

Working from home during Covid-19: employment income taxes (2) 1/44/20



Director, Tax, and Head of Pan-Baltic
People and Organisation Practice, PwC
Latvia

Irena Arbidane

This article completes what we wrote last week.

Working from home in Latvia for a foreign company

Latvian residents

Before examining Latvian payroll tax obligations, we need to find out whether the foreign company is liable to register a permanent establishment (“PE”) in Latvia. This article explores the applicable rules, assuming the company’s activities do not amount to a PE (for details see below “Do employees working for a long time in another country create tax risks for the employer?”)

A Latvian tax resident who carries out their duties in Latvia is required by law to pay taxes in Latvia. No double tax treaty (“DTT”) exemptions are available, and all taxes on remuneration are payable in Latvia from day one.

To pay Latvian taxes, the taxpayer should first register with the State Revenue Service (“SRS”). The law requires the person to register but also permits the foreign company to do this. The chosen type of registration does not affect the total tax burden.

An employee who starts or continues to work remotely from home in Latvia should be aware that PIT is payable in Latvia. If there is an effective DTT in place and the foreign company holds the employee’s residency certificate, then foreign taxes are not payable.

Each year the SRS receives data from Latvian banks on fund movements in resident accounts. After analysing this data, the SRS has information about income received in the person’s account and can ask questions about Latvian taxes. If the SRS sees that work is done in Latvia but taxes are not paid, then penalties can be imposed, so we recommend registering in good time. Penalties for evading taxes and failing to register can equal the amount of PIT due or triple the unpaid amount of national social insurance (“NSI”) contributions.

Non-Latvian residents

If an employee keeps their foreign tax resident status but works for a foreign employer in Latvia, PIT is payable in Latvia unless the criteria of DTT article 15(2) are met. In other words, payroll taxes are payable in Latvia if the person spends more than 183 days in Latvia in any 12-month period and if their remuneration for the work done in Latvia is attributed to a Latvian company or to a PE the employer is using in Latvia.

If PIT is paid in Latvia, the person’s country of residence will not charge PIT. An exemption is mostly obtained through the annual income tax return if tax is payable twice during the year.

Paying NSI depends on applicable international rules. If an A1 certificate is obtained, NSI is not payable in Latvia, and most countries offer the option of obtaining a certificate retrospectively.

Working abroad for a Latvian company

If a Latvian company's employee works abroad remotely, then a number of questions arise:

1. Does the employee's presence abroad require the company to register for foreign taxes under local law? Registration may be required for various taxes – labour taxes, CIT and VAT (for details see below “Do employees working for a long time in another country create tax risks for the employer?”)
2. Does foreign or international law provide for an exclusion from tax payment or prescribe any period during which it is considered that taxes are not payable (e.g. the DTT 183-day exclusion or paying NSI only in the home country based on Regulation (EC) No 883/2004 of 29 April 2004 on the coordination of social security systems and an A1 certificate)?
3. How should foreign taxes be paid? And who is responsible for paying them? This is primarily important when it comes to figuring out which person any tax recovery action can be brought against.
4. How to avoid double taxation in Latvia? Clearly, taxes should not be paid twice on the same income, yet there is also a need for fast and easy tax refunds. Latvian law provides for a procedure under which an exclusion from PIT payment can be exercised when remuneration is paid. For this purpose, the SRS should be notified that the employee is staying abroad and documentary evidence should be presented to prove that foreign PIT has been paid. In practice, people usually continue paying NSI in Latvia after receiving an A1 certificate that helps them avoid having to pay foreign NSI.

As a result, such situations involve a heavy administrative burden, as one tax is paid in Latvia and another abroad. As well as tax matters, it is important to assess the legislation on employment and safety at work (e.g. whether there are any changes to the vacation or dismissal rules).

Do employees working for a long time in another country create tax risks for the employer?

A long presence of employees in any country other than the one where they usually carry out their duties and where the company is incorporated can create a PE for CIT purposes. This is determined in accordance with each country's national law and international rules, i.e. DTT article 5. For example, if an Italian company's employees work for a long time in Latvia, we mainly need to examine the Latvia-Italy DTT to determine whether the Italian company has a PE in Latvia.

A PE can arise if the company has a fixed place in another country through which it carries on a business, such as distributing goods, signing contracts or making decisions. A home office out of which an employee works for the company can also create such a fixed place of business.

Employees who stayed at home to work remotely during the spring phase of the Covid-19 pandemic did so because of restrictions imposed by the government. The OECD recommends that this home working should be treated as force majeure and not as the company's business initiative. Accordingly, given the emergency nature of the Covid-19 pandemic and assuming that home working does not become habitual for the company over time, this should not create a PE because –

1. home working is not sufficiently permanent or continuous;
2. the company has neither access to nor control over the home office, except through this one employee.

Once the borders open and people resume travelling, we will need to answer these questions: How long can home working be treated as force majeure? When will the general rules apply to PEs?

With foreign employees working in Latvia for a long time, we should also assess whether the company has a fixed establishment for Latvian VAT purposes, which does not depend on the existence of a PE.

Upcoming events

On 3 and 4 December 2020, we will be looking at changes to the payroll tax treatment in PwC's Academy seminar "Personāla nodokļu piemērošana Covid-19 apstākļos."