

ASSESSMENT OF AGRICULTURAL TAX BURDEN IN LATVIA

Inguna Leibus¹, Dr.oec., professor,

¹Latvia University of Agriculture

Abstract. No preferential tax regime for agriculture is imposed in Latvia. Farmers pay the same taxes as entities from other economic sectors; though, tax reliefs are applied to substantially reduce tax payments made by farmers to the budget. Therefore, the tax burden in agricultural sector is significantly lower than the general tax burden in Latvia. Nevertheless, it increases faster irrespective of many tax reliefs. The research **aim** is to study the dynamics and structure of tax payments in agriculture of Latvia to identify factors promoting the increase of tax burden. Result of the research concluded that the tax burden in agriculture grows at expense of production or production prime costs impacting taxes, while the capital tax burden decreases in the recent years. The planned inclusion of subsidies into the taxable income will increase budget revenues from capital taxes; thus, allowing to decrease labour taxes further leaving an impact on the prime cost of agricultural produce and enhancing the competitiveness of agricultural products produced by Latvia's farmers.

Key words: agricultural taxation, tax reliefs, agricultural tax burden.

JEL Code: H26, Q14

Introduction

Latvia's farmers shall be competitive compared with the neighbouring countries. The application of tax reliefs is one of the key fiscal instruments to support a particular sector. There is no specifically designed agricultural taxation system in Latvia as farmers pay the same taxes as entrepreneurs from other sectors; however, farmers receive very substantial tax reliefs. Nevertheless, the annual tax burden in agriculture has increased for the past years. The research **aim** is to study the dynamics and structure of tax payments in agriculture of Latvia to identify factors promoting the increase of tax burden. The advanced **hypothesis** – increase in the tax burden on agriculture in Latvia is primarily caused by an increase in the tax burden on labour. The following **tasks** are set for the research: to analyse the changes in legal status of taxpayers in agricultural sector, to analyse the structural changes of tax payments in agricultural sector and to study the impact of tax reliefs on the agricultural tax burden.

The research employs monographic and descriptive statistical methods and covers the period from 2005 to 2015, though, in some cases the period is shorter due to the insufficiency of the data.

Research results and discussion

In recent years, there have been relatively few research on agricultural taxation, and the existing studies basically focus on developing countries, where agriculture occupies a very large proportion of GDP. It is recognized that the tax ratio is lower in those countries where the share of agriculture in GDP is higher, since countries apply tax exemption to a large part of agricultural activities due to political reasons (Brun, Diakite, 2016).

The EU agricultural taxation is more researched by the scientists of new Member States, which can be explained by a more significant role of agriculture in GDP of these countries. Polish researchers Soliwoda and Pawlowska-Tuszko when comparing agricultural taxes divide the EU Member States into three groups: 1) countries with special preferential taxation system for agriculture; 2) countries with limited preferences directed to agriculture; and 3) countries with systems without tax preferences for agriculture (Soliwoda, Pawlowska-Tyszko, 2014). Consistent with this division, Latvia is a country with essential preferential taxation system for agriculture. Poland and Lithuania, the neighbouring countries of Latvia, in turn, had a preferential taxation system for agriculture, and these countries have implemented significant tax reforms particularly

¹ Corresponding author. Tel.: + 37129458010 E-mail address: inguna.leibus@llu.lv

in recent years to include agriculture in the single taxation system. However, according to Lithuanian scientists, the tax reform has caused higher tax calculation costs than the increase of agricultural tax burden (Slavickiene, Savickiene, 2013). The comparison of tax burden in agricultural enterprises of different size has allowed Lithuanian colleagues to conclude that small and medium size farms have higher tax burden (Miceikiene, Girdziute, 2016). Similar situation is identified also in Latvia – tax burden decreases with the sales increase of a farm (Leibus, Irmeja, 2014). It is worth mentioning that recently tax legislation has been improved in Latvia – a number of measures have been undertaken to harmonise tax rules and to ensure higher fairness particularly in the agricultural sector.

