

ASSESSMENT OF INCOME TAXATION OF PERFORMERS OF ECONOMIC ACTIVITIES

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Abstract. *In the changing economic situation of nowadays, flexible forms of employment become more popular, and a performer of economic activities is one of them. They have to face the inconstant tax policy of Latvia, be able to choose a payment regime from earned income, which is most suitable for them. The authors believe it is worthwhile to find out the opinions of performers of economic activities and to assess tax liabilities, which is an important requirement for the planning and development of their activities. The goal of the research is to assess the taxable income regimes for performers of economic activities in Latvia and to find out their opinion on their satisfaction with the tax policy. The approaches of the research are: the monographic and descriptive methods, document analysis, logically construction, statistical analysis, and a sociological research method – a pilot survey. The research resulted in the assessment of taxable income regimes and their application in various situations. By conducting the pilot survey, it has been discovered that performers of economic activities find it difficult to understand standard regulations and accounting management; they lack comprehension of the importance of SSIMC and its advantage for the future. The calculations made by the authors show the amounts of the tax burden formed with each tax payment regime.*

Keywords: *income; microenterprise tax; personal income tax; patent fee; self-employed; state social insurance mandatory contributions.*

JEL code: *H21; H24; H25; M10*

Introduction

In the changing economic situation of nowadays flexible forms of employment become more popular among employers and employees, and one of them is to register as a performer of economic activities. It provides individuals with more freedom of action and personal independence, as well as with the possibility to get some additional income doing full time work or part time work along with the main work. As per the Latvian statistics, the quantity of self-employed individuals tends to increase every year; in the time period from 2003 to 2016 the quantity increased by 27.2% points and amounted to 33.8% of all economically active units in Latvia in 2016 (Centrālā statistikas pārvalde, 2018).

Performers of economic activities have to face the inconstant tax policy of Latvia, be able to follow the changes in the tax legislation and choose a payment regime from earned income, which can often cause difficulties.

The research studies made in other countries show that tax rates have an essential influence on the decision to start self-employment (Bhat, 2017), it is possible to hide one's real income if there is a lack of standard regulation (Finardi & Bayer, 2016), and the differences in salary and self-employment income taxation make an essential influence on becoming self-employed (Bruce, 2000).

The research is currently important, as the government of Latvia does not really understand itself how to support and benefit performers of economic activities to develop their work, and frequent amendments to the tax legislation prove it. Therefore, the authors believe it is worthwhile to find out the opinions of performers of economic activities and to assess tax liabilities, which is an important requirement for planning and development of their activities.

The goal of the research is to assess the taxable income regimes for performers of economic activities in Latvia and to find out their opinions on their satisfaction with the tax policy.

The tasks of the research:

- 1) to assess the income taxation regimes for performers of economic activities in Latvia;
- 2) to evaluate the satisfaction of performers of economic activities with the tax policy in Latvia;
- 3) to make a comparison of the tax payment regimes for performers of economic activities.

The approaches of the research are: the monographic and descriptive methods, document analysis, logically construction, statistical analysis (grouping of data, relative ratio), a sociological research method – a pilot survey of performers of economic activities). The analysis tools of Microsoft Excel were used for data processing.

The research was done based on the analysis of scientific publications and the standard regulations of the tax legislation, the data of the Central Statistical Bureau and the State Revenue Service, as well as the evaluation of the questionnaires of the conducted survey.

Definition of a performer of economic activities and income taxation regimes in Latvia

The terminology used in Latvia regarding the economic activity of a natural person is not similar to as they use the definitions “performer of economic activities” and “self-employed”. In accordance with the tax legislation, a performer of economic activity is a person who is registered with the State Revenue Service (SRS) and whose work is focused on producing goods, performing work, trading and providing services for

revenue (On Personal Income Tax, 1993). Conversely, the term “self-employed” is defined by the State Social Insurance Law and is legally used if a natural person is also registered as a mandatory social insurance payment maker to perform economic activities. (Par valsts sociālo apdrošināšanu, 1997).

