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THE IMPACT OF LABOUR TAX COSTS ON THE COMPANY STRATEGIC DECISION MAKING AND INTERNAL ACTION PLAN TO CONTROL TAX PAYMENT IN THE COMPANY

Abstract:

The company sustainable development is closely linked with the control of expenses and the ways how to reduce its impact on company cash flow. In Baltic countries business environment is becoming less attractive as a result of tax burden. It encourages tax payers to seek alternative solutions for the reduction of tax burden, especially in relation to labour tax costs and its impact on company cash flow. The article focuses on the assumption that the impact of labour tax costs on business environment in Lithuania and Estonia is much more favourable than in Latvia. Having evaluated labour costs and taking into consideration that they occur under the same production conditions in each of the Baltic countries, we can draw the conclusion that such assumption is false. It cannot be applied in strategic decision making and internal action plan design. When developing tax planning strategy in companies by considering which taxes create the heaviest tax burden, as well as by looking at the ways how it affects investment and company expenses, the calculations have been carried out that lead to the conclusion that tax policy in all Baltic countries and its impact on business environment is similar. Therefore, strategic decision to move business from one territory of the country to another country could turn out to be inefficient. Such decision does not refer to internal action plan of controlling tax payment administration in the company. The analysis indicates significant differences in administration of national taxation.

Keywords:

tax burden, labour costs and taxes, management of tax payment

Introduction

Sustainable development of an enterprise is highly dependent on the economic activity of the country. The higher the payable tax burden of an enterprise, the higher is the risk for the sustainable development of an enterprise. The reduction of the payable tax burden effect on the enterprise's financial flow is one of the most complicated strategic tasks of finance management. The essence of finance management in an enterprise is to make optimal decisions in the area of finance and to fulfil the task of gaining maximum profit. In tax planning and payment controlling, the creation of an internal enterprise finance management planning system is closely linked with effective financial flow management, including tax payment flow's management. A recurring problem in Latvian companies is the inelastic tax payment management, that is based on the transaction chain "transaction-entry-calculation-tax effect (sanctions)", not on the chain of actions "tax effect analysis–analysis of registration's possibilities–transaction–standardised entry tax payment", which is the way it supposed to be, that is pointed out by one of the most popular contemporary tax experts in Latvia – K. Ketners (Ketners, 2008, p 56).

Tax payment management should be done into to **two directions**. First direction is the **strategic decision making** – by doing tax payment management in regards to the whole business planning, optimizing taxes instead of primitively reducing them, that can lead to sanctions and penalties, if done incorrectly or inadequate to the requirements of the regulations. The other direction is the **tactical decision planning**, that is associated with the national law, compliance with other tax area related legislative requirements, taking in account tax effect analysis in a specific case, using exemptions, reliefs, registration peculiarities.

Tactical management is closely linked to tax payment control organisation in an enterprise. Management and control requires using previously established procedures, that are related with transaction registration and tax bookkeeping standardisation, which allows reducing the risk for transaction with economic content and essence.

1. The effecting factors when making strategic decisions in tax planning

When creating tax planning strategy in an enterprise, it should be evaluated which taxes make up the biggest part of tax burden and how they affect investments and enterprise's expenditure for different production-related factors. For the evaluation of separate taxes effect on the level of microeconomics and macroeconomics, the following quantitative indicators can be used:

- separate tax burden considering its source of payment
- separate tax debt amount in regards to the whole amount of the debt

- separate tax amount in regards to the whole tax payment amount

(Ketners, 2009, p 64).

The total amount of the tax burden in an enterprise will not show which taxes create the largest burden for the payer. It can be determined by comparing the tax burden indicators to the source of payment. In such territorial small countries as Latvia, Lithuania or Estonia, around 90% of economic activity operators are micro-enterprises (since 2016.). Since the introduction of state mandatory social insurance contributions (known as the social tax in Latvia from 1991. till 1997.), this payment has become a hindering factor, which is intensively evaluated, when making strategic finance management decisions, because it makes up the largest share in labour taxes, in comparison to other Baltic countries. On the other hand, the tax burden effect on the sales volume is lower than the average in European Union (EU), and the same can be said about the capital tax.

