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COMMERCIAL LAW

In accordance with the Commercial Law, in case of increase of a share capital by investment in kind, including in instances of capitalization of debt, a qualified evaluation report is required as to fair market value of the investment in kind. This is true if the increase of share capital exceeds LVL 4000. The evaluation may be done only by licensed evaluator licensed by the Commercial register in Latvia. We are glad to inform that one of a few licenses for capitalization issued by the Commercial register is with our firm. Capitalization of a debt may be done without any limitation if equity is negative. Based on the old law, the increases of a share capital could not be done by way of capitalization if equity was negative. Pursuant to law "On insolvency" negative equity is a characteristic of insolvency, therefore, before the end of financial year it is recommended to increase equity to positive.



On May 1, 2004 Latvia will join European Union. Latvian government has specified grant procedure of EU funds to businesses.

LITIGATION

We are summarizing some recent court cases our firm was engaged in, mainly representing companies in tax related disputes.

Coca-Cola HBC v. SRS

Coca-Cola filed a case against State Revenue Service (SRS) for additional assessment of VAT on gifts given by the company to winners of prizes such as bicycles, cars and other goods as a result of marketing efforts. Tax office argued that gifts are taxable with VAT 18%. On the other hand, tax office argued that in case gifts are not taxable,

input VAT deducted by acquiring gifts are not VAT deductible as gifts shall classify as VAT exempt supplies, and therefore, VAT paid for exempt supplies are not deductible. The Supreme court hold for Coca-Cola HBC deciding that gifts are not taxable with VAT as VAT law provides for a definition of VAT supply as only done for consideration.

In case tax office asserts incorrect VAT deductions, it shall in an audit indicate the amounts wrongly deducted, so a tax office cannot in general state a principle, but must indicate special amounts incorrectly deducted.

Svenst Brikett Energy v. SRS

The Riga regional court has hold for a subsidiary of Swedish company – "SBE Latvia" deciding that SRS has incorrectly assessed VAT for import of fixed assets. The assets were imported as equipment for using in a saw pellet factory. Tax office took the whole amount of factory equipment imported and applied VAT regardless of exemptions obtained from tax office earlier. We have argued that part of services of installation which according to the Custom's law shall not be included in the import value of the equipment was incorrectly included by a tax office in the import value. Also, according to the Convention of 1973 „On Harmonization of Customs

Procedures”, customs administration shall not impose penalties unless activity of a taxpayer is of gross negligence. To prove absence of gross negligence taxpayer shall have enough documents to show that upon import enough procedures were applied in correct way.

Tech Data v. SRS

The Riga regional court hold for Tech Data - a US based distributor of electronic products for settlement of VAT upon import. Tech Data was assessed for not being able to prove that import VAT was paid on the border. Tech Data to be able to provide speedy import procedures has paid in advance more VAT for tax clearance purposes in deposit to customs authorities therefore, court held that existence of deposit available to custom’s authorities relieves Tech Data from liabilities in case customs authorities has used the deposit in incorrect way. It was important in this case that the court allowed as evidence use internal accounting entries and printouts to show the VAT (deposit) by the Tech Data. The tax office did not appeal the decision with the Supreme court and was forced to repay the VAT assesses with interest.

LBE v. Ludza municipality

In a case of debt collection for supplied heat to a local municipality the Supreme court hold to arrest movable and immovable property of the municipality. The threshold of having preliminary injunction is to prove that the defendant “possibly will not be able to fulfill the judgment”. We have argued that based on a balance sheet data municipality cannot reasonably without subsidies from a central government to fulfill the judgment as according to their latest balance sheet cash available was only about 15% of

the monetary claim, but liabilities and other creditors were enormous.

