
LATVIA

***Business and
Taxation Guide***

Preface

This guide is intended as a general guide and should not be acted upon without further advice.

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1. GENERAL INFORMATION

Attraction for foreign investors

Latvia, one of the three Baltic states, is located at the crossroads of Northern and Eastern Europe, on the east coast of the Baltic Sea. The Republic of Latvia borders Estonia in the north, Russia and Belarus in the east, and Lithuania in the south, and has a sea border with Sweden in the west. Other neighbouring countries include Finland, Poland and Germany. The strategic location of Latvia has always been a major influence on the country's diverse historical and cultural experiences, and its commerce.

This region has been one of Europe's fastest-growing markets. As a matter of fact Latvia developed to one of the most liberal economies in the World after regaining independence from the Soviet Union in 1991!

The development of democracy, political systems and economic environment, as well as the existing infrastructure provide evidence that Latvia is an excellent business environment. When Latvia became a member of the EU in 2004 it adopted all duties and legal rights of the European Union.

Area and population

Latvia is situated in the northern part of Europe, covers an area of 64,589 sq. km, and it has 494 km of coastline. A total of 39% of the total surface area is agricultural land of which arable land constitutes 26%; 44% of the territory is covered by forests. Most important economic resources are raw building materials such as limestone, gypsum, dolomite, clay, sand and gravel. Peat is the only combustible mineral with a certain industrial significance.

The population of Latvia is 2.2 million (January 1, 2009); 68% live in urban and 32% in rural areas. Riga, the capital, is the largest city with 717,371 residents according to 2008 data. The next biggest cities are Daugavpils, Jelgava, Liepaja and Ventspils. A total of 59% of the population are Latvians, 28% are Russian, 3.6% are Belarusian, 2.5% are Ukrainian, 1.35% are Polish and 5.55% belong to other ethnic groups.

Constitution and political situation

The Republic of Latvia regained its independence in 1991 (after two – German and Russian – occupations following the first period of statehood from 1918-1940). Since then its national governments have implemented economic reforms based on the principles of free trade and with the goal

of integrating Latvia into economic, political and cultural processes of Europe. On April 30, 2004, Latvia joined NATO, and on May 1, 2004, it became a member of the European Union.

The Republic of Latvia is an independent and sovereign democratic republic wherein the supreme power of state is vested in the people.

The type of government in Latvia is parliamentary democracy, where power relations in the parliament are determinative upon formation of a government. The Parliament of Latvia is elected every four years. The functions of the Parliament, the President of the Republic, the Government of the Republic, and the courts are organized on the principle of separation and balance of powers. The head of the state is the President of the Republic – at present (May 2007) Valdis Zatlers.

History

On November 18, 1918, Latvia proclaimed its independence. The Republic of Latvia lasted a little more than 20 years. In 1939, Latvia was occupied by Russian troops and incorporated into the Soviet Union in 1940. Not long after that German armies occupied the nation from 1941 to 1944. After that Russia took control of Latvia.

Latvia was one of the most economically well-off and industrialized parts of the Soviet Union.

Liberalization in the communist regime began in the 1980s in the USSR with the perestroika and glasnost instituted by Mikhail Gorbachev. Several mass socio-political organizations were constituted that made use of this opportunity. On May 4, 1990, the Supreme Council of the Latvian SSR – elected in the first democratic election since the 1930s – adopted a declaration restoring independence that included a transition period between autonomy within the Soviet Union and full independence. On August 21, 1991, parliament voted for an end to the transition period, thus restoring Latvia's pre-war independence. On September 6, 1991, Latvian independence was again recognised by the USSR.

Economic situation

In the period from 2003 to 2007 the economy of Latvia had rapid growth. During this time Latvia had the highest economy growth rates in the EU. In 2006 the economic growth reached the peak amounting to 12.2%. In 2007 economic growth started to slow down amounting to 10.3%. There were several factors that led the economy to overheat: real estate prices jumped more than 60% (in both 2005 and 2006), credit grew at an annualized rate of more than 50; domestic demand grew tremendously, wages and prices inflation accelerated in early 2007, with core inflation rising to almost 10% by mid-2007. The CPI-based real effective exchange rate appreciated by 15% from EU accession to the end of 2007. Substantial wage increases and low productivity growth eroded the competitiveness of Latvia significantly. Instead of the anticipated gradual adjustment period, the Latvian economy went through a "hard landing", as in Novem-

ber 2008 the state had to take over the then second largest commercial bank of the country, which had incurred serious problems, and to satisfy an increased demand for euros the central bank had to buy around 570 million lats in November and December.

Consumer price inflation in the first half of 2008 remained high, which was influenced by significant supply-side factors – increase of administratively regulated prices (electricity, natural gas and heating), growth of fuel prices, increase of excise on tobacco and fuel, rise of food prices. Total consumer price increase in May 2008 compared to May 2007 comprised 17.9%, which is two times higher than a year before (8.2%). However, since June 2008, as the impact of supply-side factors has decreased, inflation has started to decline and in December 2008 it was 10.5%; in February 2009, 9.6%. It is expected that inflation will continue to fall and in the second half of 2009 it could become negative.

A crisis offers opportunities for taking measures to mitigate social and economic problems and carrying out deep structural reforms to underpin a quick and sound recovery, which will enable Latvian economy to fully benefit from the growth opportunities that will emerge in the aftermath of the crisis. Therefore the government is taking actions to prevent the economy from the further slowdown, to stabilize and revive the financial system, to improve the efficiency of public administration by reducing its expenditures, and to restructure the economy of Latvia by increasing its competitiveness. A substantial optimization and reduction of budget expenditures is foreseen in 2009 and 2010. Public administration apparatus will be reduced by at least 15%, education and health sectors will be reformed. The government will implement strict fiscal policy to achieve Maastricht convergence criteria in 2011 in order to receive invitation to join the euro zone.

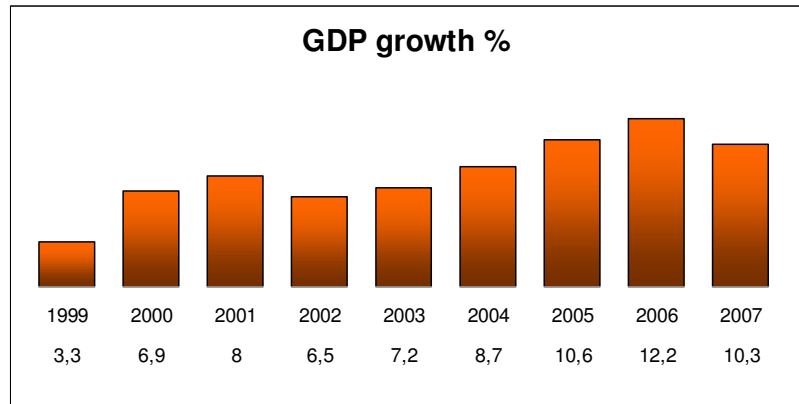
Main economic indicators

GDP (Gross Domestic Product) % change on the same period the year before:

The economic growth of Latvia reached a remarkable 12.2 per cent in 2006. In 2007 the economic growth decreased to 10.3 per cent. During 2008, economic growth slowed down and was negative in the third quarter – 4.6%¹. The estimated growth for the whole year of 2009 is minus 5%².

¹ Latvian Ministry of Economy data.

² According to Latvian Economy Minister Kaspars Gerhards, 11.02.2009



Source: Eurostat

CPI (Consumer Price Index):

In 2008, the average inflation rate was 10.1%. At the beginning of 2008 prices increased more rapidly than in 2007, amounting to 17.7% in the second quarter. The increase of consumer prices slowed down in the second half of 2008.

2008 4th quarter: +15.4%; 2008 III quarter: +15.8%;
2008 2nd quarter: +17.7%;
2008 1st quarter: +16.4%;
2007: +10.1%.

Average monthly gross wage:

Average monthly gross wage³ according to the Statistics office of Latvia:

2008: 677 euros;
2007: 560 euros;
2006: 426 euros.

Unemployment rate according to ILO standards (% of the unemployed in active labour force aged 15-74) in 2004-2008:

2008 4th quarter: 9.9%;
2008 3rd quarter: 7.2%;
2008 2nd quarter: 6.3%; 2007: 6.0%;
2006: 6.8%;
2005: 8.9%;
2004: 10.4%.

Banking and finance

The Bank of Latvia maintains a fixed national currency exchange rate. This reduces uncertainty, eliminates exposure to currency risk and gives entrepreneurs a stable base for planning and setting prices. On January 1,

³ Currency exchange rate used: 1euro=1.4096 LVL,

2005, the national currency lat (LVL) was re-pegged from the SDR currency basket to the euro at the rate EUR 1=LVL 0.702804. The new peg was due to Latvia's plans to join the European Exchange Rate Mechanism II (ERM II) and, after fulfilment of required criteria, the Economic and Monetary Union (EMU).

The financial sector reforms commenced in a business environment characterized by the currency board system and liberalization of external policies – most restrictions on capital movement were immediately abolished. Taking account such conditions and the fact that the economy was restrained by hard budget constraints, the internal strength of the financial sector was one of the most important considerations and tasks to achieve. The characteristics of the Latvian money market system are the fixed exchange rate, the absence of traditional monetary policy tools and the free movement of capital.

Today banking services in the Republic of Latvia are offered by 21 banks and five branches of foreign banks as well as by credit institutions or their subsidiaries registered in the countries of the European Economic Area that have submitted their applications to the Financial and Capital Market Commission. Seven electronic money institutions and three money market funds have also been registered with the Bank of Latvia.