Both legal entities (limited liability and joint-stock companies characteristic with an owner's limited liability) and natural entities (household farms and individual merchants, which have a full owner's liability) operate in the agricultural sector in Latvia. There is still a high proportion of farms with statutory legal entity status but given an owner's full responsibility they are more considered as natural entities. The breakdown of all agricultural companies by type of income tax – either payers of corporate income tax (CIT) or personal income tax (PIT) – is more appropriate for the analysis of taxes than the breakdown by legal status. Unfortunately, no data are gathered according to such breakdown. In Latvia, small farms (annual income below EUR 300 thou.) may freely choose the type of income tax; in addition, it may be changed every calendar year. It was very expressive in 2010-2012, when the payment of CIT (lower income tax rate, subsidies being tax exempt) was more profitable for agricultural companies; hence, many farms were registered as CIT payers. A tendency to re-establish the

status of PIT payer by employing its advantages (easier accounting, no additional income tax payments on an owner's personal consumption) is observed for the past years.

Between 1991 and 2016 or within the period when Latvia regained its independence, the Enterprise Register of the Republic of Latvia has registered 38.4 thousand farms, of which 11.5 thousand farms or 30 % have been liquidated; this means that 26.9 thousand farms are still registered hereof. An intensive liquidation of farms started in 2014 with the introduction of a minimum annual income tax payment of EUR 50. The minimum tax introduction was aimed to reduce the number of inactive companies. Though, a proportional increase of active agricultural companies is not observed, since the number of economically active units has also significantly decreased (Table 1), i.e. by 15.6 % within 10 years. The largest decrease relates to farms (30.4 %) due to legal deficiencies of farm status in Latvia or the contradiction between the legal status of a farm and the full material liability of an owner. Still the majority of farmers perform active agricultural activities under the status of self-employed persons (51.5 % in 2015), i.e. registering themselves as taxpayers by the State Revenue Service (SRS) without registering a company. This reflects the high proportion of small agricultural companies. However, the number and proportion of self-employed persons shows a decreasing tendency (by 19.7 % and 2.6 percentage points (pp) respectively). The number and proportion of individual merchants increase; yet, it is relatively small as the legislation of Latvia does not prescribe a compulsory registration of a merchant in case of small-scale economic activities (with an annual turnover below EUR 300 thou.).

Table 1

Economically active agricultural units and their breakdown by legal status in Latvia

Legal status	Type of income tax	2005		2010		2015		Changes 2015/2005, %
		Number	%	Number	%	Number	%	
Commercial companies	CIT	1465	4.5	1957	6.4	3440	12.6	+134.8
Individual merchants	PIT	112	0.3	528	1.7	555	2.0	+395.5
Self-employed	PIT	17457	54.1	16226	52.7	14019	51.5	-19.7
Farms	PIT/CIT	13219	41.0	12100	39.3	9207	33.8	-30.4
Total	-	32253	100.0	30811	100.0	27221	100.0	-15.6

Source: the CSB data, 2016

Tax payments made by agricultural producers to the state budget increase with every year contrary to the reduction in the number of active agricultural companies (Table 2); thus, in 2015, tax payments have grown more than 2.67 times or 167.2 % compared with 2011. The only exception was the year 2014, which was very

unfavourable for crop farming. According to the SRS data, in 2015, the farmers have paid almost EUR 77.9 million to the state budget. Yet, this figure excludes immovable property tax payments on land paid to the budget of local governments and taxes related with the use of vehicles.

Table 2

The state budget revenues from agricultural producers in Latvia, thou. EUR

Type of tax	2011	2012	2013	2014	2015	Share 2015, %	Changes, 2015/2011, %
PIT	14050.7	16441.8	19000.6	13980.8	22746.5	29.2	+61.9
CIT	2247.2	1785.2	7099.1	1493.7	1386.1	1.8	-38.3
MSSIC	28033.1	31165.3	37722.2	26165.3	41553.4	53.3	+48.2
VAT	-16228.0	-4480.9	6145.9	6444.7	11579.8	14.9	+171.4
Excise	565.3	708.2	722.2	127.6	39.5	0.1	-93.0
Natural resource	370.6	361.0	441.6	322.4	525.3	0.7	+41.7
Customs	113.1	132.9	91.0	28.0	61.6	0.1	-45.5
Total	29152.0	46113.5	71222.5	48562.6	77892.1	100.0	+167.2

