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NOTE

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Monitoring Guidance: 2017 Guidance on tax privileges related to special economic zones - Replies to questionnaire (Latvia)

Delegations will find attached the reply received from Latvia.

**Annex II: Questionnaire on 2017 Guidance on tax privileges related to SEZ Reply by
Wednesday, 31 March 2021**

Scope of the 2017 Guidance: <i>business tax privileges available for a special geographic area of a Member State</i> <i>("special economic zones" SEZ)</i>		
	YES	NO
Do you have special economic zones (special geographic areas for businesses) in your country, irrespective of the name used? ¹ <i>If there are different types of SEZ in your country, please fill out a separate questionnaire for each type.</i>	YES	
Are any <u>business tax privileges</u> available for the respective SEZ?	YES	
If affirmative, which ones (please describe briefly)?	<p>In Latvia there are 3 special economic zones (<i>Liepaja Special Economic Zone, Latgales Special Economic Zone and Rezekne Special Economic Zone</i>) and 2 free ports (<i>Riga Free Port and Ventspils Free Port</i>)ⁱ (further – SEZ/Free Ports). The special direct tax regime provides for real estate tax and corporate income tax credit. <u>The special tax regime was enacted with purpose to promote entrepreneurial activities within the specified territories.</u></p> <p>The main benefits for capital companies or licensed capital companyⁱⁱ operating in SEZ/Free Ports are as follows:</p> <ul style="list-style-type: none"> • 80% allowance on real estate tax • 80% allowance on corporate income tax on dividends (distributed profit). <p>Tax allowance is limited to investment made by a zone capital company or a licenced capital company (<i>company entered into an agreement with the free port or zone authority regarding commercial activities in the free port or special economic zone territory</i>)ⁱⁱ.</p> <p>Latvia's SEZ/Free Ports regime were assessed in the past.</p>	
or Have you implemented the 2017 Guidance after its endorsement by the Group?		NO

¹ Where appropriate, if a national SEZ has been previously assessed “not harmful” it would be useful if Member States could make a brief reference to this assessment in their response.

<p>Did your pre-existing rules already provide for similar provisions as those set in the 2017 Guidance?</p>	<p>YES Latvia's SEZ/Free Ports pre-existing rules already provide for similar provisions set in the 2017 Guidance. All relevant provisions are provided in Law "On Application of Taxes in Free Ports and Special Economic Zones" (further - Law) ⁱⁱⁱ and in each specific SEZ/Free Ports law (see endnote "i").</p>	
<p>With regard to the special geographic areas (SEZ) identified:</p>	<p>YES (comments)</p>	<p>NO (comments)</p>
<p>a i) Does access to the zone</p> <p><input type="checkbox"/> specifically favour foreign investors? or</p>		<p>NO</p> <p>Activity of other commercial companies and organizations is allowed in the territory of SEZ/Free Ports in accordance with general procedures, however, such commercial companies and organizations do not have the rights to apply tax allowances provided in Law. The tax allowance is available only for zone capital companies or licensed capital company ⁱⁱ that actually carry on business in the specified territory and the company shall be located in the territory of SEZ/Free Ports and performs commercial activities only in the</p>

		<p>territory of SEZ/Free Ports. Therefore, for non-resident company (Permanent establishment) is not possible to obtain status of SEZ/Free Ports capital company nor conclude an agreement with SEZ/Free Ports Authority without establishing company in SEZ/Free Ports territory, thus non-resident companies can't directly pretend to apply tax allowance available to SEZ/Free Ports zone capital companies or licensed capital company.</p> <p>To enjoy the tax allowance, company shall be registered in Latvia according to national legislation.</p> <p>In conclusion it shall be noted that foreign investment is allowed.</p>
<p><input type="checkbox"/> discriminate against domestic investors?</p>		<p>NO See answer above.</p>
<p><i>de jure</i></p>		<p>NO According to provisions of Law ⁱⁱⁱ and relevant special SEZ/Free Ports law provision ⁱ.</p>
<p><i>de facto</i> [please insert relevant numbers regarding the use of the measure by domestic companies, foreign and (directly or indirectly) foreign owned companies for the last 3 years]</p>		<p>NO As mentioned above, all companies allowed to use the measure, shall be</p>

		<p>located in SEZ/Free Ports territory and registered in the Commercial Register in accordance with the procedures laid down in the Commercial Law or the Law On State and Local Government Capital Shares and Capital Companies in domestic companies. Thus, are considered as domestic companies, nevertheless investors can be Latvian or foreign natural persons or legal persons, which have entered into a contract with SEZ/Free Ports Authority on investments for the performance of commercial activity in the in such case - foreign owned companies.</p> <p>SEZ/Free Ports there are 45 companies with 100% local capital, 81 companies with mixed local and foreign capital.</p>
ii) Do the tax benefits available to companies operating in the zone:	YES (comments)	NO (comments)
<input type="checkbox"/> specifically favour transactions with non-residents? or		<p style="text-align: center;">NO</p> <p>The tax allowance is available only for zone capital companies or licensed capital companies that actually carry-on business in the specified territory and the company shall be located in the territory of</p>