Today, Latvia's financial markets are dominated by the banking sector and the role of the securities markets is modest. In 2008, the total assets of the 10 leading banks amount 12 561 million euros. Banking assets averaged growth of 38% per year from 2003 to 2007. In 2006 banking assets growth was the highest: 45%. With the overall economic slowdown, banking asset growth started to decrease amounting to 6% in 2008. In January 2009, the Latvian banking sector assets decreased by 1%.

The leading banks have been formed into banking groups covering all main financial sector services. The four leading banks represent approximately 54.10%⁴ of the total banking assets concentration in Latvia.

According to the Financial and Capital Market Commission data, foreign shareholders owned 77.3% of the total paid-up share capital in Latvian banks at the end of 2008. They held over 50% of paid-up share capital in 11 banks.

The State of Latvia is the owner of only one bank, i.e. the SJSC Latvijas Hipoteku un zemes banka, which also functions as a development bank⁵. Within the state support programme, the SJSC Latvijas Hipoteku un zemes banka has taken over 85% of JSC Parex Banka.

On April 16, 2009, the cabinet of ministers of the Republic of Latvia signed agreements with the European Bank for Reconstruction and Development (EBRD) on purchase of state-owned shares of Parex Bank, as a result of which the EBRD has become a holder of 25% and one share of the JSC Parex banka.

⁴ Source: <http://eng.bankasoc.lv>

⁵ At the end of 2008, its share capital accounted for 5.5% of the total paid-up bank capital.

Leasing

There are over 30 leasing companies, most of them related to the banks or large financial groups, such as DnB NORD Lizings, SEB Lizings, Swed-bank Lizings, Parex Lizings, but there is also GE Money and local leasing firms that provide full spectrum of services: finance lease, operating lease and other lease options as well as factoring.

Insurance

The insurance sector is represented by 11 non-life and 4 life insurance companies since those operating in life insurance are not permitted to operate in the non-life insurance business and vice versa. The dominating players are associated with the large European insurance and financial groups - Sampo, Seesam, If and Ergo. Local insurers usually position themselves in a certain niche of the market (BTA in the transport sector, RSK – health and accident insurance). Insurers are well staffed with brokers (96 brokerage firms and extensive list of sole licensed brokers), mainly local ones, but there are also worldwide brands (Marsh).

Other participants in the capital market

Savings and loan associations

There are 34 savings and loan associations that operate as closed mutual funds. They are established by a defined group of individuals (members) enabling to provide mutual financing.

Investment companies

The investment market, represented with approximately 10 investment companies, is still under development. These companies manage 20 investment funds (15 funds are open).

Pension funds

Twenty-one private pension funds (one is closed) operate in addition to the state pension plans. Thirteen pension plans are available.

Interest rates

In January 2009 the average weighted interest rate for short-term loans in LVL was 17%, long-term loans in LVL –16.5%. Interest on loans in EUR was 6.2% (short-term) and 7.7% (long-term).

In January 2009 the average weighted interest for short-term deposits in LVL was 6.6%, for long-term posits, 10.7%, while for deposits in EUR the interest rates were 3% and 5.8%, respectively.

Protection of intellectual property

Regulatory framework

As a member of the WIPO (World Intellectual Property Organization) Latvia has adopted most of applicable treaties, including but not limited to the Paris Convention for the Protection of Industrial Property, Berne Convention for the Protection of Literary and Artistic Works, Madrid Agreement Concerning the International Registration of Trademarks and the Protocol Relating to the Madrid Agreement Concerning the International Registration of Trademarks.

Their provisions are incorporated into acts: Patent Act, Trademarks and Indications of Geographical Origin Act, Industrial Designs Act, Protection of Topographies of Semiconductor Products Act, Copyright Act. The Patent Office of the Republic of Latvia is responsible for industrial IP (the Patent Office keeps the State Registers of Patents, Industrial Designs and Trademarks and License Contracts, performs examination and keeps the Register of Professional Patent Attorneys. Industrial property information is open to access in the Official gazette - "Patents and Trademarks"). Foreign individuals and entities may apply to the Patent Office patent agents (the Professional Patent Attorneys).

Trademarks

Use of unregistered trademarks is possible as long as it does not infringe on the legal rights of other persons or conflict statutory rules. Full protection of a trademark, however, can be obtained upon its registration with the Patent Office. Applicants may opt for the following type of protection to their trademark:

- National registration (effective only in Latvia) which costs LVL 125 (EUR 177.85) for one trademark class plus LVL 20 payable for each next class of goods and services,
- Community registration (effective in whole EU) which costs EUR 1600 for three trademark classes (plus EUR 200 for each subsequent class),
- International registration (world-wide protection available in 73 states, members of the Madrid system as per Madrid Convention), while actual protection depends on selected jurisdiction and corresponding fees being as follows: LVL 49 (EUR 69.72) payable to the Latvian Patent Board and CHF 903 to WIPO plus specific fees established in the respective jurisdiction for each trademark class.

The registration process lasts 6 months (in reality 12 months) and trademarks become protected 10 years from the application; this term can be extended for unlimited number of times, each time for another 10-year period.

International and EU registrations each have several advantages. EU registration requires a single application, and payment of one fee, after which registration of the trademark becomes valid in the whole EU. International registration under the Madrid system also requires one international application in one language and choosing countries where the protection will be in force, while total fee (summing up the fees payable in each selected jurisdiction) is rather expensive. Otherwise applications may be filed at each national patent office of a contracting party.

Patents

Inventors again may apply for national, EU or international registration of patents. Overseas international registration of patents is recognized under the Patent Cooperation Treaty. Exclusive rights shall come into force in full scope on the day when the notification regarding the grant of the patent is published, and shall expire not later than after 20 years from the filing date of the patent application.

Industrial designs

. The registration of a design shall be valid for 5 years from the filing date. Upon the expiration of this period, registration may be renewed each time for a new five-year period until the maximum time period for the protection of a design – 25 years from the filing date – is reached.

Intellectual property (IP) protection measures

IP owners are entitled to exercise all possible legal measures to protect their rights. Traditionally this includes submitting a claim to the court in order to prevent unauthorized use of IP as well as to recover actual damages. Various measures, ranging from cease and desist orders to compensation of lost profit and surrender of items produced or profit gained, may be imposed by the court. Besides, IP owners (or their authorised agents) are entitled to commence special customs measures to preclude the release of counterfeit or pirated goods on the domestic market.

Others

Protection of economic rights of Latvian holders of copyrights and of neighbouring rights is mainly provided by the Copyright and Communication Consulting Agency/ Latvia Copyright agency (AKKA/LAA). It represents about 2 million authors (including 3,000 domestic ones) according to mutual contracts on representation concluded with 85 copyright organizations worldwide. Public performance of music of the above authors at the cafés, restaurants, discotheques, shops and other places require licence agreement with AKKA/LAA and payment of royalties, which are pending on type of business and location (from minimum monthly fee of LVL 19 up to 8% from sales price of tickets, if any).

Protection of personal data

EU Directive 95/46/EC on the protection of individuals with regard to processing of their personal data and free movement of such data are pro-

vided in the Protection of Private Data of Individuals Act. Systems of personal data processing are registered with the State Data Inspection.

Competition

Competition

Regulatory framework

Foreign investors commencing their business in Latvia, either directly or in a joint venture or by acquiring a local firm, have to comply with requirements of the Competition Act, which is based on the Council Regulation (EU) No 1/2003 and *acquis communautaire*.

Government agencies

The Competition Council of Latvia (LCC) closely supervises the behaviour of market participants and is in charge of undertaking the measures to prevent market concentration, abuse of dominant position and reviewing complaints. LCC is allowed to exercise a wide range of preventive and penalty measures (up to 10% of annual turnover) to ensure fair market conditions for operating businesses.

Agreements between market participants

The Competition Act prohibits and invalidates any agreements between the market participants that are aimed at, or may result in hindrance, restriction or distortion of competition in Latvia including, but not limited to, agreements on fixing of tariffs or prices, division of markets, customer base, suppliers and others (excluding the traditional block exemptions under the EU law). To avoid negative consequences, such agreements require a prior confirmation with LCC that examines its beneficial effects.

Dominant position

According to the Competition Act dominant position is an economic (commercial) position in a relevant market of a market participant or several market participants if such participant or such participants have the capacity to significantly hinder, restrict or distort competition in any relevant market for a sufficient length of time by acting with full or partial independence from competitors, clients, suppliers or consumers.

Any market participant who is in a dominant position is prohibited from abusing such position in any manner within the territory of Latvia. The Act states examples of abuse of dominance: refusal to enter into transactions with other market participants or to amend the provisions of a transaction without an objectively justifiable reason, including unfair and unjustified refusal to supply goods or deliver services; restriction of the amount of the production or sale of goods, the market or technical development without an objectively justifiable reason to the detriment of consumers; imposition of provisions according to which the entering into, amendment or termination of transactions with other market participants makes such participants dependent on whether these market participants accept such additional obligations which, by their nature and commercial use, have no connection with the particular transaction; direct or indirect

imposition or application of unfair purchase or selling prices or other unfair trading provisions; or application of unequal provisions in equivalent contracts with other market participants, by way of creating for them, in terms of competition, disadvantageous conditions.

