COMPARISON OF THE TAXATION SYSTEMS OF THE BALTIC COUNTRIES

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Abstract. Taxation has always been a topical issue, which undergoes continuous change and improvement. Taxation impacts all the important measures of the national economy and every resident of a country, therefore the establishment of an effective and simple taxation system that would ensure the development of the national economy, the welfare of people and revenues to the central budget is very important. In the course of forming the taxation system, every country has to think not only about gaining bigger revenues from taxpayers, but also has to be able to protect its country against squandering, to think about the encouragement of the competitiveness of the country, the attraction of investment, the development of the business environment, and the promotion of people’s welfare. The goal of this study is to compare the taxation system of Latvia with the taxation systems of Lithuania and Estonia, to identify the factors influencing it, to analyse the changes of the Baltic countries taxation systems implemented during recent years, and find out what experience could be taken over by Latvia.

Key words: taxes, the principles of taxation, tax discipline, tax evasion

JEL code: H20

Introduction

Globally, there are different models of taxation systems, which are different as to the principles of operation and the implementation mechanisms. However, it is impossible to recommend the copying of any of them and its application to the conditions of Latvia, where there is high unemployment, a huge state administration with disproportionate expenditure and large procurements, bad roads, low wages and high prices, enormously expensive projects, and irresponsibility of the resolutions adopted at the government level.

The hypothesis of the research: if Latvia uses the proper taxation principles and effective tax system elements of Lithuania and Estonia, then unemployment rate and illegal economy would decrease but the business environment would improve.

The aim of research is to explore tax systems of the Baltic States, to evaluate how taxation principles are enforced in the Baltic States, and to present proposals for improvement of Latvia tax system.

The tasks of the research were set in order to achieve the aim: 1) to analyse the directions of tax systems development in the Baltic States; 2) to explore the tax discipline in Baltic.

Generally, the national taxation (fiscal policy) has a huge role in national economy both for encouraging the economic growth and for ensuring a balanced economic growth and the national financial stability. An effective taxation system should be based on the correct taxation principles, which were initially defined by A. Smith and later systematised by the German financier A. Wagner (1835-1017) as follows: 1) financial principles; 2) the principle of the national economy (the mix of the types of taxes); 3) the principles of ethics and fairness; 4) tax management principles; 5) balanced split of taxes - taxes have to comply with taxpayer’s income; 6) the certainty of taxes - clarity as regards the amounts and terms of payable taxes; 7) collection of taxes at the most convenient time; 8) the shift of the tax burden to the net income - the net profit should be subject to taxation rather than the capital; 9) cheap collection of taxes - the least possible expenditure for collecting taxes (Ketners K., Lukasina O. 2008).

Research methods used in the paper are as follows: monographic, statistical, questionnaire survey, and the logical and constructive methods.

The taxation principles that were systematised in the 19th century are valid also today. A country can use taxation for either developing or hindering its economics and business. The taxation system of each Baltic country has its own specific features, which are determined by social economic differences, mentality, and the national tradition.

Research results and discussion

1. Directions of the development of the taxation systems in the Baltic countries

In the course of building their taxation mechanisms, the Baltic countries have different approaches to the issues regarding the tax burden on legal and natural entities, the taxation policy compliant with the structure of manufacturing and households, the taxation base, tax rates, tax relieves, etc. The analysis will first focus on the ratio of taxes of the Baltic countries to the GDP and the evaluation of factors influencing these indices.

In Latvia, the highest tax burden was in 2000. The evaluation of the development over several years reveals that the lowest burden was in 2007 and started to increase again as of 2008. The total tax burden (inclusive of social insurance contributions) in Latvia reached the level of 29.8% in 2010, and this is considerably below the mean level of the EU (35.6%). The above figure is the

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third lowest index in the European Union after Lithuania and Romania.

