

# GUIDE TO LATVIAN BUSINESS LAW



**Law firm Prieks & Partners**

85 Brīvības str., P.B. 136, LV 1001 Riga, Latvia  
Tel. +371-920 5181

in co-operation with

**Advokatfirmaet Kjellegaard Jensen**

Tuborg Boulevard 12  
DK-2900 Hellerup (Copenhagen)  
Tel. +45 36 94 44 61

## DISCLAIMER

To the best of our knowledge, the information provided in this publication is based on the current laws and other legal acts of the Republic of Latvia. This publication is for information purposes only, designed to provide potential foreign investors with basic knowledge about parts of the Latvian legal system, including factors, which should be considered before either investing, outsourcing, acquiring an existing business or starting new operations in Latvia.

It is intended to provide a summary of the law with regard to doing business in Latvia only. For this reason, the information contained in this publication should not form the basis of any decision as to a particular course of action; nor should it be relied on as legal advice or regarded as a substitute for detailed advice in individual cases.

The legislation accounted for is current as of September 2003 and does not purport to be an exhaustive description. Comprehensive local advice should always be obtained before implementing any plans to invest in Latvia. An update is presently being made.

For questions or matters involving Latvian law, please contact:

**Sworn advocate, attorney-at-law Ilona Kjellegaard Jensen**

**Law firm Prieks & Partners**

85 Brīvības str., LV 1001 Riga, Latvia

P.B. 136, LV 1001 Riga, Latvia

Tel. +371-920 5181      [ilona.jensen@mail.tele.dk](mailto:ilona.jensen@mail.tele.dk)

**Representation office in Copenhagen**

**in cooperation with Advokatfirmaet**

**Kjellegaard Jensen**

Tuborg Boulevard 12,

2900 Hellerup, Denmark

Tel. +45-22 89 81 33 (mobile)      fax. +45-36 94 40 10      [ilona@nkj-legal.com](mailto:ilona@nkj-legal.com)

[www.nkj-legal.com](http://www.nkj-legal.com)

**General representative in Denmark of**

**Riga Region Development Agency**

Rātslaukums 1, LV 1010 Riga, Latvia

Tel. +371- 7026094      [www.rcc.lv](http://www.rcc.lv)

For questions or matters concerning Danish law, please contact:

**Attorney-at-law Nils Kjellegaard Jensen, LL.M. (L)**

Tel. +45 36 94 44 61      [nils@nkj-legal.com](mailto:nils@nkj-legal.com)

## LIST OF CONTENTS

1. Business Opportunities - Overview .....	4
2. Prieks & Partners Law Firm .....	5
3. Company & Commercial Law Etc.....	6
3.1 Limited Liability and Stock Companies .....	6
3.2 Branches and Representative Offices.....	8
3.3 Annual Reports .....	9
3.4 Agents, Distributors and Contract Manufacturing.....	10
3.4.1 Agency Agreements.....	10
3.4.2 Distributorship Agreements.....	12
3.4.3 Contract Manufacturing - Outsourcing.....	13
4. Real Estate Property.....	15
5. Free Movement of Workers.....	16
6. Employment - Staff .....	16
7. Corporate Income Tax and Personal Income Tax Etc.....	18
7.1 Corporate Income Tax.....	18
7.1.1 Tax System and Taxable Entities.....	18
7.1.2 Taxable Income.....	19
7.1.3 Thin Capitalisation & Transfer Pricing .....	19
7.1.4. Tax Incentives and Concessions.....	19
7.1.5 Group of Companies .....	20
7.1.6 Inter-Company Dividends .....	20
7.1.7 Double Taxation.....	20
7.2 Personal Income Tax .....	20
7.2.1 Tax Residence Rules.....	21
7.2.2 Taxable Income.....	21
7.3 Social Security Contributions.....	22
7.4 Value Added Tax, Etc. ....	23
8. Litigation .....	24
8.1 Latvian Court System.....	24
8.2 Enforcement of EU-Judgements in Latvia Etc. ....	26

# 1. Business Opportunities - Overview

Latvia's accession to the EU as of May 1, 2004, put renewed focus on enhancing trade, investments and commercial relations between Latvia and other EU-member states, including Denmark. On April 16, 2003, Latvia signed the Accession Treaty, and on September 20, 2003, a referendum was held in Latvia with a significant majority of "Yes".

Albeit Denmark and other Scandinavian countries already have a remarkable share of foreign investments in the share capital of enterprises registered in Latvia, it is presumed that Danish and Scandinavian enterprises may profit further from investing in Latvia (outsourcing, production relocation, acquisitions, trade partnering). Excellent transportation structures, a long industrial tradition, and Western European work practices paired with relatively low average wages, make Latvia *prima facie* a superb investment location. Especially in the following sectors;

In electronics and mechanical engineering Latvia has a long tradition of excellence and the availability of relevant skills.

Chemical and pharmaceutical industries offer a highly developed scientific research structure, and strong links to the Russian and CEE markets.

In the IT-sector, a state-of-the-art telephone and data communications network, and highly qualified yet inexpensive IT specialists could make Latvia an ideal contract manufacturing and outsourcing place.

Food processing industry, which offers high quality raw materials, has good historical trading ties with Russia and the Baltic Region.

In addition, Latvia offers supreme conditions for the shipping industry – two Free Ports (ice free in winters) with special tax incentives for registered shipping companies. Most recently a tonnage tax regime has been introduced.

The corporate income tax is a flat rate of 19% (2003), which will be lowered to 15% in 2004.