Concentration

For competition law purposes, the concept of "concentration" includes the merging of two or more independent market participants in order to become one market participant (consolidation), the joining of one market participant to another market participant (acquisition), and a situation where one or more market participants acquire a decisive influence over another market participant or other market participants. Market participants who have decided to merge (Paragraph 1 Section 15) shall, submit a full-form merger notification report to the Competition Council if the combined turnover of the participants in the merger for the previous financial year in the territory of Latvia has exceeded LVL 25 million. The market participants specified in Paragraph two of Section 15 are entitled to submit to the Competition Council a short-form merger notification report, if one of the following conditions exists: none of the participants in the merger operates in a single concrete market or in a market that is vertically related thereto; or the combined market share of the market participants involved in the merger does not exceed 15 per cent.

Group of companies -

The main aim of the Group of Companies Act is to provide protection for creditors and minority shareholders rights. These rights shall be reflected in a group of companies contract by which a company subjects its management to another undertaking (management contract) or undertakes to transfer all of its profit or part of it to another undertaking (transfer of profit contract). A group of companies contract is also a contract by which the company subjects its management to another undertaking and undertakes to transfer its profit to this other undertaking (management and transfer of profit contract). A group of companies' contract should stipulate appropriate indemnity to minority shareholders in a form of annual payments proportional to their investment (capital shares) in the company's equity (a payment of indemnity).

If a group of companies contract has not been concluded, the executive body of a dependent company shall prepare a report on dependency for each accounting year. The report on dependency shall be prepared and approved together with the annual accounts of the dependent company.

The report on dependency is subject to review by a sworn auditor together with the annual report of the dependent company.

Legal system

The legal system is based on Romano-Germanic law, but in practice case law also exists. A decision of the Supreme Court usually sets a precedent. Generally recognized principles and rules of the international and EU law

are incorporated into national legislation. The Civil Act (1937), Commercial Code (2002) and other relevant acts regulate the main part of commerce. Hierarchy of national legal acts is as follows: international agreements, constitution (Satversme), laws, Cabinet' regulations, legal acts issued by the Government Bodies and municipalities.

There is three-tiered court system for the ordinary court of law: first instance courts (city or county court, or district courts – for specific categories of cases), appellation instance courts (district courts and the Supreme Court) and appeals court (Senate of the Supreme Court).

Constitutional Court

The Constitutional Court has the right of declaring laws, acts or their parts null and void. There are 7 judges and they are confirmed by the Saeima for 10 years.

Administrative courts

To protect individuals dealing with the state and municipal bodies, the system of administrative courts was introduced at the beginning of 2004. Now there is only one first instance and appellation administrative court (situated in Riga) as well as a cassation instance - Administrative department of the Senate of the Supreme Court.

Any individual may submit a claim against state or municipal institution, including the State Revenue Service, and dispute these administrative acts. Litigations are based on the objective investigation principle, rather than competition, i.e. – judges collect all evidence either themselves or order parties to do it.

Business services

There is a diverse range of business service providers. Companies operating in Latvia can freely obtain professional competencies from the international companies/networks and local experts with a deep understanding of the below industries:

- Professional services: legal, audit, accounting, corporate finance, tax, management consulting;
- Recruitment, staffing and HR management;
- Advertising and media, PR and strategic communications;
- Market research and competitive intelligence;
- Quality management & standardization, including ISO certification;
- Customized IT solutions & technical consulting;
- Call centre services.

Human resources

Labour

In 2008 the total size of the Latvian labour market was 1.15 million persons, of whom the majority are concentrated in the largest cities — Riga, Daugavpils, Liepaja and Jelgava. Average gross monthly salary in the private sector is LVL 446 (~EUR 637), but it does not reflect the actual remunerations paid out in many businesses as “envelope pay”.

As of January 1, 2009, the burden of personnel taxes (23% personal income and 33.09% social insurance) amounting to 50% cost on the top of net salaries encourages many companies to pay their staff as “envelope pay”. The minimum statutory salary is LVL 180 (~EUR 257).

The unemployment rate was 12.3% (in January 2008 – 6.5%) in January 2009, due to which the labour market has become considerably more attractive to employers compared to previous years.

Education and skills

In 2008, there were 60 higher education institutions in Latvia (26 colleges – 18 are state and 8 private, and 34 other higher education institutions– 19 are state and 15 private), most of which belong to the state, the rest founded by other legal entities or private individuals. A positive tendency is the rapid rise in student numbers seen in recent years. The number of students enrolled in the 2007/2008 academic year was over 127,000, most of whom (almost 90 thousand) attended public institutions. About a third of them study at state expense, while the rest pay tuition. The regulation of tuition fees is under discussion.

In Latvia there are 552 students per 10,000 people, which is the second highest in the world. This maintains the inflow and availability of labour and intellectual capacity in the domestic market. As a result of an underestimation of needs for some social science subjects, such as business and law, during the Soviet period, and the resulting shortages in specialists, these subjects have become the most popular with students in recent times. However, natural sciences and technology, particularly IT and applied technologies, are currently experiencing increased demand, as a direct result of the need for these skills in the expanding industrial sector. Together with the achievements of Latvian scholars (microbiology, mathematics, medicine, chemistry), is viewed by the Government as having potential to generate future experts with high competitive capacity in both local and international labour markets.

Educational institutions offer good academic and technical competence. Furthermore they provide higher education in an international atmosphere and successfully participate as host universities within various mobility schemes. Examples are EU Socrates/Erasmus and Leonardo da Vinci, Nordplus and HESP. Latvia also exports higher education services, especially within the areas of technology, transport and health sciences, as Latvian universities provide highly competent and very cost-effective education.

Employment policies/ law

Latvian Labour law complies with the basic policies introduced by the EU law. It is supported by a huge number of EU requirements on work safety, labour place adequacy and other matters, which often are too advanced for many local companies. Standard working time is 8 hours per

day and 40 hours per week; vacations are four calendar weeks (excluding 10 days of state holidays) after first 6 months of employment.

An employer and an employee establish an employment legal relationship by a contract of employment. By means of a contract of employment an employee undertakes to perform specific work, subject to specified working procedures and orders of an employer, while the employer undertakes to pay the agreed work remuneration and to ensure fair and safe working conditions that are not harmful to health. A contract of employment shall be entered into in writing.

As a general rule, contracts of employment are concluded for an unspecified period of time (Section 43 of the Labour Act). Fixed-term contracts are only admitted in a restricted number of cases, defined in Section 44. This was one of the major changes included in the new Labour Act, harmonizing Latvian law with Directive 1999/70/EC on fixed-term work. Fixed-term employment contracts are permitted in the cases of seasonal work, work in activity areas where a contract of employment is normally not entered into for an unspecified period, replacement of an employee who is absent, casual work which is normally not performed in the company, emergency work in order to prevent the consequences caused by an unexpected event, etc. Fixed-term contracts may also be concluded in special areas such as sports.

Parties to a contract of employment concluded either for a fixed period or an indefinite period can agree upon a probationary period (Section 46 and following of the Labour Act). The maximum length of a probationary period is three months. A probation period shall not be determined for persons under 18 years of age. Where the contracted term of a probation period has expired and the employee continues to perform the work, he or she is considered to have passed the probation period (Section 47 (2) of the Labour Act).

Termination of the contract of employment

A contract of employment can be terminated either at the initiative of an employer or an employee. A contract of employment may also be terminated by expiry of a fixed-term contract, by mutual consent of employer and employee, or pursuant to the request of a third party.

Parents (guardians) or the State Labour Inspection have the right to request in writing the termination of an employment relationship with a person who is under 18 years of age if such person performs work, which jeopardises his or her safety, health or morals or negatively affects his or her development or education.

Grounds for termination

Termination at the initiative of the employer

Pursuant to Section 101 of the Labour Act, an employer has the right to give a written notice of termination of a contract of employment only on the basis of circumstances related to the conduct of the employee, his or her abilities, or of economic, organizational, technological measures or measures of a similar nature in the undertaking only in the following cases:

- an employee has without justified cause significantly violated the contract of employment or the specified working procedures;

- an employee, when performing work, has acted illegally and therefore has lost the trust of the employer;
- an employee, when performing work, has acted contrary to moral principles and such action is incompatible with the continuation of employment legal relationships;
- an employee, when performing work, is under the influence of alcohol, narcotic or intoxicating substances;
- an employee has grossly violated labour protection regulations and has jeopardised the safety and health of other persons;
- an employee lacks adequate occupational competence for performance of the contracted work;
- an employee is unable to perform the contracted work due to his or her state of health and such a state is certified with a doctor's opinion;
- an employee who previously performed the relevant work has been reinstated at work;
- the number of employees is being reduced;
- an employer – legal person or partnership – is being liquidated.

Termination at the initiative of the employee

An employee can also terminate a contract of employment. He or she has a duty to give a notice in writing one month in advance, unless a shorter time limit for the giving of a notice of termination is provided by the contract of employment or the collective agreement. By agreement of an employee and his or her employer, a contract of employment may be terminated also before expiry of the time period for a notice of termination.

These provisions do not apply if the employee has good cause, based on considerations of morality or fairness. If an employee terminates the contract of employment based on such good cause he or she is entitled to severance pay.

Prior notice is required to terminate a contract of employment concluded for an indefinite period as well as a fixed-term contract where an employer intends to terminate such contract before the expiry of the term. An employer, when giving a notice of termination of a contract of employment, shall comply with different time periods, depending on the grounds of dismissal. The notice of dismissal will take effect either immediately, or 10 days after the notice, or one month after the notice, accordingly to Sections 103 and 101 of the Labour Act.