In Estonia, the tax burden (inclusive of social insurance contributions) in 2010 amounted to 36.8%, it was above the level of the pre-crisis years, however, below the level of 2009, and it proves the recovery of the economics to some extent. In 2009 and 2010, tax revenues were influenced by the increase of the VAT rates and the excise tax. Temporary measures, for example, postponement of contributions to the second pension tier, slightly increased the tax burden as regards year 2008. In 2010, the tax burden in Estonia was close to the mean level of the EU-27 (35.6%) (Eurostat, 2012) and it was considerably above the level of other Baltic countries.

In Lithuania, the lowest total tax burden (inclusive of social insurance contributions) was in 2010 and amounted to 29.0%. In comparison with the two other Baltic countries, the Lithuanian tax burden is close to that of Latvia (29.8%) and 7.8 percentage points below that of Estonia (36.8%).

The above-mentioned findings lead to the conclusion that Estonia has the highest tax burden among the Baltic countries. The further analysis will focus on the factors that could have most impact on these indices. Gross wages in business sector is one of these factors. According to the Eurostat data, Belgium has the highest tax rate applicable to low wage earners among the EU countries, whereas the tax rate of Latvia is highest and the tax rate of Estonia is lowest among the Baltic countries.

The data in the Table give evidence that the highest earnings in the Baltic countries are found in Estonia. Up to 2007, the lowest earnings were in Latvia, whereas since 2008 the lowest earnings were in Lithuania. According to the Eurostat data, the minimum wage in Lithuania is slightly lower than in other Baltic countries (Minimum wage statistics..., 2012). In addition, average hourly labour costs in the business economy do not differ a lot among the Baltic countries in 2009 (Average hourly labour costs..., 2010). The tax rate applied to persons with low wages presents another factor, which may influence the tax burden of residents.

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Tax revenues are influenced also by the demographic situation in Latvia. Emigration from the Baltic countries alongside with the decline of the economic conditions lead to the decrease of the population and, consequently, to the decrease of the tax revenues.
should be mentioned as an important factor. According to the official data, approximately 6.3 thousand people emigrated from Latvia in 2009, although more than 15 thousand people from Latvia have been registered in Great Britain during a year, and this is twice as many as in 2008. Usually, highly qualified employees and young people choose to search for jobs elsewhere, and this factor deteriorates the quality of human capital in the Baltic countries. The comparison of the Eurostat data during the period from 2003 to 2012 allows concluding that the population of Estonia amounted to 1.339 million in 2012, and it was 1.3% below the level of 2003, whereas the population of Lithuania was 3.007-million, which is 13.1% below the level of 2003. The population of Latvia was 2.331-million in 2003, and since 2003, the number of population has decreased by 12.4%. In 2012, it reached the level of 2.041 million (Demographic balance ..., 2012). Lithuania and Latvia experienced the highest decline in the number of population during the reviewed period, whereas the negative development of the population is not so very pronounced in Estonia. Latvia is losing the people who could establish new companies and jobs. Moreover, tax revenues depend on the above processes. The taxation system influences also the welfare level.

The accession to the EU, Latvia took over its practice as regards the assessment of the poverty risk index and other indices. In the EU, poverty is defined as insufficient income and resources due to which a person’s standard of living is below the generally accepted level in the relevant community. In Latvia, the poverty risk index is defined as the proportion of people (percentage) whose equivalent available income is below 60% of the median of the national equivalent available income.

According to the provisional data of the survey “European Union statistics on income and living conditions (EU-SILC)” summarised by the Central Statistics Bureau (CSB), 425 thousand or 19% of people were subject to the relative poverty risk in this country in 2010 (Ekonomiska krize ..., 2012). The poverty risk index was 19% in 2004; 23% in 2005; 21% in 2006; 26% in 2007, and 26% in 2008 (Ekonomiska krize ..., 2012). The average EU index was 16%. Similar, although slightly better indices than the one of Latvia are reported by Lithuania, Estonia, Greece, Spain, and Italy. The thresholds of poverty risk differ across countries because the incomes of people differ. For example, in the Netherlands a person would be subject to the poverty risk if he/ she earned 685 LVL per month, whereas in Slovakia the corresponding threshold would be 168 LVL per month.