Average salaries are still very competitive in terms of qualifications and efficiency of local staff in comparison to average wages. The average monthly wage (incl. of social contributions) in Latvia is DKK 1,979 (approx. EUR 266) as opposed to DKK 2,495 (approx. EUR 336) in Lithuania and DKK 3,017 (approx. EUR 406) in Estonia (*Source: Børsen July 18, 2003/DI; Danish Industry*).

Latvia has a population of approx. 2.3 Mio. It may be considered a small market. Latvia enjoys, however, a unique geographical position (e.g. Free Port of Riga) as a stepping stone or hub to the other Baltic countries (Riga is situated a few hours drive from both Vilnius and Tallinn!) and to Russia and other CEE countries (Central Eastern Europe).

Even though still in a transition period, the political, executive and legal/judicial systems are improving in terms of transparency, predictability and respect for democratic principles. The macroeconomic development is continuously showing growth in all basis sectors of economy.

## 2. Prieks & Partners Law Firm

The Law Firm of Prieks & Partners is mainly practising law in various corporate, finance and commercial areas and has many years' experience in assisting national / international enterprises coming to Latvia achieving their goals.

For the benefit of our clients, we keep close ties with the government institutions and local business community. If required, we are also able to introduce our clients - also to other needed top professionals (tax advisors, accountants etc.) with whom we co-operate.

Prieks & Partners maintain strong relations with law firms in the other Baltic States, Russia and the EU and elsewhere, and has established a promising co-operation with Law Firm Kjellegaard Jensen in Denmark. Partner Ilona Kjellegaard Jensen (born Prieks) is married to Law Firm Kjellegaard Jensen partner Nils Kjellegaard Jensen and is residing in Copenhagen, Denmark, however not practising locally in Denmark.

After accession to EU, Latvian jurisprudence will experience the same influence of EU-law at all levels (private, governmental and judicial) due to the fact that the so called *acquis communautaire* (all EU-case law etc. so far) is immediately applicable, and cross border co-operations between lawyers will be facilitated - not least to the benefit of the clients involved in cross-border transactions.

We can serve our clients in English, Latvian, Russian, German and in Danish, and focus on always providing a personal, independent, efficient and value-adding service.

Partner Ilona Kjellegaard Jensen was recently appointed sole general representative in Denmark to the **Riga Region Development Agency** - underlining her high credentials in local governmental and business community. This Agency promotes investments opportunities and business co-operations in the Capital and main business regions around Riga, organizes procurement for national/regional business projects, co-ordinates EC fund co-finance and may be a helpful partner for a foreign investor in most phases of an investment in Latvia.

For further details please contact Ilona Kjellegaard Jensen.

### **3. Company & Commercial Law.**

It is allowed for foreign entities themselves to carry out business in Latvia in the form of a subsidiary, either a limited liability company (SIA) or a stock company (A/S) or through a branch. It is also an option to set up a representative office save from when carrying out entrepreneurial activities.

There are no restrictions on the ownership of Latvian companies by foreigners. 100% foreign owned enterprises are allowed. Yet there are requirements for certain number of residents to be in the Management Board.

Latvian businesses and foreign owned business are mainly organised as limited liability companies (SIA).

In some cases, entering the Latvian market may be realized without actually having the foreign business entity itself carry on business in Latvia.

The entering into of a distribution or commercial agency agreement in Latvia does not in itself constitute carrying on business in Latvia – neither for tax purposes. Accordingly, it is often appropriate for a foreign entity to consider the use of a Latvian agent or distributor as an alternative to expanding its business operations into Latvia by setting up a company or branch. Please see below in section 3.3.

#### **3.1 Limited Liability and Stock Companies**

The minimum requirements for the registered share capital in limited liability and stock companies are LVL 2,000 (approx. EUR 3,060) and LVL 25,000 (approx. EUR 38,350) respectively. Higher capital requirements apply in respect of stock companies in the banking and insurance sector.

The share capital in either form of company may be paid up in cash or in-kind contributions, subject however to an independent expert's evaluation.

Both limited liabilities and stock companies are vested with the status of a legal entity, distinct from the personality of their shareholders. "One shareholder" companies are permissible.

One important advantage of having a subsidiary in either form in Latvia is the limited liability (the Latvian subsidiary's creditors do not have access to the foreign shareholder's funds).

Shares in a company represent a portion of the corporate equity. There is no minimum or maximum amount of shares that a company is allowed to issue, unless otherwise specified in the incorporating documents.

Latvian company law bases on a two-tier corporate governance structure. Besides the supreme shareholders' meeting, a management board (min. 1) and the council/supervisory board (min. 3) must be established. The latter body, however, is optional for limited liability companies.

The law sets out the powers vested with the shareholders' meeting, and allocates all other (executive) powers and competences to the management board. The council/supervisory board represents the interest of the shareholders between the shareholders meetings and supervises and controls the management board.

For now, at least half of members of the management board must be domiciled in Latvia. There are no citizenship requirements. After accession of Latvia to the EU, it may be expected that for EU-citizens also the domicile requirement will be abolished.

The right of representation of management board members - the authority to represent the company jointly or severally must be explicitly stated in the statutes.

Each manager of a company is required to act in good faith with a view to the best interests of the company and when exercising his duties the managers must utilize reasonable care, diligence and skill, and they are also required to comply with the legislation, company's statutes and shareholders' resolution. In certain circumstances, managers may incur personal liability for their negligent actions or omissions.

Stock companies may issue both registered and bearer shares as well as bonds whilst a limited liability company may issue registered shares only. A stock company is generally entitled to issue different classes of shares which may confer on their holders different rights, such as voting rights, rights to fixed dividends, and pre-emptive rights to the winding up proceeds, etc.