During a probationary period both parties can terminate the employment relationship giving prior notice in written three days before termination. An employer as well as an employee, when giving the notice of termination of a contract of employment during a probation period, does not have to indicate the cause for such notice (Section 47(1) of the Labour Act). An employee has no protection against unfair dismissal during probationary period. However, an employee has the right to request appropriate compensation, if an employer has violated the prohibition of differential treatment when terminating the contract of employment during probationary period (Section 48 of the Labour Act).

Foreigners subject to immigration controls must obtain work permits in order to work in Latvia. A permit is issued only for a particular job with a particular employer and may be for a limited period. Application may then be made to extend the permit. The validity period of the work permit depends on the status and citizenship of a person applying for it. The restrictions on receiving a work permit are not applicable to EU citizens. An expatriate who is an EU citizen must receive a residence permit if his anticipated stay in Latvia will exceed 90 days in any given six month period. A residence permit can be obtained on a number of grounds, the primary reason being to work in Latvia or for rendering services.

2. REGULATION OF FOREIGN INVESTMENTS

General information

Many investors view Latvia as a base for further expansion eastwards. Latvia's excellent location might be worth considering when there is a need to cover the whole Baltic region from a single production or distribution unit, or when establishing a representative office in this region. The good transport infrastructure and transit opportunities enhance Latvia's advantageous geographical location. Three major ice-free ports a growing international airport, and road and railway networks contribute to Latvia's role as a regional transport hub. Latvia offers a politically and economically stable environment for foreign businesses, which is an important factor in the selection of investment locations. Latvia's status as an EU member state evidences long-standing stability. Foreign companies operating in Latvia especially appreciate the highly qualified, educated and easily adaptable workforce, which speaks several languages and is available at rates which are by far lower than those in the investor countries.

The government of Latvia has developed state support programmes for enterprises registered in Latvia. Within the programmes covering 2007-2013, grants are likely to be available for the following activities:

- The foundation and support of the Centre of Competence
- Support for the Technology Transfer Centre
- Technology incubation
- Business incubators in regions
- Development of new products, services and technologies
- Involvement of highly qualified employees
- Development of the industrial areas used in business
- Development of investments in small- and medium-sized enterprises in regions with
- Special support status
- Education and re-qualification of employees
- Support for start-up capital
- Risk capital fund
- Guarantee for credits of small- and medium-sized enterprises
- Alternative investment market.

The Latvian government recognises the contribution of foreign investment to the national economy and actively promotes the inflow of foreign investment. National legislation gives foreign investors the same rights and obligations as Latvian investors. In general, foreign investors are treated in exactly the same way as local private enterprises, and given the same kind of rights and responsibilities.

Grants and state aid

Regional Development fund at the Ministry of Economics compensates interest on loans borrowed due to establishing new employment-generating businesses within the regions having the special support status. Newly recruited staff may be trained partially at Government's expense if training programmes have prior approval by the state Employment Service.

As EU member state Latvia has access to structural funds: in the period from 2004 through 2006 the aggregate financing allocated to Latvia represents EUR 845 million (EUR 625 million from the EU structural funds and EUR 220 million from the national budget of Latvia and budgets of local authorities), and additional EUR 710 million for transport sector and environmental sector are available from the Cohesion Fund. EU funds available to Latvia, as the poorest among the EU member states, amount to EUR 5.7 billion available during 2007-2013.

3. REAL ESTATE AND OWNERSHIP

General information

As a country with a relatively low population density, Latvia provides a range of location choices for both industrial and office needs. There are a number of factory buildings in all the largest cities, along with historical city centres that gradually develop from residential into commercial, entertainment and shopping areas.

Commercial real estate

After joining the EU in May of 2004, Latvia's real estate market has experienced fast growth of prices. In the end of the year the real estate prices were up by thirty percent. Credits to households and in particular mortgage loans have had the most dynamic evolution and fuelled the unsustainable real estate bubble in Latvia. It exploded in 2008 incapacitating Latvian economy and government.

The activity on Latvia's apartment market is slowing down and the number of deals, registered in the Land Register in 2008, was 65% lower than in 2007, it has now dropped to the lowest point in the last seven years, according to the real estate company Latio.

In February 2009, in comparison with January, the prices fell by approximately 7.6%, with the average apartment price reaching EUR 814 (LVL 570) per square meter last month, according to a study carried out by the real estate company Balsts. At the moment, the average apartment prices stand at the same level as they were in December 2005.

Today before issuing loans, banks carefully assess applicants' existing liabilities; furthermore, almost in all cases they demand the borrower to have a guarantor. Therefore increasingly more buyers purchase apartments using their savings, already around one-half of the apartment purchase deals are carried out without mortgaging.

At the moment the highest activity is in the rental market, enterprises and households are trying to benefit from the current situation and reduce their monthly costs. Apartment sales market, despite the rapidly decreasing prices, has not yet adapted to the new situation with the same speed because of the strict regulations that buyers have to be met to take out a mortgage loan. As long as nothing changes in banks' credit policy, apartment prices will continue to shrink, very possibly at the same pace as now.

The largest decrease in prices in 2008 was for sale of units for which the rental payment has decreased by up to 50%.

Subject to location and rented area, the following rentals are available in Riga:

- Apartments - EUR 3-10 per m²,
- The average office space rent prices now range between EUR 7-9 (LVL 4.9 to LVL 6.3) per m².

Purchasing real estate

Real estate ownership and related rights (liens, long-term leases) shall be registered based on a written agreement and request verified by a notary with the land book. In most instances local municipalities have preemptive rights, which takes only 20 days to clarify. Nevertheless, most businesses use legal gaps to avoid it. Stamp duty of 2% from the value of a real estate or transaction price whichever is higher is payable upon changing the title, but LVL 30,000 (EUR 42,686) is maximum ceiling. Other taxes (VAT, income or capital gains tax) depend on several factors including seller's status and his residence.

Historically a different set of laws rule the transactions with urban and rural land. In principle, there is no discrimination as to the origin and status of overseas and local purchasers.

Limitations

Except for protected zones and forests, foreigners can buy real estate. However, different procedures are applicable depending on the person's residency and status of land.

There are no limitations for EU residents to acquire directly land within the cities, while purchase of rural land requires municipal approval until 2011. The most simplified way for foreigners (both EU and non-EU) to acquire the land is throughout a limited liability company that is registered either in Latvia or one of the EU member states provided it meets the following criteria:

- At least 50% owned by Latvian or EU residents (citizens or incorporated businesses), or
- Incorporated either in Latvia or one of the EU member states if at least a 50% share is owned by the residents of a country who have a ratified investment protection treaty with Latvia before 1997.

However, if there is a treaty, but it is ratified or concluded after 31 December 1996, overseas residents may buy on a reciprocal basis (i.e. if Latvian residents have the same rights to purchase the land in a foreign country). If this treaty mechanism is not available, foreigners should seek for municipal approval on the purchase agreement. This may be refused if the acquisition contradicts local development plans, in which case the property will be subject to compulsory disposal within the next 2 years.

4. BUSINESS ORGANIZATIONS AVAILABLE TO FOREIGN NATIONALS

Pursuant to the provisions of the Commercial Code, the following types of companies can be established in Latvia:

- Private limited company (*Sabiedriba ar ierobežotu atbildību*), corresponds largely to German GmbH;
 - Public limited company (*Akciju sabiedriba*), corresponds largely to German AG;
 - Branch office of a duly incorporated foreign company (*Filiale*);
 - Representative office;
 - General partnership, corresponds largely to German OHG;
 - Limited partnership, corresponds largely to German KG;
 - **European Economic Interest Grouping**;
 - **Sole Merchant** (*Individualais komersants*);
-

5. SETTING UP AND RUNNING BUSINESS ORGANIZATIONS

A company incorporated in accordance with Latvia law and a branch office of a foreign company, acquires its legal status and existence from the time it is registered in the Commercial Register, which is kept by the registry departments of their local courts of first instance. Full disclosure of essential information must be made to the register, which thereby becomes public and examinable by everyone. An entry in the Commercial Register is legally held as correct with regard to all third parties, except where the third party knew or should have known that the entry is not correct. A public notary is a mediator between an enterprise and the register. For establishment the memorandum or resolution of foundation and the articles of association of the limited liability company must be notarized. The submitted documents must be in the Latvian language or together with a notarized translation. It is possible to purchase previously incorporated companies inexpensively.

Private limited liability company

A private limited liability company (*Sabiedrība ar ierobežotu atbildību*) may be established by at least one member with a minimum share capital of LVL 2000 (EUR 2846) contributed either in cash or in-kind. When contribution of tangible or intangible assets exceeds LVL 4000 or makes up 50% of the share capital, it should be valued by certified experts. The Board shall consist of at least one member elected by the General Meeting of Shareholders (GMS) for a period of up to 3 years (Council is optional).

Public limited company

A public limited company (*Akciju sabiedrība*) is another type of a limited liability company that may be required to conduct certain business (banking, insurance) and/or going public. It may be established by one or several shareholders with initial share capital of LVL 25,000 (EUR 35,572), except for larger-scale businesses where higher thresholds are required. Again, a certified expert is required to evaluate contribution of assets as described above. There is a two level management system: a Council consisting of at least 3 members (or 5 if shares are publicly traded) elected by GMS for a period of up to 3 years to supervise the Board. The Board consist of at least one member elected by the Council for a period of up to 3 years. Public emission and trade with the emitted shares is allowed after notifying of the Central Depository and opening of a stock account.