Based on the Eurostat data, it has been assessed that 16.3% of the EU-27 people were subject to the poverty risk in 2009. The above proportion, which has been calculated as the average weighted value of the results by countries, differs a lot in different countries. According to estimations, in the four EU Member States, i.e. in Latvia (25.7 %), in Romania (22.4 %), in Bulgaria (21.8 %), and in Lithuania (20.6 %) the poverty risk refers to more than one fifth of the people (Nabadzibas riska ..., 2011). Gini coefficient can be used for identifying the welfare level of people. It varies from zero to 100. Gini coefficient equals zero in case of absolute equality of income (i.e. all the people have the same income), and the closer it is to 100, the higher is the inequality of income. At the global level, Gini coefficient fluctuates from approximately 0.232 in Denmark to 0.707 in Namibia. In 2010, the Gini coefficient in Latvia equalled 0.352 or 35.2% (Dzīni koeficients, 2012). In 2011, the Gini coefficient in Latvia – 37.7% was above the relevant indices of Estonia (34%) and Lithuania (36%) (Baltijas valstis, 2012).

According to the survey of 2008, the Gini coefficient in Estonian was very close to the average European coefficient and maintained a relative stability in this respect, still displaying a trend towards a slight increase of the inequality. The attitude towards the manifestations of poverty in the relevant country by people of Latvia, Lithuania and Estonia differ. In Latvia, 88% of people consider that the poverty is widespread in the country, whereas in Lithuania this index is 79%, and in Estonia – 73% (Special Eurobarometer ..., 2010). The comparison of available statistical data in Latvia from the social point of view follows.

If an employee’s minimum wage amounted to 200 LVL in 2011, and there were no dependants, the net pay amounted to LVL 144.75 (200 LVL - 11% VSAOI [mandatory social insurance contribution] - 25% IIN [Personal Income Tax]), and the threshold of poverty risk amounted to LVL 146.8 according to the Eurostat data. The minimum subsistence level income in Latvia amounted to LVL 172.3 in 2011, i.e. the minimum required for a person to live.

According to the statistical data, the number of employed persons amounted to 787 017 as in January 2012, and the minimum wage was paid to 196 133 employees or 27.1% of the total number of employed persons (Darba samaksa, 2012). The number of retired persons equalled to 581 864 in the last quarter of 2011, an average monthly old age pension amounted to LVL 177.34 (Pensionaru skaits ..., 2012). This means that Latvian pensioners receive the minimum consumption basket for all the years they have worked and paid taxes. According to the statistical data, 4% of pensioners receive the pension below LVL 100, whereas 18% receive from LVL 100.1 to

<table>
<thead>
<tr>
<th>Latvian minimum monthly wage, poverty risk threshold and the minimum consumption basket</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<th>2011</th>
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<tbody>
<tr>
<td>Minimum monthly wage</td>
<td>80</td>
<td>90</td>
<td>120</td>
<td>160</td>
<td>180</td>
<td>180</td>
<td>200</td>
</tr>
<tr>
<td>Poverty risk threshold/ average</td>
<td>77.1</td>
<td>88.7</td>
<td>117.25</td>
<td>169.10</td>
<td>191.6</td>
<td>158.78</td>
<td>146.8</td>
</tr>
<tr>
<td>Minimum consumption basket/ December</td>
<td>109.8</td>
<td>121.8</td>
<td>143.0</td>
<td>168.0</td>
<td>162.7</td>
<td>168.8</td>
<td>172.3</td>
</tr>
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</table>

Table 3

**Source:** At-risk-of-poverty..., 2012; Iedživotaju ienemumi ..., 2012
Accordingly, 76% of pensioners live on the minimum consumption basket. Moreover, if the pension exceeds the threshold of LVL 165, the personal income tax is applied (LM ..., 2012). A very strange situation emerges in Latvia, although Latvian people are facing poverty.

