

Bonus and other payments to terminated employee (2/25/17)

When a company terminates employment with somebody, it's not always possible to settle in respect of all income that is due to the former employee. A common situation involves payment of a bonus. This article explores how the employer should report such payments to the State Revenue Service (SRS).

Taxable income

A Latvian resident's employment income and deemed employment income attract so-called payroll taxes, i.e. personal income tax (PIT) and mandatory national social insurance (NSI) contributions¹ split between employer and employee, which the employer should report to the SRS via the Electronic Declaration System (EDS).

Under section 8(2) of the PIT Act and Cabinet Regulation No. 899, income subject to payroll taxes comprises salary, bonuses, one-off remuneration, regular remuneration and other income the employee receives on the basis of their present or past employment in companies, cooperative societies, European companies, European cooperative societies, European economic interest groups, central and local government agencies, associations, foundations, sole proprietorships, farming or fishing businesses, organisations and from private individuals, as well as remuneration for performing national service duties and income from for performing another contract of employment.

Employee stock options are also treated as a fringe benefit that attracts Latvian PIT. Section 20.2 of the NSI Act requires that the employer should calculate and pay NSI to the government for each terminated employee to whom stock options have been awarded earlier. It's important to note, however, that employment taxes apply where the criteria that qualify the exercise of stock options for the favourable PIT regime under section 9(1)(43) of the PIT Act are not satisfied.

The reporting obligation

Under paragraph 21 of Cabinet Regulation No. 827, the employer should file the employer's statement via EDS by the monthly time limit specified for paying mandatory NSI contributions.

If a former employee's additional income is paid in the next month after the termination, the tax return for the current month should report the employment income in column 6 and an increase or a reduction in mandatory NSI contributions in column 7.

Example 1

Employment is terminated on 31 March, the employer's statement for March is filed on 15 April, and additional income is paid on 21 April. The additional income is then reported in the employer's statement for April, stating the additional employment income in column 6, NSI in column 7, and PIT in column 8.

However, where income resulting from former employment is paid after a period that exceeds one month, the employer's statement for the period to which this income relates should be adjusted to show the

additional employment income on a new line and in column 4 and the NSI contributions in column 5, showing the date of actual payment in column 10. However, PIT should be reported in the Statement of Amounts Paid to the Individual (Summary) for the period in which the payment is made.

Example 2

Employment is terminated on 20 February, but an annual bonus is not paid until 15 June. So the employer's statement for February should be adjusted in June, show the bonus income and relevant NSI contributions on a new line, and PIT should be reported in June by completing the Statement of Amounts Paid to the Individual (Summary), stating June as the tax period.

Section 20.2(2) of the NSI Act states that where the employer hasn't adjusted the employee's income and NSI contributions for the month preceding the month under review, the employer is permitted to adjust those amounts within three years. Such an adjustment must not, however, result in a reduction in the employee's income and NSI contributions.

¹ Unless another country has issued an A1 certificate.