Proposed changes in personal taxation from 2021 (3/40/20)

On 2 September the Cabinet of Ministers debated an informational report prepared by the Ministry of Finance ("MOF") on how to develop future tax policies that would promote Latvia's social sustainability and economic competitiveness. The report identifies a number of issues in the tax system, which are to be resolved by a number of tax policy changes in 2021, 2022 and 2023. This article explores how the MOF proposes to change the rates of mandatory national social insurance ("NSI") contributions, personal income tax ("PIT") and solidarity tax, as well as income-differentiated personal allowances from 2021.

The MOF says these changes aim to reduce the tax burden and make Latvia more competitive at Baltic level, particularly in industries with a high added value, by minimising the inequality of income from 2021.

A reduction in the NSI rate

The first proposed change is to shave one percentage point off the NSI rate and return to the rate split applicable in 2014–2017:

- The worker rate would be 10.5% (this year 11%);
- The employer rate would be 23.59% (this year 24.09%).

As we can see, the percentage point has been split in half to ease the employer and the worker equally.

Solidarity tax ("ST")

ST is to be adjusted according to the total reduction in the NSI rate. Specifically, from 2021 the MOF suggests making the ST rates equal to the proposed NSI rates (10.5% for the worker and 23.59% for the employer monthly). The annual ST rate would remain at 25.5%, as it has been this year and last year.

Given the NSI reduction, changes are also proposed to the ST rate split:

- The worker rate – the rate paid into the PIT account – 10% (this year 10.5%);
- The employer rate – the pension insurance contributions rate – would be set according to the post-reduction NSI rate split (this year 14%). A key change from 2021 is that this part of ST would go into the special budget of state pensions at large.

Another aspect to consider is that the proposals allocate one percentage point to the mandatory health insurance payment.

Personal income tax

As ST is currently compensatory in nature, some of it is paid into the person's PIT account and annually offset against the PIT liability arising between the applicable second progressive PIT rate of 23% and the third – the highest – PIT rate of 31.4%.[1] This top rate should also be adjusted to match the proposed changes in the NSI and ST rates.

With half a percentage point to be shaved off the ST rate, i.e. the worker part paid into the PIT account (currently 10.5% and 10% from 2021), the third progressive PIT rate would shrink from 31.4% to 31%. The

MOF estimates that the PIT rate reduction should offset the changes in the ST rate so that the ST payer has no additional PIT to pay annually. Accordingly, from 2021 a 31% PIT would apply on the slice of annual income that exceeds the maximum income subject to NSI (EUR 62,800).

No change is expected to the first or the second progressive PIT rate:

- a 20% PIT will be charged on an annual income of up to EUR 20,004;
- a 23% PIT will apply on the slice of annual income between EUR 20,004 and EUR 62,800.

Income-differentiated personal allowances (“IDPA”)

The MOF suggests raising the upper limit of income eligible for IDPA. There are plans to set the limit at EUR 1,800 a month in 2021 (currently EUR 1,200). This would make IDPA available to more taxpayers, as the proposed increase of EUR 600 is six times as much as the earlier increment of EUR 100 annually beginning from 2018, when the upper limit was EUR 1,000.

As before, any income that reaches or exceeds the upper limit would get no IDPA (EUR 0).

No change is expected in personal allowances, which would remain at EUR 300 a month (EUR 3,600 a year) in 2021. And no change is expected in the upper limit of income eligible for a personal allowance (EUR 500 a month).

We will be writing about some other proposed changes to personal taxation next week.

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[1] The SN compensatory mechanism operates for taxpayers whose income attracts ST.