It can be concluded from the above mentioned that poverty problems are not being solved in Latvia. Despite the high tax burden in Estonia, there is no emigration from this country; the average wage is much higher in Estonia than in Latvia, and the tax burden on Estonian people with low income is much lower than in Lithuania or Latvia. In addition, Gini coefficient in Estonia is much lower than in the other Baltic countries.

In Latvia, there is negative attitude towards the existing taxation policy and the system of taxes mainly because the distribution of taxes is not uniform, thus the principle of uniformity is not applied. When a decision on the increase of tax rates or expansion of the taxable base is taken, it is necessary to consider performed studies and figures in detail. A taxation system should encourage people to engage in economic activity and to earn a wage above the minimum subsistence level income, and the poverty risk cannot be above the minimum subsistence level income as it is revealed in the Table.

2. Analysis of particular taxes in the Baltic countries

In the Baltic countries, the taxation system consists of two types of taxes, i.e. direct and indirect taxes. Taxes can be used for exercising a direct impact upon people’s income and the purchasing ability of people. Indirect taxes are defined as a percentage added on top of a price or absolute amounts. A buyer pays the tax, which is included in the price and gives it to the seller, and the seller transfers the tax to the budget. A mediated link is established: a tax is actually paid by a buyer, and it is transferred to the budget by the seller.

The total tax revenues of the central budget amounted to 3 881.1 million LVL, which is by 439.9 million LVL or 12.8% above the level of the year 2010. The actual performance in the year 2011 exceeded the plan by 167.3 million LVL or 4.5%. In 2011, the total tax revenues of the central budget accounted for 28.0% of the estimated GDP (FM ..., 2012). The assessment of tax revenues reveals that the estimated tax revenues do not correspond to the actual tax revenues. This problem applies to almost all types of taxes. The authors consider that this problem emerges because insufficient analysis is performed before increasing or decreasing of tax rates when resolutions are adopted at the government level.

The state social insurance contributions, the revenues of the personal income tax and the corporate income tax account for the majority of the revenues of direct taxes. The social insurance contributions present the biggest tax from the point of view of revenues.

In Latvia, the value added tax (VAT) and excise tax revenues account for the majority share of the revenues from indirect taxes. The VAT revenues present an important source of revenues of the basic budget, and in 2011, they accounted for 50.9% of the tax revenues of the central basic budget (FM ..., 2012). In 2012, the major consolidation measures in the central budget in Latvia were as follows: a 15% increase of the tax rate for gambling, gambling machines, and gambling tables; and the expansion of the VAT base. Moreover, the taxable base of the property tax was expanded by including auxiliary buildings, parking lots, houses, and land plots that were owned by religious organisations, yet, not used for religion related purposes.

In 2012, the Law on Declaring the Material Status and Undeclared Income of Natural Entities adopted at
the end of 2011 influenced the tax revenues, pursuant to which the declarations of the material position had to be submitted to the SRS [State Revenue Service]. In 2012, the SRS received declarations of the material position from 130 073 natural entities, and 80 persons declared income, which was subject to the personal income tax but had not been declared before, in the amount of 2 739 402.8 LVL, and the payable tax for this amount was 410 652.14 LVL (Nulles deklaracijas ..., 2012). The Law provided an opportunity to declare the taxable income, which had not been declared before for improving the monitoring of a person’s financial position.

Direct taxes and social contributions account for the highest share in the tax revenues of the central budget of Lithuania. In 2009, the proportion of direct taxes decreased, and the state social contributions increased. In the course of fighting the central budget deficit, Lithuania, similarly to its neighbouring country Latvia, implemented considerable changes in the taxation system, for example, as regards the tax of private vehicles (cars, motorcycles, yachts, and horses), implementation of the progressive personal income tax, the increase of the corporate income tax from 15% currently to 20%, and the tax for the interest income (Lietuvas nodoklu ..., 2012). In 2010, the Lithuanian central government received 49.19% of the total tax revenues, which is considerably below the EU average level (58.8%). Municipalities received 11.8% of the total tax revenues, which is above the EU average index (10.6%) (Eurostat ..., 2012). Despite all the above changes, the Lithuanian taxation system has maintained its competitiveness, and its tax burden is comparatively low.

