INCOME TAXATION DEVELOPMENT TRENDS IN THE BALTIC STATES

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Abstract. The three Baltic States were the first to adopt flat tax systems in 1994 and 1995, thus, becoming the first modern countries to apply flat tax structures. The idea of a flat tax, i.e. a tax levied at a single rate, has become an increasingly discussed and implemented fiscal strategy across Europe and the rest of the world afterwards. However, despite some general similarities, the taxation system differs across the Baltic States which has led to the aim of the present research to study the income taxation trends in the Baltic States. The research leads to the conclusion that the Estonian tax system is one of the most liberal and simplest systems even in the world. The most rational income taxes among the Baltic States are observed in Lithuania (15% both CIT and PIT). Estonia and Lithuania have the same PIT and CIT rates, while Latvia applies the most severe PIT rate (24%). Changes in tax revenues and government expenditure occur automatically with a change in the economic situation. This means that the application of fiscal policy instruments may either hinder or promote the tax system development and respectively the development of income taxation. Hence, the basic difference in the taxation systems of the Baltic States include the calculation and application of the tax-exempt minimum, tax reliefs, and flexibility of the system to the changing economic conditions.

Key words: income, personal income tax, corporate income tax, economics, Baltic States.
JEL code: G30,H24,H60

Introduction

Despite some general similarities like flat rates and low tax burdens, the taxation system differs across the Baltic States. Generally there are two income taxes in the Baltic States – personal income tax (PIT) and corporate income tax (CIT) which constitute a single income taxation system. Any person gaining income is a personal income tax or corporate income tax payer, unless statutory provided otherwise. The income taxation system is based on the equity principle which is the main taxation principle resulting from imposition of income taxes calculated on taxpayers' solvency. Equity signifies equal treatment of equals. Horizontal equity in taxation means that persons under similar circumstances should bear equal tax burdens. It follows that individuals with the same income or the same increases in income or wealth should be taxed equally. There would be no preferential treatment for various sources of income – labour, investment, entrepreneurship, gifts, prizes, scholarships, inheritances etc.

The majority of states impose a progressive income tax, while the Baltic States apply a horizontal equity principle, i.e. income is taxed proportionally using a flat tax rate. Different tax reliefs and tax allowances are a special issue of the income taxation and they are aimed at the achievement of either social or economic targets. The standard theory of optimal taxation posits that a tax system should be

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chosen to maximise a social welfare function subject to a set of constraints. The literature on optimal taxation typically treats the social planner as a utilitarian: that is, the social welfare function is based on the utilities of individuals in the society (Mankiw et al., s.y.). Economic allowances usually coincide with the willingness to support business development. One exceptions and tax reliefs help guarantee a more equitable taxation system, while the others create derogations from the equity principle observation; however, they complicate the taxation system and raise the costs of its administration in any case. Therefore, general tax imposition principles are naturally competitive and their simultaneous and equal degree application is impossible even on the condition of an ideal taxation system. No country can be absolutely independent in the taxation policy formation, since it shall consider the international competitiveness in attraction of capital and investment. Hence, there is at least a minimum necessity to introduce such tax reliefs which would promote prerequisites for the attraction of investments in the competition of other countries (Andrejeva, Ketners, 2008).

Different researchers (Andrejeva, Ketners, 2008; Feith, Majak-Knöbl, s.y.; Jakusonoka, 2013; Joppe, 2010; Ketners, 2009; Mankiw, Weinzierl, Yagan, s.y.; Maslauskaite, Zorgenfreija, 2013; Masso, Krillo, 2014; Skapars, Sumilo, Dunska, 2010; Stucere, Mazure 2012, 2013; Vitola, 2010; Woolery, 1989) have studied and discussed various tax and taxation aspects. The present research advances the **hypothesis** that the taxation systems differ among the Baltic States. Consequently, the research **aim** is to study the income taxation trends in the Baltic States. The following research **tasks** are set to achieve the research aim:

1) to characterise the income taxation systems in the Baltic States;
2) to analyse the income tax rates and the total tax-of-GDP burden;
3) to draw comparative assessment on the development of income taxation systems in the Baltic States.