The term „self-employed” is used in foreign scientists’ research papers and statistical editions. In the editions of the Central Statistical Bureau of Latvia, a self-employed person is considered to be a person who performs his or her own business activity, professional practice or agricultural activity in order to earn revenue or benefits, and, in addition, does not employ other workers. (Centrālā statistikas pārvalde, 2014). It is also explained in the EU statistics that self-employed persons are those who do not have a paid job as a primary activity, otherwise they are employed. (Eurostat, 2018). In the Merriam-Webster’s dictionary, a self-employed person is the one who gets revenue directly from his or her business activity, trading or profession, rather than gets a salary from an employer. (Merriam-Webster, 2018).

Leibus (Leibus, 2008) and Parker in their research studies have been studying (Parker, 2018) the problem of a separate classification of a person who performs an economic activity for tax needs or other needs. The authors believe it is necessary to match the usage of terms in the tax legislation and statistics to make the information comparable.

A performer of economic activities is allowed to manage accounting in a single - entry system. A performer of economic activities can manage accounting on his or her own or use the services of others in accordance with a signed accounting service contract. (Sidraba, 2009).

Performers of economic activities can choose one of the tax payment regimes while registering their activity. The following tax payment regimes are offered in Latvia:

- 1) personal income tax (PIT) and state social insurance mandatory contributions (SSIMC);
- 2) microenterprise tax (MET);
- 3) patent fee.

PIT and SSIMC are paid by the performers of economic activities who did not apply for any other tax payment regimes at the moment of registration.

A progressive rate of 20% per year for income up to EUR 20004, 23% per year for income more than EUR 20004, and 31.4% per year for income more than EUR 55000 has been introduced for the personal income tax in 2018 (On Personal Income Tax, 1993).

The difference between the revenue and expenses or the income of a performer of economic activities is taxed with a personal income tax. From the year 2018, January 1, only 80% of revenue can be deducted as expenses.

Fixed assets expenses, taxes paid for employees and for oneself can be adjusted in the full amount. (Bērziņa, 2017). The approach of expenses readjustment in respect with self-employed revenue has a significant impact on the tax base level; therefore, it is worthwhile to set fixed expenses regardless of revenue (Grasgruber et al., 2017).

By calculating the personal income tax for a taxation year, it is possible to adjust the verified non-taxable income, tax relief and justified expenses. The tax reform benefited those with less income, since from 2018 the non-taxable minimum amount for monthly income up to EUR 440 is EUR 200, relief for dependent persons increased to EUR 200. However, if personal gross income exceeds EUR 1000 per month, the non-taxable minimum amount is not applied, therefore, a larger personal income tax amount is paid and persons do not feel the changes of the reform. The same way the eligible expenses for education and medical services increased to EUR 600 per year, however, it cannot exceed 50% of the yearly taxed income of a person.

When a performer of economic activities has reached the amount of income which exceeds the minimal monthly wage or salary defined in the state, this person starts paying **state social insurance mandatory contributions** from a freely selected amount of the object of contributions, which in 2018 is not less than EUR 430 (Noteikumi par valsts .., 2013) and the performer of economic activities is considered a self-employed person in the understanding of the State Social Insurance Law.

In 2018, the SSIMC rate for self-employed persons in the general case is 32.15%, which is 1.02% points more than it was in 2017. The mandatory pension insurance in the amount of 5% of the difference between a freely selected amount of the object of mandatory contributions and actual income has been introduced in 2018 to protect the interests of a performer of economic activities and ensure receiving a state pension (State Revenue Service of Latvia, 2018). In the authors' opinion, it essentially increases the tax burden, since the SSIMC rate for a self-employed person is 2.9% points higher than it is for an employee.

Because of the mandatory 5% pension insurance introduction, the number of SSIMC payers in the 1st quarter of 2018 has increased by 84.4% points in comparison with 2017, however, it approximately amounts to 17 % of the overall number of performers of economic activities. (Valsts ieņēmumu dienests, 2018). Leibus and the others have studied this problem, pointing out that in Lithuania all self-employed persons participate in the state social insurance system and suggesting to reduce the income from which SSIMC have to be paid. (Leibus et al., 2016).