Branch

A branch (*Filiāle*) is a part of undertaking, which has a certain degree of independence and is separated territorially or in some other manner from its main office. A branch has no legal entity status, but it should be registered and obtain a domestic tax code. Special rules are applicable for taxation of a Branch's profits (Permanent Establishment), with regard to allocation of expenses and accounting vouchers.

Branches of foreign companies in Latvia have no legal personality. However a branch of a non-resident company is treated by the law as a separate Latvian taxpayer subject to the same reporting requirements as are applied with respect of local companies.

Representative office

A representative office is not a legal entity and it cannot trade. Nevertheless, it shall be registered with the Commercial Register and to pay payroll taxes if there are employees. Term of representative offices is not limited, but founders should avoid actual business resulting in a Permanent Establishment.

Partnerships

There are two kinds of partnerships – general and limited – distinguished by the scope of liability of its partners. A partnership is not a legal person, but it may be registered for VAT (not income tax) purposes. Furthermore partnerships acquire most legal rights and obligations, including the property ownership. In principle a partnership may exist unregistered. However, if it becomes a VAT payer, distributes gross profits to its partners or requires commercial licence, registration is mandatory. Partnership agreements are not compulsory, but recommended in order to specify planned contributions or representation of its partners (if latter is limited). Partnerships are popular in such areas as construction, law, audit and few others, whereas certain sectors such as gaming or financial markets have statutory restrictions on opting for a partnership.

European Economic Interest Grouping

The European Economic Interest Grouping (EEIG) as set forth by the Council regulation No 2137/85 may be registered with the Latvian Commercial Register. EEIG may be established by at least two persons (legal, private) performing their principal activities in different EU member states or if central administration and principal activities of EEIG partners are carried out within the different member states. The purpose of EEIG is to facilitate economic activities of its members.

Sole merchant

A sole merchant (*Individualais komersants*) is a private individual engaged in a business which generates annual turnover over LVL 200,000 (approx. EUR 284,574) or alternatively – employs more than 5 employees and generates annual turnover over LVL 20,000 (approx. EUR 28,457). A sole merchant pays 25% individual income tax and is liable in business with all his personal belongings and assets. Registration at the Commercial Register is required.

Commercial agents, brokers and self-employed persons

Commercial agents and brokers are registered as self-employed persons (*pašnodarbinātais*). Commercial agents and brokers are making contracts and other arrangements on behalf of the principal and, unless otherwise agreed, reimbursed on commission bases as stipulated by the Commerce Act.

To optimise taxes and increase a net current income, liberal professions often register as self-employed. This requires an individual to register his/her self-employed status with the authorities and to pay to State Revenue 15% income tax and social insurance from the minimum threshold of LVL 2160 per year.

6. CORPORATE TAXATION

Taxpayers

Corporate income tax is applicable on the worldwide income of resident corporations and permanent establishments of non-residents. Non-residents are subject to withholding taxes on the defined type of income earned in Latvia.

Tax rates

In accordance with the Corporate Income Tax Act, initially adopted in 1995, companies established or registered in Latvia, earning business income in Latvia are subject to corporate income tax at 15%. Non-resident companies without a permanent enterprise in Latvia are subject to tax on their profits in Latvia. Dividends are exempt from tax if received from domestic subsidiaries or EEA countries. Dividends received from non-residents in third countries also are exempt if the Latvian recipient holds more than 25% of the capital and voting power of the payer and the payer is not located in a “black list” country. Other dividends are taxed at a 15% rate with a credit for foreign tax withheld.

Non-residents are taxed on the following sources of income under the following withholding tax (WHT) rates:

- Dividends – 10% (0% tax applies if the recipient of another EU or EEA country);
- Management and consultancy fees – 10%;
- Interest paid to related parties – 10% (From 1 July 2009, 5% applies if the recipient is a resident of another EU country and owns more than 25% of the company paying interest); - Interest payments made by Latvian registered commercial banks to related parties - 5%
- Right to use intellectual property rights in respect of literature and artistic works – 15% (from 1 January to 30 June 2009, 10% tax applies, and from 1 July 2009, 5% is applicable if the recipient is a resident of another EU country and owns more than 25% of the company paying royalties);
- Right to use other intellectual property rights – 5%;
- Payments for the use of fixed or movable property in Latvia – 5%;
- Proceeds from the sale of real estate or real estate company shares in Latvia – 2%.

Tax relief may be applied on dividends, interest, royalties and consultancy fees paid to the residents of the countries that have an effective

double tax treaty with Latvia provided that prior arrangements with the Latvian tax authorities are made.

The marine fleet is subject to 15% tonnage tax, with a different method of income calculation. Tonnage tax is calculated from tonnage of watercraft used in international marine traffic by applying a specific income coefficient defined in the Corporate Income Tax Act.

Off-shores

Off-shores include 67 major low tax jurisdictions listed by the Government . Unless there is a prior exemption from tax authorities, payments to off-shores are subject to ordinary corporate income tax (15%) except for the following transfers:

- Dividends – subject to ordinary withholding tax (10%);
- Repayment of loan principal or loans advanced (tax free);
- Interest on account and deposits paid from credit institutions registered in Latvia (if interest rates applied adequate to those used in the ordinary course of business);
- Payments for imported goods originated in the respective off-shore;
- Other payments if a prior exemption from tax authorities is obtained.

In certain cases this also applies to Latvian resident individuals.

Tax base

Tax base constitutes taxable income calculated based on financial profit (loss). Financial profit (loss) shall be adjusted under the Corporate Income Tax Act stipulating the following main adjustments reflected in the tax return:

Increased (decreased) by:

- Expenses unrelated to the business;
- Increase in provisions (included in the Income statement as expense);
- Financial depreciation;
- Payments to non-residents (except for dividends and proceeds from the sale of real estate) if applicable tax has not been withheld;
- 40% of representation expenses (restaurant bills, business entertainment expenses, etc);
- Negative valuation adjustments except for exchange differences;
- Other items prescribed by the Corporate Income Tax Act;

Decreased (increased) by:

- Tax depreciation;
-

- Decrease in provisions (included in the Income statement as income);
- Positive valuation adjustments except for exchange differences;
- Real estate tax (if not included in the Income statement in profit before tax);
- It is established that for the expenses, occurring during the taxation period, for establishment of a new work place for an employee with a disability group;
- of a certain amount of credit percent that the taxpayer should pay for a loan of a similar amount (in the amount of the increase of the equity share).

The income derived from sales of fixed assets (including technological equipment) shall be subject to corporate income tax exemption, under provision that a new similar fixed asset is purchased within a 12-month period;

Tax depreciation

For tax purposes, fixed assets should be depreciated under the reducing balance method using the following rates:

- Buildings and constructions 10%
- Railway, marine and power equipment 20%
- Electronic equipment 70%
- Other (furniture, cars, equipment) 40%
- Oil research and extraction equipment 15%

The value of new technological equipment acquired in the period from 2009- 2013 may be increased using the ratio 1.5 to claim higher tax depreciation.

Land (including woodland with standing forest) cannot be depreciated for tax.

Further intangibles may be depreciated for tax under straight-line method:

- Concessions 10%
- Patents, licences and trademarks 20%
- Research and development costs 100%

Starting 2009 for a new registered patent or trademark – cost base is increased by 150%.

Interest

Interest accruing on loans from Latvian-registered banks is fully deductible. Non-bank loans are subject to thin capitalization (1:4 ratios) requiring companies to increase their taxable income by the higher of the following two amounts:

- The amount calculated as actual interest proportionally to the excess of the average loan exceeding over four times the company's equity at the beginning of tax year, or
- The difference between the actual interest and amount calculated using the following formula: loan principal multiplied by the average short-term interest on the last month of company's tax year as published by the National Statistics Committee 16.8% for LVL and 6.8 for EUR in December 2008) and multiplied by coefficient 1.2.

Transfer pricing

Payments to related parties are deductible provided they meet statutory provisions as to the normal arm's length price (there are five methods entitling tax authorities to adjust a transaction price including cost plus method, comparative price method, further sales method). Transactions between related parties and inter-company pricing are closely scrutinized by the tax authorities to ensure that this is the case. If such payments are considered excessive, tax authorities may rule that the excess amounts are not deductible expenses (or adjust income and charge addition tax if price is low). They also have special rights to adjust a company's income, charging 15% tax, if the spread of the transfer price applied by related parties differs more than 20% from the price applied to third parties on identical transactions.

Investment deductions

Financial investments are not tax-deductible. Neither increase nor decrease of value of investments makes any tax impact. If trade of securities, other than listed ones, is occasional (i.e. owned at least 12 months and not more than one sale is carried during the fiscal year), any losses incurred upon their sale may be offset against taxable income generated from sale of other securities during the subsequent 8 years, but not in excess of actual amount of losses.

Bad debts

Losses incurred as a result of the bad debts can be written off if debtor is acknowledged insolvent by the court or if it is the state or municipal body that has been liquidated. The latter is applicable only to debtors that are Latvian or EU residents (or permanent establishments), or residents of a country that has a double tax treaty with Latvia.

Exchange gains and losses

All transactions in accountancy shall be reflected in lats as per the exchange rate set forth by the Bank of Latvia on the day of transaction (www.bank.lv). At the year-end assets and liabilities shall be revaluated, using the exchange rate of 31 December. Profits less losses arising from differences in exchange rate are taxable at 15% corporation tax.