The monographic descriptive method, methods of analysis and synthesis as well as the logical and constructive methods are used in the research. The authors have used legal enactments, statistical data, and working papers and research done by local and foreign scientists for the needs of the present study.

Research results and discussion

Characteristics of the income taxation systems in the Baltic States

Estonian income taxation system

The Estonian tax system is one of the most liberal and simplest systems in the world. Estonia is a European pioneer in income taxation having introduced flat income tax rates. The main reasons for introducing flat rate were as follows: there is no need of frequent adjustment of tax brackets and it is easier to administer a flat tax system for both taxpayers and tax administrators, besides a flat tax system provides more transparency (Estonian Taxes and ..., 2012). There is no corporate income tax on reinvested profits. The resident companies and permanent establishments have to pay tax only on dividends and other distributed profits, fringe benefits; gifts, donations and representation expenses; and expenses and payments not related with business.

As there is no need, the corporate entities are not subject to tax depreciation rules. All distributions are subject to income tax at the grossed-up rate of 21/79 of the amount of taxable payment. The transfer of assets of the permanent establishment to its head office or to other companies is also treated like a distribution. As of January 1, 2009 dividends paid to non-residents are no longer subject to

withholding tax at the general rate of 21%, irrespective of participation in the share capital of the distributing Estonian company. Only capital gains derived by non-residents from the sale of Estonian real estate or shares and liquidation proceeds of real estate companies are subject to a 21% tax. No traditional thin capitalization rules apply, i.e. substantial debt financing at market interest rate is tax neutral (Estonian Taxes and ..., 2012).

Residents pay tax on their worldwide income. Taxable income includes, in particular, income from employment (salaries, wages, bonuses and other remuneration); business income; interest, royalties, rental income; capital gains; pensions and scholarships and alimony payments received. Taxable income does not include dividends paid by Estonian or foreign companies when the underlying profits have already been taxed.

Non-residents pay income tax on their income from Estonian sources. Income taxable in Estonia includes income from employment or government services provided in Estonia; income from business carried out in Estonia; part of interest received from Estonian sources that is above market rates; royalties arising in Estonia; certain types of capital gains; gains from disposal of assets located in Estonia; directors' fees paid by Estonian enterprises; and income of a sportsman or an artist from his activities in Estonia, pensions, insurance payments. The tax rate is 21% of taxable income. The withholding tax rate on royalties, payments to non-residents for services provided in Estonia, and on payments to non-resident artist and sportsmen is 10%. Estonia has double taxation avoidance treaties with 48 countries (Estonian Taxes and ..., 2012).

Latvian income taxation system

The Latvian tax system is not the simplest one; however, it cannot be described as very complicated as compared with the old EU Member States. The tax system in Latvia is still changing. In Latvia, the personal income tax consists of salary tax calculated from the income acquired by the employee and paid by the employer; fixed income tax regarding income from economic activity; tax for income from economic activity where it is not the object of the enterprise income tax, and tax from other sources of income; tax for income from capital, including tax from an increase in capital; license fees for the performance of separate types of economic activities; and the parts of the micro-enterprise tax in accordance with the Micro-enterprise Tax law (Par iedzivotaju ..., 1994).

Resident companies are subject to 15% income tax. As of 2011, a reduced rate of 9% applies to micro-enterprises (annual income below LVL 70,000 = approximately EUR 100 000, up to 5 employees and shareholders are individuals) (Feith et al., s.y.).

Dividends are subject to income tax of 10%, interest payments are subject to 10% tax if paid to related parties (one company holds 25% of capital or voting rights in another company), 10% withholding tax also applies to management and consulting fees, 5-15% to royalties and 15% on the payments to off shore jurisdictions), 0% for all payments to Lithuania. With certain exceptions, the taxation of a non-resident company's permanent establishment in Latvia is similar to the taxation of resident companies.