The name of the company or "Firma" is subject to some restrictions in order to avoid names that are too general, misleading or inappropriate. There is a screening process and it is possible to pre-clear the desired name prior to executing all documents and applying for registration of the incorporation.

A company is formed by drafting and filing certain prescribed documents with the Commercial Register of Companies'. The preparation of the incorporation documents and the filing procedure would normally be carried out on behalf of the foreign investor by a lawyer.

The costs of establishing a Latvian company are relatively low. Registration fees payable to the Government vary from LVL 200 - 250. Other fees for public notary and the lawyer's fee are added. Legal fees depend upon the complexity of the company's structure etc.

Basically, in a standard case the total foundation costs amount to LVL 500,- for the incorporation of a Latvian limited liability company.

The entire procedure can be accomplished rather quickly once also public documents with legalisation have been obtained. Generally, an application for registration must be submitted to the Commercial Registrar not later than 2 weeks after the incorporation meeting.

The registration process is performed within 2 weeks. In urgent matters, registration may be done within 4 days (for double standard rate), and within 2 days (if the triple duty is paid).

Documents in other languages have to be translated and verified by a Notary Public prior to filing with the Registry. Public documents issued abroad must be legalized by a special procedure.

The company comes into legal existence upon the registration in the Commercial register. Simultaneously, the company has to be registered as a taxpayer with the State Revenue service.

A separate registration with the VAT taxable persons' register is required where necessary (cf. section 7.4 below).

All company documents filed with the Commercial Registrar are open to public inspection at a nominal charge. Copies of the relevant company files may be inspected personally at the Companies' registry office.

### **3.2 Branches and Representative Offices**

Branches of foreign companies in Latvia have no separate legal personality. However, a branch of a non-resident company is treated for tax reasons as a separate Latvian taxpayer subject to the same tax reporting and audit requirements as are applied in respect of local companies.

As described in further detail below, profits of a Latvian branch of a non-resident company are taxed on a normal assessment basis at the same rate as the profits of a resident company. There is no withholding tax on the remittance of taxed branch profits to the foreign head office, whilst under the present law in general a 10% withholding tax is imposed on the remittance of dividends out of taxed profits from a Latvian subsidiary.

The branch structure may have a potential advantage. This structure can be useful for a new business where start-up losses are expected, provided that these losses can be set off for tax purposes against profits arising in the country of residence of the head office.

No tax incentives are available to branches. There are fewer deductible expenses in branches than in respect of subsidiaries.



A branch also has to be registered with the Commercial Registry. Certain incorporation and other documents pertaining to the foreign company must be translated, legalised and filed.

A responsible branch officer must be appointed. The branch officer must have residence in Latvia. After accession of Latvia to the EU, it may be expected that for EU-citizens the domicile requirement will be abolished as regards branches of companies domiciled in other EU-member states.

### **3.3 Annual Reports**

Any company registered with the Enterprise Register in Latvia regardless of the nature of its activities or ownership must perform book-keeping and prepare annual reports and present its financial statements.

However, banks, credit and insurance institutions must prepare their financial reports in accordance with special legislation. Agricultural and aqua-cultural (fishery) farms and individual businesses where the annual revenue from business transactions is less than 45,000 LVL (approx. EUR 67,500) per year of accounting are exempted.

The financial year should comprise 12 months (usually the calendar year). The company may however have another start and end of the financial year if laid down in the company's articles of association. The initial reporting year of a newly established company may comprise a shorter or longer period, however in no event in excess of 18 months. If the starting date of an already existing company is changed, the financial year may not be longer than 12 months. The financial year should be similar for the parent company and subsidiary companies in a one concern (group).

An annual report must be completed for each financial year. It comprises the financial statements and the management report. The financial statements comprise the balance sheet, the p/l statement, the cash flow statement, the statement on changes in shareholders' equity and explanatory notes to the financial statements.

The financial statements must be audited by a Latvian sworn auditor, if the company exceeds two of the below listed criteria:

- Assets of LVL 100,000 (approx. EUR 150,000)
- Sales of LVL 200,000 (approx. EUR 300,000)
- 25 employees during the fiscal year

Not later than 1 month after the approval of the (audited) annual report by the shareholders' meeting and no later than 4 months after the end of the financial year, the

(audited) annual report must be filed with the tax authorities (see below in section 7.1) and the Enterprise Register.

“Big companies” may file their annual report within 7 months after the end of the fiscal year. These companies are also required to publish the audited annual report in the national business publication (“Latvijas Vestnesis”). “Big companies” are companies which exceed:

- assets LVL 1,000,000 (approx. EUR 1,500,000),
- sales LVL 2,400,000 and (approx. EUR 3,600,000)
- average number of employees during the financial year is 250,

All annual reports submitted to the Enterprise Register are publicly available.

Consolidated financial statements are required for a group of companies (concerns).

### **3.4 Agents, Distributors and Contract Manufacturing**

The legal frame for business in Latvia is laid down in the Commercial Code. It came into effect 1 January 2002. Strongly influenced by German law, the Code comprises major parts of Latvian commercial law. It is in line with EU-directives. A number of areas of commercial law are the subject of special enactments, e.g. the Commercial Pledges Act, the Competition Act, the Concerns / Group of Companies Act, Trademarks Act, etc.

The Code contains *inter alia* provisions on (independent) commercial agents in conformity with the EU-Directive on Commercial Agents etc., which have been implemented in all existing EU-countries.

#### **3.4.1 Agency Agreements**

A commercial agent is defined as an agent who undertakes for the principal to independently and permanently engage in e.g. the sale of goods on behalf of the principal by soliciting offers to the principal, or by concluding agreements in the principal’s name.

