

The instability of taxation policy in Latvia as a deterrent to the successful development of micro business

E Sventitskaya¹, Yu Kochetkov^{1, 2*}

¹Baltic International Academy, Lomonosova Str. 4, LV-1019 Riga, Latvia

²Institute of Mathematical Sciences and Information Technologies, Liepaya University, Liela Str. 14, LV-3401 Liepaya, Latvia

*Corresponding author's e-mail: Juris.Kocetkovs@rtu.lv



Abstract

The goal of the research is to analyse some aspects of formation of the taxation system, the sector of economically active self-employed persons in Latvia and their provision with social guarantees, as well as evaluate the opportunity of applying a uniform tax to micro businesses. Small business is the most important driving force behind the development of the economy and the society as a whole. State aid to entrepreneurs working in this field is necessary and urgent. In 2010, Latvia adopted the Law on Micro-enterprise Tax aimed at creating favourable conditions for business development. However, in subsequent years, the Law has been changed many times. To enable the sustainable development of economy, increase employment, reduce social tension and emigration, effective laws should be stable in the country. Micro businesses need a uniform tax, which includes deductions for social protection.

Keywords: taxation policy, micro business, uniform tax

1 Introduction

Changes in the economic situation of Latvia have given rise to entrepreneurial activity of the population. One manifestation of this activity is the rise in the number of micro businesses and self-employment, which have had a significant impact on the creation of a competitive environment and satisfaction of people's needs for goods and services. State aid to entrepreneurs working in this field is necessary and urgent. At all stages of economic development of the country, nation-wide tasks have two almost opposite goals – full employment and an increase in real income of the population, on the one hand, and the collection of taxes to ensure the country's activity, on the other hand. The both goals are directly related to the economic security of the country. Search for balance between these parameters is performed by countries in different ways at all stages of economic development. The goal of the research is to analyse some aspects of formation of the taxation system, the sector of economically active self-employed persons in Latvia and their provision with social guarantees, as well as evaluate the opportunity of applying a uniform tax to micro businesses.

2 Analysis of situation

According to J. Keynes, rapid economic growth will ensure only the active state intervention in the national economy and the active manipulation of taxes. In the period of economic recession for the revival of economic growth, it is necessary to reduce taxes, provide more benefits and create appropriate tax regimes. In the period of economic growth, to prevent the onset of the overproduction crisis, on the

contrary, it is necessary to raise tax rates and reduce benefits. The 1980s marked the beginning of the theory of supply-side economics developed by A. Laffer and M. Feldstein, who opposed the active role of the state in economic regulation. The main focus of this theory is the reduction of tax burden to stimulate economic growth. In order to increase the pace of economic development, the second step is the employment of unemployed active population of the country. The population employment issue is always of major importance. All over the world, small business is the most important driving force behind the development of the economy and the society as a whole. At present, when Latvia as well as the whole world is experiencing economic slowdown, the small and micro businesses have taken the brunt of the protracted economic crisis [1].

In Latvia, the number of the registered self-employed persons increased by 36.8% in the period from 2010 to 2015. Self-employed persons make up 10.6% of the country's active age population aged 20 to 64 years [2]. This study does not include business persons that have registered their activity in the Register of Enterprises, receiving the status of a legal entity. The number of self-employed persons able to provide themselves with at least minimum social guarantees decreased in the period under review (calculated according to the CSB of Latvia) (Figure 1).

According to statistics, even in case of active participation of entrepreneurs to provide themselves with the means of existence, the income of many entrepreneurs was at a minimum level that either resulted in the fact that social security contributions were not paid to the state budget or the lion's share of business was withdrawn into the shadows. There are many causes of such deplorable results and the main one is high tax rates.

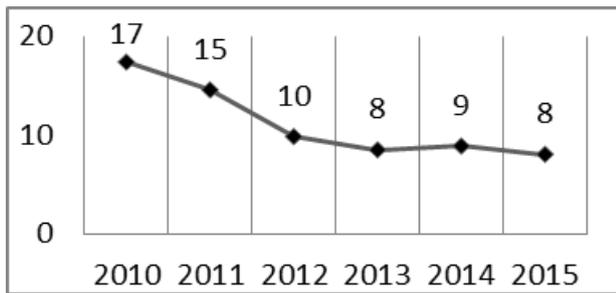


FIGURE 1 Dynamics of registered self-employed persons paying social security contributions to the state budget of Latvia from 2010 to 2015.

Axis OY – %

In August 2010, the Law on Micro-enterprise Tax was proclaimed by the President of the Republic of Latvia. The goal of the Law was to reduce the level of unemployment, decrease administrative and tax burden for micro businesses, especially at the beginning of economic activity. Self-employed persons with the planned annual net turnover of less than 100 thousand € and employing not more than 5 workers who receive salary not exceeding 720 € could register their own business and gain the right to pay taxes imposed on micro businesses to the state budget. The tax rate is 9% of net turnover. This tax on micro businesses includes personal income tax of 35% of the paid tax and compulsory payments of social insurance of 65% of the amount of tax. Within 5 years to December 2015, the Law

References

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has undergone various additions and changes more than 6 times. Without additions and amendments, the Law existed not more than 2 years in a row. In 2014, the Law underwent changes twice, and in 2015 it was changed three times. In January 2016, the Law on Micro-enterprise Tax in Latvia underwent further changes and additions in the form of new restrictions. Under such conditions and in the prevailing economic situation, they were practically deprived of the opportunity to run business, and enterprises were forced to close down. Thus, at the end of 2016 there were more than 50 thousand micro businesses in Latvia, whereas in early 2017 their number decreased by more than 6 thousand.

3 Conclusions

In 2010, Latvia adopted the Law on Micro-enterprise Tax aimed at creating favourable conditions for business development, reduction of unemployment and the shadow economy. However, in subsequent years, the Law has been changed many times; various additions and limitations of its application have been introduced. The attempt to simplify the tax legislation has not been practically implemented. To enable the sustainable development of economy, increase employment, reduce social tension and emigration, effective laws should be stable in the country. They should be simple and focus on promoting the development of micro businesses. Micro businesses need a uniform tax, which includes deductions for social protection.

[2] Statistics Database 2016 *Central Statistical Bureau of Latvia* <http://www.data.csb.gov.lv/Table> 20 October 2016