Currently non-resident companies being residents in the EU and EEA states are not subject to withholding tax on dividends, while in general dividends paid to non-residents are subject to 10% withholding tax. Interest payments to non-resident companies are subject to 10% withholding tax if the payer and the recipient are related parties (5% for the EU and EAA entities) (Feith et al., s.y.).

ISSN 1691-3078; ISBN 978-9934-8466-0-1
Economic Science for Rural Development
No. 33, 2014

Latvian residents are subject to taxation on their worldwide income. General flat rate of the income tax is 24%, and also includes self-employed. 10% tax rate applies to dividends, interest and rental income and insurance payments. Income from capital gains is taxed at 15%. The standard personal income tax also applies to non-residents. Taxation of non-resident individuals is limited to their activities in Latvia. The income taxed in Latvia includes, among others, dividends paid by resident corporations, interest payments and income from the disposal of capital assets. By way of exception, income of non-residents from the disposal of financial instruments is not subject to personal income tax in Latvia. Latvia has double taxation avoidance treaties with 50 countries (Feith et al., s.y.).

Lithuanian income taxation system

The **Lithuanian** tax system has undergone several changes in the last few years. In 2009, a tax reform was introduced, aimed at collecting more revenue. The rates of major taxes - VAT, CIT, and social tax were raised. However, the heavier tax burden had negative effect, especially on small and medium sized businesses; several amendments into the laws were made in 2010-2011 to pursue more business friendly policies.

The profit of Lithuanian companies is subject to an income tax of 15%. A reduced rate of 5% applies to small businesses (annual income below LTL 1 million ~ EUR approximately 290 000 and up to 10 employees). Thin capitalization rules: debt to equity ratio 1:4 applies; interest-free loans are not included in controlled debt. Generally, dividends received by a resident company are subject to corporate income tax at a rate of 15%. A participation exemption applies to dividends paid to a parent company holding more than 10% of the voting shares in the distributing company continuously for at least 12 months, provided the distributing company is not established or otherwise organized in a tax country. Interest payments and royalties are taxed with a 10% rate. Capital gains, also from sale and lease of real estate, income from performing and sports activities and management fees, all are taxed at a 15% rate. All payments to Latvia are not taxed. There are a few differences in taxation of non-resident companies as compared with resident companies. A participation exemption in taxing dividends applies here as well; non-residents from the EU and EEA countries pay no tax on interest and royalties (Feith et al., s.y.).

Residents are subject to personal income tax on their worldwide income. The general flat rate is 15%. A reduced, 5% rate applies to certain activities carried out by self-employed. Noticeably, dividends received in Lithuania are taxed with a higher 20% rate. Interest income is taxed with a 15% rate. Capital gains are tax-exempt if derived from the sale of shares acquired before 1999, otherwise taxed as ordinary income (15%). Non-residents pay income tax on their income sourced in Lithuania. Basically the same rates apply as to residents unless reduced under double taxation treaties. Similarly to Latvia, the sale of shares by non-resident is not taxed in Lithuania. Lithuania has tax treaties with 48 countries (Feith et al., s.y.).

Statutory income tax rates and general tax burden

In the period of 2011–2012, many EU Member States increased personal income tax, mainly by increasing statutory rates. This was often done on a temporary basis in the form of general surcharges or solidarity contributions for high-income earners. Measures to reduce tax on labour aimed mainly to increase work incentives for specific groups. Social security contributions were also increased in many countries, by increasing the standard rate and the rates applicable to specific groups. Several Member

