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Corporate Income tax law clarified

Recently the new Governmental Regulations regarding corporate income tax was adopted. The new rules come into force on 1st of July 2006. The rules regulate as well as interpret how the withholding tax shall be imposed on payments to non-residents of Latvia.

Withholding taxes

Law „On Corporate Income Tax” adopted in 1995 determines that withholding tax is imposed on payments that are paid from residents and permanent establishments to non-residents, if on these payments the personal income tax is not imposed. The withholding tax is due in the moment of payment or decrease of liability in a balance sheet of the payer if decrease results from an offset of liabilities with a counterclaim and shall be paid into State budget until the 15th day of the following month. It is also allowed by law not to withhold the tax, except on dividends and payments for sale of immovable property,

but in this instance the payment made does not reduce taxable incomes of Latvian company, namely, this payment is non-deductible cost. Law „On Corporate Income Tax” determines percentage rates as follows:

- 1) 10% from value of dividends, except cases, when dividends are paid to resident of other European Union state, if the resident owns at least 25% from capital and votes in the company paying dividends at least 2 years without interruption (including the pay-out day of dividends);
- 2) 15% from gained incomes from participation in partnership;
- 3) 10% from payment for management and consulting services;
- 4) 10% from interest payment, if payer and

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receiver are related parties or persons, except payment to related parties resident in EU countries;

- 5) payment for intellectual property- in amount of 15% from payment for copyrights (including neighbouring rights) or rights to use copyrights (including neighbouring rights) and also to literary and art, including films and video films; percentage for other intellectual property in amount of 5% from payment, except payment to companies resident in EU country;
- 6) 5% from reimbursement for use of property situated in Latvia;
- 7) 2% from reimbursement for alienation of real property situated in Latvia;
- 8) 15% of all payments made by Latvian residents or permanent establishments of non-residents to individuals, companies and other persons, that are established, found or just are situated in low-tax or off-shore countries and territories prescribed by Governmental Regulations.

Intellectual property rights

Governmental Regulations precise that payment for copyrights (including neighbouring rights) or right to use the copyrights (including neighbouring rights), if related to computer program, should be imposed with a tax of 5%. The respective payments are related to use of copyrights or the right to use copyrights, but a payment for use of materialized creation that is protected by copyrights, cannot be considered as a payment for use of copyrights or the right to use copyrights. Neighbouring rights belong to performers, phonogram producers, film producers and broadcasting companies. The objects of neighbouring rights are performance and its fixation, phonogram, film and broadcast. The subjects of neighbouring rights are performers, phonogram producers, film producers and broadcasting companies or their assignees and legatees.

Consulting fee

Governmental Regulations specifies that consulting services means all consultative services rendered to Latvian taxpayer or permanent establishment of non-resident (e.g., rendering services, preparation of different kind of works and materials (calculations, projects, business plans), information providing about changes in accounting programs, in market research and advertisement, as well as in a market of equipment and

manufacturing technologies and other questions, that are related to strategic development of performer of economical activities, manufacturing and realization of products, research of economical activities of performer). The application of law services are qualified as consultative services, because of their economical substance and nature, not only legal form.

Defining payments

The „payment” is considered as any payment reducing taxable incomes of payer. „Payment” also includes percents, royalty, payment for services, payment for reimbursement of factual expenses, payment for insurance premium, bail and earnest, that is paid by Latvian residents and permanent establishments of non-residents in Latvia to any person, that lives or is established in low-tax or off-shore country or territory, apart from if it is paid in cash, by transfer or other. Tax should be imposed in the moment of payment on all payments to off-shore or low-tax countries or territories also if the payment is made in advance. The reimbursement for use of property in Latvia is considered as reimbursement from movables or real property. To summarize, the governmental regulations precise different kind of payments which are subject to the withholding tax. In the same time, taxpayers may rely also on double taxation treaties which decrease the above-mentioned withholding tax rates. For example, Latvian double tax agreements does not foresee withholding tax on consulting fees.

Public Procurement Law

The Parliament of Latvia has recently passed the new Public Procurement Law of 2006.

Definition of public procurement procedure

The law relates to the procurements made by following contracting authorities: state or municipal institutions, companies fully or partly (for more than 50%) owned or financed by state or municipal institutions. The public procurement procedure means the procedure where the contracting authority selects the tenderer and assigns it with the rights to enter into the public construction, supply or service contracts. The scope of public supply contracts include also purchase and lease contracts.

Exceptions for assigning contracts without procurement procedure

The law allows the contracting authority to assign contracts without specific procurement procedure in certain areas- for example, research, purchase of immovable property, contracts for maintaining public electronically networks, supplies of certain military goods. Other specific laws govern assignments of such contracts.

The Public Procurement Law provides thresholds upon which the procurement procedure does not apply. The certain procedure is only for procurements with expected price 10'000 LVL or more.

On tenders from 1'000-10'000 LVL only the information shall be published in home page of respective contracting authority or on local newspaper.

Also a private individual or a company financing supplies, purchases and works from their own resources, if such resources are co-financed by state budget or public funds (for example, EU structural funds), is considered as the contracting authority and shall organize procurement procedures.

For example, such persons shall organize the procurement procedures prescribed by law for (i) construction works if they are financed for more than 50% directly from own resources and if the expected price of works is equal to 3'550'844 LVL or more and (ii) for supplies related with construction- if the expected price is 141'953 LVL.