The relevant section/division of Commercial Code contains many mandatory rules from which the parties cannot derogate unless it is favourable to the agent. Nor by opting out of Latvian law (i.e. choice of foreign law), the provisions may be deviated from to the detriment of the commercial agent. Besides this, the laws of the country of domicile of the principal may be chosen.

The agency agreement shall be in writing.

The purposes of engaging an agent is to promote sales in one's own name and often payment is made directly to the principal. The agent may of course be empowered to collect outstanding amounts from the customers.

The agreement is set up in such a way that the principal pays the agent on a commission basis. The fixing and calculation of commission is a key element of the contract.

Another key element is to define the relevant contract products and the territory. If the agent takes over existing customers their identification and average annual turnover should be agreed on before-hand by way of an appendix. Upon termination, the agent can claim compensation only if due to his/her activities new customers have been won or trade with existing customers have increased.

Often the agent does not handle invoicing and delivery etc. of the goods him- or herself. It may be agreed that the principal is entitled to claim back paid commission to the agent in the event of non-payment by the customer, unless it is due to circumstances within the control of the principal.

The agent is obliged to make all reasonable efforts to procure offers. Moreover, he/she is to keep the principal informed of the sales activities and submit periodically his forecasts and other developments in the market.

If the agency agreement has not been agreed for a specific period of time, the agent will - save from in the event of material breach of obligations - be entitled to a notice of termination corresponding to 1 month (to the end of a month) for each year the agency contract has been in force. The maximum legal termination period is 4 months. A longer termination period may be specifically agreed between the parties.

If the agency agreement has been agreed for a limited period of time and the parties continue their relationship after the end of the agreed contract term, then the entire agreement shall be deemed to be for an indefinite period of time. When assessing the notice of termination the entire contract period shall be included in the calculation.

Each party may terminate or cancel the agreement, if the other party has materially failed to perform his/her obligations under the agreement and due notice has been served.

Upon termination, the agent may be also entitled to a lump sum compensation or indemnity payment, not to exceed 1 year's commission calculated on the basis of the average of the past 5 years' commission paid or the shorter period for which the agreement has existed.

It is a precondition that the principal gains substantial benefits from new customers or significantly increased sales to “old” customer even after termination and that payment of compensation in the concrete case is “fair”.

The agent is e.g. not entitled to a compensation / indemnity if the agreement has been terminated by the agent him-/herself (save from when due to the principal having given substantial cause) or if the principal’s termination was for (justified) cause. The claim of compensation / indemnity must be set forward by the agent at least 1 year after the end of the agency agreement. Otherwise, it is time-barred.

It is possible to agree upon competition restraints with a validity of up to 2 years after the termination of the contract. A competition clause must be limited to the same geographical area and the same field of activities as hitherto entrusted with the agent. The principal is obliged to pay a “fair” remuneration for the period of such negative restraints.

### **3.4.2 Distributorship Agreements**

The purpose of a distributorship is to engage an independent third party to undertake to market and sell the principal’s products in Latvia in the distributor’s own name.

Distribution may be as a sole or often exclusive distributor. The exclusive distributor enters into an agreement with the producer in accordance with which the producer agrees only to sell the products to that particular distributor in the given territory - a vertical restraint. Such exclusive agreements will usually result in the restraint of intra-brand competition due to the exclusion of competition. In general, it is not forbidden to agree upon exclusive distribution.

However, if a so-called *absolute territorial protection* is built into the agreement, implying also protection of the distributor from passive parallel imports from dealers or distributors in other countries, then the agreement may normally be forbidden under EU-competition law (when these rules come into effect after Latvia’s accession). Each distributor in such other countries may however lawfully be obliged not to actively seek customers outside of his/her designated territory.

Although the distributor sells the products of the producer, bearing the brand or trademarks of the producer, the distributor is working independently and in his/her own name and on his/her own account and risk.

As opposed to the commercial agent, a distributor will obtain his /her remuneration from the profits of the re-sale of the products. The producer is not entitled to prescribe binding resale prices.

Focus should be made on defining the contract products and the territory in the agreement.

A distributor bears all risks associated with sales, including non-payment of a customer. The distributor is normally obliged to maintain and insure warehouse facilities at his/her own costs and risk, and often to keep a minimum inventory.

The producer may retain title and ownership to the goods under certain circumstances, until the distributor has paid the purchase price. The distributor will then be obliged to keep the merchandise of the producer separate from other merchandise in the warehouse and to keep and make periodical separate accounts for the goods in consignment. The producer may conduct periodical inspections and control/verify the consignment accounts.

It is normal to impose obligations on the distributor in respect of how marketing is to be undertaken, minimum sales (e.g. as a condition to uphold exclusivity), minimum stock, service and after-sales support and training of distributor's staff.

Distributors are not covered by any specific statutory legislation in Latvia and the distributor has therefore only the rights contained in the contract as well as by virtue of general principles of law.

The contract may be terminated as set out in the agreement, and otherwise with a "fair" notice. Analogous application of to the termination notice provisions found in the Commercial Code's section for commercial agents can be expected in some cases.

It may always be recommended to explicitly agree to have the distributor waive any rights to and disclaim compensation / indemnity after termination.

### **3.4.3 Contract Manufacturing - Outsourcing**

Increasingly companies outsource their entire manufacturing and production, assembly, packing etc. of one or more mass products (to be sold under their brand) to third parties in countries with lower average wages and other production costs to meet global competition and/or to increase profits.

With Latvia's excellent transportation structures, long industrial tradition and Western European work practices combined with low average wages, manufacturing contracts with Latvian enterprises is no doubt an eligible option for Western enterprises.