States reduced their headline tax rate on corporate income; while in a few others marginal tax rates were increased by means of surcharges or levies applicable only to the largest companies. Changes in corporate tax bases were slightly more common. They consisted mostly of generous tax relief on investment in physical capital or R&D, whilst restricting the deductibility of other items (e.g. operating losses). These reforms resulted in a slight change in the composition of total tax revenues for 2011 and 2012 compared with 2010, with the share of indirect taxes forecast to rise by almost one percentage point of GDP (Tax Reforms ..., 2012). Therefore, in 2012, the average statutory tax rates on personal income in the EU-27 and the EA-17 countries rose by 0.3 and 1 percentage points respectively compared with 2009. Smaller differences were observed in the tax rates on corporate income, i.e. 0.5 percentage points in both cases. No changes were introduced in Estonia and Latvia, while Lithuania decreased the PIT rate by 9 percentage points and the CIT rate – by 5 percentage points (Table 1).

Table 1

Statutory income tax rates in the EU-27, the EA-17 and the Baltic States in 2000, 2009, 2012 and 2013, %

	Tax on personal income				**Tax on corporate income**			
	2000	**2009**	**2012**	**2013**	**2000**	**2009**	**2012**	**2013**
EU-27	44.8	37.8	38.1	38.7	31.9	23.5	23.0	23.0
EA-17	47.1	42.1	43.1	44.3	34.4	25.9	25.4	25.7
Estonia	26.0	21.0	21.0	21.0	26.0	21.0	21.0	21.0
Latvia	25.0	23.0	25.0	24.0	25.0	15.0	15.0	15.0
Lithuania	33.0	24.0	15.0	15.0	24.0	20.0	15.0	15.0

Note: **Euro area** (EA17): Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland

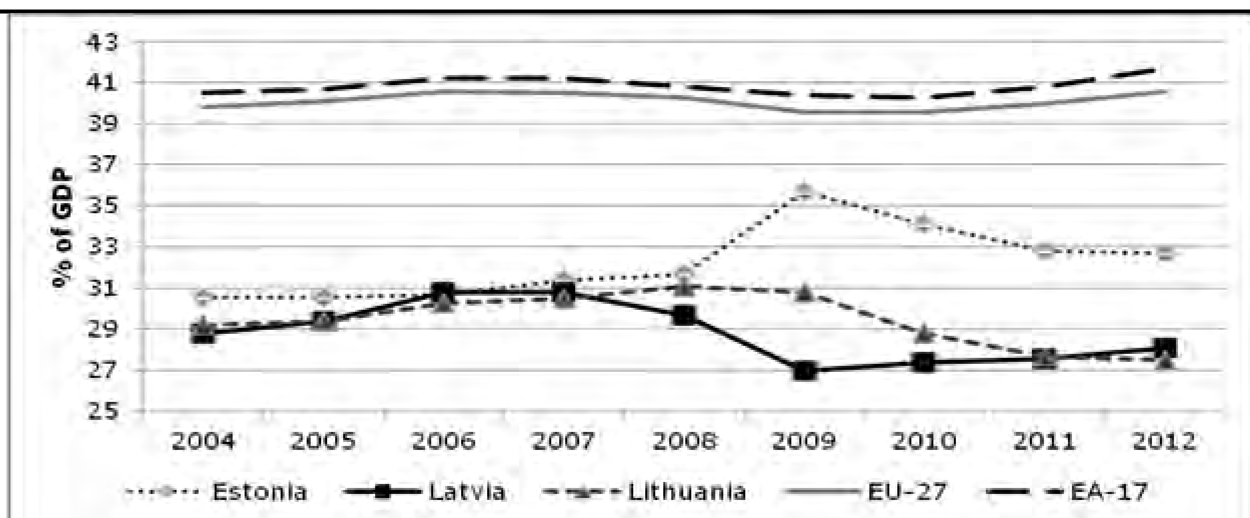
Source: Eurostat, 2013

In 2013, the average highest personal income tax rate in the EU-27 was 38.7%, up from 38.1% in 2012, while quite lower the level of 2000 at 44.8%. The highest top rates on the 2013 personal income are observed in Sweden (56.6%), Denmark (55.6%), Belgium (53.7%), Portugal (53.0%), Spain, and the Netherlands (both 52.0%), and the lowest in Bulgaria (10.0%), **Lithuania** (15.0%), Hungary, and Romania (both 16.0%) (Eurostat, 2013).