In Estonia, similar to many other new Member States, the proportion of direct taxes jointly with social contributions within the total tax revenues is quite high. Social insurance contributions account for an important share within the total tax revenues. In 2010, the proportion of indirect taxes decreased. Local municipalities receive 13.4% of tax revenues, which is the seventh highest index among the EU-27 countries. The revenues of the central government equal to 67.9% of the total tax revenues (Eurostat ..., 2012). In Estonia, there is established a quite a simple taxation system. In order to maintain the simplicity, transparency and easiness of use of the system, just few exemptions were allowed, however, at the same time tax rates were kept quite low.

Upon facing a high central budget deficit in 2008-2010, during the recession, the Estonian government needed to raise several taxes, including the value added tax (VAT) and the excise tax. However, the Estonian taxation system can still offer various advantages to foreign investors in addition to the fact that this system is easy to understand and easy to handle.

### Personal income tax

Personal income tax is among the main direct taxes in the Baltic countries. In Latvia, the personal income tax rate equals to 25%. Whereas, 15% rate is applied to the capital increase, and 10% tax rate is applied to other income from capital (e.g. dividends, interest payments, etc.). PIT is reduced for the incurred expenses for medical treatment and education. Estonia is among the Member States where a uniform PIT rate is applied. The uniform tax rate of 21% has been applied since 2008, and it is applied to all kinds of income from employment and personal capital (dividends, interest, capital increase, royalties, etc.). The untaxed minimum income and the income tax rate have been stable since 2008, and this has contributed to the collection of tax revenues. Mortgage interest payments and tuition fees may be deducted from the taxable income. The personal income tax is divided between the central and local government. The local government receives 11.4% of the tax revenues; the rest is transferred to the central government budget. The central government is entitled to receive the whole amount of income tax paid by non-residents and residents from their pensions and the capital increase.

In the Lithuanian budget, labour taxes present the most important source of revenues and account for approximately 50% of all the tax revenues. The PIT is applied to various kinds of income in Lithuania. Several kinds of income (various kinds of pensions, some insurance bonuses, heritages and gifts, various interest income, sailors’ income, small farms, scholarships, etc.) are released from the taxation. Capital income is taxed at 15%, still there are various exceptions. Income gained by alienating a property is released from taxation if the owner has been residing in the relevant property for at least three years (or two years if the sale refers to the owner’s main residence, or if the income is used for buying a property in Lithuania or another EU country within a year’s time).

### Corporate income tax

Under the conditions of the economic downturn, the revenues of the corporate income tax (CIT) have decreased considerably in all the Baltic countries because the profit has decreased, for example, in Latvia the revenues have decreased 4.5 times, in Lithuania...
2.5 times, and in Estonia by 50%. It should be taken into account that in Estonia the CIT has to be paid only if the profit is distributed as dividends. In Latvia, when new technological equipment is purchased, its value is increased by 50% (coefficient 1.5 is applied) for the purpose of assessing the CIT. In Lithuania, the income subject to the CIT may be reduced by the expenditure which has been incurred because of purchasing factory buildings, equipment, etc., however, this reduction may not exceed 50% of the CIT.

The advantage of taxing the corporate income only when the profit is withdrawn from a company presents the most important advantage.

In Latvia, the CIT is among the lowest ones in the EU and amounts to 15%. During the period from 2001 to 2004, the rate was gradually lowered from 25% to 15%. As of 2011, Latvia has introduced a 9% tax rate for small micro companies with revenues not exceeding 100 000 EUR per year and employing up to five employees.

