Special discounts to employees: tax issues (2/36/19)

Businesses are developing a variety of methods for attracting, motivating and retaining customers and employees. Those methods usually mean expenses that need correct tax treatment. We have written about customer loyalty event expenses here.[1] This article explores some of the tax issues arising from special discounts a company might provide to its employees.

Background

Retailers and manufacturers as well as service providers typically offer their employees special discounts for the goods they sell or make and for the services they provide. Employee discounts often exceed those allowed to customers. This could be simply a higher discount or an opportunity to earn loyalty points faster. In any case, if we compare the benefits provided to employees and those available to customers, we can see that employee discounts on the same product or service are higher.

Personal income tax rules

Under the Personal Income Tax (PIT) Act[2] and rules passed by the Cabinet of Ministers,[3] PIT should be charged on all benefits provided to the employee and their family members under their employment contract. An anonymised tax ruling published by the State Revenue Service[4] says that discounts to employees are a benefit they receive under their employment contract. This implies that any employee discounts are subject to PIT.

However, the Cabinet rules also say that PIT is payable on the market price of goods or services.[5] One of the simplest methods would be to determine the difference between benefits provided to customers (i.e. the market price) and those provided to employees so that PIT would apply on the difference only. We have also heard this view from officials at the Ministry Finance.

Practical PIT treatment

In practice, of course, it might not be so easy to compare the market price and the discount allowed to employees, particularly if a company offers a variety of discounts.

We believe that businesses using this scheme with a straightforward discount system should charge PIT on the difference between customer discounts and employee discounts. This would also be the safest approach in mitigating PIT risk.

A more complicated system would need a detailed evaluation to understand whether it is possible to determine arm’s length discounts and how this can be done. As a result of this evaluation, it would be advisable to prepare a defence file (similar to transfer pricing documentation) for supporting the market price of the benefit. This document would definitely help in negotiations with the State Revenue Service if the company is undergoing a PIT audit.

[1] https://www.pwc.com/lv/lv/news/klientu-piesaistes-izdevumi-jauna-uin-likuma-gaisma.html
[2] Section 8(2) of the PIT Act

[3] Paragraph 18.1 of Cabinet Rule No. 899, *Applying provisions of the Personal Income Tax Act*

[4] https://www.vid.gov.lv/sites/default/files/28.06._vid_np_iin_piemerosana.pdf

[5] Paragraph 18.3(4) of Cabinet Rule No. 899, *Applying provisions of the Personal Income Tax Act*