In 2013, the average highest corporate tax rate in the EU-27 was 23.0%, stable compared with 2012, while quite lower its level in 2000. The highest statutory tax rates on the 2013 corporate income are recorded in France (36.1%), Malta (35.0%), and Belgium (34.0%), and the lowest in Bulgaria and Cyprus (both 10.0%), and Ireland (12.5%) (Eurostat, 2013).

The most liberal income taxes among the Baltic States are observed in Lithuania (15% both CIT and PIT). Estonia and Lithuania have the same PIT and CIT rates, while Latvia applies the most severe PIT rate (24%).

In 2012, the overall tax ratio, i.e. the sum of taxes and social contributions in the EU Member States (EU-27) amounted to an equivalent of 40.6% of the EU-27 GDP, which is the second highest indicator in the analysed period; similar ratio was observed in 2006. The EA-17 countries produced almost identical figures, i.e. 41.7% and 41.2% in 2012 and 2006 respectively (Figure 1).



Source: authors' construction based on Main National ..., 2014

Fig.1. **Total tax burden as percentage of the Gross Domestic Product in the Baltic States, the EU-27 and the EA-17 for the period of 2004-2012**

The data of Figure 1 outline that the tax burden has been quite similar in the Baltic States until 2007 when it ranged between 28.8% and 30.8% of GDP. More vivid differences are earmarked in 2008 with the deterioration of the worldwide economic situation. The year 2009 generates very explicit tax burden scissors, i.e. 8.7 percentage points with the highest tax burden in Estonia (35.7%) and the lowest one – in Latvia (27%). Latvia was the most severely hit by the financial and economic crisis – salaries and wages were dramatically cut followed by the PIT increase from 23% in 2008 and 2009 to 26% in 2010. Yet, at the same time, it maintained the lowest tax-to-GDP ratio among the Baltic States in 2009.

The development of income tax revenues as a percentage of GDP coincides with the general economic development of the country and produces similar tendencies with the general tax burden versus GDP (Table 2).

Table 2

Income taxes as a percentage of GDP in the Baltic States for the period of 2004-2011

	2004	2005	2006	2007	2008	2009	2010	2011
PIT								
Estonia	6.3	5.6	5.6	5.8	6.2	5.7	5.4	5.2
Latvia	6.0	5.7	6.1	6.1	6.4	5.4	6.1	5.6
Lithuania	6.8	6.8	6.8	6.6	6.5	4.1	3.6	3.5
CIT								
Estonia	1.7	1.4	1.5	1.6	1.6	1.9	1.4	1.3
Latvia	1.8	2.0	2.3	2.7	3.2	1.6	1.0	1.4
Lithuania	1.9	2.1	2.8	2.6	2.7	1.8	1.0	0.8

Source: authors' construction based on Taxation Trends ..., 2013

Before the economic recession, the highest income tax–to-GDP ratio was observed in Lithuania with a slight exception of the corporate income tax in 2008 when Latvia produced the highest indicator of 3.2%. The growth in the corporate income tax revenues mainly explains the increase of the ratio. The CIT share of total GDP in Latvia exceeds the respective ratios of Estonia and Lithuania by 1.6 (twice) and 0.5 percentage points. Small differences are seen in the PIT-to-GDP ratio in 2008. The share of income taxes of total GDP declines in the following years, basically it is related with the decrease of income tax revenues and increase of the share of other taxes in the GDP volume.

