

The International Comparative Legal Guide to: Corporate Tax 2008

A practical insight to cross-border Corporate Tax work



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1 General: Treaties

1.1 How many income tax treaties are currently in force in your jurisdiction?

Latvia currently has forty four income tax treaties in force. Main countries with which Latvia has *Conventions for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital* in effect are - Armenia, USA, Moldova, the Czech Republic, Denmark, Estonia, Iceland, Canada, Croatia, Germany, Ireland, Uzbekistan, Lithuania, the Netherlands, Norway, Poland, Finland, France, Sweden, UK, Slovenia, Belarus, China, Ukraine, Malta, Slovakia, Singapore, Switzerland, Kazakhstan, Romania, Belgium, Bulgaria, Spain, Turkey, Hungary, Portugal, Georgia and Greece.

Personal and corporate income tax paid in the above-mentioned countries may be credited against individual income tax payable in Latvia and vice versa, or in the case of Lithuania, exemption system is applicable.

1.2 Do they generally follow the OECD or another model?

Latvia income tax treaties generally follow the OECD model convention.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties take effect after they are ratified by the Parliament. Treaties are applied the following year after the ratification by both involved countries.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Latvia generally incorporates anti-treaty shopping rules.

For example, treaties with USA and Finland do not foresee limitation of benefits articles.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Tax treaties override any rules of domestic law after the treaty takes effect.

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

State duties are applied on certain formalities for performance of a legal act by notary. Registration of the transfer of real estate and property ownership in the Land Register, with a sales agreement, is subject to duty of 2% from the value of the property, with a cap of Ls 30,000, if the individual registers a first or second property. In other alienation cases state duty is 4% for individuals. Where the transfer is a gift to the individual, the duty is 3% from the value of the property, with a cap of LVL 50,000, if the individual registers a first and second property. In other gift cases state duty is 6% for individuals.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Value Added Tax shall be charged on any supply of goods or services, on the import of goods, as well as on self-consumption. Value Added Tax rates are 18%, 5% and 0%.

- The standard rate of VAT is 18%, applied to any supply of goods or services which are not exempt or subject to 0% or 5% rate.
- The reduced rate of VAT is 5%, applied to pharmaceuticals, veterinary medicine, infant products, books, certain mass media products, hotel accommodation costs, water supply, certain utility services, sport tickets, electricity and heating for inhabitants.
- The 0% rate is mainly applied to exports and certain supplies within EU. The 0% VAT rate for intra-community supplies is applied if the recipient of goods is an EU entity which is registered with its home country's VAT register and transport documents demonstrate that the goods were actually delivered. The 0% rate is also applied to intermediaries who re-sell goods to end consumers within EU countries.

The supply of goods is the transfer of their ownership to another entity so entitling the latter to dispose of the transferred possession. The first sale after completion of the construction of a building is also considered as the supply of goods.

The supply of services is a transaction based on activities carried out by an entity for a consideration. They include the activities of self-employed individuals, the transfer (sale) of any obligations, rights or intangible assets, obligations to refrain from activities or to accept any activity, as well as the lease of goods. Personal (self)-consumption is the supply of one's own goods and services to an entrepreneur, his family members, employees or other persons free of charge.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

A number of goods and services are exempt from VAT, e.g. certain services with an educational value or cultural function, insurance services, the sale of shares, land and lotteries.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

VAT taxpayers are entitled to deduct the tax paid on their supplies (input VAT) from the tax which they charge their customers (output VAT), if those incoming supplies ensure the entrepreneurial activity of the taxpayer.

If the goods acquired and services received are used for the carrying out of both taxable and non-taxable transactions, and separate accounting for such goods and services has not been ensured, the part of input value added tax to be deducted during the taxation period shall be calculated on the basis of the proportion between taxable and non-taxable transaction.

2.5 Are there any other transaction taxes?

Customs duties are taxed in certain cases of import and export.

2.6 Are there any other indirect taxes of which we should be aware?

Yes. Excise tax is applied to alcohol, tobacco, cars, fuel as well as to products for heating. Natural resources tax is applied to extraction of natural resources, pollution of environment, sale of goods detrimental to environment, sale of tableware and packing. Gambling and lottery tax is levied on business entities that have obtained gambling licenses. Customs duties are generally payable for goods imported from outside EU.

3 Cross-border Payments

3.1 Would there be any WHT on royalties paid by a local company to a non-resident?

Yes. A withholding tax of 5-15% is applicable to royalties paid to non-residents, as follows:

- 15% is applied to payments regarding copyrights (including neighboring rights) or the rights to exercise copyrights (including neighboring rights) to literary or artistic works, including films, video films or sound recordings; and
- 5% is applied to payments regarding other types of intellectual property.

However, if the tax treaty provides a lower rate than the domestic rate, the tax treaty rate may be applied if before the payment, a residence certificate is obtained and other formalities in relation to decrease of the withholding tax complied are with.