The head of an enterprise should work in tandem with the accountant and the lawyer in order to establish a tax policy for the specifics of the enterprise’s activity. The enterprise’s employees in charge should be capable of reacting timely to changes in tax legislation. The government’s various decision acceptances differently influence the amount of profit and taxes (Bērziņa, 2009).

In order to reduce the amount of the tax burden, the heads of an enterprise establish tax planning schemes; taking in account the surrounding countries tax legal environment’s loyalty for the tax payer. When creating its tax policy, Latvia must constantly consider Lithuanian and Estonian governments’ entrepreneurship supporting tax policies.

When evaluating the friendliest tax policy for the business environment, entrepreneurs compare different tax planning methods used in each country by evaluating tax policy’s loyalty towards business environment.

The following aspects are analysed when making a comparison:

- the use of tax reliefs and loopholes in law
- the use of accounting policy’s advantages
- the use of low tax territories and areas
- the use of tax payment deadlines
- the choice of transaction form.

The use of tax relief application method is substantially correct in every possible application of reliefs according to the criteria laid down in the law. On the contrary, the use of loopholes in law is a method, that is only possible in short-term. Highly qualified and experienced consultant, whose addition is expensive, can determine the law’s “weak-spot”. Moreover, this method can lead to conflicting situations and judicial work that demands additional funding, resources and affects reputation.

The use of registration policy manifests itself in a way that an enterprise by itself has the rights to develop its own bookkeeping registration methodology with whose help, when organized correctly, it is possible to make tax reduction.

The use of territories and areas of low taxes happen with the use of business partners or tax intermediaries, who are registered in countries that have low taxes, but actually operates in various other countries of the world. When carrying out transactions with such enterprises, it is possible to reduce the amount of the payable tax. Trust system can also be used, which means separating the control from ownership rights.

Corporate income tax payment procedure can be used as a bright example in tax payment deadline adjusting. The calculated corporate income tax for the taxation year must be paid within 2 weeks after submitting annual report. To move further away from the moment of having to pay taxes, enterprises deliberately submit the annual report on the last day, thus making tax administration's work notably harder.

If the regulations state separate tax regimes, then it is possible to change the legal form in order to gain as more favourable mode of tax payment. In the Bank groups and PricewaterhouseCoopers (PWC) prepared report (2014) about tax policies in the world, it was concluded, that the overall tax rate in Latvia keeps declining and makes up 35% which is the 11th lowest indicator in EU and in the region of European Free Trade Association (EFTA), and the lowest in Baltic States. The overall tax rate in Lithuania is 42,6%, Estonia – 49,3% (PWC, 2015).

The overall tax rate, which is calculated as the overall enterprise's tax liability in percentages from profit before taxes, makes up state's tax revenue divided by GDP. The overall tax rate of 35% in Latvia consists of 4,9% of corporate income tax, 27,2% labour tax and 2,9% - other taxes. On the other hand, in Latvia the average amount payable taxes in entrepreneurship is one of the smallest (only 7) and ranks Latvia in the Europe's top 5 together with Norway, Sweden, Estonia and Malta.

"When comparing data about Latvia to Europe and the rest of the world it shows that our county (Latvia) and our tax rate have the possibility of being competitive – here enterprises can divert more their resources towards the development of economic activity or the paying of dividends. When looking from the government's point of view at the moment it would be important for the responsible institutions to improve the tax collecting process effectiveness, while maintaining an attractive environment in the eyes of entrepreneurs and investors, and creating a stable tax policy in the country," explains the head of PWC, Zlata Elksniņa-Zaščirinska.