Industrogradja v. Dienvidu Tilts

Our firm represented a Croatian construction company “Industrogradja” for appealing decision of Riga municipality Tender Commission for awarding governmental contract to “Dienvidu tilts” worth of about 85 million lats. The appeal was filed with the Procurement Supervision bureau. During the proceeding we required to municipality to provide evidences that the project is sufficiently funded. The Municipality was not able to provide sufficient sources of finance for this project and also argued that inflation which “Industrogradnja” has counted in their offer, but the other party-not, plays no role in assessing bids. As result of the proceedings and putting the focus of the financial issues on this bid, the contract is not concluded on this day with the construction contract is not concluded with the winner as the tender needed to be organized not as a domestic tender, but as an international tender were the EU Cohesion funding could be used in financing the construction.

EU FUNDING FOR PRIVATE BUSINESS

On November 2, 2003 the Ministry of Economics has adopted 5 state aid programmes for commercial activities. These programmes set the framework for acquiring funding related to commercial activities (excluding farming) from 2 EU structural funds (European Regional Development Fund and European Social Funds) according to the respective priorities and activities of the Development plan.

Co - financing

The ceilings of available co-financing and for some programs- also participation, depends whether the company can be estimated as a Small and Medium sized Company (SMC) (available funding shall be higher) or not. According to the Control of Aid for Commercial Activity Law the SMC means the company with less than 250 employees, annual net turnover- less than LVL 23 000 000 or balance sheet value- less than LVL 15 000 000, and in which not more than 25 % of the shares or the voting rights belong to one or several companies which do not comply with the aforementioned criteria.

Programs

In program “Support to consultations and participation of companies in international exhibitions and trade missions” only SMC may participate. The grant ceiling for a project is LVL 10 000. Up to 6 projects may be favoured for a company. The programme co-finances to 50% of expenses. The justified expenses are payments for consultants, transport, information materials and fees of participation, rent and promotion activities for exhibitions. In programme “Support to modernization of business infrastructure” the grant ceiling for a project for establishment and reconstruction of infrastructure communications is LVL 500 000, for business development according to international standards- LVL 1 000 000, for partial infrastructure establishment (e.g. technological and manufacture centres, laboratories) - LVL 1 500 000. Up to 3 projects may be favoured for a company. The programme co-finances by 65% (for SMC) and by 50% (for the rest) of total expenses. The justified expenses



among other also include construction fees, patent fees.

In programme "Support to development of new products and technologies" the grant ceiling for a project is LVL 150 000, up to 6 projects may be favoured for a company. The programme co-finances by 45% (for SMC) and by 35% (for the rest) of total expenses for designing works and by 50% for technical pre-research.

At least 2 funds will be established in the framework of programme "Support to risk capital of SMC", the companies operating in investment administration may pretend for development of such fund. The total public finances for each fund will not exceed 70%. The risk capital investment from funds for a SMC shall not exceed LVL 300 000.

In programme "Support to development of qualification, re-qualification and further education" the grant ceiling for a project is LVL 30 000. The programme co-finances by 80% (for SMC) and by 60% (for the rest) of expenses for general education and by 45% (for SMC) and by 35% (for the rest) - for education related to business of respective company.

Applications

Application forms and exact list of documents required for application will be available in a nearest future, but will include the business plan, technical documentation, estimate of planned works and additional documents (tax settlement certificate, necessary licences etc.). It is planned that initial projects should be prepared by June 2004. Funds are allocated in an order of competition. Those succeeded will have to follow the procedures of public procurement for supplies and works needed for implementation of the project.

Residence certificate

Please, see below a residence certificate form which may be used to obtain decreased withholding tax rates based on double tax treaties' benefits.

