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Lack of rationality: why Latvia cannot establish a decent holding regime?

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EUR 200,000,000!!! How did I get this not so small number? I multiplied 100,000 by 2,000. The first number roughly illustrates how many new companies where registered in Cyprus since 2004. The second number is a modest annual fee in Euros for maintaining a Cyprus holding company operational. Just a couple of days ago I was planning a holding structure for one of our Latvian based clients. Not surprisingly, my e-mail was filling up with materials from Cyprus, which arguably is the friendliest and also the most tiresome EU jurisdiction for tax planning. To explore more "fancy jurisdictional brands" I made an inquiry to Sweden, which is capable of providing "tricks" similar to those offered by Cypriots just at a premium price. For the sake of formality, the Netherlands were also explored (a nice regime, but Latvian locals usually get scared by the price) and maybe some other countries.

What our client and I were doing was finding an entity that allows two things:

- to sell the shares of a limited liability company and be sure that the capital gains realized are not taxed (capital gains exemption);
- to receive and to payout dividends without any tax burden, including distribution of the aforesaid tax-free capital gains (dividends exemption).

In very simple terms that is all one expects from its holding company.

Every time I conduct holding planning I feel a lot of disappointment from different angles. First, in my view, Latvia could potentially be a very capable holding jurisdiction, at least for Eastern European countries like Russia or Ukraine. The Latvian banking sector demonstrated this potential rather persuasively (or at least used to demonstrate that until the "Parex Bank drama"

was launched). Second, the Latvian taxation regime has for many years in its essence not been that far from capable as a holding jurisdiction and it would not take much to establish one here (its potential success in another issue). Third, I respect my foreign colleagues, but I wish my firm could receive fees from clients residing in neighboring countries. Altogether, these clients pay substantial amounts to maintain their holding companies in Cyprus, Sweden, Malta and the Netherlands, while the same could (should) be possible also in Latvia. Also, local hotels, airlines, restaurants and everything else that may exist around a prosperous holding regime would be happy to provide their service and earn extra income.

What should Latvia do to step onto the "holding companies" stage and to become a star there? A minimum program would be to properly implement the abovementioned exemptions for dividends and capital gains.

Latvia has the most trouble with capital gains exemption as gains derived from the sale of shares (apart from listed shares) are treated as ordinary income subject to corporate taxation. A hardly explainable paradox is that for many years natural persons in Latvia have been able to sell their shares and capital gains have been exempt from personal income tax. On the one hand, Latvia practiced a rather extreme form of capital gains exemption, which was of great value to wealthy local individuals, but gave very little incentive for foreign investors. As one can imagine not so many foreigners and their families would change their place of residence to Latvia to benefit from such a taxation regime not to mention our gloomy grey autumn-winter season. On the other hand, Latvia has not been able to set up a regime, which is not only available in such countries as Cyprus or Malta, but also in Sweden, Belgium or the Netherlands.

Latvia is doing much better with regard to dividends exemption. In relation to EU and EEA companies, dividends exemption is functioning. Other countries may be roughly divided in two groups: third countries (Russia, Kazakhstan, etc.) and offshore countries (British Virgin Islands, Belize, etc.). Receiving dividends from Russian or other third country companies is tax exempt as long as a minimum shareholding of 25% is maintained. However, a payout of dividends from Latvia to third countries encounters an irritating 5%-10% withholding. Frankly, I do not see the point of keeping all these restrictions with regard to third countries because either a business is not established in Latvia or it is established via EU holdings that benefit from Latvia-EU dividends exemption, and that does not impose specific restrictions or taxes on the flow of dividends.

For the issue of offshore companies and dividends, then the flow of dividends is taxed: outbound – 10% and inbound - 15%. As long as there are such holding regimes as Cyprus, Malta, Hungary and maybe some other jurisdictions, there will always be ways to work around the stiffer Latvia.

Finally, implementing formal legislative changes probably does not attract an immediate flow of the holding business. However, that should be a good starting point. A more difficult task would be to gain the reputation of a stable and predictable tax jurisdiction, which is quite difficult for a country that tends to amend tax legislation just before Christmas.
In any case why not attempt to join the "holdings family" where Latvia should fit well.