In the report "Paying Taxes 2015" between 190 countries, Latvia rank's in 24th position, Estonia – 28th, but Lithuania – 44th. All of the Baltic countries have moved up in the rankings in comparison to last year (PWC, 2015). When comparing to "Paying Taxes 2014" (in the rating between 189 countries) Latvia ranked in the 49th position, Estonia – 32nd, but Lithuania 56th (PWC, 2014).

The volume of tax rate does not reflect the peculiarities of taxable base's calculations as well as exceptions and reliefs, so the volume of tax rate cannot be used for the basis of a valid tax burden analysis.

When examining and comparing tax base's rates in Baltic countries, as seen in table 1, it can be concluded, that corporate income tax rate in Latvia and Lithuania are the same – 15%, but in Estonia it is 20/80 from the paid net dividends. In Estonia the corporate income tax has to be paid only when the dividends have been paid, although every month a payment must be made from the "expenses not related with economic activity". In the Baltic States the corporate income tax rate is lower than the average in EU.

Table 1: The applicable tax rates' comparison in the Baltic States for 2015, %

Country	**Latvia**	**Estonia**	**Lithuania**
Corporate income tax	15	20/80	15
Added value tax	21;12	20; 9	21; 9; 5
Personal income tax (standard rate)	23	20	15
Social contributions (employee)	10,5	1,8 +2	9
Social contributions (employer)	23,59	33+0,8	30,98 - 32,6
Property tax	0,2-3	0,1 - 2,5 (land)	0,01 - 4(land) 0,3 - 1(buildings)

Source: businessnetwork.lv

Moreover, the added value tax (AVT) standard rates in the Baltic countries are similar (Table 1). In Latvia the AVT standard rate is 21%, the reduced AVT rate 12% (is applied to medication, medical equipment, the delivery of specialized food products for infants, books, hotel accommodation services, etc.). In Lithuania the AVT standard rate is also 21%, the reduced AVT rate is 9%, (is applied to hotel accommodation services, books, etc.), but the reduced AVT rate of 5% is applied to medication and medical equipment. In Estonia the AVT standard rate is 20%, the reduced rate is 9%, (is applied to hotel accommodation services, medicine, medical equipment).

Personal income tax and social insurance contributions are the hardest to compare, because an additional criterion has to be taken into account, for example, family status and applicable reliefs.

Table 2: The payable taxes share's apportionment in Baltic State's enterprises in 2015, %

	Profit tax	Labour taxes	Other taxes	The sum of taxes
Latvia	6,1	27,2	4,7	37,9
Lithuania	5,7	35,1	3,1	43,9
Estonia	8	39,4	11,2	58,6

Source: businessnetwork.lv

In order to encourage the economic competitiveness, which is one of the goals of tax policy, the tax policy itself should be competitive. The data shares of payable tax in

Baltic countries (Table 2) point towards to Latvia having a competitive advantage in comparison to Lithuania and Estonia. Although, the question remains unanswered: why do Latvian entrepreneurs choose to expand their entrepreneurship under the tax jurisdiction of Lithuania and Estonia when making strategic finance management decisions?

Latvian entrepreneurs point out the advantages of these 2 countries, especially application of labour taxes in comparison to labour taxes in Latvia. In order to identify the truthfulness of this assumption, a research has been done in which the same conditions were applied.

2. Labour tax advantages in the tax policies of Baltic States

Considering that labour is a resource, which an enterprise pays for in order to be able to do business, an enterprise, that wants to lower its expenditure, should, first of all, reduce the costs of labour, in order to develop its business activity. When planning further development of an enterprise, an important question is the one that regards the number of employees and their pay. This balance sheet item is the enterprise's regular payments which should be taken in account throughout the whole period of activity. This balance sheet item can also be influenced by state policy – by setting new labour tax rates and reliefs. Even though the tax policies in all of the Baltic countries are similar, there are noticeable differences in tax rates and reliefs. To be able to understand the factual situation and to understand in which of the countries the chosen enterprise and its employees would have the largest advantages, the authors have made a comparison between Baltic States' labour tax rates, their procedures of application and differences.