At some point in a process of planning to outsource production/manufacturing, the parties will have to negotiate and conclude a written contract manufacturing agreement, laying down in detail the rights and obligations of each party. The agreement sets forth the mutual rights and obligations such as

(non-exclusive) license to manufacturer for the term of the agreement for patents, utility models, know-how, trademarks, logos etc.,

authorised personal and key personal/managers/owners, and steering committees,

order forecast, orders, exclusivity or preferred production capacity, authorisations for material procurement by producer, (minimum) inventory, ownership to inventory,

production and delivery flexibility, increases/decreases of orders, cancellations, shipment, delivery terms, delay, engineering / products changes,

provision of, financing (pledging) and ownership to new (non-)specific tools, software, etc. required for the production, insurance

quality control, product acceptance, warranty, faulty products, epidemic defaults, model / principles for allocation of warranty costs, repair, replacement, spare parts,

invoicing and payment terms, additional costs, price changes (due to price changes for raw materials, exchange rates etc.),

term and termination (finished products, inventories, tools etc. and survival of certain provisions),

defence etc. against infringements of third party proprietary rights, obligations to pay royalties, public approvals,

confidentiality, and non-disclosure,

producer's security interest in products delivered, and

governing law and venue (or arbitration).

Often contract manufacturing agreements are detailed and complex, and various appendices of managerial, commercial and technical nature are needed to clearly regulate the entire supply chain management, product quality procedures etc.

From time to time, the parties agree that throughout the contract both of them shall seek to decrease the production costs by suggesting and implementing (agreed) efficiency improvements etc., whereby both parties from a practical point of view should have a financial incentive to do so.

## **4. Real Estate Property**

All real estate property including any encumbrances (e.g. mortgages) and easements must be registered in the Land Book, a publicly accessible court register of immovable property.

Registration is a perfection act. If the transfer is not registered with the Land Book, it is still legal but the acquirer may not transfer e.g. the title until registration has taken place.

Annual tax on real estate property shall be paid by individuals and legal entities that own or have legal control over real estate property in Latvia. The immovable property tax rate for 2003 is 1.5% of the cadastral value of the land and the average book value or the inventory value of buildings and constructions on the land.

Under present Latvian law, land may be acquired and owned without limitations by e.g.:

- Latvian citizens;
- a company registered in Latvia provided that:
  - more than a half of the capital is owned by Latvian citizens, the state or local governments;
  - more than half of the capital is owned by individuals or legal entities with residents in countries with which Latvia has signed investment treaties enacted in 31 December 1996 (e.g. Austria, Canada, Denmark, Estonia, Finland, Germany, Great Britain, Lithuania, Norway, Sweden, Switzerland, and USA);
  - more than a half of the capital is jointly owned by above mentioned persons;
  - It is a public joint stock company listed on the stock exchange.

Individuals and legal entities other than those mentioned above may acquire land only with the permission of the local government. However, these individuals are prohibited to acquire land situated:

- on the Latvian borders to Estonia, Lithuania, Belarus and Russia;
- in the protected coastal and other protected zones near public water lines etc. ;
- in agriculture and forestry areas.

As of April 15, 2003, however, certain important amendments were made.

As of May 1, 2011, all EU-citizens and legal entities domiciled in an EU-member State may acquire land in Latvia on the same terms and conditions as Latvian citizens and legal entities.

For the transition period from May 1, 2004, through May 1, 2011, EU-citizens and legal entities domiciled in an EU-member State may acquire agricultural land or forestry areas if it occurs as part of an agricultural business and if they have lived for more than 3 years or if they have been engaged in agricultural business for min. 1 year. In other cases, there are still particular restrictions to the acquisition of land by EU-citizens and legal entities domiciled in an EU-member State.

A mortgage institute financing system is developing rapidly.

A real estate transfer duty of 2% of the higher of the sale price or the cadastral value is payable by the purchaser. The duty may not exceed LVL 30,000 (approx. EUR 45,000).

## **5. Free Movement of Workers**

Citizens of all EU and the EFTA member states (Iceland, Liechtenstein, Norway, Switzerland) and of Andorra, Malta, Cyprus, Vatican, and Monaco may (already) now enter Latvia without a visa.

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 granted for a limited period. The work permit is normally issued for 1 year at a time. Application may then be filed to prolong the work permit.

An expatriate may not stay in Latvia without a residence permit for a period exceeding 90 days in any given 6 month period. A residence permit can be obtained on a number of grounds.

After accession to EU, all citizens of EU-members states have a EU-treaty based right to obtain a working permit (and a residence permit) in Latvia. Latvia is not likely to impose (reciprocal) restrictions on the free movement of workers in an initial period after May 1, 2004, even if certain EU-member states like Germany and Austria are considering to do so.

## **6. Employment - Staff**

The new Labour code - effective as of 1 June 2002 - lays down employers' and employees' rights. The rules are in accordance with relevant EU-directives. The major aspects of the Labour Code are highlighted below:

**Employment Contracts:** The employment contract must be concluded for an indefinite period of time, except for temporary work. If a manager of a company is employed based



upon an employment contract, it must be concluded for a definite period of time. The period of the employment contract concluded for a definite period of time cannot be more than 2 years (including extensions of the term).

**Probation/trial period:** A trial or probation period of maximum 3 months may be agreed.

**Working Hours:** The regular daily work hours cannot exceed 8 hours and the regular weekly work hours are 40 hours. Overtime is permissible if the employer and the employee have agreed upon it in writing. The overtime work cannot exceed 48 hours during any 4 weeks' period or 200 hours during a calendar year.

**Minimum Wages:** The minimum monthly wage established by the Government was LVL 60 (approx. EUR 90) (2002). Employees who perform overtime work must receive an additional payment of min. 100% of the applicable hourly or daily salary rate.

