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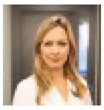
Were you expecting letter? State Revenue Service's initiative in fighting shadow economy 1/35/24

Senior Consultant, Tax, PwC Latvia
Madara Hmelevska

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



Manager, Tax, PwC Latvia
Viktorija Lavrova

The State Revenue Service (SRS) has drawn up a plan for dealing with situations where individuals have not reported their income in full. This year the SRS has identified about 70,000 individuals with a difference of at least EUR 20,000 between their bank account turnover and reported income. In September the SRS plans to send out notices asking those individuals to review their income and report it in full.

Sending such letters is not a new practice – the SRS has used them for several years to check that a person reports all taxable and non-taxable transactions. A letter arrives through the SRS's electronic reporting system. The SRS has 30 days to wait for a response from the person giving reasons for the discrepancy or adjusting their annual tax return if they find the discrepancies between the bank account turnover and the tax return arise from unreported income.

PwC experience

Our clients have received similar letters asking for an explanation of their bank account turnover since 2018, with the SRS collecting information on Latvian residents' accounts at local and foreign banks since 2017. Yet the information available to the SRS is limited. Only one number is available – the bank account turnover, which will be scrutinised by the SRS if it's substantially different from the reported income. This initiative helps the SRS verify that the person has reported their income in full and there are no further transactions or taxable income to be reported on the tax return and charged to personal income tax (PIT).

Here are some insights from our experience:

1. Information based on documentary evidence minimises further enquiries from the SRS. Submitting copies of contracts and bank account statements with reasonable explanations will help you communicate with the SRS effectively.
2. It's crucial that you communicate with the SRS early, especially if you also need to submit information on your foreign accounts, with bank statements not coming through before the deadline for giving your response. It's possible to agree with the SRS on an extension to the time limit for preparing your reply.
3. One of the options is to deregister your tax residence to avoid having to give explanations in the coming years. Our clients often neglect to deregister their tax residence, so they receive and will keep receiving such enquiries. If the person is a foreign tax resident, then deregistering their tax residence will provide arguments for giving the SRS only partial information on their Latvian-source income.

4. It’s worth supporting your reply about the substance of transactions with explanations of why this income is not taxable in Latvia, invoking particular sections of the law or articles of the treaty. For example, income from performing job responsibilities outside Latvia is not charged to Latvian PIT if income tax has already been paid in the foreign country. This must be demonstrated by documentary evidence of tax paid abroad.

The goal of the SRS initiative

The SRS’s goal is not only to increase tax revenues but also to educate the public on the significance of taxes in national welfare. This year stands out, as the SRS has never sent notices to individuals on such a massive scale but has paid more attention to the range of legal entities in the context of reducing the shadow economy. According to the plan, this year notices will go to persons with a difference of at least EUR 20,000 between their bank account turnover and reported income. Next year the SRS plans to identify taxpayers with an income difference of EUR 10,000.

The SRS management hopes that most of the discrepancies are due to non-taxable income or ignorance, rather than deliberate tax evasion. Baiba Smite-Roke, SRS Director-General, has emphasised in public discussions that taxpayers will not be punished for reporting their income voluntarily, but a penalty will be charged on those who wilfully avoid responding to SRS notices. PwC experience suggests that discrepancies are often due to non-taxable transactions that persons have carried out but have not reported, so additional tax payments are rare. However, paying an extra amount of tax voluntarily will lead to a late fee being charged.

Takeaways

It’s important to cooperate and promptly respond to an enquiry from the SRS – if necessary, file the annual tax return or any adjustments to it and explain the origin of income, stating why it was not reported on the tax return. If the taxpayer is unable to obtain all the required information by the deadline, it’s best to ask the SRS for an extension to the time limit for preparing a reply, rather than ignoring the enquiry without communicating with the SRS.

If the taxpayer does not respond to a notice, the SRS will carry out an in-depth audit and may issue an invoice for unpaid taxes if any breach is detected. However, if income is reported and taxes paid, no penalty will be charged. The SRS says that late fees can be charged on persons that have filed their tax return late, creating a tax debt that has been paid late.