Factors that influence the amount of payable labour tax are the non-taxable minimum and child and dependent care credit, as well as the amount of state declared minimum wage (Table 3).

Table 3: Minimum, average wages, non-taxable minimums and tax reliefs in Baltic countries in 2016, EUR

Comparable indicator	**Latvia**	**Lithuania**	**Estonia**
Minimum wage	370	350	430
The average wage in the country	785	554	826
Non-taxable minimum	75	200	170
Child and dependent care credit	175	120	154

Source: Swedbank Finanšu institūts (2016)

Estonia has the largest minimum wage (from the Baltic countries) – 430 EUR, Latvia follows second with 370 EUR, but Lithuania has the smallest minimum wage – 350

EUR, a similar trend can be seen when comparing average wages – Estonia has the largest average wage, but Lithuania has the smallest average wage.

On the other hand, the non-taxable minimum is the largest in Lithuania – 200 EUR, in Estonia 175 EUR, but in Latvia only 75 EUR. Since 2016 differentiated calculation and process of application are gradually introduced to non-taxable minimum in Latvia, that will lead to not having non the -taxable minimum applied to monthly before-tax salary that exceeds 1400 EUR. The differentiated application of non-taxable minimum to different amounts of wage has already come in to force in Lithuania.

Child and dependent care credit is the largest in Latvia – 175 EUR, Estonia follows with 154 EUR, but in Lithuania it is 120 EUR. In Estonia the child and dependent care credit is applied every month – it can be claimed as a part of repayment of overpaid taxes once a year by submitting annual income tax return, but it should be noted that this only applies to families with two or more children.

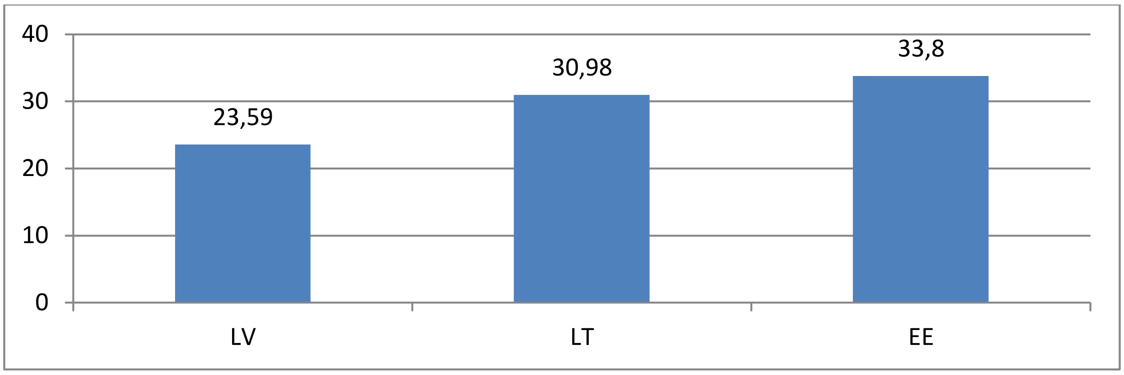
One of the most important components on labour tax, which notably increases the labour tax burden in Latvia is the state mandatory social insurance contributions (SMSIC from here on), that the employer pays by applying the rate of 23,59% to employee’s before-tax salary when being in employment relations. In Latvia the employer also pays the risk fee of 0,36 EUR every month for every employee.

In Lithuania the differentiated rates exists in the area of social insurance. Employer makes payments of: 23,3% to pension insurance, 3,4% to illness and maternity insurance, 3%to health insurance, 1,1% to unemployment and from 0,18% to 1,8% to insurance regarding accidents that occur at work. On the contrary, the employee makes payments in the amount of 3% to pension insurance and 9% to health insurance.

The social insurance contribution system in Estonia is more complicated than in the other two Baltic countries, because it consists not only of social tax, but also from different additional payments: a payment of 1,6% to unemployment insurance, that is withheld from the employee’s salary, unemployment payment of 0,8%, that is paid by the employer, as well as social tax of 33% from before-tax salary, that is also paid by the employer (the minimum amount of the tax is 117,15 EUR monthly) (Business network, 2015).