ISSN 1691-3078; ISBN 978-9934-8466-0-1
Economic Science for Rural Development
No. 33, 2014

Table 3 provides the summary on budgetary adjustments made by the governments of the Baltic States; these adjustments were targeted to overcome the financial crisis and inter alia included the changes related with the income taxes, basically the revenue part.

Table 3

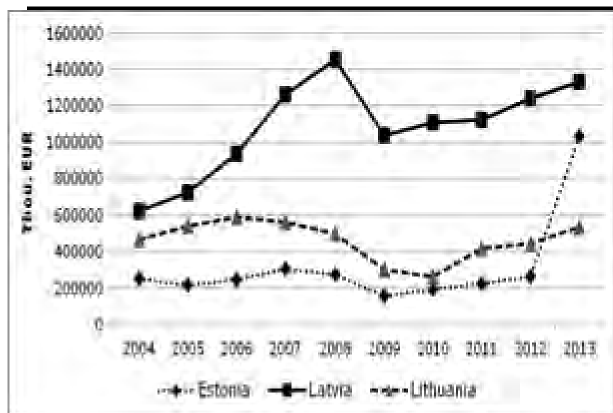
Budgetary adjustments in the Baltic States during the financial-economic crisis

Country	Expenditure	Revenue
Latvia	• Cuts of public sector operating expenses by 18% in 2009 and later. Central government officials saw cuts of 30% between 2009-2011, while public wages were cut by 25%. • Sickness benefits exceeding a threshold were cut by 50%; old-age pensions cut; the part of the social insurance contributions to the compulsory private funded pension pillar were reduced from 6% to 2%. Increase in retirement age to 65 (2012).	• Increase in the rate of **PIT** 23-26% (2010); employee social contribution rate 9-11% (2011); VAT increase from 18-21% (2009) and then to 22% (2011); increase of the excise duties on alcohol, tobacco and energy; increase in vehicle taxes. • Broadening of the base for the **PIT** and VAT. • Introduction of a progressive real-estate tax in 2009 that was doubled in 2011.
Lithuania	• Cuts of public sector operating expenses by 10% in 2009. The cuts were progressive (8-36%), and highest earners took larger hits. • Sickness benefits curtailed; old-age pensions cut; the part of the social insurance contributions to the compulsory private funded pension pillar were reduced from 5.5% to 2%.	• VAT increase from 18 to 21% (2009); **CIT** tax rate 15-20% (2009); increase in excise duties. • Broadening of the base for VAT, by reducing the number of goods with favourable rates, and increasing the favourable rates. • Introduction of a real-estate tax.
Estonia	• Cuts to public sector operating expenses by 8% in 2009. Some groups, like teachers, were subjected to a lower pay cut than others. • Sickness benefits for the first days of leave were cut; pensions were not indexed by the planned 14%, but rather by 5%; state-financed contributions to the second pillar were stopped (July 2009 – December 2011). Retirement age to be raised from 2017.	• Planned **income tax** rate reduction was postponed; unemployment insurance contributions increased from 0.9 to 4.2% of gross wages; VAT increase from 18 to 20%; • Broadening of the base for VAT, by reducing the number of goods with favourable rates, and increasing the favourable rates. • No new taxes introduced