Issued pursuant to the Agreement between the Republic of Latvia and _____
For the Avoidance of Double Taxation and Prevention of Fiscal Evasion (hereinafter – Tax Agreement)

Residence Certificate-Application for Reduction of or Exemption from Latvian anticipatory taxes withheld at source from payments (royalties, interest, management and consultancy fees, leasing fees, dividends and certain other types of income) paid to residents of _____

I. Recipient of payment

1. Name, surname (title, if company) _____
2. Passport (identification document) or certificate of incorporation no, date of issue _____
3. Full address: _____

II. Payer of income

1. Name, surname (title, if company) _____
2. Passport (identification document) or certificate of incorporation No., date of issue: _____
3. Full address: _____
4. For individuals - civil code no: _____

III. Income

1. Type of income _____
2. Date and no. of contract _____
3. Date as from which reduction or exemption is claimed _____
4. Other relevant information _____

IV. Statement of recipient

The undersigned declares:

that he (the above mentioned company) is a resident of _____
according to the Tax Agreement between _____ and the Republic of Latvia;
that he (it) is the beneficial owner of the _____;
that the above mentioned income was not derived through permanent establishment or fixed base maintained him (it) in the Republic of Latvia.

Place and date _____

Company add stamp here

Signature of the recipient or if a company its representative

V. Statement of the _____ fiscal authorities

We confirm that the above mentioned recipient is a resident of _____
according to the Tax Agreement between _____ and the Republic of Latvia and that the statement made in this form by the recipient himself or by his/here representative are true to the best of the _____ Tax Administration knowledge.

Place and date _____

Signature

Office seal

VI. Statement of the Republic of Latvia State Revenue Service

We confirm that the recipient mentioned in part I is rightful to use reduction of or exemption from Latvian taxes according to the Tax Agreement between _____
and the Republic of Latvia in respect of income mentioned in Part III, and that the payer of the income mentioned in Part II is rightful to apply reduction of or exemption from Latvian taxes in respect to the income mentioned in Part III.

Place and date _____

Signature

Office seal

IMMIGRATION NEWS

Social insurance payments

As of October 17, 2003 immigration authorities have set new amount for legal livelihood source. For board members of the Latvian legal entities, the amount is 346 LVL per month. For expatriates who work in Latvian legal entity and do not have signatory rights in the company the salary amount is set 173 LVL per month. On the residence permit registration moment the social insurance payment amount shall be calculated from the above mentioned sums and the reference from SRS regarding social tax payments shall be presented to the Immigration department in case the permit is prolonged. If after 1 year the permit is arranged not as a prolongation, but as a new permit, the social insurance payments certification is not required. For the immigration invitation approval the reference form SRS is still required, but now in cases when the company has tax debt to the state budget and it still wants to invite expatriates to work in the company – the SRS shall grant the acceptance note for such an invitation.

Obligation to inform

In case an expatriate leaves Latvia, the company shall inform immigration authorities regarding termination of the employment or other labour permit related relationship with expatriates. The immigration authorities will cancel the permit based on the notification. No state duty shall be paid for the cancellation. The obligation to inform is mandatory also for companies if they want to continue to employ other expatriates.

On-line verifications

Recently immigration authorities started to perform verification regarding expatriates who are elected in board in Latvian legal entities. The immigration authorities are now connected in on-line regime with the database of the Enterprise register. Therefore, if an individual is elected in a board in two or more Latvian companies, the work permit shall be obtained for all positions. Mandatory salary for board members which is determined in amount of 346 LVL shall be divided accordingly working hours. If the person works in two companies then half of the working day may be attributed each company. New regulations “On employment of the foreign persons in Latvia” (which will become effective beginning of next year) will determinate detailed requirement to obtain work permits for all the positions where person is elected or working in Latvia. The new requirement also applies if the person performs registration of the existing residence permit.

ACCOUNTING NEWS

New accounting regulations

From October 30, 2003 new regulation “On performance of bookkeeping” is in force. The new regulations determine that accounting software shall provide possibility to record data in the following formats: MS Excel, dBase/FoxPro, Text Report files, Flat files or ODBC data sources. Companies using above mentioned programs which do not correspond to the new requirements may use the software until December 31, 2004. It is specified that booking entries shall be made till 15th of the following month for the prior month’s transaction.

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