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Bank account turnover out of line with tax filings (1) 1/4/21

Tax Director and Pan-Baltic People & Organisation Leader, PwC Latvia
Irena Arbidane

Last year the State Revenue Service ("SRS") for the first time analysed data supplied by the Latvian banks to find income unreported by Latvian residents. Many taxpayers had a letter from the SRS asking them to explain why their bank income details do not match their tax filings. This article explores how the SRS runs taxpayer checks and what response is advisable.

Latvian and foreign banks have to disclose taxpayer account turnover to the SRS

The SRS has legal access to extensive data from local and foreign banks. Since 2017 the SRS has been receiving information on Latvian residents' accounts from foreign banks. Information exchange is taking place between countries that have joined the OECD's global standard on automatic exchange of financial account information (Common Reporting Standard).

The Latvian banks' obligation to provide information on non-residents' accounts is governed by the Taxes and Duties Act and the Cabinet of Ministers' Rule No. 20, *How a financial institution properly checks financial accounts and provides the State Revenue Service with financial account information* (an appendix lists countries whose residents are subject to financial account reporting by the Latvian banks).

The Taxes and Duties Act has been amended with effect from January 2018 to require the Latvian banks and payment service providers to disclose residents' bank account turnover to the SRS. Since 2019 the SRS has been receiving information on bank customers with a debit or credit turnover of EUR 15,000 or more on their demand deposit accounts and payment accounts in the previous year. The customer details disclosed include their first name, surname and personal identity number as well as the debit and credit turnover and total balance on all their accounts.

Information available to the SRS

The information disclosed by the Latvian banks is fairly limited by law. All the SRS gets is a summary, i.e. total incoming and outgoing payments and the account balance, not an account statement with details of each transaction. The information available to the SRS does not include details of particular incoming amounts, payers or purchases.

The information required from foreign bank accounts is broader and includes details of account balances and certain types of income: interest, dividends and financial asset sales.

Based on the information available from these resources, annual income tax returns and other information reported by Latvian taxpayers such as employment income statements, the SRS carries out analytical work and compares the data received with the income reported to the SRS. If discrepancies are found, the SRS will send a letter to the taxpayer through the Electronic Declaration System asking them to explain the discrepancies, report any unreported income, and pay additional tax. In preparing an initial request, the SRS does not have access to account statements or details of each transaction. In practice the SRS will demand this information from the banks under the State Revenue Service Act if the taxpayer fails to respond or fails to submit account statements in response to the initial request.

The SRS will analyse the taxpayer’s explanations to verify the information. In practice this involves searching national registers (such as the Enterprise Registry and the Land Registry) as well as asking details and explanations from third parties such as individuals and organisations that have lent to or borrowed from the taxpayer.

Possible causes of discrepancies

Discrepancies between the annual income tax return and the bank account turnover can arise from various payments entering the bank account, which do not always go on the annual income tax return or attract personal income tax (“PIT”). In practice we often see that a mismatch between the bank account credit turnover and the annual income tax return does not necessarily mean the taxpayer has understated their annual income and underpaid PIT. The SRS does not have access to full bank account printouts and is therefore unable initially to verify whether the taxpayer has honoured their tax obligations.

Discrepancies between the annual income tax return and the bank account turnover can have various causes, such as transfers between the taxpayer’s accounts at one credit institution or several institutions. Payments from one account to another create credit turnover in both the account where income was initially received and the one to which it was later transferred. Also, discrepancies can arise from transfers between family members, spouses and relatives for daily needs and major purchases that do not create taxable income but do create credit turnover on the bank account.

It is important to note some other cash flows that do not create a PIT liability but can lead to discrepancies between the annual income tax return and the bank account turnover. For example, a sale of real estate between two individuals can create account turnover. If one of the conditions laid down by the PIT Act is met, the transaction does not create taxable income but should still be reported on the annual income tax return. Borrowings from credit institutions and loan repayments during the tax year can create account turnover but do not represent taxable income. Also, if funds have entered a taxpayer’s Latvian bank account from an investment portfolio but the income does not exceed the funds invested, there is no obligation to report it or charge PIT.

In our next article we will discuss the best response from a taxpayer being asked to explain their bank account credit turnover.