Unexpected overpayment of income tax in Electronic Declaration System (2/24/19)

Individuals preparing their annual income tax return this spring had to consider the changes made by the tax reform of 2018. Quite a few people preparing the tax return electronically were in for a surprise.

One of the biggest surprises was an unexpected overpayment of personal income tax (PIT) for a certain group of persons, i.e. those –

1. who are employed in a member state of the European Union, the European Economic Area, Norway or Switzerland ("foreign countries"), and
2. whose foreign employment income exceeded EUR 55,000 in 2018, and
3. who continued to pay mandatory national social insurance contributions (NSIC) in Latvia.

Calculated automatically after preparing the annual income tax return on the Electronic Declaration System (EDS), the PIT overpayment for this group of persons may reach even several thousand. Why is that?

A recalculation of solidarity tax

The employer charges PIT at 20% and 23% on employment income at source for an employee whose Latvian salary exceeds the NSIC cap and who pays NSIC in Latvia. A 31.4% PIT is applied to that employee through the annual income tax return. In fact, however, there should be no further PIT to pay because adopting the system of progressive PIT rates was coupled with amendments to the Solidarity Tax (ST) Act to provide that persons whose employment income exceeds the NSIC cap and who are ST payers will have 10.5 percentage points of their ST transferred into their PIT account. So, although the employer has only applied PIT at 20% and 23% at source on income exceeding the NSIC cap, the person should have no further PIT to pay because of ST's compensating mechanism (this article offers more details of how to calculate taxes with the employer and through the annual income tax return).

Our experience suggests that this calculation is made automatically, and filing the annual income tax return on the EDS presents no problem in this regard.

Can we hope for a refund of ST?

In certain cases, this recalculation leads to a PIT refund. If a person has been posted to work abroad or works in two or more foreign countries and has taken out a Latvian A1 certificate, they should pay Latvian NSIC on their foreign employment income, with ST due in Latvia after exceeding the NSIC cap.

In this case, the foreign employment income is exempt from Latvian PIT because foreign income tax has been charged on it. So the foreign income does not need the same compensating mechanism as the Latvian employment income. But the ST recalculation is made in any case and automatically available in the person's EDS account. Below is a calculation for someone gaining no employment income in Latvia:

		EUR
1	Income gained in EU member state	75,000

2	Latvian NSIC and ST paid, employee part (2 = 1 x 11%)	8,250
3	Part of ST transferred to PIT account (3 = (1 – EUR 55,000) x 10.5%)	2,100
4	Latvian taxable income	0
5	Latvian PIT due	0
6	Latvian PIT paid after ST recalculation (6 = 3)	2,100
7	PIT overpayment (7 = 6 – 5)	2,100

And there is no way to adjust this PIT overpayment through the EDS, but is a refund due nevertheless? Because the ST recalculation was adopted to compensate for the top rate of PIT on the Latvian taxable income of persons paying NSIC in Latvia, we have sent a letter to the State Revenue Service (SRS) asking whether the person can really expect a PIT refund in this situation. The SRS is going to consult the Ministry of Finance before sending a reply. We will keep you posted on any progress.