

# Personal Income Tax Act to be amended (1/30/17)

On 9 May 2017 the Cabinet of Ministers decided to support the National Tax Policy Framework 2018–2021, which provides for a major overhaul of the tax system. A set of proposals for amending the Personal Income Tax (PIT) Act, supported by the Cabinet of Ministers, are now publicly available.

As well as differential rates of PIT on different levels of income, many other important amendments are being proposed. This article explores what we see as key changes.

## Dividends

Income from capital other than capital gains, including dividends, currently attracts a 10% PIT. Dividends are paid out of profits that have already been charged to a 15% corporate income tax (CIT). Thus dividends are first charged to CIT and then to PIT.

The proposals raise the rate of PIT on dividends to 20%. However, where a company has already charged its profits to CIT, there will be no PIT to pay.

The proposals envisage a three-year period of transition during which dividends will continue to attract a 10% PIT. Accordingly, a 20% PIT on dividends is to apply from 2021.

## Allowable expenses

Latvian individuals that have paid PIT during the tax year are eligible for a refund of PIT on their allowable expenses through the annual income tax return. The allowable expenses are listed in section 10 of the PIT Act. Taxpayers can claim the following expenses:

- mandatory national social insurance contributions (the employee part);
- contributions to private pension funds up to 10% of the person's annual taxable income;
- life insurance contributions up to 10% of the person's annual taxable income;
- spending on education and medical services (except for dental services and scheduled operations) up to €215 a year for each family member;
- spending on dental services and scheduled operations – without restriction;
- donations to public benefit organisations; and
- donations to political parties.

At the same time, contributions to private pension funds, life insurance contributions, donations to public benefit organisations and donations to political parties in total are allowed up to 20% of the person's annual taxable income.

The following allowable expenses are proposed from 2018:

- mandatory national social insurance contributions (the employee part);
- spending on education and medical services (except for dental services and scheduled operations), donations to public benefit organisations and donations to political parties up to 50% of the person's annual taxable income, capped at €600 a year for each family member;
- contributions to private pension funds and life insurance contributions up to 10% of the person's annual taxable income, capped at €4,000 a year.

Since the relevance of allowable expense categories varies from person to person, it is not possible to

accurately measure the effect of the proposed changes on the amount of PIT overpayment. It is estimated, however, that putting these restrictions on allowable expenses would increase PIT revenue streams into central and local government budgets. This means that the individual would be eligible for a lower refund of overpaid PIT.

#### Personal allowance

The annual differential personal allowance has been in operation since 1 January 2016. This allowance is calculated according to a formula adopted by the Cabinet of Ministers to ensure that individuals on lower incomes take a higher personal allowance.

When paying wages, employers apply the minimum personal allowance, and individuals can ask to apply the full annual differential personal allowance by filing their annual income tax return voluntarily. This means an increased administrative burden on the taxpayer and the tax authorities alike.

According to the proposals, the annual differential personal allowance will be applied at source. The expected personal allowance would be calculated by the State Revenue Service on the basis of income earned in past periods. The amount of personal allowance would be updated every six months.

Please note that applying the annual differential personal allowance may result in someone being given too large a personal allowance, that is if a person's income in the previous period was lower than their income in the current period. According to the proposals, the person in this situation would be required to not only pay extra PIT but also file the annual income tax return.

These proposals are yet to be debated in Parliament.