When compiling previous data, the employers’ tax burden in social contributions is the highest in Estonia, but lowest in Latvia (Figure 1), the difference is almost 10 percentage points. In Lithuania the level comes close to the level in Estonia, but is still lower by 3 percentage points.

Figure 1: Employer's SMSIC in Latvia, Lithuania and Estonia, % from before-tax salary in 2016



Source: Likums „Par valsts sociālo apdrošināšanu", Lietuvos Respublikos Socialinės apsaugos ir darbo ministerija, Sotsiaalmaksuseadus

For practical comparison of tax burden, authors' have done calculations with the average wage of each country, in order to identify in which of the Baltic countries starting a business would be more useful. By making a decision in which the criteria is the lowest labour tax payments (the rest of the enterprise's indicators are invariable) (Table 4).

Table 4: Salary and tax calculations for an employee in the legal environment of Baltic States, 2016 legal provisions

Indicators	**Estonia**		**Latvia**		**Lithuania**	
	EUR	%	EUR	%	EUR	%
Average salary (before-tax)	826,00	74,74	785,00	80,88	554,00	76,34
Non-taxable income	324,00		250,00		320,00	
Employee's taxes from salary	125,51	11,35	186,52	19,21	77,48	10,68
Net salary	700,49		598,48		476,52	
Employer's taxes	279,19	25,26	185,54	19,12	171,74	23,66
Employee's and employer's taxes	404,70	36,61	371,06	38,23	249,22	34,34
The employer's total costs for 1 employee	1105,19	100	970,54	100	725,74	100

Source: authors' calculations

After doing calculations, it can be concluded that the employer's tax burden is the highest in Estonia; it makes up 25% of all labour costs, but the lowest employer's tax costs are in Latvia and makes up only 19% of all labour costs. If we analyse the obtained calculations from the employee's point of view then the situation is opposite, because the overall tax burden is the highest in Latvia – 38,6%, but in Lithuania and Estonia it is 2% lower.

For a practical comparison of labour costs, the authors have made calculations assuming that the average salary in all of the Baltic countries is the same. For the calculations it was assumed that the employee's before-tax salary is 826 EUR (Table 5).

Table 5: Labour costs' calculation, if the basis of the salary is the same in all of the Baltic States, 2016 legal provisions

Indicators	Estonia		Latvia		Lithuania	
	EUR	%	EUR	%	EUR	%
Salary (before-tax)	826,00	74,74	826,00	80,88	826,00	76,34
Non-taxable income	324,00		250,00		320,00	
Employee's taxes from salary	125,51	11,35	199,26	19,51	139,09	12,85
Net salary	700,49		626,74		686,91	
Employer's taxes	279,19	25,26	195,21	19,12	256,06	23,66
Employee's and employer's taxes	404,70	36,61	394,48	38,63	395,15	36,52
The employer's total costs for 1 employee	1105,19	100	1021,21	100	1082,06	100

Source: authors' calculations

After doing calculations it can be concluded, that, if we assume the salary is the same in all Baltic countries, the highest labour costs are in Estonia, but the lowest in Latvia. Thereby the assumption that the labour costs are the highest in Latvia is not confirmed. Although, after doing calculations it can also be concluded that the net salary in Latvia is the lowest in comparison to the rest of Baltic countries.

This means that at equal pay rules the employees in Latvia receive 12% less than in Estonia and for 10% less in Lithuania.

Conclusions

1. Estonia's government gives great importance to the stability factor of the tax system. This is why it is not typical for it to be unpredictable.
2. Due to the large costs the labour tax creates the largest payable tax burden in enterprises.
3. In the results of calculations, the authors identify the risk of labour outflow from Latvia to Estonia and Lithuania, instead of the risk of business relocation to the previously mentioned countries.

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