

# New start-up law makes Latvia ideal for starting business

The newly adopted start-up legislation makes Latvia a very attractive place to start a business, including tax deductions for the companies and their employees.

As of January the 1<sup>st</sup> 2017, Act on Aid for Start-up Companies is applicable providing various advantages for start-up companies registered in Latvia. This makes the Baltic country a very competitive place in EU to register a start-up company.

Most governments prefer to support their start-ups by providing various grant programmes and venture capital investment subsidies. However, start-up specific tax breaks like the ones contained in the newly adopted Latvian law are quite rare.

## What are the criteria for 'start-ups'?

The objective of the legislation is to stimulate a formation of start-ups in Latvia enabling research and use of innovative ideas, products, and processes within business activities.

According to the definition provided by the act, a start-up is:

*'a capital company possessing a high growth potential and its main economic activity is related to design, production or development of scalable business models and innovative products'.*

Although the act does not elaborate on what is understood by "a high growth potential", a company must meet certain criteria in order to be entitled to receive the benefits provided by the act, such as

- the start-up company must carry out commercial activity for the first five years since its registration in the commercial register (older companies are not covered),
- the income from which the start-up company derives its economic activity during the first five years of its registration must be below 5 000 000 EUR,
- the size of the start-up's investment/s must at least amount to 30 000 EUR in each year the aid is granted and must be obtained from qualified venture capital investor/s, etc.

Pursuant to the act a *qualified venture capital investor* is either;

1. an alternative investment fund ("**AIF**") registered in Latvia in accordance with the Law on Alternative Investments Funds and their Managers or,
2. a foreign legal entity registered in accordance with an equivalent regulatory framework on AIFs, which during the past three years has made an early stage venture capital investment/s in at least three companies with commercial activity. In addition, it is required that each investment shall at least amount to 30,000 EUR. However, the investment must not exceed 200,000 EUR in each company, and the investor share must not exceed 20 % of the company's equity capital.

## 5 years of aid programmes and tax reduction

Besides definitions of a start-up and features thereof, the act contains support measures to start-ups such as;

- aid program for attracting highly qualified employees,
- fixed payment aid program, or
- personal income tax reduction and enterprise income tax reduction, which are all available for a start-up in the period of first five years from its registration.

The fixed payment aid program enables the employer to replace a social insurance payment payable for an employee with a fixed payment corresponding to two minimum social insurance payments regardless of the amount of the salary. Thus, the employer will only be required to pay approx. 250 EUR, which is approx. 21 per cent of a salary of 1200 EUR or 6 percent for 4000 EUR. In comparison, in Lithuania the employer is required to pay 54 per cent of the salary.

Furthermore, according to the act a start-up is eligible to apply for the aid program for attracting highly qualified employees with a doctor's or master's degrees or employees with 5+ years of experience. According to this regime, the Latvian government covers all social and personal taxes. Furthermore, such employees receive full social benefits.

The act does not only support start-up companies as it also contains benefits for the employees of such a start-up. Thus, the start-up companies' employees are exempt from the personal income tax. However, the exemption is limited to a fixed payment, which is derived from the salary paid to the employee.

In addition, the start-up company is entitled to enterprise income tax reduction up to 100 per cent. The reduction of 100% shall apply if *de minimis* aid threshold has not been reached. The reduction may not be applied to enterprise income tax part that is calculated for the following:

1. expenses not related to the economic activity;
2. accumulated reserves;
3. fines or contractual penalties;
4. payments to a non-resident from whom an enterprise income tax should have been withheld, however, it was not;
5. part of expenses incurred as a result of reassessment of the assets;
6. the amount of bad debts not complying with the conditions set by the Law on Enterprise Income Tax; the difference between value of product or service received or product or service provided and the market value.



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