In Lithuania, the general uniform rate is 15%. As of 1 January 2012, 5% CIT rate was applied to business companies employing up to 10 persons and with the turnover below 1 million LTL (289 500 EUR) (the preceding threshold was 500 000 LTL).

### State social insurance mandatory contributions

The Estonian social provisions are funded mainly by the social tax paid by employers; usually its rate equals 33% of the gross wage for each employed person. Self-employed persons also pay the social tax. Employees who have joined the second tier of pensions (it is mandatory for everybody born after 1983) have to pay additional 2%, which is transferred to the personal pension account. In this case, the split of the 20% pension insurance system is as follows: 16% from the state pension insurance system (the first pillar) and 4% from the mandatory funded pension system (the second pillar). The social tax, comparable to the employer’s mandatory social insurance contributions in other countries, is an important tax in Estonia from the fiscal point of view. In 2010, these contributions accounted for 35.6% of the total tax revenue, and this has been the highest proportion in the EU until now. Whereas, the employees’ social contributions accounted for mere 2.4% of the tax revenues (Eurostat ..., 2012).

In Lithuania, social insurance contributions currently amount to 30.8%, of which 27.8% are contributed by the employer and 3.0% by the employee. During the period from 1 August 2010 to 31 July 2012, in Lithuania the share of the social tax payments for the pension insurance was reduced for the employers who employed a person who had never been employed before and who received a low wage (up to 700 EUR) for a period of one year. Therefore, the employer saved 23.3%, and the employee saved 3% of the total payment of 31% and 9% accordingly and paid 7.7% and 6% social tax accordingly.

### 3. Tax discipline

The fighting against a very high proportion of shadow economy should be among the tasks to be solved by the government. Therefore, whistleblower programmes have been introduced in the USA. Within such a programme, the government institutions would offer an attractive remuneration to persons who report on fraudulent transactions. The remuneration has to be high enough for justifying the risk. In addition, confidentiality of these persons has to be provided, and they have to be protected against eventual repressions by their employer. It is interesting to note that this practice was intended to be implemented in Lithuania in 2010. A bonus, which may amount even up to 10% of the identified transaction value,
however, not exceeding 100 000 LTL (approximately 20 000 LVL) would be paid to every reporter. The resolutions on the payment of bonuses would be adopted by a special committee appointed by the Prime Minister in cooperation with the Ministries of Finance and Interior.

In Lithuania, the Law on the Release of the Bad Debts of VAT payments entered into force on 1 January 2012: if it has not been possible to recover a debt within 12 months and the status of the bad debt is proved, a business is entitled to correct the assessed payable VAT amount. It should be noted that this rule applies to payable VAT amounts for goods (services) sold as of the beginning of 2012.

In Estonia, the issue of tax discipline is studied by the Institute of Sectors. The Estonian Tax and Customs Board summarises the data on shadow economy, including the trends of payment of the excise tax, "envelope wages" and others based upon the individual reports received from each institution, and develops the general report on the proportion of the "grey sector" regarding each tax. Based on this analysis, it develops recommendations of what should be done for improving the collection of each tax. The latest assessment amounted to approximately 337 million LVL. This is the amount of unpaid tax, mainly on the account of the value added tax. This figure corresponds to approximately 3.6% of the gross domestic product (GDP); these are losses from tax revenues. There are no accurate assessments, we consider that the total proportion of the shadow economy amounts to somewhere between 10-20% of the GDP (Graudins ... 2012).

In Latvia, pursuant to Section 25 of the Law "On Taxes and Duties", debts and also related penalties and late payment penalties are cancelled for bankrupt companies, companies that have not applied for entering in the Commercial Register, individual (family) companies, also farms and fisheries in case of the death of their founder-owner, for natural entities in case of their death, and for taxpayers if the resolution on the recovery of delayed tax payments has lost its validity. During 11 months of 2011, the cancelled amounts of budget debts totally amount to 117 999.4 LVL (Informacija ... 2011). The VAT accounts for the highest share therein, i.e. 76.66%.