Performers of economic activities have the right to choose paying **microenterprise tax**, which taxes the turnover or income of a performer of economic activities that from 2018 cannot exceed EUR 40000. The tax rate

was also increased up to 15% in 2018. The paid MET is divided between the state social insurance mandatory contributions – 80%, and the personal income tax – 20% (Mikrouzņēmuma nodokļa likums, 2010). It is essential that a tax payer of a microenterprise, like an employer, cannot apply the non-taxable minimum amount and relief for dependent persons.

We must agree that the microenterprise taxation regime only partly executes its primary goal – to reduce the shadow economy and promote taking up entrepreneurship. It is often used to optimize taxes and gain maximum profit in a short-term, as well to encourage fake employment expansion, especially in private construction (SIA “Baltijas Konsultācijas” & SIA “Konsorts”, 2018). Leibus in her research also indicates that choosing the microenterprise tax is connected with the reduction of taxes and labour expenses, not with the simplification of tax calculation. (Leibus, 2012).

It should be noted that the microenterprise tax is not very popular among performers of economic activities, as in the 4th quarter of 2017 it was paid by 16094 people or 13.1% of all registered performers of economic activities (Valsts ieņēmumu dienests, 2018).

In January 1, 2010, the **patent fee** was introduced in order to ease administrative and accounting procedures for the performers of economic activities who start a business activity with moderate expenses, and to create an opportunity to develop acquired skills and knowledge in professional activities. It can be paid as a fixed contribution if working in specific professions or kinds of economic activities and if the income does not exceed EUR 15000 per year.

The amount of the patent fee in 2018 is EUR 100 for those performers of economic activities who work in Riga municipality and EUR 50 in the rest of municipalities (Kārtība, kādā piemērojama patentmaksa., 2018). Patent fee payers are socially insured against disability and have pension insurance, for which they allocate 67% of the paid contribution. A patent fee payer lists only the business activity income and does not have to submit the PIT annual income declaration; therefore, there is no right to apply for the non-taxable minimum, relief and eligible expenses.

We have to agree with Medne and Mende-Jekabsone’s opinion that in spite of the limit of the kinds of business activities, patent fee payers benefit from easier business activity accounting and tax payment, however, this personal income tax rate is used by a narrow group of entrepreneurs. (Medne & Medne-Jēkabsons, 2015). In January 2017, 2779 patent fee payers were registered with the State Revenue Service (Dārziņa, 2017), which amounts to approximately 2% of registered performers of economic activities. It also should be added that analysing the total number of the patent fee paid months of each person (from January 1, 2010 to June 30,

2016), it is possible to conclude that the majority of the patent fee payers paid only for one month (Informatīvais ziņojums., 2016).

Assessment of satisfaction of performers of economic activities with the tax policy in Latvia

In terms of the survey conducted by the authors, it was necessary to find out the opinions of performers of economic activities on their satisfaction with the tax payment regimes in Latvia, as well as of the State Revenue Service work and the amendments to the tax law in 2018; therefore, the pilot survey was conducted. The questionnaire of the survey was distributed across the social networks Facebook.com and draugiem.lv. The survey took place in the time period from January to March 2018. The response from performers of economic activities was not high, as only 51 questionnaires were filled in.

The majority of the inquired performers of economic activities were in the age range of 36-45 years – 21 persons (41%), 17 persons (33%) – in the age range of 26-35 years. It can be explained by the fact that those persons have got education and want to combine the work of their interest with gaining income; therefore it is important to choose the right field of activity (Figure 1).

