

# Solidarity tax payers: things to consider in 2018 (3/4/18)

Since 2016, solidarity tax (ST) has been charged on income that exceeds the cap set by the Cabinet of Ministers for mandatory national social insurance (NSI) contributions. This principle remains in place this year. However, paying ST will provide taxpayers with certain benefits because unlike the old rules, ST payments are now going towards healthcare, social insurance, and personal income tax (PIT) payments. Overall, the ST rules have become more favourable to taxpayers. This article explores this principle and taxpayers' obligations under the new rules.

## The employer's obligation

As before, this year the employer is required to calculate and pay NSI and ST at the appropriate rate of NSI on the entire gross employment income. The standard rate of NSI in 2018 is 35.09% (with 11% borne by the employee and 24.09% by the employer). The employer offsets the entire amount of the employee's NSI and ST as allowable expenses against their employment income.

The further distribution of NSI and ST is administered by the National Social Insurance Agency (NSIA), considering the annual cap on income for NSI purposes (€55,000 in 2018). And from 2018 onwards the NSIA will be administering the further distribution of ST as described below.

## The distribution of ST and adjustments

Under the ST Act effective from 1 January 2018, the ST paid will be split as follows:

- 1 percentage point to finance healthcare services, with 0.5 points coming from the employee's part of ST and 0.5 points from the employer's part of ST;
- 4 or 10 percentage points into the taxpayer's private pension fund if they are or are not a member of the tier 2 pension scheme respectively;
- 10.5 percentage points become PIT; and
- the rest goes into the special budget for state pensions.

The ST Act does not provide for a different split if a person's NSI rate is lower than the standard rate. So the fixed percentage points apply to all ST payers regardless of their NSI status and rates used. Accordingly, any NSI payers with rates below the standard rates will have lower amounts of money going into the special budget for state pensions.

The table below provides a comparison based on the following example:

1. the employer applies payroll taxes to the ST payer;
2. the annual tax return is filed.

The example assumes that the employee has filed their payroll tax book and their employment income qualifies for 20% PIT at source, but no personal allowance is available because the income exceeds €1,000 a month.

	Monthly calculation	Monthly	Annual (monthly x 12)
1	Gross amount	5,000.00	60,000.00

2	NSI and ST employee part ( $2 = 1 \times 11\%$ )	550.00	6,600.00
3	Income subject to 20% PIT ( $3 = 1,667 - 2$ )	1,117.00	13,404.00
4	20% PIT ( $4 = 3 \times 20\%$ )	223.40	2,680.80
5	Income subject to 23% PIT ( $5 = 1 - 1,667$ )	3,333.00	39,996.00
6	23% PIT ( $6 = 5 \times 23\%$ )	766.59	9,199.08
7	Total 20% PIT and 23% PIT ( $7 = 4 + 6$ )	989.99	11,879.88
8	Net amount ( $8 = 1 - 2 - 7$ )	3,460.01	41,520.12

	Monthly calculation	Recalculation through annual tax return	Employer
1	Gross amount	60,000.00	60,000.00
2	NSI and ST ( $2 = 1 \times 11\%$ ) including	6,600.00	6,600.00
2.1	NSI ( $2.1 = 55,000 \times 11\%$ ) and	6,050.00	
2.2	ST ( $2.2 = 1 - 55,000) \times 11\%$	550.00	
3	ST part transferred to PIT ( $3 = (1 - 55,000) \times 10.5\%$ )	525.00	
4	Allowable expenses after adjustment ( $4 = 2 - 3$ )	6,075.00	
5	Income subject to 20% PIT ( $5 = 20,004 - 4$ )	13,929.00	13,404.00
6	20% PIT ( $6 = 5 \times 20\%$ )	2,785.80 (2,680.80 + 20% (525))	2,680.80
7	Income subject to 23% PIT ( $7 = 55,000 - 20,004$ )	34,996.00	39,996.00
8	23% PIT ( $8 = 7 \times 23\%$ )	8,049.08	9,199.08
9	31.4% PIT ( $9 = (1 - 55,000) \times 31.4\%$ )	1,570.00 (9,199.08 - 8,049.08 + (80% x 525))	
10	Total PIT charge ( $10 = 6 + 8 + 9$ )	12,405.00	
11	PIT paid with employer and ST part transferred to PIT ( $11 = 13,404 + 9,199.08 + 3$ )	12,405.00	
12	PIT underpaid/overpaid ( $12 = 10 - 11$ )	0	

### ST payers' obligations

The taxpayer should receive a request from the NSIA for notification about their chosen tier 3 pension scheme, into which 4 or 10 percentage points of their ST contributions will be transferred. The taxpayer has 60 days after receiving the request to notify the NSIA of their chosen tier 3 pension scheme. If the taxpayer fails to comply with this obligation within six months after the 60-day time limit expires, the relevant part of ST will be transferred into the general budget for state pensions.

The ST payer will also be required under the Personal Income Tax Act to file their 2018 tax return between 1 April 2019 and 1 June 2019 in order to recalculate ST and PIT (as shown in the example).

Please note that ST payers include royalty recipients whose income exceeds €55,000 a year. Since under the amendments of 19 December 2017 to the Cabinet of Ministers' Regulation No. 899, *Application of Provisions of the Personal Income Tax Act*, royalties attract PIT at progressive rates, royalty recipients will also be subject to a ST and PIT recalculation through the annual tax return.

### The impact of the Constitutional Court's ruling

19 October 2017 is the effective date of the Constitutional Court's ruling on case No. 2016-14-01, *Compliance of sections 3, 5, 6, 7 and 9 of the Solidarity Tax Act with the first sentence of section 91 and with section 109 of the Latvian Constitution*. The Constitutional Court ruled that sections 3, 5, 7 and 9 will not be heard by the Constitutional Court or they comply with the Constitution.

Section 6, however, which provides for aligning the ST rate with the NSI rate, meaning that a rate of ST varies according to the person's NSI status, has been recognised as inconsistent with the Constitution and will cease to apply from 1 January 2019. So the ST Act is to be amended next year to provide for a rate that is independent of the person's NSI status.