Source: the SRS data, 2016

Value added tax (VAT) payments have increased most essentially (171.4 %) with the crop farming primarily ensuring the growth. Negative VAT revenues in 2011 and 2012 mean that farmers have received refund of the input VAT more than they have calculated VAT on their products. This was caused by large agricultural investments made in previous years, and the changed procedure for VAT refunds in 2011, since the overpaid VAT accrued within the previous three years was repaid hereof. In addition, a significant decrease of VAT payments is forecasted already starting from 2016 due to

the introduction of VAT reverse charge procedure for cereals.

Labour taxes, mandatory state social insurance contributions (MSSIC) and PIT constitute the highest proportions of taxes in agriculture. Increase of labour taxes is related with the average wage increase in the sector, for example, from EUR 394 in 2012 to EUR 501 in 2015 or 27.1 %. Although the wage in agricultural sector is lagging behind the national average, the difference decreases with every year: in 2012, the wage in agriculture constituted 59.7 %, while in 2015 - 63.3 % of the average

wage in the country. This fact should be assessed positively. Moreover, the average hourly rate difference is even smaller; hence, in 2015, it was 5.51 EUR/hour in the country, while in agriculture the respective figure was 4.05 EUR/hour (the SRS data) or 73.5 % of the national average. One can predict that the labour tax payments and their proportion will rise in the coming years simultaneously with the necessity to attract more skilled labour force in agriculture.

Growth of the natural resource tax in agriculture (41.7 %) is caused by a more intensive economic activity and increase in the natural resource tax rate that will also continue in the coming years.

The largest agricultural companies also carry out CIT payments, though, their share is relatively small (1.8 % in 2015), and it decreases

with every year. This is due to significant tax reliefs for farmers (tax exempt subsidies, tax reliefs for utilised agricultural area (UAA), the possibility of covering losses of the previous years).

Irrespective of the output, the immovable property tax payments on land are essential for every farmer; furthermore these tax payments annually increase but the data on tax payments by sectors are not available.

In recent years (2012-2015), the SRS summarises and publishes data on tax revenues broken down by sectors consistent with the NACE classification. Such breakdown allows analysing the tax burden (proportion of calculated basic taxes vs. sales) and its changes in agriculture (Table 3).

Table 3

Basic tax burden in agriculture in Latvia (NACE 01), %

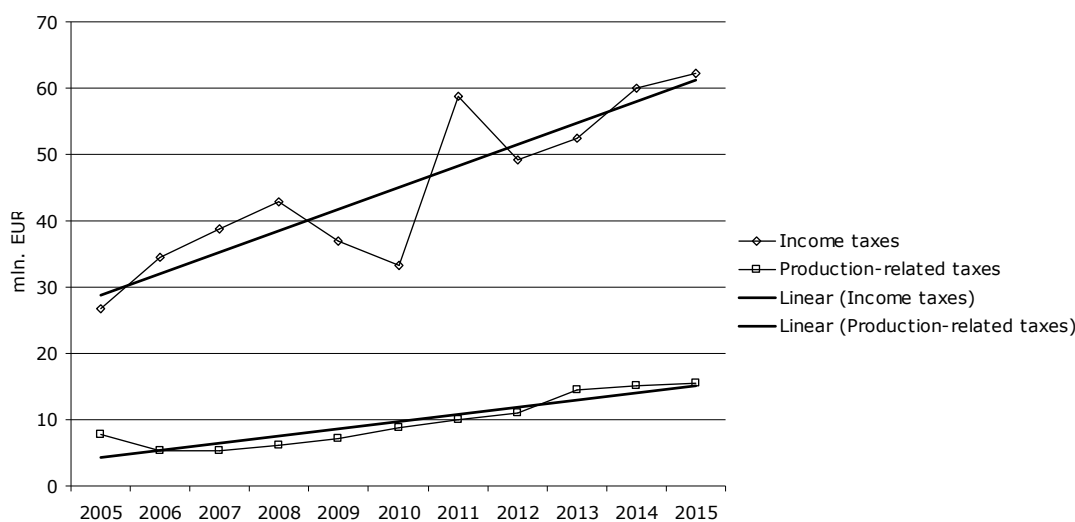
Year	VAT payments	VAT repayments	MSSIC	PIT from wages	PIT from economic activities	CIT	MET	Total
2012	5.70	-5.27	2.53	1.19	0.46	0.47	0.03	5.10
2013	5.95	-5.2	2.97	1.38	0.26	0.32	0.04	5.68
2014	5.87	-4.77	3.32	1.51	0.35	0.21	0.04	6.53
2015	6.65	-5.24	3.38	1.53	0.37	0.23	0.03	6.95
Changes, pp	+0.95	-0.03	+0.85	+0.34	-0.09	-0.24	0.00	+1.85