**Vacation:** Each employee is entitled to a paid annual vacation. Such vacation, excluding 11 public holidays, cannot be less than 4 calendar weeks.

**Termination:** Subject to 1 month's notice, the employment may be terminated by the employer if justified by employee's conduct, his person or by the imperative business necessities. The employee has the right for 1 month in advance to give notice of termination in writing, unless a shorter period is agreed individually or in the collective agreement.

**Duties of Confidentiality and Non-Competition:** The employee is by law obliged to not disclose information, which comprises commercial or trade secrets of the employer. Additionally, the employee and the employer may enter into an agreement on the limitation of employee's professional activity after the termination under certain conditions.

**Applicable Law:** Employees and employers may agree which law shall be applied to the employment relation. In the absence of such choice, either the laws of Latvia or a state where the employee performs his/her work, or the laws of the country of the place of location of the employer, or the laws of the country to which the employment relationship has its closest connections, will apply.

**Collective Bargaining Agreements:** A collective bargaining agreement may be concluded in writing between the employer (or employers' organisations) and employees' trade union or by the employees' authorized representatives. If so, the rules laid down therein must be complied with in the individual employment contracts.

Typical taxable cash and non-cash benefits of a compensation package for senior white collar expatriate are:

- Reimbursements of foreign and/or home country taxes;

- Reimbursement of school tuition fees;
- Home leave reimbursements;
- Cost of living allowances;
- Expatriation premiums;
- Housing allowances/reimbursements;
- Company vehicle;
- Medical insurance premiums;

## **7. Corporate Income Tax and Personal Income Tax Etc.**

### **7.1 Corporate Income Tax**

The corporate income tax is now a flat rate of 19% which will further be reduced to 15% in 2004.

Companies which before 2002 were eligible for specific tax rate relieves/reductions however continue to calculate the reduction entitlements based on the previous flat tax rate of 25%.

#### **7.1.1 Tax System and Taxable Entities**

Latvia has a self-assessment taxation system. This implies that the taxpayer calculates the amount of tax payable and reports this amount in an annual statement of income. The Latvian corporate tax income statement is based on the income disclosed in the Company's audited profit and loss statement for the year, which is then adjusted for specific taxation considerations. This does not apply to taxpayers opting in for the tonnage tax (see below in section 7.1.2.)

The taxation authorities may audit and contend the declaration within a period of currently up to 3 years after payment of the corporate tax for the year in question.

The tax period is the same as the company's financial year and may be different from a calendar year. Annual tax returns must be filed within 4 month after the end of the tax year. Large companies are allowed to extend this deadline up to 7 months, cf. above for filing the annual report to the Commercial Register.

Monthly advance payments of tax are required.

Taxable entities are resident companies as well as permanent establishments of non-resident companies, and non-resident entities that derive income from certain Latvian sources of income. Partnerships as such are transparent for tax purposes.

The criteria for establishing a company's residence for tax purposes is its incorporation in Latvia or that it legally should have been incorporated in Latvia. Latvia does not have an effective place of management test of residence.

### **7.1.2 Taxable Income**

The taxable base of resident companies is their global income (capital gains are treated as revenues /ordinary income as opposed to being subject to special capital gains tax).

A permanent establishment (branch) of a non-resident company is treated as a separate Latvian taxpayer. The profits of a Latvian branch of a non-resident company are taxed on a normal assessment basis at the same rate as the profits of a resident company. When computing the taxable income, internal charges between the branch and its head office expenses such as interest, management fees etc. are not deductible.

It is possible to carry tax losses forward for 5 years only. There is no carry-back. By a change of "control" over a company the right to carry forward existing losses is lost, unless the company continues, for the next 5 years, the same fundamental business activity as it did in the previous 2 years.

From 1 January 2002 companies registered in Latvia that are involved in international shipping activities may opt in for paying corporate income tax based on the gross tonnage of the individual vessels used in their operations (tonnage tax). Once this option is taken it must be continued for 10 years.

### **7.1.3 Thin Capitalisation & Transfer Pricing**

Interest paid to anyone (except if paid to Latvian registered credit institutions) in excess of an allowed amount for the tax period is not deductible. The allowed amount is calculated by multiplying the average short-term credit rate charged by Latvian banks in the last month of the tax period, by the company's equity at the beginning of the tax period. Non-deducted interest can be carried forward indefinitely subject to the annual calculation of allowable interest. The right to carry forward un-deducted interest is lost if there is a change in ownership of the company by more than a 50%.

Also certain transfer pricing rules apply. An arm's length price test must be applied, and upon demand documented, in respect to transactions with associated foreign persons as well as with resident persons who enjoy income tax relief.

### **7.1.4 Tax Incentives and Concessions**

A company registered and operating in a special economic zone (e.g. Liepaja) or in a designated Free Port (such as e.g. the Free Port of Riga) enjoys higher rates of depreciation and a longer term (10 years) for carrying losses forward. A company registered and

operating in a special economic zone or free port may qualify for both annual real estate tax relief of up to 100% and corporate income tax relief of 80%.

Various other tax incentives etc. are eligible in certain circumstances.

### **7.1.5 Group of Companies**

A parent and its 90% owned subsidiary are treated as a group. The companies must be domiciled in Latvia or in a country with which Latvia has an operative Double Taxation Treaty (e.g. Denmark). Although there is no fiscal unity for taxation purposes, consolidated financial statements are required for the group. Losses can be transferred between group members who are domiciled in Latvia.

### **7.1.6 Inter-Company Dividends**

Regardless of ownership level, dividends from Latvian companies are received by Latvian legal entities tax-exempt (save from when the dividends are paid by a Latvian company that utilizes some form of corporate income tax relief. In such event, the dividends are subject to tax in accordance with the percentage of the tax relief obtained by the paying company).

