How far we are from tax reform (3/15/17)

The government plans to launch a new tax reform have recently caused heated controversy, given the proposal to zero-rate retained earnings for corporate income tax (CIT) purposes, following the Estonian model. Although the bill is still being drafted, the opinions expressed by the institutions involved in formulating tax strategy make it clear that the reform will affect not only certain classes of subjects of law or types of companies, but every taxpayer.

Given the rapid pace of change, this series of articles will explore the progress in drafting and debating the proposed amendments, with examples to illustrate how particular changes to the tax regime might affect the overall tax burden in the long-term, as well as sharing our views on things to consider in planning corporate tax policy. The new tax regime is to apply from 1 January 2018.

Proposed corporate income tax (CIT) changes

For starters we will list the main changes being proposed as part of the tax reform according to the information currently available:

- 20% CIT on payment of dividends to individuals and entities;
- 0% CIT on retained earnings;
- 20% CIT on non-business expenses;
- tax losses do not accrue/ are not available;
- no capital allowances for investment in non-current assets;
- monthly CIT returns.

The list of the proposed amendments is currently under discussion and can be changed, with the institutions involved in tax policy formulation still actively debating issues such as –

- whether the new CIT regime provides for keeping any of the tax reliefs and allowances available so far and to what extent;
- restrictions on writing off bad debts and recognising losses;
- thin capitalisation rules;
- restrictions on deductible representation costs;
- the length of the transition period and its application to profits accrued before 1 January 2018.

Proposed personal income tax (PIT) changes

Significant changes are expected to the PIT treatment of paid employees and traders. While some questions about the content of the PIT reform are still open to debate, we will list the main proposals:

- lower the rate of PIT to 20% (on annual income of up to €40,000);
- 0% on received dividends from which CIT has been withheld, with 20% on other dividends;
- raising the minimum monthly wage to €430;
- a differential monthly personal allowance (€0–300) applicable during the tax year and subject to review every six months;
- abolishing solidarity tax;
- a reduced rate of NSI contributions on traders' income below the statutory minimum monthly wage;
- NSI contributions on authorship fee recipients who are employees in parallel;
- a cap on deductible business expenses (with a period of transition for accrued losses);
- progressive PIT rates, i.e. 23% on annual income exceeding €40,000 (€45,000 after 2018);

- the same rate for all traders;
- the same rate for all types of capital income;
- administering the differential monthly personal allowance etc.

Proposed microbusiness tax changes

Despite the government's earlier plans to devise a new tax regime for newly formed businesses to replace microbusiness tax (MBT), the tax reform proposals provide for changes to certain MBT criteria and administration procedures for MBT payers:

- lowering the revenue cap to €40,000 a year;
- raising the monthly salary cap to €900 a month;
- an exemption from accounting and reporting, as the banks will be responsible for withholding tax from an MBT payer's business account.

Since the content of the proposals is indeed comprehensive, the government agencies in charge are still in the process of putting together proposals, which according to current forecasts might be publicly available in late spring.

Our upcoming articles will explore how each tax regime practically affects the tax burden, with relevant tax charge simulations, and will follow the drafting of tax reform bills, as well as comparing the main similarities and differences between the tax regime adopted in Estonia and the one proposed in Latvia.