In Estonia, the amounts of tax debts are not cancelled, their payments are deferred instead. It means that the deadline of settling the payment is extended in Estonia. The revenues service prefers to agree with a business on a deferred payment instead of seeing this business going bankrupt (Graudins U., 2011). In Estonia, this opportunity was utilised by numerous companies, which would have gone bankrupt. In 2009, the financing earmarked for the revenue service was not reduced when the Estonian government reduced the central budget expenditure. We increase the financing for the service to ensure better fighting against the shadow economy. The Estonian revenue service was among the few institutions to whom more financing was allocated, and it could employ more people. During its daily operations, this institution focuses mainly of the big debtors. The payment of taxes has been simplified thanks to the use of electronic means of communication.

Conclusions, proposals, recommendations

1. In the course of creating the taxation mechanism, the Baltic countries have different approaches to the tax burden on legal and natural entities, the taxation policy compliant with the structure of manufacturing and households. Moreover, the principles of imposing taxes are different in each country.

2. In Latvia, the estimated tax revenues do not correspond to the actual tax revenues. This problem applies to almost all types of taxes. The authors consider that this problem emerges because insufficient analysis is performed before the increasing or decreasing of tax rates.

3. Under the impact of the globalisation process, the capital is becoming much more mobile and it can outflow from the country if it does not implement the required measures in the taxation area for the attraction of the capital. The globalisation results in a risk of decreasing tax revenues because the tax competition between countries is intensifying, new and much more extensive opportunities of tax evasion emerge, and other problems appear. Therefore, countries have to be prepared to accept this new policy and to gain maximum benefit from it as well as to implement required measures for minimising the harmful impact of taxes mobilisation.

4. The Latvian taxation system does not solve poverty issues. In Latvia, the reduced VAT rate on food products should be introduced for minimising the inequality between various groups of people.

5. The Ministry of Finance of the Republic of Latvia should introduce a clear taxation policy with defined long-term goals related to the harmonisation of the EU single market and encouragement of sustainable development. Unjustified and too frequent change of tax rates causes people’s distrust of the government. The proportion of indirect taxes within the tax revenues should be increased to make the taxation system more flexible and responsive to changes in the economic growth. It is necessary to provide a clear review of the utilisation of collected taxes.

6. The motivation of taxpayers is related to the manner of spending the taxpayers’ money by the government. If money is wasted, taxpayers will not be motivated to pay taxes. The motivation of taxpayers is related to the size of tax rates and the taxable base.

7. Tax evasion depends on the development level of the country and the institutional environment. The high proportion of the shadow economy, which was caused mainly not by too high tax rates, but by the low morale of tax payment, has been established due to the impact of historical aspects and due to the lack of information. The tax amounts assessed by the SRS cannot be collected; therefore, it is necessary to introduce a uniform payment for each business.

8. In the course of improving the taxation system, the regulating (encouraging) function of taxes should be given a priority. It should be used for speeding up the economic development, in the result of which the
budget revenues will increase (the fiscal function). Therefore, the development of manufacturing based on innovations and new technologies in all the sectors of the national economy should be set as the strategic goal of the Latvian taxation policy for the next 5-10 years.

9. Labour taxes have to be lowered considerably. The reduction of rates will not result in the decrease of budget revenues because those who have been unofficially employed will start to pay taxes and the “envelope payments of wages” will decrease.

10. Relieves of the personal income tax and mandatory social contributions have to be applied to taxpayers who start to work in rural districts and small towns, in depressed regions, and in newly established companies.

11. Tax relieves should be used for encouraging the increase of the birth rate and lowering the emigration.

12. Relieves of the corporate income tax should be granted to newly established companies: during the first three years a company should be released of this tax payment, more frequent tax settlement terms and lower amounts of payments have to be set.

13. When taxes are low in Latvia, the environment will be favourable for foreign investors for building big production facilities and manufacturing products in Latvia, people will have jobs, and there will be money in the central budget.

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