Source: Maslauskaite, Zorgenfreija, 2013

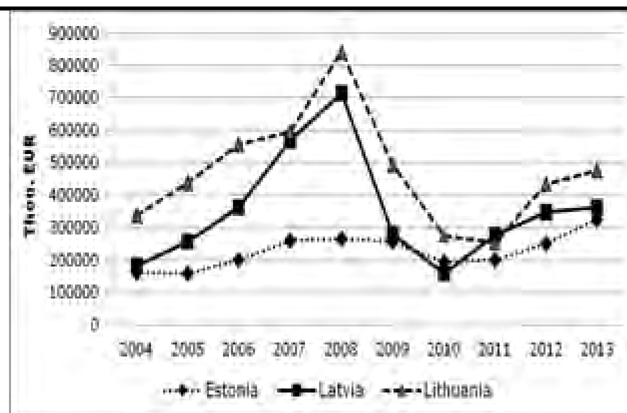
The implemented measures have been effective in stabilising the Latvian budgetary situation. Latvia increased the **PIT** rate 23-26% (2010) and the employee social contribution rate 9-11% (2011) as well as it broadened the base for the **PIT** and VAT, and introduced a progressive real estate (immovable property) tax. Lithuania introduced comparatively more stimulus measures than the other two Baltic States, for example, the personal income tax was reduced by 9 percentage points to 15% and exemptions were added to excise duties. The measures granted the needed credibility and put the economy on a more sustainable path. Estonia introduced several one-off measures aimed at improving the budget balance in order to qualify for the introduction of euro. In addition to the consolidation measures, the Estonian government attempted to further liberalise the economy (Maslauskaite, Zorgenfreija, 2013).

A partial impact of the implemented crisis aversion measures on the income tax revenues in the Baltic States is outlined in Figures 2 and 3.



Source: authors' construction based on Valstybes ..., s.y.; Statistics Estonia, 2014; Kopsavilkums ..., 2013

Fig. 2. **Personal income tax revenues in the state budgets of the Baltic States for the period of 2004-2013**



Source: authors' construction based on Valstybes ..., s.y.; Statistics Estonia, 2014; Kopsavilkums ..., 2013

Fig. 3. **Corporate income tax revenues in the state budgets of the Baltic States for the period of 2004-2013**

According to Figures 2 and 3, Latvia experiences a very rapid growth of income tax revenues in the state budget among the Baltic States between 2004 and 2008. Hence, in 2008, the revenues collected from the personal income tax in Latvia exceed the respective revenues of Estonia and Lithuania 5.2 and 2.9 times. Estonia and Lithuania had moderate growth in the PIT revenues and, thus, the decline was comparatively slight compared with the decrease in the PIT revenues in Latvia (almost 30%) in 2009. In general, the decrease relates with the dramatic reduction of wages and salaries consequently reducing the amounts paid to the budget. Even, the reduction of tax-exempt minimum in Latvia could not limit this decline. In 2013, Estonia shows a very radical increase in the PIT revenues, i.e. 3.8 times compared with 2012. The CIT revenues show that Latvia and Lithuania experienced a rather similar increase in corporate profits simultaneously producing high CIT revenues in the state budget. In 2009, the CIT revenues decreased by 45% in Lithuania, 44% in Latvia, and 25% in Estonia. All Baltic States demonstrate an increase in the PIT and CIT revenues starting from 2011 which coincides with the stabilisation of the economic situation. The expansion of the tax base for items taxed by the CIT also explain the increase in the CIT revenues to the state budgets.

Comparative assessment on the development of income taxation systems in the Baltic States

The personal income tax is one of the basic tax revenues in the state budgets of the Baltic States, so the tax-exempt minimum is one of the most significant indicators underlying the differences in the development of income taxation systems (Table 4).

Table 4

Tax-exempt minimum in the Baltic States for the period of 2004-2013, EUR per year

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Estonia	1074	1304	1534	1534	1726	1726	1726	1728	1728	1728
Latvia	358	444	546	854	1366	1067	598	768	768	768
Lithuania	1007	1007	1007	1112	1112	1632	1632	1632	1632	1632

Source: authors' construction based on Valstybes ..., s.y.; Statistics Estonia, 2014; Kopsavilkums ..., 2013

ISSN 1691-3078; ISBN 978-9934-8466-0-1
Economic Science for Rural Development
No. 33, 2014