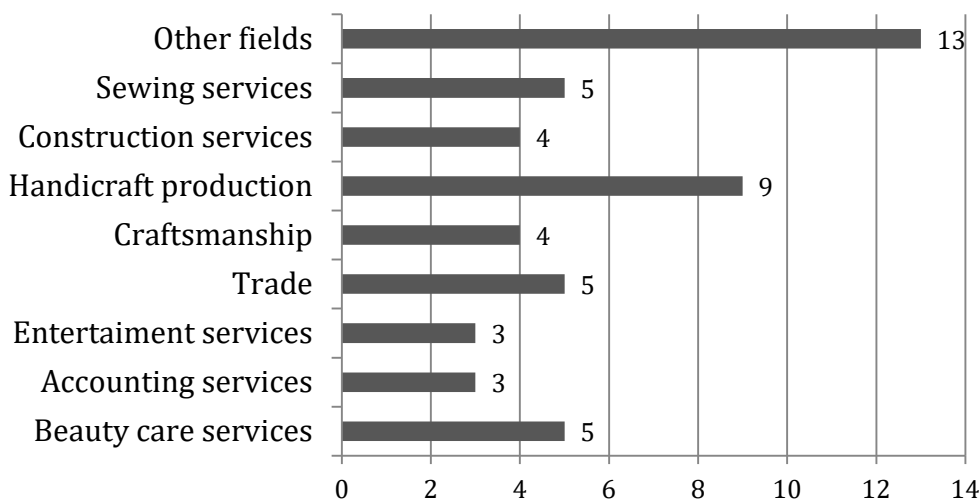


Fig. 1 Primary field of activity of the inquired performers of economic activities (Source: compiled by the authors)

Most of the inquired performers of economic activities, 17 persons, offered various kind of services, 13 persons worked as craftsmen and handicraftsmen, and 13 persons worked in some other fields of activities, for example, indoor cleaning, babysitting, translating, advertising services, etc.

A third of the inquired persons did the amount of work that was equal to full-time work; 1/3 considered it additional work for getting income and 1/3 performed contract work, or worked part-time.

Employers preferred their workers being registered as performers of economic activities to reduce labour expenses; employers also preferred having collective agreements with self-employed persons (Leibus, Vitola, 2007). This way a fake self-employment problem is created, benefiting employers rather than the self-employed. In another survey, 4% of the inquired stated that it was the initiative of their employer. ("Baltijas Konsultācijas" Ltd. & "Konsorts" Ltd., 2018). USA researchers (Dawson et al., 2009) state that a profession, lifestyle, more flexible working hours, additional income, alternative to employment, etc. can be a motivation to take up economic activities. In this survey, 92% of the persons replied that they registered as performers of economic activities because of their own initiative to earn additional income; however, the rest mentioned other reasons, which could be initiated by an employer as well.

The tax policy adjustments complicate the accounting work for performers of economic activities; however, 67% of the inquired persons manage accounting on their own, and the others partly of fully use accounting services.

As it was previously described by the authors, performers of economic activities have the right to choose one of the three tax payment regimes: PIT and SSIMC or MET or patent fee. Of the inquired persons, 75% chose to pay PIT and SSIMC, 18% paid MET and 7% chose to pay the patent fee. As the reasons of their choice, the persons mentioned that the relevant tax payment regime was advised by the staff of the State Revenue Service; or they chose the most familiar one to them due to the lack of information, which was PIT and SSIMC. The performers of economic activities who chose this tax payment regime had larger expenses during their activity, reducing the payable part of PIT and SSIMC. The persons who chose paying the microenterprise tax stated that they had to pay a moderate tax amount and the tax declaration was understandable.

As a disadvantage of the chosen tax payment regime, the payers of the microenterprise tax mentioned a small contribution to social insurance; on the contrary, the payers of PIT and SSIMC marked as disadvantages frequent changes in the tax policy and the high SSIMC rate, which performers of economic activities bore fully on their own, in comparison with employers who had to pay only 11% of their revenue part; as well as the fact that from 2018 performers of economic activities can deduct only 80% of their income as expenses. Therefore, it became more complicated for performers of economic activities to manage their accounting and prepare reports.