3.2 Would there be any WHT on interest paid by a local company to a non-resident?

WHT in amount of 10% shall be calculated on interest paid to related parties - non-residents. Interest paid by commercial banks registered in Latvia to related parties shall be taxed with WHT in the amount of 5%.

However, if the tax treaty provides a lower rate than the domestic rate, the tax treaty rate may be applied if before the payment residence certificate is obtained and other formalities in relation to a decrease of the withholding tax are complied with.

3.3 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Deductible interest for corporate income tax is the smallest of the following: a) interest calculated by multiplying 1.2 times the average short term credit interest rate set by the Central statistical bureau within the last month of the taxation year (rate in April 2007 was set at 11.1%); or b) proportionally the ratio of difference of debt against 4 times that of equity within the first month of the taxation year. Calculations of equity must exclude amounts in long-term re-evaluation reserve and other reserves. This is applicable to all interest payments for debt obligations, including interest payments for financial lease and factoring. Interest accrued before 2003 may be carried forward for up to five years in amounts of 20% of interest accrued. It is not permissible to carry forward interest.

3.4 If so, is there a "safe harbour" by reference to which tax relief is assured?

Thin capitalisation is not applicable to loans from Latvian banks or EU registered banks.

3.5 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Thin capitalisation is applicable to any interest debt, comprising interest on financial lease and factoring.

3.6 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

According to the law "On Corporate Income Tax", withholding tax in amount of 10% is applicable to dividend payments to non-residents. The tax treaties may provide different tax rates.

Withholding tax is not applicable on dividend payments to residents of EU and EEZ member states. Currently, withholding tax rate is 10% on dividend distributions unless an applicable tax treaty provides a lower rate.

However, if the tax treaty provides a lower rate than the domestic rate, the tax treaty rate may be applied if before the payment residence certificate is obtained and other formalities in relation to decrease of the withholding tax complied with.

3.7 Does your country have transfer pricing rules?

In determination of taxable income, profit shall be increased by the difference rising from selling fixed assets or goods (products, services) if prices are lower than market prices and if the transaction partner is a related person or company, which is exempt from income taxes.

A related company is a company which is in the same group of companies. A group of companies consists of a principal company and subordinated companies. A principal company is a company which is a resident of Latvia, a resident of an EU member state, or a resident of a state with which Latvia has concluded a tax treaty. A subordinated company is a company where 90% is owned by a

principle company; or by one or several subordinated companies of the principle company; or the principle company and one or several subordinated companies.

A related person is considered a person (his or her relatives to the third degree or spouse, or those in affinity with such person to the second degree), who owns more than 50% of share capital or value of shares or whose decisive influence over a company is ensured by a contract or otherwise.

Transactions with low tax countries are always considered as transactions with related parties and payments to low tax countries are ordinarily subject to 15% withholding tax. The list of low tax countries is as follows: Antilles (the Netherlands), Andorra, Anguilla, Antigua & Barbuda, Aruba (the Netherlands), Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei Darussalam, Cayman Islands, Cook Islands (New Zealand), Costa Rica, Dominican Republic, Ecuador, Gibraltar, Grenada, Guam, Guatemala, Guernsey, Hong Kong (Sjangan), Isle of Man, Jamaica, Jersey, Jordan, Jisbuty, Kampione, Kenya, Kuwait, Labuana (Malaysia), Lebanon, Liechtenstein, Liberia, Maldives, Macao, Madeira (Portugal), Mauritius, Marshall Islands, Monaco, Montserrat, Nauru, New Caledonia, Niue (New Zealand), Olderne, Panama, Qatar, San Marino, Seychelles, St. Helens, St. Kitts and Nevis, St. Maria Island (Portugal), St. Pierre and Michel (France), Samoa, Santome and Prinsipi Republic, St. Lucia, St. Vincent and Grenada, Tahiti (French Polynesia), Tonga, Turks and Caicos Islands, United Arab Emirates, Uruguay East Republic, Vanuatu, Venezuela, Virgin Islands (USA) and Zanzibar Islands (Tanzania).

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax is 15%.

4.2 When is that tax generally payable?

The tax year is generally the calendar year, but it may differ if so stipulated by a company's charter.

The annual income declaration must be filed within 30 days from the annual shareholders' meeting, but not later than four months after the year-end.

Companies must pay tax in advance in instalments by the 15th day of each month. In general, for the period from the first month of the taxation period up to and including the month that the annual report is filed, but not later than four months after the taxation year ends, monthly advance instalments are equal to 1/12 of the annual tax calculated for the year, two years prior to the current tax year, adjusted for inflation.

For the remaining months, the monthly advance payments are each equal to 1/8th of the following: the tax calculated for the preceding year, adjusted for inflation and reduced by the advance tax payments made in accordance with the above procedure.

Any outstanding tax must be paid within 15 days of the due date for the annual income declaration.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

According to the law "On Corporate Income Tax", companies registered in Latvia are subject to tax on their world-wide income.

Non-resident companies without a permanent establishment in Latvia are subject to tax on their revenue in Latvia.