The tax-exempt minimum is closely related with the subsistence minimum, i.e. life expensiveness, resources necessary to cover daily expenses and necessity to ensure the national development. However, the analysis of items taxable by the PIT shows that the tax-exempt minimum cannot be regarded as efficient tax relief instrument. The comparison of the changes in the tax-exempt minimum of Latvia and Estonia reveals that Estonia has not reduced the tax-exempt minimum in 2009. The basic reason is a stable economic system and development of the country. Latvia, in its turn, dramatically reduced the tax-exempt minimum from July 2009 when it decreased from EUR 128 to EUR 50 per month. This was done to increase the tax revenues in the state budget. The tax-exempt minimum has almost not changed in Estonia outlining that Estonia has a simple and stable, and progressivity-based direct tax policy. From 2014, Latvia has increased the tax-exempt minimum to EUR 900 per year. Seeking to increase budget revenues and also to protect the lowest-income population, from 2009 Lithuania applies a tax-exempt minimum (TEM) to each person individually, depending on its work-related income (before taxes). The higher the income, the TEM is proportionately reduced. At present, an individual whose monthly income incidental to employment relations or relations in their essence corresponding to employment relations does not exceed EUR 2780 per year is subject to the TEM of EUR 1632 per year. No TEM is applicable to work-related income exceeding EUR 10 948 per year (before taxes). The TEM applied in 2008 did not depend on the amount of income and the basic TEM was EUR 1112 per year. If employment related income exceeded EUR 232 per month, monthly TEM was calculated according to the following formula: monthly TEM = 136 – 0.2*(an individual's employment related income per month – 232). From 1 January 2014, if the monthly employment income does not exceed EUR 290, the monthly allowance is EUR 165.

Corporate income tax in Latvia is one of the lowest in the EU, i.e. 15% that presently is one of cornerstones for attracting investments. From September 2010 Latvia introduced a new tax – a micro-enterprise tax which prescribes payment of 9% from a micro-enterprise turnover. From 1 January 2013 the corporate income tax is not be assessed on dividends paid to non-resident corporations and on dividends received from non-residents. Starting from 1 January 2014 the corporate income tax is not assessed on interest paid to non-residents and on payments for the use of intellectual property. In 2011, Latvia reinstated the corporate tax credit for large investment projects of EUR 4.3 million. From 1 January 2013, corporate income tax is not assessed on dividends paid to non-resident corporations and on dividends received from non-residents. Starting from 1 January 2014, corporate income tax is not assessed on interest paid to non-residents and on payments for the use of intellectual property. This rule will not apply to payments from low tax countries or countries charging no tax.

Estonian Income Tax Act does not envisage the CIT reliefs, and non-taxation of reinvested profit is mentioned as the basic tax incentive. Lithuania and Latvia apply CIT incentives for R&D, investment projects, industry and possibility of carrying forward losses.

Conclusions, proposals, recommendations

1. The Estonian tax system is one of the most liberal and simplest systems in the world, Estonia being a European pioneer in income taxation having introduced flat income tax rates. The most liberal income taxes among the Baltic States are observed in Lithuania (15% both CIT and PIT). Estonia and Lithuania have the same PIT and CIT rates, while Latvia applies the most severe PIT rate (24%).

2. The corporate income tax reliefs may not be evaluated unequivocally – they increase the state competitiveness in the sphere of taxes, though, at the same time they distort the market and they are not socially equal to all taxpayers.
3. The tax-exempt minimum is closely related with the subsistence minimum, i.e. life expensiveness, resources necessary to cover daily expenses and necessity to ensure the national development. The calculation of the tax-exempt amount greatly differs in Lithuania where it is calculated depending on a person's income before taxes.
4. Estonian Income Tax Act does not envisage the CIT reliefs, and non-taxation of reinvested profit is mentioned as the basic tax incentive, while Lithuania and Latvia apply CIT incentives for R&D, investment projects, industry and possibility of carrying forward losses.
5. The basic difference in the taxation systems of the Baltic States include the calculation and application of the tax-exempt minimum, tax reliefs, and flexibility of the system to the changing economic conditions. The comparison shows that the Baltic States develop their taxation systems and gradually adjust them to facilitate business, attract investment and promote competitiveness.

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