As it is known, the mandatory pension insurance (OPI) of 5% was introduced in 2018 for performers of economic activities; 55% of the inquired persons evaluated it in a negative way, as it increased the tax burden. A part of the inquired did not consider these contributions worthwhile since they saw no guarantee these contributions would be profitable in the future. It is mentioned in another research studies as well that the self-employed lack the understanding of the importance of mandatory contributions; there is a desire to gain more today without thinking about the future. In addition, the situation gets worse because the society in general does not believe in responsible tax collection, its usage and the pension system (SIA “Baltijas Konsultācijas” & SIA “Konsorts”, 2018; Leibus, 2008).

A question about the responsibilities of performers of economic activities was also included in the survey questionnaire for the purpose of finding out which causes more difficulties. (Figure 2).

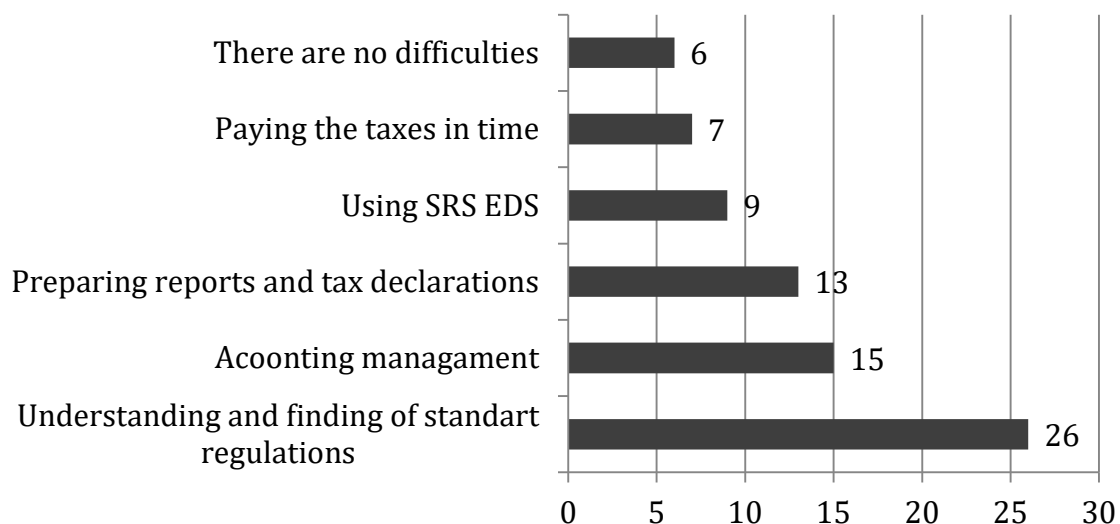


Fig. 2 Replies of the inquired persons to the question “Which responsibilities of performers of economic activities do you find most difficult?” (Source: compiled by the authors)

Most often, the difficulties were caused by understanding and finding some necessary standard regulations (34%), followed by accounting management (20%) and preparing reports and tax declarations (17%). The results of the survey show that accounting management and tax calculation caused difficulties to performers of economic activities since legislation changed every year, therefore it was hard to track whether the information published by the State Revenue Service was full enough. The surveys from the researches of other authors also show that self-employed persons, as the main issues, mentioned the changing tax policy of Latvia, the complexity of

tax legal regulation and difficulties to understand it, as well as a mild bureaucracy level of the tax administration and accounting (SIA “Baltijas Konsultācijas” & SIA “Konsorts”, 2018; Leibus, 2008).

The performers of economic activities also evaluated their collaboration with the State Revenue Service staff. The results of the survey show that 16% of the inquired persons were satisfied with their kindness and tax related competence; 33% were partly satisfied, and 39% were dissatisfied or partly dissatisfied. As the reasons, the persons mentioned that the staff often could not give answers to the questions of interest or offered formal answers, naming law articles only. This means the State Revenue Service staff may be incompetent in the questions that are important particularly to performers of economic activities in such topics as accounting, legislation, tax calculation and other related questions.