Source: the SRS data, 2016

The basic tax burden in agriculture increases with every year, i.e. in the period of 2012-2015, the increase accounted for 1.85 pp or 0.62 pp annually on average. As noted above, the largest increase in the tax burden is due to the growth of labour taxes and VAT. In contrast, operating income or profit tax burden tends to decrease: PIT by 0.09 pp and CIT – 0.24 pp, which manifests the low level of income or profit in agriculture as well as substantial income tax reliefs for farmers.

The Ministry of Agriculture annually calculates the amount of production and income taxes in agricultural sector when analysing the changes of value added and income in agriculture (Latvijas

lauksaimniecība, 2016). The Ministry of Agriculture calculations (Figure 1) demonstrate that the amount of income taxes in agriculture exceeds the amount of production taxes more than three times. Besides, income taxes grow more rapidly than production taxes. In fact, income taxes also include labour taxes hereof. It is believed that attributing of labour taxes to production costs would be more appropriate, since paid labour force compared with the work of own family members plays a more significant role in agriculture with every year. Consequently, taxes on labour have an increasingly higher impact on the prime cost of agricultural produce.



Source: Latvijas lauksaimniecība, 2016

Fig. 1. Production and income taxes in agriculture in Latvia, mln EUR

Tax reliefs, which are also called tax expenditure, play an essential role in agriculture. Tax expenditure are any incentive that reduces the amount of tax owed by a group of taxpayers compared with other taxpayers. Tax expenditure may express itself through exclusions from the taxable base, tax-exempt minimums, preferential tax rates, deferral of tax liability, tax credits etc. In Latvia, farmers pay taxes consistent with the general procedure, i.e. there are no special taxes for farmers; though, significant tax reliefs are applied for the agricultural sector (Table 4).

In total, there are 15 taxes in Latvia, of which eight taxes prescribe various reliefs for farmers. These tax reliefs substantially reduce agricultural tax burden. In addition, reliefs are applied both to income and production taxes.

The most fundamental tax reliefs for agriculture (Table 5) refer to a preferential excise tax for diesel fuel (EUR 36.9 mln in 2015), which is 2.1 times more compared with 2010.

Substantial amendments to excise tax reliefs for farmers were done in 2015: 1) tax exemption was substituted by a reduced excise tax 50 EUR/tonne (341 EUR/tonne in general case); 2) relief is attributed also to animal husbandry; 3) differentiated tax relief amount for diverse sectors. Nevertheless, the introduced amendments to the excise tax rates have not reduced the overall tax relief amount for farmers.

Table 4

Tax reliefs in agriculture in Latvia

Type of tax	Reliefs for farmers
CIT	1) tax-exempt object – subsidies for agriculture and rural development (till 31.12.18); 2) tax relief – 14.23 EUR/ha for cultivated UAA
PIT	Tax-exempt objects: 1) subsidies for agriculture and rural development (till 31.12.18); 2) income from agriculture and rural development ≤ 3000 EUR/per year
MSSIC	Self-employed farmers of retirement age, disabled persons of Groups 1 and 2
Labour taxes	In crop farming, smaller tax is paid for seasonal agricultural workers - 15 % of gross wage (of which 10 % are redistributed as PIT and 90 % as MSSIC)
VAT	Entities not paying VAT receive a 14 % compensation on agricultural produce supplied to processing companies
Excise	Lower tax rate 50 EUR/t is paid for diesel fuel
IPT	A tax on agricultural land is paid from a special value to limit an annual tax increase ≤ 10 % per year
VOT	For trucks farmers pay 25 % of the tax amount
CCT	Exempt from tax on vehicles (cars)