Types of procedures

The law provides following types of procedures-open competition, restricted competition, negotiated procedure, price quotation and design tender (the latter relates only to constructions). The application of certain type of procedure depends from the expected price of a contract and type of the contract (is it construction, supply or service contract). For example, the price quotation shall be applied for all supplies above 10'000 LVL, services between 10'000 and 50'000 LVL, and construction works between 10'000 and 120'000 LVL. The main difference between the price quotation and competition is that in quotation the sole criteria is the lowest price, but in competition also other criteria are valued (experience, expected quality etc.).

Assignment of Contracts

Comparing to previously procedure in more cases the call of tenders shall be published in the home page of Procurement Surveillance Authority. For example, currently the information on price quotations also shall be published- the contracting authority at least once a year shall notify the information on expected contracts where the price quotations may be applied. A company wishing to participate in a tender and get a contract assignment shall regularly check the mentioned homepage. The notification on planned tender shall include among other subject of the tender, place where the applicants may obtain acquainted with the rules of the certain tender, and term and place for submission of applications. The decisions of the contracting authority may be appealed within the Procurement Surveillance Authority.

Interest rate calculation



Recently adopted changes to the civil law of Latvia transpose the requirements of EU Directive 2000/35/EC on combating late payment in commercial transactions. Previously if the interest rate was not determined by the loan contract, it was considered that the interest rate set by law had been implicitly agreed to. Also, in other kind of agreements if the rate of interest was not determined, it was deemed that contracting sides had agreed on the interest rate set by law, determined as 6%, which had not been changed since 1937 when the civil law was adopted.

Now according to the requirements of the Directive the interest rate is seven percentage points above the reference rate set by a national bank of Latvia (currently four percent).

According to civil law, interest means the compensation for the use of money or movable property, or for a delay proportional to the amount and the duration of use.

It should be mentioned that the main difference between a contractual penalty and interest is that the increase in interest has to stop when it reaches 100% of the debt, such a restriction does not

apply to a contractual penalty. The percentage has to be calculated only for the debt or from the main capital.

Civil law also determines that the interest rate has to be paid for delayed payment of debt, even if the debt itself has no interest, as well as for delayed payment of invoices.

Latvia did not exercise its right to fix the period after which interest becomes payable to a maximum of 60 days for particular kinds of contracts. Instead interest becomes payable 30 days after the debtor received the invoice or an equivalent request for payment, or 30 days after the date of receipt of the goods or services (if the date of the receipt of the invoice or the equivalent request for payment is uncertain or has been received by creditor before he received the goods), or 30 days after the date of acceptance of the supplied goods (if it is determined by the contract).

It is expected that these amendments will solve the problems arising from unpaid bills to small and medium-sized enterprises in Latvia and will facilitate the process of obtaining payment for delivered products and services.

Share buyout in regulated market of Latvia

Recently the amendments to the Financial Instrument Market Law in Latvia of 1995 have been passed developing the regulations for regulated market participants on the share buy-out.

The buyout bid is considered as a public bid to certain part of shareholders of a company being in public circulation (the target company) to buy their shares expressed by another shareholders or other company or individuals. The law provides 3 types of share buyout bids – mandatory, voluntary and final.

Mandatory buyout

A buyout bid regarding minority shareholder shares shall be mandatory expressed by another shareholder (i) acquiring directly or indirectly majority- the half or more shares with voting rights; and (ii) voted in a shareholders meeting for the exclusion of the shares from a regulated market. Such a decision cannot be made in a closed voting. Therefore a decision regarding exit from the regulated market shall be made in an opened voting.

Voluntary buyout

A person or company is entitled to make a voluntary share buyout bid their purpose is to acquire least 10 % of the shares with the voting rights.

Where control (the half or more of all shares) has been acquired following a voluntary bid to all the shareholders, the abovementioned obligation to make mandatory bid no longer applies.

Final buyout

A person directly or by a voluntary buyout offer acquiring 95 % or more of all the shares (major shareholder) is entitled demand that other minority shareholders sell their shares to the major shareholder..

The law prescribes establishing the price of one share in mandatory and final share buyout

bid by dividing equity to a number of shares. Upon making a decision on granting permission to make a bid, the FCMC shall simultaneously notify the bidding party and the respective organizer of a regulated market institution on which the shares are admitted to trading and send the prospectus of the share buyout bid in an electronic form to that market organizer. A market organizer shall post a prospectus of a share buyout bid on its Internet homepage without delay.

Prospectus and Timing

In any share buyout case the offerer shall submit a prospectus regarding the share buyout bid to the Financial and Capital Market Commission. The prospectus shall include the offered purchase regulations (term, price etc.) and, in case of voluntary offer- the minimal and maximal number of shares offered to be purchased. The purchase regulations shall be similar for all shareholders having the same category shares. The Commission shall review the prospectus within 10 days.

A share buyout bid shall be valid for a period of 30 to 70 days, starting on the day of making the bid. There are significant differences in all of the above mentioned buyout cases depending whether a shareholder accepts or rejects a buyout bid. If mandatory or voluntary buyout bid has been made, a person can choose to accept the bid and sell his or her shares or to reject it. However, if final share buyout bid has been made, a person on mandatory base shall sell the shares. If a shareholder does not accept a final share buyout bid by the expiration date, the shares shall be blocked on his or her accounts on the next day after the expiration date and the shareholder shall lose its using rights.

The new amendments more specifically clarify the regulatory framework for share buyout in Latvia.

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NEWLY EMPLOYED

We are pleased to announce that **Ieva Laiviņa** has joined the firm as a lawyer. She joined from Legal department of Latvian subsidiary of "General Electric Money" and been working with compliance and transactions matters and been studying in the Law school in Latvia as well as in Northampton College in USA.