Comparison of the tax payment regimes for performers of economic activities

The authors made some calculations setting the amount of the tax burden for various amounts of income in 2018 to evaluate which of the tax payment regimes is more profitable for performers of economic activities (Table 1). Let's say, the registered economic activity field of a performer of economic activities is a beauty care service – a nail care specialist in Riga municipality. Three situations will be applied to the tax calculation:

- 1) EUR 200 revenue, EUR 90 expenses per month, does the main job for another employer, the salary tax booklet is submitted there;
- 2) EUR 500 revenue, EUR 200 expenses per month, works full-time, the salary tax booklet is not submitted to another workplace;
- 3) EUR 1200 revenue, EUR 420 expenses per month, works full-time; the salary tax booklet is not submitted to another workplace. Pays SSIMC from the state fixed minimum monthly wage.

Table 1 Comparison of the tax amounts of performers of economic activities in 2018 (EUR) *(Source: compiled by the authors)*

Index	General regime			Microenterprise tax regime			Patent fee regime		
	1.	2.	3.	1.	2.	3.	1.	2.	3.
Revenue	2400	6000	14400	2400	6000	14400	2400	6000	14400
Expenses	1080	2400	5040	-	-	-	-	-	-
Income	1320	3600	9360	-	-	-	-	-	-

Non-taxable minimum amount	-	2400.00	942.87	-	-	-			
SSIMC	-	-	1659.00	-	-	-	-	-	
OPI 5%	63.50	180.00	210.00	-	-	-	-	-	
PIT	251.30	204.00	1309.63	-	-	-	-	-	
MET	-	-	-	360	900	2160	-	-	
Patent fee	-	-	-	-	-	-	1200	1200	1200
Total tax burden	314.80	384.00	3178.63	360	900	2160	1200	1200	1200

The calculations show that the general tax payment regime is the most profitable for the performers of economic activities with average revenue. (PIT and SSIMC). It is more profitable to choose paying the patent fee, which does not depend on the amount of revenue, only in the case when the revenue exceeds EUR 10000, but is not more than EUR 15000. The same way MET also becomes more profitable when revenue increases, and it is not possible to apply the non-taxable minimum amount to the general tax payment regime. It also should be noted that the tax burden can be decreased by tax relief and eligible expenses by applying the general tax payment regime, which cannot be used by the payers of MET and the patent fee.

Performers of economic activities have to make calculations to be able to predict the payable taxes; it would be easier with a tax calculator available on the State Revenue Service homepage.

Conclusions and suggestions

1. The definitions „performer of economic activities” and „self-employed” are used in the tax legislation of Latvia, however, the term „self-employed” is used in foreign scientists’ research papers and statistics. It is necessary to match these definitions to make the information comparable.
2. Performers of economic activities in Latvia have a possibility to choose among three tax payment regimes: PIT and SSIMC, MET and the patent fee. PIT and SSIMC are the most popular, as the other two are chosen only by approximately 15% of all performers of economic activities, which is also proved by the results of the conducted survey.
3. Of the inquired performers of economic activities, 55% evaluated the mandatory contributions of 5% for pension insurance in a negative way, which increased the tax burden for average and large income from economic activities; there was also the lack of understanding of the importance of paying contributions and its benefit for the future. It is advised to revise the amount of the SSIMC rate or to cancel the

mandatory contributions of 5% for pension insurance if the contributions are paid in full amount at least from the minimum amount.

4. Changing standard regulations and accounting management cause difficulties to performers of economic activities. Of the inquired persons, 39% were dissatisfied or partly dissatisfied with the advice provided by the staff of the State Revenue Service and with collaboration with them, mentioning that the staff of the State Revenue Service often could not give answers to the questions of interest or offered formal answers. Therefore, the State Revenue Service has to improve their guidance materials and the competence of the staff.
5. By making the calculations, it was acknowledged that the PIT and SSIMC tax payment regimes would be more profitable for average income. On the contrary, the situation changes for the income that exceeds the minimum wage set by the state. It also should be noted that the tax burden is decreased by the non-taxable minimum amount, tax relief and eligible expenses by applying the general tax payment regime, which are not used for the payers of MET and the patent fee. Performers of economic activities have to make calculations to be able to predict the payable taxes, and it could be easier with a tax calculator.

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