The domestic rate of withholding tax on (out-bound) dividend payments to non-resident legal entities is 10%. After accession to EU, the EU-Parent-Subsidiary Directive will become applicable for dividend payments from Latvian subsidiaries to parent companies in other EU-member States, and *vice versa*.

Dividends from non-resident companies (in-bound) are normally taxable. They are, however, not taxable if at the moment of payment the Latvian recipient owns at least 25% of the capital and voting rights in the distributing foreign company (this does not apply if the distributing foreign company is resident in a listed low or nil tax jurisdiction (i.e. in so called tax havens).

### **7.1.7 Double Taxation**

Foreign income taxes paid are not tax deductible in Latvia. A tax credit may be granted for these taxes but not exceeding the amount of Latvian tax payable on that income (i.e. ordinary credit) on a source-by-source basis. Latvia has an extensive number of Double Taxation Treaties, incl. with Denmark.

## **7.2 Personal Income Tax**

Latvian personal income tax is levied at a flat rate 25%. The tax year for individuals follows the calendar year.

Annual declarations must be filed by 1 April after the end of tax year. Personal income tax declaration is prepared on a self-assessment basis and may be audited etc. up to 3 years after the tax became payable. If the tax liability assessed exceeds 100 LVL (approx. EUR 150) the tax can be paid over 3 months in equal instalments.

Individual income tax in respect of employment income (salary) is usually withheld by the employer (payroll tax or PAYE (“pay-as-you-earn”). All employers in Latvia, including permanent establishments (branch) of foreign companies, must withhold payroll tax from the salary paid to all employees, and remit this withheld tax to the tax authorities on monthly basis on the salary payment date.

Foreigners working in Latvia for a non-Latvian employer must register with the tax authorities and either of them must, on a monthly basis, pay personal income tax based on the monthly salary.

With respect to social contributions, please refer to section 7.3 below.

### **7.2.1 Tax Residence Rules**

For tax assessment purposes a distinction is made between residents and non-resident taxpayers.

Latvian tax residence is established e.g. when a person has his/her permanent residence in Latvia, or if an individual is present in Latvia for more than 183 days in a 12 month period beginning or ending in a taxation year;

There are no special procedures for terminating personal tax residence in Latvia. An individual who does not want to be considered a tax resident in the following year, will no longer be a tax resident from the date he/she leaves Latvia provided that he/she can show he/she has greater ties outside of Latvia than in Latvia (“centre of life interests”).

### **7.2.2 Taxable Income**

Resident taxpayers are taxed on their global income.

Non-resident taxpayers are taxed on specific Latvian sources of income, including e.g.:

- employment income for duties performed within Latvia in favour of a Latvian or foreign employer, or performed outside Latvia for a Latvian employer;
- income from independent professional services rendered to Latvian residents or registered permanent establishments within and outside Latvia;
- income from performing duties as the member of a Board or council of a Latvian company;
- income (as partner) from a Latvian registered partnership;

- income in the form of liquidation proceeds from the liquidation of a Latvian company that exceed payable dividends;
- income from the sale or use of immovable property located in Latvia;
- income from the lease of movable property in Latvia;
- income from agricultural production from "individual" farms;
- dividends;
- interest income, except interests from Latvian credit institutions;
- income from intellectual property (royalties);

Examples of some tax-exempt sources of income for resident taxpayers are:

- Dividends from Latvian companies that have paid the full rate of tax on the profit from which the dividend is paid otherwise a pro rata exemption is given;
- Income from deposits in Latvian registered credit institutions;
- Income from the sale of personal property. Real estate and shares and securities must have been held for 12 months to be exempt.

The majority of tax-exempt sources of income items also apply to non-residents.

There are limited deductions under Latvian Law. Deductible items are primarily the mandatory social security contributions and to some extent contributions to private pension schemes.

Non-resident taxpayers and individuals who are resident for a shorter period than 6 months in a tax year are only entitled to the standard deductions like social security contributions.

Particular rules are applicable for calculation of the income of a self-employed individual.

### **7.3 Social Security Contributions**

Mandatory social security contributions are payable in respect of gross employment income. Social security contributions are only payable up to a maximum annual income threshold of 18,400 LVL (approx. EUR 27,600) (2003).

Employer's rate is 24.09% and employee's rate is 9%, if the employee is employed with a Latvian resident employer (2003).

Social security contributions are at a rate of 33% for resident employees working in Latvia for a non-resident employer (i.e. without a branch office in Latvia).

Foreigners working in Latvia for a foreign employer (that does not have a registered branch office in Latvia) and who are in Latvia for more than 183 days must register and pay social security contributions at the rate of 31.06%.

Foreigners who will be working in Latvia for less than 12 months can be exempt from Latvian social security contributions provided that social security contributions are paid in their country of residence.

After accession to EU, the particular EU-social security system for migrating workers will become applicable.

#### **7.4 Value Added Tax, Etc.**

Individuals or entities which in the course of a trade or profession perform transactions subject to VAT within Latvia are liable to levy and pay VAT. VAT declarations are filed on a monthly basis. Input VAT cannot be claimed in respect of exempt transactions and input VAT can only be claimed in respect of transactions that are directly related to the income production.

Transactions subject to VAT are the supply of goods or services within Latvia (i.e. place of supply/service within Latvia), self-consumption, the import of goods and export of goods and services. Individual and legal entities whose taxable transactions exceed 10,000 LVL (approx. EUR 15,000) in a 12 month period must register separately as a VAT payer.

After accession to the EU, all intra-EU deliveries will follow the particular EU-VAT regime.