Tax losses

Tax losses can be carried forward for up to eight years. Taxpayers registered in Special Economic Zones have a 10-year limit. Where a change in the 'control' of a company occurs, the right to existing losses is lost unless the company continues the same fundamental business activity for the next five years that it undertook during the previous two years.

Tax payments and returns

Tax for the current year is payable in advance based on the results of the previous year. Overpaid taxes are usually transferred for settlement of other taxes or refunded within 30 days based on the taxpayer's application. Corporation tax return must be presented together with annual accounts (four months after the end of the tax period), but declarations on payments to non-residents – monthly, until the 15th day of the following month.

Double taxation relief

There are two ways for applying tax reliefs from double tax treaties (Chapter 10): either to complete the residency application form and submit it for approval to fiscal offices of two countries before exercising a transaction and making mutual payments to overseas (which requires at least 30 days to confirm the respective forms and agreements with Latvian tax authorities) or to carry out the transaction and withhold statutory taxes from the payments to overseas and afterwards apply to the tax office for a tax refund.

7. PERSONAL TAXATION

Residence

Latvian tax residents are:

- Citizens and permanent residents of Latvia;
- Individuals present in Latvia for 183 days or more in any 12-month period starting or ending in the calendar year.

Personal income tax

There is a flat tax rate of 23% applicable on personal worldwide income. Tax base for non-residents represent 15 types of Latvian source income including, but not limited to, employment and professional income earned either in Latvia or overseas on behalf of a Latvian resident-corporation. Ten types of income, including capital gains from the sale of personal assets and dividends distributed from Latvian-taxed corporate profits qualify for exemption; however, not all exemptions are applicable to non-residents.

Personal income tax-exempt income in Latvia is listed below:

- Dividends paid by Latvian or other EU companies;
- Income from deposits in banks registered in Latvia;
- Lottery wins, if the amount does not exceed expenses incurred on them, maximum LVL 500;
- Income from the sale of personal property, excluding the sale of real estate held for a period less than 12 months;
- Compensation paid by an employer to an individual (final consumer), provided the individual purchases a certain amount of goods from that company;
- Insurance benefits received
 - except compensation payments for life, health or accident insurance if premiums were paid by the employer
 - upon expiration or breach of agreements;
- Income derived from Latvian State or municipality bonds;
- Certain business travel expenses;
- A number of government benefits.

Deductions

Further tax deductions are available before applying personal income tax:

- National Social insurance paid by employee;
-

- Tax exempt minimum – LVL 90 per month until 31st June 2009 and LVL 35 per month starting 1st July 2009 (LVL 750 per year), applicable only for tax residents;
- Statutory allowances for dependents, medical costs and education, applicable only for tax residents;
- Medical expenses (up to LVL 300 per calendar year summarized with education expenses);
- Dentistry services (not limited);
- Education expenses (up to LVL 300 per calendar year summarized with medical expenses);
- Insurance premiums and payments to private pension funds (summarized, limited up to 20% of taxable income in particular calendar year);
- Expenses related to creation of art, music, literary, scientific, educational etc. works;
- Donations to certain listed organizations (up to 20% of taxable income).

Compliance

It is compulsory for the Latvian resident corporations to withhold 23% income tax (also social insurance as referred below) from the salary and other defined sources of income paid to the individuals except those registered as self-employed. Employers are liable for calculating and paying this tax. Sole merchants (self-employed persons) and expatriates seconded to Latvia and employed by foreign corporations are liable to calculate and pay personal income tax (annually) and social insurance contributions (quarterly) by themselves.

National Social insurance

The insured persons may be domestic and foreign individuals working in Latvia on behalf of Latvian or foreign corporations as well as sole merchants. Tax base is determined as follows:

- For employees – gross salary of the first LVL 29,600 per year;
- For sole merchants (self-employed persons) – optional income between LVL 2,156 to LVL 29,600 per year.

Within different classes of taxpayers tax rates are as follows:

- Expatriates seconded to Latvia and working on behalf of foreign companies – 31.13% (on the Latvian source income as from 184th day of their presence in Latvia);
- Self-employed persons – 30.48% (on an opted statutory amount);
- Domestic and foreign individuals working for Latvian resident corporations
- 33.09% calculated on wages and other fringe benefits (9% payable by employee and 24.09% by employers).

Domestic companies are liable to timely and correct payment of social insurance, including the tax element payable by employees (9%). The latter shall be withheld from the salary in the manner similar to the income tax and transferred to the SRS on the same day as salaries.

Commerce risk levies

This is an additional levy to ensure compensations payable to employees upon company's insolvency. They are payable by the company at the amount of LVL 0.25 per each employee every month.

Tax optimization/ reliefs

Whilst there are plans to approximate rates for taxation of personal (23%) and corporate (15%) income, current difference is significant. Therefore, liberal professions and expatriates opt for setting up their own limited liability company used as a financial vehicle to collect earnings with 15% tax applicable on corporate profits, determined after allocation of business expenses. Expatriate individuals however are to consider their home country rules as Latvian source dividends may become taxed in a home (residence) country. In such a case self-employed status may be alternative that leads to higher net income, however less social guarantees.

8. DOUBLE TAXATION AGREEMENTS

The network of international treaties signed by Latvia concerning taxes, foreign investments and other rights and interests is sufficiently broad and includes the most relevant jurisdictions. Latvia has double tax avoidance treaties with over 30 countries. With a few exceptions that relate to national security foreign traders enjoy the same rights as domestic businesses.

Latvia has signed the attached list of the double tax treaties with the following tax rates (they do not reflect tax reliefs applicable to the dividends, interest and royalties distributed to the EU companies):

Recipient	Dividends (1)	Interest (2)	Royalties (3)	Rentals of industrial, commercial or scientific equipment and real estate	Man- agement fees (4)	Disposal of real estate
	%	%	%	%	%	%
Treaty:						
Albania	10/5	0/5/10	5	5	0	2
Armenia	10/5	0/5/10	5/10	5	0	2
Austria	10/5	10	5/10	5	0	2
Belarus	10	0/5/10	5/10	5	0	2
Belgium	10	0/5/10	5/10	5	0	2
Bulgaria	10/5	0/5	5/7	5	0	2
Canada	10/5	0/5/10	5/10	5	0	2
China	10/5	0/5/10	5/10	5	0	2
Croatia	10/5	0/5/10	5/10	5	0	2
Czech Re- public	10/5	0/5/10	5/10	5	0	2
Denmark	10/5	0/5/10	5/10	5	0	2
Estonia	10/5	0/5/10	5/10	5	0	2
Finland	10/5	0/5/10	5/10	5	0	2
France	10/5 (6)	0/5/10	5/10	5	0	2
Georgia	10/5 (7)	0/5/10	5/10	5	0	2
Germany	10/5	0/5/10	5/10	5	0	2
Greece	10/5	0/5/10	5/10	5	0	2
Hungary	10/5	0/5/10	5/10	5	0	2
Iceland	10/5	0/5/10	5/10	5	0	2
Ireland	10/5	0/5/10	5/10	5	0	2
Israel	5/10/15	5/10	5	5	0	2
Lithuania	10/0	0	0	0/5 (5)	0	2
Kazakhstan	10/5	0/5/10	5/10	5	0	2
Kyrgyzstan	10/5	5/10	5	5	0	2
Malta	10/5	0/5/10	5/10	5	0	2
Macedonia	10/5	5	5/10	5	0	2
Moldova	10	0/5/10	5/10	5	0	2
Netherlands	10/5	0/5/10	5/10	5	0	2
Norway	10/5	0/5/10	5/10	5	0	2
Poland	10/5	0/5/10	5/10	5	0	2
Portugal	10	0/5/10	5/10	5	0	2
Romania	10	0/5/10	5/10	5	0	2

Serbia and Montenegro	10/5	10	5/10	5	0	2
Singapore	10/5	0/5/10	5/7.5	5	0	2
Slovakia	10	0/5/10	5/10	5	0	2
Slovenia	10/5	0/5/10	5/10	5	0	2
Spain	10/5	0/5/10	5/10	5	0	2
Sweden	10/5	0/5/10	5/10	5	0	2
Switzerland	10/5 (7)	0/5/10	5/10	5	0	2
Morocco	10/6	0/10	10	5	0	2
Turkey	10/5	0/5/10	5/10	5	0	2
United Kingdom	10/5	0/5/10	5/10	5	0	2
United States	10/5 (6)	0/5/10	5/10	5	0	2
Ukraine	10/5	0/5/10	5/10	5	0	2
Uzbekistan	10	0/5/10	5/10	5	0	2

Explanations:

(1) 5% applies if the beneficial owner is a company that holds directly at least 25% of the shares. According to the majority of the double taxation treaties the 25% requirement is fulfilled if the shareholder has 25% of the capital. Some treaties provide a withholding tax rate of 15% on dividends, Latvian legislation applies a maximum rate of 10%, which is the highest applicable rate for dividends paid to all countries (except dividends distributed to the EU residents holding over 25% of the shares based on EU directive 90/435/EEC).

(2) 10% applies if recipient is a related party. 5% applies if payment to related party is made

by a commercial bank registered in Latvia.

(3) 10% or 7.5% applies on royalties for literary or artistic works, including movies, videos and recordings.

(4) Treated as part of business profits. 0% if permanent establishment does not exist.

(5) 5% on rentals of real estate.

