

Proposed changes to labour taxation: what taxpayers need to know 2/41/24



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Following a lively public debate about revising the Latvian system of labour taxation to make it more competitive in the Baltic region, the Ministry of Finance has put together and on 26 September 2024 presented proposals for amending the Personal Income Tax (PIT) Act. The proposals make several changes to PIT treatment, affecting the rates, personal allowances and other core principles of tax treatment. This article explores key changes to labour taxation affecting taxpayers from next year.

New rates

A key proposal is to replace the current three progressive PIT rates with two:

- A rate of 25.5% on income not reaching the maximum that is subject to mandatory national social insurance contributions (MNSIC) – EUR 105,300 a year or EUR 8,775 a month from 1 January 2025
- A rate of 33% on the slice of income exceeding the MNSIC maximum

Individuals paying MNSIC in Latvia will not be subject to the rate of 33% until they file their annual tax return (ATR). Since the proposals do not abolish solidarity tax, employers paying monthly income that exceeds the MNSIC maximum will have to apply MNSIC and the first rate (25.5%) on the entire income. When the ATR is filed, the employee will be subject to the part of solidarity tax covering the PIT charged at the rate of 33%.

As the new rates are put in place, the rates of 20% and 23% on other types of income will be increased. From next year a flat rate of 25.5% will be charged on income such as capital gains, interest, royalties and payments to persons based, formed or set up in tax havens listed in the Cabinet of Ministers' rules.

Additional PIT on income exceeding EUR 200,000

The proposals charge an extra rate of 3% on the slice of a person's total income exceeding EUR 200,000. With the extra rate, the tax base will comprise all items of income received during the year, including:

- Taxable income:
- Employment income (wages, salaries, bonuses and other employer benefits subject to payroll taxes)
- Taxable income from business activity reported on the ATR
- Income from intellectual property
- Taxable income from capital gains (i.e. income arising on the disposal of real estate, shares and other financial instruments mentioned in the Financial Instruments Market Act or

investment fund certificates)

- Income from capital other than capital gains (i.e. interest income, dividends, dividend equivalents, income from investing contributions to private pension funds, income from individual management of financial instruments under the investor's authorisation, etc.)
- Exempt income – dividends, dividend equivalents, deemed dividends and surplus assets on liquidation on which corporate income tax (CIT) has been paid in Latvia or CIT (an equivalent tax) paid abroad or PIT (an equivalent tax) withheld abroad.

Additional PIT will not be charged until the ATR is filed, and the proposals charge it from 2025. So, taxpayers will have to make their first payment of PIT at the new rate in the summer 2026.

Personal allowances

To simplify the taxation of employee income, the proposals replace the income-differentiated personal allowance with a flat personal allowance of EUR 510 a month applicable to every taxpayer regardless of their level of income from 2025.

This personal allowance is to be gradually increased in the coming years:

- EUR 550 a month in 2026
- EUR 570 a month in 2027

The proposals double a pensioner's monthly personal allowance of EUR 500 to EUR 1,000 from 2025.

The monthly allowance of EUR 250 for dependants will remain.

Employer expenses

The proposals broaden the range of staff expenses or additional benefits on which the employer will not have to withhold payroll taxes. From next year the basket of tax allowances available under a collective agreement will also include staff relocation, accommodation and transport expenses. However, the employer's compensations cannot exceed a total annual expense limit of EUR 700 multiplied by the average headcount. Although each worker is entitled to an average of EUR 700 a year, the new rules will permit the employer to reimburse a larger expense to a particular worker without exceeding the total cap.

The current conditions for relief will stand, including the condition that employer-paid expenses for all workers under a collective agreement do not exceed 5% of the employer's total gross annual payroll.

The proposals will facilitate the taxation of excess spending because from 2025 the employer will only have to include excess spending as a non-business expense in the CIT base on the tax return for the last month of the financial year. So the employer will no longer have to charge payroll taxes on each worker's excess spending for the year.

The proposals also increase the employer's childbirth benefit and funeral benefit to EUR 500 a year, as well as the exempt gift of EUR 15 to EUR 100 a year.

Other changes

The proposals set a flat limit of EUR 1,500 on all cash and non-cash prizes received in contests and

competitions. At the same time, an exemption will be retained for a cash prize paid to laureates of the Baltic Assembly, for the Cabinet of Ministers' Prize, and for cash prizes the Cabinet awards for excellent achievements in sports.

If the proposals are passed, PIT will be exempt on winnings from the current national lotteries "Sporta loterija" and "Sporto visi", as well as "Senatnes loterija", which the Ministry of Culture will be running next year with the public-benefit aim of preserving the Latvian cultural and historical heritage.

We are again looking at the lawmaker's plan to re-extend the grace period prescribed by the PIT Act's transition rules during which royalty recipients are not liable to register as economic operators. According to the proposals, the royalty recipient can avoid having to register as an economic operator at least until 31 December 2027, while the payer of income will have to continue withholding taxes on the amount due at a rate of 25%.

Overall, the proposals to the PIT rules make important changes giving employers and workers more scope to reduce their tax burden. As the period of consultation is over, the proposals are likely to be presented to the Cabinet of Ministers soon. If the changes are approved, the proposals will be making their way to Parliament, which is likely to debate them in a single package with next year's national budget. We will carry on monitoring the legislative process and keep you informed of key developments.