

Tax reform: changes affecting royalty recipients and self-employed persons (2/31/17)

We have written about proposed changes in the area of social insurance. This article explores practical changes affecting individuals that receive royalties and self-employed persons in terms of mandatory national social insurance (NSI) contributions and pension insurance contributions.

Changes affecting royalty recipients

Under the current rules, a royalty recipient who is also an employee is not required to contribute NSI on royalties received. A royalty recipient who is not an employee can contribute NSI as a self-employed person:

1. If their monthly royalty income does not exceed the minimum wage,¹ no mandatory NSI contributions are due;
2. If their monthly royalty income exceeds the minimum wage, NSI is payable by the royalty recipient at a rate of 31.13% on a freely chosen amount of royalties that is no less than the minimum wage.

Individuals receiving royalties will remain subject to these arrangements. However, any entity paying royalties that is resident in Latvia or registered for Latvian tax purposes will have to pay 5% pension insurance contributions on those royalties. This means that royalty payers in Latvia will incur extra costs on royalty payments regardless of their amount and the recipient's status. And since the minimum wage is to rise in 2018,² royalty recipients will see an increase in their minimum base for NSI purposes, which will push up their mandatory NSI contributions.

It is important to note that the new requirements will apply to a certain class of royalty payers, which excludes non-Latvian residents. In other words, if a Latvian tax resident receives royalties from a foreign company that does not have a permanent establishment in Latvia, then neither the royalty payer nor the recipient will have to pay pension insurance contributions. Since there is a mechanism in place that allows non-residents to register for Latvian NSI purposes, it would be possible to require that foreign royalty payers should register in Latvia and pay pension insurance contributions. However, such a requirement is not in place as yet.

Below we offer a comparison of contributions due where royalties exceed the minimum wage and the recipient chooses to contribute NSI on the minimum wage (€380 in 2017 and €430 in 2018).

The NSI rates are prescribed by Cabinet Regulation No. 759, but it is unknown as yet whether the amendments will cause a change in the NSI rate applicable to royalty recipients. For this reason we use the current NSI rate for royalty recipients and self-employed persons in these examples.

	2017	2018	Difference
Monthly royalty	€500	€500	
NSI payable by royalty recipient	€380 x 31.13% = €118.29	€430 x 31.13% = €133.86	+ €15.57
Pension insurance contributions payable by royalty payer	-	€500 x 5% = €25	+ €25

The table below provides a comparison of contributions due where royalties do not exceed the minimum wage and the recipient is not required to contribute NSI:

	2017	2018	Difference
Monthly royalties	€300	€300	
NSI payable by royalty recipient	€0	€0	0
Pension insurance contributions payable by royalty payer	-	€300 x 5% = €15	+ €15

The two examples above are meant to alert royalty payers, who will have to pay pension insurance contributions regardless of royalty amounts.

Changes affecting the self-employed

Like royalty recipients, self-employed persons have to contribute NSI by freely choosing a NSI base that is no less than the minimum wage. Self-employed persons also have to pay pension insurance contributions, but unlike royalty recipients, those are payable on the difference between the actual income and the NSI base.

Below we compare contributions due where a self-employed person's monthly income exceeds the minimum wage and they choose to contribute NSI on the minimum wage:

	2017	2018	Difference
Monthly income	€500	€500	
NSI payable by self-employed	€380 x 31.13% = €118.29	€430 x 31.13% = €133.86	+ €15.57
Pension insurance contributions payable by self-employed	-	(€500 - €430) x 5% = €3.50	+ €3.50

As we can see, unlike royalty recipients, the self-employed have to shoulder an additional burden of social contributions, while facing lower pension insurance contributions in similar circumstances. It is important to note that unlike royalty recipients, all of the self-employed person's income is subject to pension insurance contributions regardless of whether that income comes from a Latvian or foreign registered taxpayer.

¹ The minimum wage is €380 in 2017.

² According to publicly available information the minimum wage is to reach €430 in 2018.