(6) At least 10% shareholding required.

(7) At least 20% shareholding required.

(8) At least 10% shareholding and USD 75 000 capital contribution required.

9. VALUE ADDED TAX

General principles

The Latvian VAT system is harmonized with the EU 6th VAT Directive. Delivery of goods, supply of services, community acquisitions, import and self-consumption are taxable for VAT. Local persons conducting these activities should register for VAT within 30 days as soon as their taxable transactions reach LVL 10,000 (EUR 14,228) in a 12-month period. It is possible for businesses to register for VAT before reaching of this threshold.

Foreign entities, from the EU or elsewhere, that conduct VAT-taxable transactions in Latvia must register for VAT purposes before commencing transactions irrespective of the amount such transactions, unless the reverse-charge method applies.

Tax rates and object

The VAT rates are 0%, 10% and 21% applicable as follows:

- 21% rate is applied on most domestic sales and services including intra community acquisitions as well as third country imports (unless exempt or subject to 10%);
- 10% rate is imposed on medicines, medical goods and equipment; infant products; supply of heating, electricity and natural gas to inhabitants; public transport services within Latvia; mass media products.
- 0% rate is applicable to the export and transit of goods and services related to the export, intra community shipments to VAT registered persons in other EU member states and most of the services rendered on behalf of overseas recipients or EU-registered VAT persons (also taxpayers).

Compliance

Taxable persons are entitled to recover the VAT paid to suppliers or upon import of goods provided that purchase is made for the provision of taxable supplies (21%; 10% and 0%). Taxable period is a calendar month: VAT should be accounted for and paid (difference between the input and output) monthly, and reported to the tax authorities until the 15th day of the following month. As soon as the company registers for VAT, it is entitled to deduct input VAT incurred upon the purchase of services or

goods. Output VAT should be accounted for upon receiving of advance payment or delivery of goods or services. Invoices shall be issued within 15 days after supply of services or delivery of goods.

Inland delivery of goods shall be supported with invoices that contain serial numbers assigned by the tax authorities. Invoices should contain the following information at minimum:

- Names, addresses and VAT numbers of seller and purchaser;
- Date and number of invoice;
- Date of delivery of goods or services;
- Name, price, amount and units of goods or services;
- Tax rate, calculated tax amount and total price;
- Reference to the appropriate clause of Latvian VAT Act if 0% VAT rate is applied.

Input VAT incurred on both taxable and tax-exempt supplies may be recovered proportionally to taxable versus total supplies. Separate accounting of transactions and related VAT may lead to substantial VAT savings.

Sales lists containing information on goods sold to the other EU member states shall be submitted to the State Revenues Service (SRS) on a quarterly basis until the 15th day of the following month. A liability to enter *Intrastat* declarations starts as soon as the annual EU shipments exceed LVL 98,000, and in the case of EU purchases, LVL 100,000.

VAT application for EU residents

VAT registration for EU resident companies is required for:

- Community acquisitions taking place in Latvia;
- Deliveries of excise goods to VAT non-registered (VAT exempt) persons in Latvia;
- Distance sales exceeding EUR 36,000 per year;
- Assembling and installation of goods to VAT non-registered persons;
- Provision of services related to education, sport, culture, science and arts in Latvia;
- Provision of services related to real estate located in Latvia;
- Provision of services related to transportation, handling and storage of goods on behalf of VAT non-registered persons.

The reverse charge VAT system is applicable in all other cases. However, voluntary registration for VAT is allowed. The reverse charge rules are not applicable to VAT exempt persons.

VAT refund

VAT refunds to foreigners without any business and registered presence in Latvia are available on an annual basis according to the principles of the 8th and 13th VAT EU directives. Application for the refund may be submitted to the SRS until 30th June of subsequent year together with the

accounting vouchers verifying value added tax paid in Latvia during the previous year.

Refund conditions:

- To receive a VAT refund, a foreign entity must not be registered for VAT in Latvia, as well as it must not be engaged in economic activities that have to be registered in Latvia;
- To receive a VAT refund for purchased goods and services, the VAT must actually be paid.

Minimum amount:

- If the application for VAT refund relates to a period of three months or more, but less than one calendar year, the total tax amount refundable must be not less than LVL 135;
- If the application for VAT refund relates to a period that is one calendar year or the remaining part of it (the last two months of the calendar year), the minimum amount of VAT is LVL 20.

Documents that must be enclosed with the application:

- Original invoices – the invoices must comply with the requirements of the Value Added Tax Act of March 9, 1995;
- Proof of payment for the invoices (e.g., bank orders of payment, internet-banking printouts, cash register);
- A statement issued by the tax authority of the relevant country which certifies that at the moment of purchase of goods or services, or upon launch of goods for free inland circulation the entity has registered as a VAT-taxable entity in their country of residence (the statement is valid 12 months from the date of issue);
- Original customs declarations. The translation of the statement is not required;
- If the application for VAT refund is submitted via an authorized representative – the original power of attorney. The power of attorney must meet the requirements of the following international conventions: Convention Abolishing the Legalization of Documents in the Member States of the European Communities of 25 May 1987 and the Hague Convention Abolishing the Requirements of Legalization for Foreign Public Documents of 5 October 1961. The power of attorney issued in Lithuania, Estonia or Poland must have the certification by notary. The power of attorney issued in other EU countries, Norway or Switzerland must be certified with apostille.

VAT shall not be refunded:

- For acquisition of unused real estate and services received in relation to construction, reconstruction, renovation, restoration or repair of real estate;
 - If the invoices do not conform with the requirements of the Value Added Tax Act;
 - For goods purchased and services received for personal use;
 - To travel companies and agencies, if they perform activities in compliance with Article 13 of Value Added Tax Act (article 26 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common System of Value Added Tax: Uniform Basis of Assessment).
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10. OTHER TAXES

Natural resources tax

According to the new Natural Resources Tax Act adopted in 2005 and in force since 2006, a natural resource tax is payable by individuals or legal entities or associations who under the respective licence (if such is required under law) perform any of following actions:

- In the territory of Republic of Latvia (or continental shelf) acquire any taxable natural resources.
- In the territory of Republic of Latvia (or continental shelf) makes taxable pollution
- Import environmentally non-friendly goods or packaged goods for distribution in the customs territory of the Republic of Latvia
- In the Republic of Latvia, distributes locally produced, environmentally non-friendly goods or packaged goods.

The Packaging Act was adopted on 2002. Tax on the packaging of products is calculated on every unit of packaging. The number of packaging units should be specified by accounting documentation and a document listing standard packaging units, or by a supplier's statement, or by agreement on obtaining the goods, or by a cargo waybill approved by a customs authority, or by the consumption of standard packaging units. If the taxpayer does not know the packaging type and size, an opinion should be obtained from the Latvian Packaging Certification Centre.

Tax is imposed on the following packaging types: glass (tax rate in 2008 – LVL 0.20, 2009 – LVL 0.25 per kg), polymers (2008 – LVL 0.60, 2009 – LVL 0.65), metal (2008 – LVL 0.45, 2009 – LVL 0.70), pulp and other natural-fibre raw materials, paper, cardboard (2008 – LVL 0.15, 2009 – LVL 0.30), laminates with polymer or metal components are taxed according to which component makes up the major proportion in the material.

Tax relief may be granted to a taxpayer who finances projects aimed at reducing environmental pollution, up to the total of the sum invested, or implements a voluntary programme for the management of packaging waste, or participates in an emission-quota-trading system.

Customs and excise

Excise system is based on the EU Directive 92/12/EEC. Excise tax (with few exceptions) is imposed on the manufacture or import of ethyl alcohol, spirits, wine, beer, tobacco, coffee, non alcoholic beverages and petroleum products. Certain excise goods, such as tobacco and spirits, are subject to licensing and thus there are special rules for their trade and paying of excise tax. AAD and SAAD documents are accepted for movement of

excise goods. EU regulations 2913/92/EEC, 2454/93/EEC and *acquis communautaire* on customs tariffs, procedures, warehousing are in force in Latvia.

Pursuant to the Excise Tax Act, adopted in October 2004, excise tax rates are as follows:

- Soft drinks (LVL 4 per 100 litres)
- Coffee (LVL 100 per 100 kilograms)
- Beer (LVL 1.45 per 100 litres for each % proof, but not less than LVL 4)
- Wines and other fermented drinks (LVL 40 per 100 litres)
- Alcoholic beverages up to 15 proof (LVL 42 per 100 litres)
- Alcoholic beverages between 15-22 proof (LVL 70 per 100 litres)
- Other spirits and alcoholic beverages (LVL 825 per 100 litres)
- Cigarettes (LVL 22.5 per 1000 cigarettes)
- Cigars (LVL 11 per 1000 cigars)
- Tobacco (LVL 23 per 1000 grams)
- Petrol, diesel (LVL 234-300 per 1000 litres)

Real estate tax

Real estate tax is charged annually at the standard tax rate of 1.0% and is payable by any entity holding Latvian real estate. If a real estate property (or any part of it) is sold or put into operation within 10 years of the date of purchase, part of the VAT deducted at the time of purchase must be repaid to the government. The amount is calculated as 1/10 of the deducted input tax multiplied by the number of years remaining until the end of the said 10-year period (from the date of purchase or placement into operation). This repayable input tax amount is included in the value of the real estate, and a buyer shall not be entitled to deduct it as input tax.

