Personal Income Tax Act to be amended in 2022 1/45/22

Director, Tax, and Head of Pan-Baltic People and Organisation Practice, PwC Latvia

Irena Arbidane

Amendments to the Personal Income Tax (PIT) Act were announced on 31 October 2022. The outgoing government has managed to introduce a number of important legislative changes. This article explores changes to the special rules of section 11.13, governing how income from an investment account is determined.

Overall the amendments affect the following areas:

1. Additions have been made to the list of income types that will not be included in the person's annual taxable income and will not be considered taxable income.
2. The procedure for determining taxable income derived from business has been changed.
3. Clarifications have been made to determine business income for taxpayers with double-entry bookkeeping.
4. Changes have been made to the special rules for determining income from an investment account to secure an easy exchange of information for investment account holders.
5. There is a new rate of 5% on a non-Latvian resident's interest income (and equivalent income) if the PIT Act's criteria are met.
6. The date has been specified on which income arising on the disposal of a capital asset during an individual's insolvency proceedings is treated as received.
7. An individual's interest income (not related to employment and not exempt) paid into an investment account by business operators and other persons will be subject to the usual procedure for taxing interest income paid into an investment account.
8. The PIT Act's transitional provisions have been added to.

Income from an investment account

If an individual invests or trades in securities, then income arising on asset sales generally attracts a 20% PIT. However, if dealings in financial instruments involve an investment account and the requirements of section 11.13 are met, then a favourable PIT regime is available. This means that a 20% PIT must be charged only when the amount of money paid out of the investment account exceeds the amount paid into it.

Let us now examine the current law – before the amendments come into force – and then look at the new law.

The old PIT treatment of investment accounts opened in Latvia

The special rules placed the onus of notifying the State Revenue Service (SRS) about the registration and opening of a Latvian resident's investment account on the financial institution, or on the investment

account holder if the investment service provider failed to report account information. In practice, confusing situations might arise where both the account holder and the financial institution believed the duty of notification was on the other party, so neither of them notified the SRS and an investment account might have gone unrecognised by the SRS.

In certain situations, the financial institution had failed to evaluate the duty of notification, so details of the customer's investment account did not reach the SRS.

The new PIT treatment of investment accounts opened in Latvia

Section 11.13 of the PIT Act will now have rules stating that a Latvian-registered investment service provider or a foreign-registered investment service provider's branch in Latvia, with which the taxpayer has opened an investment account, is required to report investment account information by the end of the tax year. Thus, only financial institutions will be responsible for providing the SRS with information on investment accounts opened in Latvia. These changes are expected to prevent misinterpretation because the duty of notification is now placed on one party only.

The old PIT treatment of foreign investment accounts

The PIT Act created some uncertainty about providing the SRS with information on the opening of an investment account, without laying down a particular rule to explain this.

The new PIT treatment of foreign investment accounts

If an investment account is opened abroad, the holder must notify the SRS of investment account status being granted to that account by the end of the tax year.

The new PIT rules for the investment account holder's protection

Since the investment account holder should not be held liable for the financial institution's failure to notify the SRS, section 11.13 will now have rules stating that if the SRS is not duly notified of the taxpayer's investment account through the financial institution's fault, the SRS will not treat this as a basis for not recognising the account as an investment account.

To give investors confidence about their investment account status, the SRS will be required to give the taxpayer an opportunity receive on-demand information on all of his investment accounts notified to the SRS.

Summary

Through these amendments the lawmaker has defined how information should be exchanged with the SRS and has given investment account holders confidence by improving the PIT Act:

1. Latvian financial institutions are to provide the SRS with information on investment accounts opened in Latvia.
2. If the financial institution fails to notify the SRS, this is no basis for not recognising an investment account.

3. The party liable to provide the SRS with foreign investment account information has been specified.
4. The SRS will be required to provide investors with information on all of their investment accounts notified to the SRS.

Although the legislation is becoming increasingly favourable to investors, there are still some confusing aspects. We would therefore recommend assessing each situation on its merits, and in consultation with the SRS or tax consultants, to assure the investor that he is entitled to the favourable PIT regime.