IPT - Immovable property tax, VOT - Vehicle operation tax, CCT - Company car tax

Source: author's construction based on the tax laws of the Republic of Latvia

Unlike most of the EU Member States, special VAT exemptions are not applicable for agricultural produce in Latvia. The only exception is the reduced VAT rate (12 %) for the supplies of specialised food products intended for infants, for example, milk and dairy products, soy

products, fruit, berry and vegetable juices, squashes and purees; special easily digestible meat products and homogenised mixed-ingredient products; drinks for infant nutrition etc. A VAT compensation paid by a processor of agricultural produce to a farmer who is not a VAT payer is a material VAT relief in agriculture. The compensation is paid in the amount of 14 % of the value of sold produce. In 2015, farmers received EUR 7.9 mln as VAT compensations, i.e. 1.4 times more compared with 2010 (Table 5). Increase of the VAT registration threshold 3.5 times in 2011 enhanced the growth of VAT compensation payments. Hence, the number of VAT payers in the sector decreased and a greater number of farmers were able to receive a VAT refund, as they were no longer entitled to the input VAT.

Table 5

Tax reliefs for agriculture in Latvia, mln EUR

Type of tax relief	2010	2011	2012	2013	2014	2015	2015/ 2010
VAT compensation 14 %	5.7	7.2	8.3	8.3	8.2	7.9	1.4
Excise tax cut	17.2	17.2	33.9	36.3	34.1	36.9	2.1
CIT relief for UAA	2.0	1.6	3.4	2.2	1.3	2.6	1.3
CIT exemption for subsidies	n.d.	16.0	17.2	14.3	16.1	14.7	-
Income gained from agriculture and rural development and not taxed by PIT	n.d.	n.d.	10.1	4.1	3.9	3.7	-

Source: Latvijas lauksaimniecība, 2016; Likuma "Par valsts ..., 2017

Significant CIT reliefs for agriculture include the following aspects: 1) CIT is not imposed on subsidies, thus, reducing the CIT payments by EUR 14.7 million in 2015; and 2) the CIT relief for UAA equalling to EUR 2.6 million (Table 5). The CIT relief amount varies every year, as it greatly depends on the industry earnings and the

number of CIT payers. In addition, farmers also employ general CIT reliefs, for example, reduction of CIT taxable income for the previous years' losses, tax benefits for investment and donations.

Small-scale farmers (annual turnover below EUR 300 thou.) receive a PIT relief by applying a non-taxable minimum to an income from agriculture and rural tourism (EUR 3000 per year). In 2015, this relief reduced PIT payments to farmers by EUR 3.7 mln (Table 5). Exemption of subsidies from taxes constitute a substantial PIT reliefs in agriculture (similar with CIT); there are no data on the amount of relief.

Farmers receive significant tax incentives for vehicles, for example, in 2015 the vehicle operation tax relief was EUR 0.3 mln and the company car tax relief equalled to EUR 1.4 mln (Likuma "Par valsts ..., 2017).

A tax relief for the employment of seasonal agricultural workers is being applied in agriculture from 2014 (Table 4). For these workers employers shall not pay taxes consistent with the general procedure, when tax amount may even exceed 50 % of gross wage but instead a seasonal agricultural worker income tax is paid, which amounts to 15 % of calculated gross wage and includes both labour taxes – PIT and MSSIC (Table 4). Such procedure essentially facilitates the employment of seasonal agricultural workers and reduces tax payments on low-skilled labour force. There are no data on the scale of tax incentive use; however, it may be estimated that relatively few farmers use this type of tax relief. In August 2016, only 445 workers (the SRS data) were employed as seasonal agricultural workers, which is approximately 2 % of people employed in agriculture. Moreover, the introduction of this tax incentive was aimed at reduction of illegal employment not reduction of tax burden.

