

Personal Income Tax Act to be amended on employee stock options (3/23/20)

The latest proposals for amending the PIT Act aim to encourage more startups operating in Latvia by offering an exemption on employee stock options granted by public limited companies to motivate workers.

The current rules

Any income arising on the exercise of employee stock options in public companies attracts salary tax. However, the PIT Act makes exceptions where the employee exercising a stock option has no tax implications if the criteria laid down by section 9(1)(43) of the PIT Act are satisfied:

- The option has been held for at least 36 months;
- The holder at the time of exercise is employed by the company that granted the option or by a party related to the company;
- An appropriate statement has been filed with the State Revenue Service ("SRS").

The proposed changes

To extend this exemption to shares in a private limited company, the term "stock option" needs widening to cover the acquisition of shares in a private company.

Some countries, such as the UK, Israel and the US, have adopted rules which provide that the minimum holding period for employee stock options is one year. Based on this practice, Latvia plans to reduce its current 36-month minimum holding period to 12 months. This will especially benefit startups, as they demonstrate fast and dynamic growth.

Under the current rules, an employee must exercise their stock option on or before the last day of their employment. In practice, this requirement is difficult to meet, as employment often needs to be terminated at fairly short notice. The notice period may not be sufficient for the worker to settle all the formalities involved in exercising the stock option (especially if the grantor company is based abroad) or to raise the necessary funds if the stock option plan provides for a fee payable to acquire the company shares. The proposed amendments allow the employee to exercise the stock option within six months after terminating their employment, except where termination is due to a state old-age pension being awarded (including prematurely). In that case the employee would be able to exercise the option within the time limit set by the plan, which might well exceed six months.

The proposed amendments adjust the rules for measuring the market value of shares and specify persons authorised to issue an independent opinion on the market valuation of shares in a foreign company.

The current rules are silent about notifying the SRS when changes are made to the stock option plan. The proposed amendments allow the company to modify the plan and to require the submission of relevant information to the SRS within two months.

How the proposals affect the development of the economy and society

The Latvian ecosystem of startups is developing and increasingly benefiting the economy. There are about 350 startups operating in Latvia, and 50 new startups are formed each year on average to create and supply innovative products and services. Startups have attracted investment of more than EUR 300 million in the economy since 2012. In Latvia, startups employ more than 1,600 people. Overall, the proposed amendments to the PIT Act will encourage startups to operate in Latvia and promote the development of the innovation system.