Capital gains and other taxes

There is no special capital gains tax in Latvia; the income of Latvian residents is taxed at the ordinary tax rate. However, gross proceeds from the sale of real estate (including forests) owned by non-residents in general is subject to 2% withholding tax.

Other fiscal payments are gambling and lottery taxes applicable to the gaming industry. In addition, various state and municipal duties and charges are imposed on different services, permissions and trade activities.

11. FINANCIAL REPORTING

Financial reporting

The financial year covers a 12-month period and, unless specifically reported, coincides with the calendar year. Newly established businesses are entitled to extend their first fiscal year up to 18 months. The financial year may also be shorter when a company terminates its activities, or changes the beginning of the financial year.

Credit institutions report under the International Accounting Standards incorporated into the local acts. The Companies Annual Reports Act governs financial reporting by companies and is based on the 4th and 7th EU Directives. National accounting principles are being brought into line with International Accounting Standards and Financial Reporting Standards.

Accordingly, annual reports consist of financial statements and a management report. The financial statements consist of a balance sheet, an income statement, a cash flow statement, and a statement of changes in equity, with explanatory notes. The monetary unit of Latvia, the lats (LVL), shall be used as a measure of value. Annual reports shall be prepared in accordance with the following policies:

- Going concern assumption - the company will continue as a going concern;
- Consistent use of the same valuation methods from year to year;
- Items shall be valued in accordance with the principles of prudence;
- All income gained and expenses incurred during the reporting year have to be taken into consideration irrespective of the payment date or the date the invoice has been issued or received. Expenses shall match the revenues for the reporting period;
- Assets and liabilities must be valued separately;
- The opening balance shall match with the previous year's closing balance;
- Business transactions shall be recorded due to economic substance, rather than legal form.

Any deviation shall be reflected in notes, indicating its effect on the assets, liabilities, financial position and the operational results of the company.

GMS shall approve the financial statements 4 months after the end of the fiscal year (or 7 months in case of businesses which should prepare consolidated statements). Not later than one month after approval of annual accounts and not later than 4 (or 7) months after the end of the fiscal year, they shall be submitted together with the auditor's report (if such is required and exists) to the Commercial Register and local tax office.

Consolidated reporting

A consolidated report is regulated by the Consolidated Financial Statements Act. The parent has to prepare a consolidated annual report if for two successive years the figures for the parent company together with its subsidiaries exceed any of the following two criteria:

- Total assets of LVL 1 million;
- Net sales of LVL 2.4 million;
- Average number of employees - 250.

The preparation of the consolidated annual report requires the application of the same accounting principles to all companies within the group in order to reflect their business transactions in the same manner. Consolidated statements shall be approved and presented to the authorities in the same manner as annual accounts.

If a group agreement between a controlling entity and a dependent company (as provided by the Concern Act) is not registered, a dependent company is required to draft a dependency statement that reflects inter-company transactions within the group as well as their financial impact on the dependent company.

Statutory audit

The auditor or audit committee elected by GMS shall examine the financial statements of a company. If a company's indicators exceed two of the below listed criteria, its financial statements shall be audited by a sworn auditor or licensed audit firm (hereinafter – sworn auditor):

- Total assets of LVL 250000;
- Net sales of LVL 500000;
- Average number of employees - 25.

Consolidated statements shall be audited by one or several sworn auditors. Under the decision of the Latvian sworn auditor association, the audit of financial statements should be performed in accordance with ISA. After completing the audit, auditor issues an opinion on the audit of consolidated annual accounts and the consolidated report and presents it to the executive body of the parent company of the group. The consolidated statements and auditor's opinion are publicly available.

12. INVESTMENT PROTECTION TREATIES

Latvia has investment protection treaties with the following countries:

- Albania
 - Armenia
 - Austria
 - Azerbaijan
 - Belarus
 - Belgium
 - Bulgaria
 - Canada
 - China
 - Croatia
 - Denmark
 - Estonia
 - Finland
 - France
 - Georgia
 - Germany
 - Greece
 - Czech Republic
 - Hungary
 - Iceland
 - Israel
 - Italy
 - Kazakhstan
 - Kyrgyzstan
 - Lithuania
 - Luxembourg
 - Malta
 - Macedonia
 - Moldova
 - Montenegro
 - Netherlands
 - Norway
 - Poland
 - Portugal
 - Serbia
 - Romania
 - Singapore
 - Slovakia
 - Slovenia
-

- Spain
 - Sweden
 - Switzerland
 - Turkey
 - UK
 - Ukraine
 - USA
 - Uzbekistan
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13. PRACTICAL INFORMATION

Communications

Most transportation is done by car or by bus.

As vitally important export and transit transshipment points for Latvia and several neighbouring countries, the three largest Latvian ice-free ports (Riga, Ventspils and Liepaja) ensure reliable access, 365 days a year. Connections to all other transport infrastructure elements, along with attractive tax-free zone incentives, have resulted in the ports becoming regional centres of industrial activity.

Air transport is possible to some parts of the country (Riga and Liepaja), but is not very widely used, due to relatively short distances. There are three operating airports in Latvia: Riga International Airport, Liepaja International Airport and Ventspils Airport. Nearly 99% of all air passenger and freight transport in Latvia is carried from Riga International Airport.

Riga International Airport is the leading air transport and transit centre of the three Baltic States, serving a number of airlines including Latvia's flag carrier AirBaltic, linked to the Star Alliance through its shareholder, Scandinavian Airlines SAS, and European leaders like KLM and Lufthansa.

The Latvian Railway provides freight and passenger traffic. Latvia possesses a dense railroad network connecting the country to destinations as far as the Russian Far East.

Telecommunication in Latvia is well developed. Telephone lines are established all over Latvia and in major cities sophisticated data-transfer lines have been built. All this has contributed to the rapid growth of the number of people and companies with access to the Internet – studies show that about 40 % of the economically active population is using the Internet and that the majority of companies (especially in major cities) have access to it.

There are four mobile phone operators in Latvia. Each of them has a GSM-network that covers almost the entire country. Practical mobile Internet services (e.g. GPRS) are being introduced to the public.

Language

The official language is Latvian. The Russian language is also widespread all over the country. English is commonly used by business people in doing business with foreigners. Other European languages are less commonly spoken, but one should be able to do business also in German or French.

Time zone

Latvia is two hours ahead of GMT (GMT+02) between October and March, and three hours ahead (GMT+03) between April and September, due to daylight saving time.

In Latvia the 24-hour time system is used rather than the 12-hour (a.m./p.m.) system.

Business hours

Office working hours are usually between 9:00 a.m. and 6:00 p.m. from Monday to Friday with one flexible hour for lunch.

Banking hours are generally 9:00 a.m. to 5:00 p.m. or 6:00 p.m. Monday to Friday.

Larger stores are usually open until 9 p.m. also during weekends. Gas stations and some smaller shops are open 24 hours a day.

Public holidays

There are eleven public holidays in Latvia and a national holiday:

New Year's Day	1 January
Good Friday	date varies (in April)
Easter Sunday	date varies (in April)
International Labour Day	1 May
Independence Declaration of the Republic of Latvia	4 May
Midsummer's Eve	23 June
Midsummer's Day	24 June
Independence Day	18 November
Christmas Eve	24 December
Christmas Day	25 December
Boxing Day	26 December
New Year's Eve	31 December

14. APPENDIXES

LISTED OFF-SHORES

The following jurisdictions are considered “black-listed” in the Latvian tax system:

- Andorra
 - Anguilla (United Kingdom of Great Britain and Northern Ireland)
 - Antigua and Barbuda
 - The Antilles (Kingdom of the Netherlands)
 - United Arab Emirates
 - Aruba (Kingdom of the Netherlands)
 - Virgin Islands (United States of America)
 - The Bahamas
 - Bahrain
 - Barbados
 - Belize
 - The Bermudas (United Kingdom of Great Britain and Northern Ireland)
 - British Virgin Islands
 - Brunei
 - Dominica
 - Jersey (United Kingdom of Great Britain and Northern Ireland)
 - Djibouti
 - Ecuador
 - Guernsey
 - Gibraltar (United Kingdom of Great Britain and Northern Ireland)
 - Grenada
 - Guam (United States of America)
 - Guatemala
 - Hong Kong
 - Jamaica
 - New Caledonia
 - Jordan
 - Cayman Islands (United Kingdom of Great Britain and Northern Ireland)
 - Campione (Republic of Italy)
 - Qatar
 - Kenya
 - Costa Rica
 - Cook Islands
 - Kuwait
 - Labuan (Malaysia)
 - Lebanon
 - Liberia
 - Liechtenstein
 - Madeira
 - Macao
 - Maldives
 - Mauritius
 - Marshall Islands
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- Isle of Man
 - Monaco
 - Montserrat
 - Nauru
 - Niue (New Zealand)
 - Olderne (United Kingdom of Great Britain and Northern Ireland)
 - Panama
 - Independent State of Samoa
 - San Marino
 - St Mary Islands
 - Democratic Republic of Sao Tome and Principe
 - Seychelles
 - Saint Pierre and Miquelon
 - Saint Kitts-Nevis
 - Saint Lucia
 - Saint Vincent and the Grenadines
 - Saint Helena (United Kingdom of Great Britain and Northern Ireland)
 - Tahiti (French Polynesia)
 - Turks and Caicos Islands (United Kingdom of Great Britain and Northern Ireland)
 - Tonga
 - Uruguay
 - Vanuatu
 - Venezuela
 - Island of Zanzibar (United Republic of Tanzania)
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