maximum loan must not exceed the portion of its shareholders' equity attributable to the borrower (according to its last approved financial statements).

Where a loan is treated as income and one of these criteria is not satisfied, the lender (a resident entity) will be responsible for applying PIT.

(to be completed next week)