

# Claiming social contributions as tax deductible expense (3/13/18)

The ongoing tax reform has not significantly affected the personal income tax (PIT) treatment of mandatory national social insurance contributions (NSIC). This article explores some points that have changed or might not be usual when it comes to claiming NSIC as a deductible expense for PIT purposes.

Claiming NSIC for PIT purposes: changes affecting employees

The PIT Act in force until 2018 put the following restrictions on claiming NSIC as a deductible expense:

1. only the employee part of NSIC can be claimed as a deductible expense;
2. the employee part of NSIC has been deducted from the person's gross pay;
3. NSIC have been paid in Latvia or an EEA country under its national legislation;
4. NSIC is claimed as a deductible expense for PIT purposes only once, i.e. in one country.

In 2018 these conditions stand and a further condition is added:

5. Income from which NSIC have been deducted must be charged to Latvian PIT (Section 10(9) of the PIT Act).

So this income is not eligible for an exemption from Latvian PIT. What this means in practice is that up to 31 December 2017, for example, any NSIC that had been paid in Latvia, but charged and deducted from foreign employment income not subject to Latvian PIT, could be claimed as a deductible expense. Such a situation might arise, for example, if a person held a Latvian A1 certificate and NSIC were paid in Latvia on the entire Latvian and foreign-source income. Thus, it was possible to recover any PIT overpaid in Latvia through the annual income tax return by claiming the entire employee part of NSIC paid during the year if that had been deducted from the foreign-source income. Please note that this is no longer possible from 2018.

In practice we have seen the State Revenue Service (SRS) apply the new rule retrospectively. For example, a person posted from Latvia to Lithuania in 2016 gained employment income in both countries, and NSIC were also deducted and paid in both countries because an A1 certificate had not been taken out in either country. Since the employee part of NSIC could not be claimed as a deductible expense for Lithuanian PIT purposes, the NSIC paid in Lithuania could be claimed as a deductible expense for Latvian PIT purposes under the PIT rules in force until 2018. However, when the income tax return for 2016 was filed in 2017, the SRS applied the proposed amendments retrospectively and refused a PIT refund. This means that additional liaison with the SRS is required to prove that the new rule is not applicable retrospectively.

Using NSIC for PIT purposes in other situations

Please note that NSIC can also be claimed as a deductible expense in the following cases.

## *1) Secondment*

Example 1. A Latvian company employs a person on secondment from a foreign group company. The employee holds an A1 certificate from the relevant EU member state and NSIC are paid only in that member state (in this case no contributions may be paid in Latvia!). If the foreign country recognises an employee part of NSIC and if that part has been deducted from the employee's gross pay on which Latvian PIT has been paid, and if those contributions have not been claimed as a deductible expense abroad, then they can be claimed as a deductible expense in Latvia through the annual income tax return. This option is available also to non-residents that have gained less than 75% of their annual income in Latvia.

Example 2. A situation involving an employee working for a Latvian company and its related company in, say, Estonia at the same time is technically more complicated. The Latvian company pays salary and deducts PIT at source according to the number of days worked. In other words, if the employee spent 70% of working days in Latvia and 30% in Estonia, then PIT is payable proportionally on 70% of the salary in Latvia and on 30% in Estonia. At the same time, NSIC are paid in Latvia only. Basically in this situation only 70% of the NSIC paid could be claimed as a deductible expense for Latvian PIT purposes. However, the employer should check with the SRS how to properly complete the employer's salary statements to prevent the employee from having to pay additional PIT at the end of the year because the employer has applied too much of the NSIC as a deductible expense each month.

## *2) Labour hire*

Under provisions of the PIT Act and Cabinet Regulation No. 899 for charging PIT and NSIC on labour hire, NSIC should be deducted from the hired employee's income in full, i.e. not only 11% but 35.09%. Since the requirement for deducting NSIC from the person's gross income is met, the entire NSIC deduction (i.e. 35.09% of gross income) can be claimed as a deductible expense for PIT purposes.

## *3) Self-employed pension contributions*

We have written about [changes to social tax contributions affecting self-employed persons and recipients of royalties](#).

Please note that any contributions a self-employed person pays at 5% of the difference between their actual income and income subject to NSIC that have been deducted from gross income can also be claimed as a deductible expense.

However, a royalty recipient's pension insurance contributions paid by the payer of royalty income out of their own funds cannot be claimed as a deductible expense because they have not been deducted from gross income.