



LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

Reģ.nr. 90010248231; Smilšu ielā 1-512, Rīgā, LV-1919
tālrunis: (+371) 6708 3650; e-pasts: info@fdp.gov.lv; mājaslapa: http://fdp.gov.lv

RĪGĀ

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Uz Nr.

**Prime Minister
Republic of Latvia
Māris Kučinskis
vk@mk.gov.lv**

**Chairman of the Budget and Finance (Tax) Committee
Saeima of the Republic of Latvia
Jānis Vucāns
budzeta.komisija@saeima.lv**

**Minister of Finance
Republic of Latvia
Dana Reizniece-Ozola
pasts@fm.gov.lv**

Dear Messrs Kučinskis and Vucāns,
Dear Madam Reizniece-Ozola,

Non-conformity report regarding the draft legislation of the tax reform

According to Section 29, Part 2 of the Fiscal discipline law (hereafter - FDL), if the Fiscal Discipline Council (hereafter – Council) detects infringements of the FDL, it shall prepare a non-conformity report containing recommendations for the rectification of the non-conformity. The non-conformity report shall be prepared as soon as the non-conformity has been identified, and subsequently submitted to the Cabinet and Saeima, and published on the website of the Council and the Ministry of Finance.

On 4 July¹ and 11 July² 2017 the Cabinet of Ministers, as part of implementing the proposed tax reform, passed and submitted to the Saeima on 13 July³ several draft laws that foresee a negative fiscal impact in 2018-2020. The submission of draft laws with a negative fiscal

¹ Documents available here: <http://tap.mk.gov.lv/mk/mksedes/saraksts/darbakartiba/?sede=950>

² Documents available here: <http://tap.mk.gov.lv/mk/mksedes/saraksts/darbakartiba/?sede=952>

³ Cover letter available here:

<http://titania.saeima.lv/LIVS12/saeimalivs12.nsf/0/4276DE699B61C53FC225815A00558A57?OpenDocument>

impact to the Saeima prior to drafting a new medium-term budget framework creates a potential non-conformity with Section 9 of the FDL.

The estimated fiscal impact of the tax reform is expected to be both (i) direct, as a result of changes to tax rates and regulations, and (ii) indirect, resulting from changes in the economy. The Council has looked into the fiscal impact assessment accompanying the draft laws, which was prepared by the Ministry of Finance. We note that the responsibility for the accuracy of the individual estimates lies with the Ministry of Finance.

Table 1 (see below) presents a summary of the direct fiscal impact of the proposed measures, as indicated in the respective annotations.

#	<i>Legislative tax measures proposed</i>	2018	2019	2020
1	Vehicle exploitation tax		46.4	
2	Aid to taxpayers for cancellation of penalties	33.0	33.0	33.0
3	Law on tax and fees	15.3	15.3	15.3
4	VAT	67.7	67.7	67.7
5	Gambling tax and fees	8.3	9.0	9.0
6	Personal income tax	-153.6	-202.5	-266.4
7	Excise tax	44.9	63.0	99.8
8	Abolishment of solidarity tax	2.3	-30.1	-29.7
9	Social contributions	2.2	2.2	2.2
10	Corporate income tax	-89.1	-293.0	-206.8
11	Microenterprise tax	4.2	4.2	4.2
A	Total impact	-64.9	-284.7	-271.7
B	Fiscal space (MTBFL 2017/19)	-8.1	81.6	X
C	Deviation (A+B)	-72.9	-203.1	X

Table 1. Summary fiscal impact estimated from enacting the draft tax laws adopted by the Cabinet on 4 July and 11 July 2017.

The Council refrains from commenting on the policy decisions made by the Cabinet of Ministers. Nonetheless, based on the estimated fiscal impact, the Council emphasises that the implementation of the tax reform would cause a deterioration of the approved budget balance in 2018 and 2019.

Section 9 of the FDL requires that, if the Cabinet of Ministers submits a draft law that decreases budget revenues planned in the framework law, the Cabinet shall concurrently submit a draft law or draft laws that compensate the decrease in revenues.

Secondary effects have been specified, noting that these could partially compensate the fiscal impact of the tax reform.

2018 – 75.8 million euro
 2019 – 118.5 million euro
 2020 – 233.5 million euro

However, the Council objects to basing revenue estimates on the secondary economic effects of the tax reform, without reviewing and endorsing the underlying macroeconomic indicators as part of the macroeconomic endorsement procedure. Currently, the indicators in question apply as estimated and approved during the preparation of the Medium-term Budget Framework Law 2017-2019. The projected changes to the economy and the resulting fiscal

impact, as a result of implementing the tax reform, should be assessed in the context of a new medium-term budget framework. As the Council has not endorsed the macroeconomic forecasts for the next medium-term budget framework, it objects to their use in revenue projections.

The Council welcomes tax reforms that create a strong foundation for sustainable economic growth and public finances, whilst also distributing economic resources in an efficient and equitable manner. However, the submission of draft legislation to the Saeima without specifying compensatory measures is not in compliance with Section 9 of the FDL.

The Council concludes that the non-conformity arose as a result of decoupling the submission of the draft legislation of the tax reform from the medium-term budget framework. This non-conformity could be rectified upon passing a new medium-term budget framework.

In view of the above, the Council recommends that:

1. That the fiscal impact of the tax reform be reviewed in the context of the Medium-term budget framework 2018/2020;
2. Contingency measures should be devised to prevent a deterioration of the budget balance if the projected fiscal impact of the tax reform fails to materialise, or materialise to a lesser extent than predicted.

Council Chairman

Jānis Platais

*E. Kīlis, 67083652
emils.kilis@fdp.gov.lv*