		<p>SEZ/Free Port and performs commercial activities only in the territory of SEZ/Free Port.</p> <p>Thus, we do not consider that tax benefits available to companies operating in the zone specifically favour transactions with non-residents or discriminate against domestic transactions.</p>
<input type="checkbox"/> discriminate against domestic transactions?		<p style="text-align: center;">NO</p> <p>See answer above.</p>
<p>[please insert relevant data regarding the use of the measure for the last 3 years:</p> <ul style="list-style-type: none"> - overall number of domestic companies, foreign and (directly or indirectly) foreign owned companies; and - if different (sector of) business activities are allowed in the SEZ: <ul style="list-style-type: none"> • the number of domestic companies, foreign and (directly or indirectly) foreign owned companies in each sector of activity; • the declared taxable profit/ taxable income in euros per sector of activity and per category of companies; and • the amount of tax benefits involved/ budget revenue losses due to the SEZ tax relief per sector of activity and per category of companies.] 		<p>For the last 3 years in SEZ/Free Ports are 143 companies entitled for tax benefits of which:</p> <ul style="list-style-type: none"> - 52 operate in the manufacturing sector, - 36 in the port activities sector, - 31 in warehouse and storage sector, - 6 in wholesale sector, - 5 in real estate management - 1 in web portals. <p>Data on the amount of tax benefits involved/ budget revenue losses due to the SEZ/Free Ports tax relief is provided in endnote ^{IV}.</p>
<p>b Do the regulations place restrictions on activities that require substantial economic presence?</p>	<p style="text-align: center;">YES</p> <p>To obtain the status of special SEZ/Free Ports</p>	

		<p>company is possible only for companies engaged in active entrepreneurial activity in the SEZ/Free Ports territory and under conditions to invest in the territory of special SEZ/Free Ports. The tax allowance is available only for zone capital companies or licensed capital company that actually carry-on business in the specified territory.</p>	
c	<p>Do the regulations require a definite <i>de jure</i> and <i>de facto</i> link between real economic activity carried on within the zone² and the profits for which the tax privilege is granted?</p>	<p>YES</p> <p>When taking the decisions on granting the status the each SEZ/Free Ports Authority shall evaluate the following criteria:</p> <p>value of investment, projected, created, maintained, and lost working places, projected wage levels, planned link with local enterprises (production and services' consumption, cooperation with subcontractors), planned tax payment increase to municipal budget, cargo throughput increase in port, planned utilization of local resources (material and natural resources) upon implementation of investment project and others.</p>	

² Such as distribution and manufacturing activities and activities that generate employment, assets and investments.

		<p>Thus, regulation requires a definite <i>de jure</i> and <i>de facto</i> link between real economic activity carried on within the SEZ/Free Ports and the profits for which the tax privilege is granted.</p>	
<p>d</p>	<p>Are the tax privileges available also for the highly mobile activities³ that are permitted in the zone? <i>[please list what type of highly mobile activities are permitted in the zone]</i></p>		<p>NO</p> <p>We do believe that tax privileges are not available for highly mobile activities since such activities are not permitted in the SEZ/Free Ports zone.</p> <p>In addition, it should be taken in to consideration the main purpose of the regime – it is to facilitate activity and investments in the SEZ/Free Ports territory. Thus, no interest is given in attracting geographically mobile activities.</p> <p>However, in case even such activities were attracted, the applicable tax relief still will be limited to the amount calculated on the basis of investment made in the SEZ/Free Ports territory.</p> <p>In addition, we would like to mention that in accordance with the Article 5 of Law the</p>

³ For example, activities typical of the banking or insurance industry, intra-group services (financing, leasing, distribution and other services), headquarter regimes, or activities consisting only of the holding of equity participations and earning only dividends and capital gains.

			<p>capital company will not comply with provisions provided in Law and will not qualify for tax credit if the company carries on business outside the SEZ/Free Ports territory.</p> <p>Simultaneously, it is important to note, that the paragraph 1 of Section 12 d) of the Law stipulates that long-term investments in intangibles shall conform to the requirements specified in paragraph 8 of Article 14 of the Commission Regulation (EC) No. 651/2014 of 17 June 2014 “Declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty”.</p>
e	<p>Are regular tax audits provided for to verify that the profits accruing in the zone and allocated to the activities to which tax privileges are available are commensurate with those activities?</p>	<p>If Yes, please mention how often</p>	<p>NO</p> <p>No there is no specific tax audit requirement provided in the law. Audits are performed in accordance with the general conditions.</p> <p>Simultaneously zone capital company or a licensed capital company which receives the direct tax allowance concurrently with the annual</p>