An immovable property tax relief on agricultural land is being applied from 2016. The tax calculation is based on the property cadastral

value, which has sharply increased for agricultural land – in 2016, the growth amounted to 29 % on average or even 70 % in some places compared with 2015. The value increase was primarily due to the activation of land market. The next ten years the immovable property tax on agricultural land will be calculated from specially calculated value instead of the cadastral value to slow down the rapid growth of tax. This is done to ensure an annual tax increase by not more than 10 %. This tax relief is applied to approximately 53.3 % of rural land units. Therefore, immovable property tax payments will grow for farmers with every year irrespective of the limited tax increase.

Conclusions, proposals, recommendations

- 1) No preferential tax regime for agriculture is imposed in Latvia. Farmers pay the same taxes as entities from other economic sectors; though, tax reliefs are applied to substantially reduce tax payments made by farmers to the budget. The neighbouring countries Lithuania and Poland have undertaken agricultural tax system reforms to include farmers into the single tax system.
- 2) The tax burden in the agricultural sector is significantly lower than the general tax burden in Latvia. Nevertheless, the increase of tax burden in agriculture is faster irrespective of many tax reliefs.

Bibliography

1. Brun, J. F., Diakite, M. (2016). *Tax Potential and Tax Effort: An Empirical Estimation for Non-resource Tax Revenue and VAT's Revenue*, Etudes et Documents, No.10, CERDI., p.10
2. CSP dati (2016). (*Data of Central Statistical Bureau of Latvia*). Retrieved: <http://data.csb.gov.lv>. Access: 04.01.2017.
3. *Latvijas lauksaimniecība* (2016) (Agriculture of Latvia). Latvijas Republikas Zemkopības ministrija. Retrieved: https://www.zm.gov.lv/public/files/CMS_Static_Page_Doc/00/00/00/90/30/fs-01userslinda.birinaDesktopAA2016_lauksaimniecibasgadazinojums.pdf. Access: 07.01.2017.
4. Leibus I., Irmeja A. (2014) Tax Payments of Agricultural Sector in Latvia *Economic Science for Rural Development*, Jelgava, No. 33, p.132-141.
5. *Likuma "Par valsts budzetu 2017.gadam" paskaidrojumi* (2017) (Law "On State Budget 2017" explanations), Retrieved: http://fm.gov.lv/files/valstsbudzets/FMPask_H_100217_bud2017.pdf. Access: 10.02.2017.
6. *Lursoft dati* (2016) (Lursoft Data). Retrieved: <http://www.lursoft.lv/lursoft-statistika/Uznamejdarbibas-formas>. Access: 07.01.2017.
7. Miceikiene, A., Girdziute, L. (2016). Farmers' economic viability assessment in the context of taxation and support. *The Agri-Food Value Chain: Challenges for Natural Resources Management and Society*, pp.350-360.
8. Slavickiene, A., Savickiene, J. (2013). Assessment of the principles of family holding taxation. *Intelektine ekonomika*, 7 (1), pp.86-100.
9. Soliwoda, M., Pawlowska-Tyszko, J. (2014). Agricultural Taxation in Poland vs. Solutions in Selected EU Countries. *Economic Science for Rural Development Conference Proceedings* No. 33., pp.99-107
10. VID dati (2016). (*Data of SRS*). Retrieved: <https://www.vid.gov.lv>. Access: 04.01.2017.

- 3) The increase of agricultural tax burden is mainly due to the average wage growth in the industry, which outpaces the average indicators of Latvia, and the increase of agricultural land cadastral value, which leads to the immovable property tax growth. The increase of natural resource tax payments is also forecasted due to the tax rate growth.
- 4) A significant decline of the agricultural sector VAT payments is forecasted in the coming years, since a VAT reverse charge mechanism has been introduced in grain farming, which is one of the largest agricultural sectors in Latvia.
- 5) It is negative that the tax burden in agriculture grows at expense of production or production prime costs impacting taxes, while the capital tax burden decreases in the recent years. The planned inclusion of subsidies into the taxable income (PIT for small-scale farmers and CIT for large farmers) from 2018 will increase budget revenues from capital taxes; thus, allowing to decrease labour taxes further leaving an impact on the prime cost of agricultural produce and enhancing the competitiveness of agricultural products produced by Latvia's farmers.