

Recovery of input VAT on representation and staff sustainability costs (2/11/18)

A key development in the new Corporate Income Tax (CIT) Act is the concept of “deemed distribution of profit,” which includes non-business expenses. These expenses have a new item: so-called representation and staff sustainability expenses exceeding 5% of the company’s total gross pay for the past financial year on which personal income tax and mandatory national social insurance contributions have been paid to the government. This article explores whether input VAT on representation and staff sustainability expenses is fully recoverable.

Provisions of the VAT Act

Input tax means amounts of VAT appearing on tax invoices received from other taxable persons for goods and services acquired to make taxable supplies or to make any supplies abroad that would be taxable if they took place in Latvia.¹ The taxable person may deduct their input VAT from their output tax unless the VAT Act provides otherwise.²

It follows that purchases of goods and services on which the taxable person has paid input VAT should be intended for making taxable supplies. Accordingly, we should find a link between the goods or services bought and those later sold.

The VAT Act also places restrictions on recoverable input VAT, for example, 60% of input VAT on goods and services acquired for representation purposes associated with organising public conferences, receptions and meals, and with producing items that represent the taxable person, is not recoverable.³ Also, any input VAT appearing on tax invoices for goods and services acquired for the taxable person’s staff recreation, catering, health improvement, entertainment or private needs (including transport, fuel and telecommunications) is not recoverable.⁴

However, the taxable person may recover input VAT appearing on tax invoices for goods and services acquired to carry out administrative functions (e.g. on workplace equipment and drinking water purchases) and advertising events.⁵ Latvian case law suggests that input VAT paid on setting up a recreation room and a kitchen on the company’s premises, including the cost of buying and maintaining a hot drinks machine, is also recoverable.

Staff sustainability expenses

Under the CIT Act these are expenses incurred on motivation or team-building events held for employees and any other motivation expenses not included in an individual’s income tax base, the cost of carrying employees from home to work and back, expenses incurred on events specified in collective agreements that cannot be traced to a particular individual, funeral benefits, etc. It follows that these expenses can be treated as expenses incurred for employee recreation, entertainment, private and other purposes.

Despite the changes in the new CIT Act relating to representation and staff sustainability expenses, the taxable person still cannot recover 60% of input VAT on goods and services acquired for representation purposes, and any input VAT on goods and services acquired for a taxable person’s staff recreation,

catering, health improvement, entertainment or private needs is not recoverable under the VAT Act and the Cabinet of Ministers' Regulation No. 17. Accordingly, taxable persons are subject to this input tax restriction on representation expenses and purchases for private needs of employees with respect to any expenses up to 5% of the company's total gross pay for the past financial year and any expenses exceeding this 5% limit.

¹ Section 92(1)(1) of the VAT Act

² Section 92(4) of the VAT Act

³ Section 100(1) of the VAT Act

⁴ Paragraph 159 of Cabinet Regulation No. 17 of 3 January 2013, *Application of provisions of the VAT Act and certain requirements for paying and administering VAT*

⁵ Paragraph 157 of Cabinet Regulation No. 17 of 3 January 2013