			statement of the company shall submit the State Revenue Service a report on the application of the direct tax allowances within the taxation period. Zone capital companies and licensed capital companies are subject to all generally applicable reporting and tax obligations.
f	Does the public legislation clearly define the terms and conditions:	If Yes, please indicate the relevant provisions	No
	<input type="checkbox"/> for establishing a zone,	YES Law and each specific law on Free Ports and Special Economic Zones ¹ .	
	<input type="checkbox"/> for being allowed to operate in the zone,	YES Article 5 of Law and each specific law on Free Ports and Special Economic Zones ¹ .	
	<input type="checkbox"/> for the benefits available for companies operating in the zone?	YES For direct tax Section III of Law.	
	Does the public legislation limit in time the terms and conditions:	If Yes, please mention for how long	No
	<input type="checkbox"/> for establishing a zone,		NO There is no special regulation limiting in time the terms and conditions for establishing a zone,
	<input type="checkbox"/> for being allowed to operate in the zone,		NO

		<p>Merchants which do not have the status of a zone capital company or licensed capital company may, within the territory of the SEZ/Free Ports territory, carry out commercial activity without the reliefs specified for zone capital company or licensed capital company and subject to the control of the SEZ/Free Ports Authority within the scope of the competence thereof. Those merchants and licensed capital companies which do not apply the SEZ/Free Ports zone regime do not have the right to carry out commercial activity in the territories of SEZ/Free Ports zones, except for the provision of services to a zone capital company or licensed capital company which applies the free port regime, or to the SEZ/Free Ports Authority.</p>
<p><input type="checkbox"/> for the benefits available for companies operating in the zone?</p>	<p>YES</p> <p>Allowance on direct taxes will be provided just for investments made by 31 December 2035.^v In addition Article 9(2) of Law provide that the right to</p>	

	receive the direct tax reliefs shall expire as of the taxation period in which the permit to apply the direct tax reliefs has <u>lost its validity</u> .	
Is any of the following subject to discretionary powers:	Yes	No
<input type="checkbox"/> the permission to establish a zone,		NO SEZ/Free Ports zone can be established only by enacting a law approved by the SAEIMA (Parliament).
<input type="checkbox"/> the permission to be active in a zone?		NO To benefit for SEZ/Free Ports direct tax allowances the company has to receive status of zone capital company or licensed capital company . The status of SEZ/Free Ports company is granted by the SEZ/Free Ports Authority on the case-by-case basis.

i http://www.investinventspils.lv/en/tax_incentives/

<http://www.liepaja-sez.lv/en/sez/investor-manual/>

<http://www.rsez.lv/index.php/en/opportunities/gaining-rsez-status>

<http://www.rop.lv/en/for-clients-a-investors/documents/to-obtain-free-zone-regime.html><https://likumi.lv/ta/id/282586-latgales-specialas-ekonomiskas-zonas-likums>

<https://likumi.lv/ta/en/en/id/33419-on-the-application-of-taxes-in-free-ports-and-special-economic-zones>

- ii **zone capital company** - a Liepāja Special Economic Zone capital company with which the zone authority has concluded a contract for the performance of commercial activities and making of investments in the territory of the Liepāja Special Economic Zone, a Rēzekne Special Economic Zone capital company with which the zone authority has concluded a contract for the performance of commercial activities and making of investments or the settlement of estimated wages costs in the territory of the Rēzekne Special Economic Zone, and a Latgale Special Economic Zone capital company which performs commercial activities in the territory of the Latgale Special Economic Zone and has concluded a contract with the zone authority for the making of investments or the settlement of estimated wage costs in the territory of the zone.
licensed capital company - a capital company which has concluded a contract with the free port authority for licensed commercial activities in the territory of the Free Port of Riga or the Free Port of Ventspils;

iii <https://likumi.lv/ta/en/en/id/33419-on-the-application-of-taxes-in-free-ports-and-special-economic-zones>

iv

	Number of entities that benefitted from your regime	Aggregate amount of benefits granted under your regime (e.g. the amount of income exempted from tax or the amount of tax exempted) in each sector under regime)
Year:2019	6	0.9 mln.euros
Year:2018	0*	0 mln.euros
Year:2017	60	8.7 mln.euros
Year:2016	46	5.7 mln.euros
Year:2015	38	7.6 mln.euros

* According to the data available on January 2020, and due to the new Corporate Income Tax system (distributions and non-business expenditures are taxable, leaving retained earnings tax free until distributed), none of the 100 capital companies operating in free ports and Special Economic Zones had benefitted from the regime.

∨ Paragraph 23 of Transitional Provisions of Enterprise Income Tax Law
<https://likumi.lv/ta/en/en/id/292700-enterprise-income-tax-law>