The standard VAT rate is 18%.

A new VAT rate of 9% is applicable to the following transactions among others;

- (i) supply of listed medicines and medical goods,
- (ii) supply of books,
- (iii) supply of mass media products.

The following transactions are subject to a VAT rate of zero (0);

- (i) services connected with the export of goods and transit carriage,
- (ii) supplies of goods and services connected with supply and servicing of international transport,
- (iii) travel agent's services for foreign customers and associated carriage of passengers and goods performed by international transport.

The following transactions among others are VAT exempt;

- (i) transactions in shares and other securities,
- (ii) banking and financial services excluding hire of safes and encashment,
- (iii) insurance transactions,
- (iv) sale of real estate excluding the first sale of 'new' buildings,
- (v) rental of domestic apartments,
- (vi) betting, lotteries and other forms of gambling.

Custom duties will be abolished for intra EU-trades after accession to the EU. Latvia is a signatory state to the Convention on custom duties on international goods in carriage (TIR).

## **8. Litigation**

### **8.1 Latvian Court System**

Due to the nearing accession to EU, focus is still on further building up democratic western standard courts of law. Ahead lies further strengthening of the court system to ensure effective and swift court proceedings, reform of the system of execution of (foreign) judgements, improvement of the technical basis of the courts, raising of the qualification of judges and, unfortunately, still the task to reduce corruption and the corruption possibilities also in the courts of law.

Latvia has a three level court system:

\* 24 District (City) Courts;

\* 5 Regional Courts;

\* 1 Supreme Court (in Riga).

District (city) courts form the first level of the court system, and those courts are with some exceptions established in accordance with the administrative territorial division of the Republic of Latvia.

Regional courts form the second level of the court system. The five regional courts are established in Latvia according to historical and existing regions of the State. The territorial jurisdiction of each regional court covers a particular number of district (city) courts.

Latvia's regional courts are as follows:

\* Riga Regional Court - 10 district (city) courts;



- \* Kurzeme Regional Court - 5 district (city) courts;
- \* Latgale Regional Court - 6 district (city) courts;
- \* Vidzeme Regional Court - 7 district (city) courts; and
- \* Zemgale Regional Court - 6 district (city) courts.

Each regional court has *inter alia* a Civil Division and a Criminal Division.

For the supervision of the Land Registers, regional courts have Land Registry Offices. Land Registry Offices are judicial institutions. Judges of the Land Registry Offices shall record real property and fix the rights associated therewith in the Land Register. The judicial status of judges of the Land Registry Offices shall be equivalent to that of district (city) judges. The Land Register operates in the whole of the territory of the State.

The Supreme Court – seated in Riga - forms the highest level of the court system in Latvia and the judgements thereof are final. The composition of the Supreme Court is: the Senate and two Court Chambers - the Civil Chamber and Criminal Chamber. The Senate is composed of three departments: the Civil Department, the Criminal Department and the Administrative Department.

34 district (city) courts and 5 regional courts are courts of first instance. Relevant criminal procedure and civil procedure laws determine the competence of these courts. A district (city) court is the court of first instance for civil, criminal matters and matters arising from administrative legal relations except those matters that are within the jurisdiction of regional courts and the Supreme Court.

A regional court is the first instance court for the criminal and civil matters, which are within the jurisdiction of regional courts in accordance with the procedure law.

Regional courts also operate appellate courts for cases, which have been adjudicated by district (city) courts as the court of first instance.

The Chamber of the Supreme Court is the appellate instance for matters, which have been adjudicated by regional courts as courts of first instance. The Senate of the Supreme Court is the court of cassation instance for all matters, which have been adjudicated by district (city) courts and regional courts.

The Constitutional Court exists as a separate court in Latvia, and the Constitutional Court review matters concerning the compliance of laws with the Constitution within its jurisdiction as provided for by law, as well as other matters regarding which jurisdiction is conferred upon it by law. The Constitutional Court shall have the right to declare laws or other acts or parts thereof invalid if unconstitutional. The Constitutional Court is independent in functional and organisational (administrative) aspects.

Pursuant to the Constitution, judges shall be confirmed by the Saeima (Parliament) and they shall be irrevocable. A judge may be dismissed from office against his or her will by the Saeima only in exceptional cases provided for by law and on the basis of a decision of the Judicial Disciplinary Board, or a court judgement in a criminal matter.

The law determines the maximum age for holding office as a judge as: 65 years for judges of district (city) and regional courts, and 70 years for justices of the Supreme Court with the possibility of extension up to five years.

Sworn advocates (barristers) are persons who belong to the court system and work on cases at courts of all levels and on pre-trial investigation bodies.

Partner of Prieks & Partners, Ilona Kjellegaard Jensen, is a sworn advocate, admitted to the Supreme Court since 1998.

## **8.2 Enforcement of EU-Judgements in Latvia Etc.**

As for now, no foreign judgements may be recognised/enforced in Latvia without the possibility of a new court case in the merits before the Latvian courts. After accession to EU, Latvia will be obliged by the EU-Regulation on Courts' Competence and Recognition/Enforcement of Judgements, which provide for swift automatic recognition and enforcement in one EU-member state of judgments from courts of law in other EU-member states (with the exception of Denmark).

It may be assumed that Latvia and other new EU-member states will become - at present it is not - a signatory state to the EC-Convention on Courts' Competence and Recognition and Enforcement of Judgements, which still applies in respect of Denmark *vis-à-vis* the other "old" EU-member states, and the equivalent EC/EES-Conventions (Iceland, Norway and Switzerland).

Latvia is a signatory state to the New York convention on recognition and enforcement of foreign arbitration awards.