Non-resident companies operating through a permanent establishment in Latvia are subject to tax on revenue gained by that permanent establishment, as well as revenue independently obtained abroad by the permanent establishment.

If a non-resident company engages directly in business activities that are similar to the business activities performed by its permanent establishment in Latvia, income derived from the non-resident company's activities is included in the taxable income of the permanent establishment.

Resident companies are those that are established or registered, or required to be established or registered, in accordance with the law. All other companies are considered to be non-resident companies.

Taxable income is the profit or loss reported in a company's profit or loss statement, prepared in accordance with the law "On the Annual Report of Companies" and subject to the adjustments for non-deductible costs and depreciation.

Tax depreciation for fixed assets is calculated using the double-declining balance depreciation method. To promote investment in fixed assets, the law determines increased depreciation rates. Double depreciation rates range from 15% to 70% for oil extraction tankers, technical equipment, machinery, office equipment, furniture and certain other assets. The depreciation rate for buildings and constructions is 10%.

The acquisition costs of patents, licenses and trademarks are amortised according to the straight-line method for five years, but concessions are amortised during ten years. Patents, licenses and trademarks issued for a term of less than five years, can be written off within the term of their validity for tax purposes. Research and development costs can be written off for tax purposes the same year that they are incurred. Amortisation is not allowed for trade secrets and goodwill.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Profit shown in commercial accounts is adjusted by several positions. Below are the main differences by which taxable income differs from commercial accounts.

Profit has to be increased by: depreciation of fixed assets and written-off intangible assets shown in the annual report; the total of penalties arising from contracts; payments to non-residents if no withholding tax is paid; reserves for bad debts; 40% of representation expenses; expenses related to securities which are in public circulation; interest in excess of admissible amounts (thin capitalisation); differences between transaction values and market values and differences in the value of goods (production, services).

Profit has to be decreased by: total depreciation of fixed assets and intangible investments according to the tax laws; real estate tax; duties and taxes on gambling and lotteries; total of bad debts, if the debtor has been declared bankrupt by the courts; decreases in reserves for bad debts compared to the previous tax year; dividends received; income from securities which are in public circulation and late payment fees for taxes which are subsequently decreased.

4.5 Are there any tax grouping rules? Do these allow for relief in your jurisdiction for losses of overseas subsidiaries?

Companies within a corporate income tax group are allowed to transfer loss to profitable group companies in this way leveling the tax burden. To qualify for group relief, the parent company has to

own at least 90% of subsidiaries and the parent-subsidiary relationship has to exist for the entire financial year. The head company or the sub-company for group purposes may be located in EU countries, if this company is not recognised as a non-EU tax resident based on a double tax treaty.

If companies, whose tax group is located in the EU or EEZ, have losses (calculated according to the Latvian legislation) and it is not possible to carry forward losses it is not permitted to transfer losses to another company located in the home country; however it is possible to reduce taxable income of the Latvian company (in the same tax group) by an amount which does not exceed losses of the company from which losses are transferred.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained, profits in Latvia.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

In addition to the above mentioned taxes, Latvian laws determine real estate tax at the rate of 1.5%, gambling tax, natural resources tax, excise tax and car and motorcycle tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

Inheritance tax administered by courts is 0.5% to 10% from the value of the inheritance, depending on kinship.

Corporate income tax at a glance

Corporate income tax rate %	15
Withholding tax (%) (a)	
<i>Dividends</i>	10
<i>Interest to related parties</i>	10
<i>Management (consultancy) fees</i>	10
<i>Royalties</i>	15 or 5
<i>Payments to low-tax countries</i>	15
<i>Sale of Latvian real estate</i>	2
Net operating losses (years)	
<i>Carry back</i>	0
<i>Carry forward</i>	5

(a) These taxes apply to payments to non-residents.

The definition of consultancy fees (subject to 10% withholding tax) is broadened, to include in it all consulting and management services provided to a company, not just services provided to a company's management. To avoid withholding double taxes, treaty benefits may be utilised for payments to tax treaty countries.

According to the law "On Corporate Income Tax", a withholding tax of 2% on non-residents' income from the disposal of real estate shall be applied. The new rules determine that in cases where the tax of 2% is not withheld on payments, the payable amount does not become a non-deductible expense for corporate income tax purposes. The general rule is that, where payments are made to non-residents, there is an option to withhold tax on consultancy (10%), interest to related parties (10%) and royalty fees (5% or

15%). If the withholding tax is not paid by the 15th of the following month, the full amount payable becomes a non-deductible expense for corporate income tax purposes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Resident and non-resident companies operating through a permanent establishment in Latvia shall include capital gains on securities or shares in their taxable income.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The rate of tax imposed upon capital gains shall be the same as the rate imposed upon business profits except for non-resident companies without a permanent establishment in Latvia. A final withholding tax is imposed on proceeds from the sale of Latvian real estate, at a rate of 2%, as a sale of Latvian real estate will be considered a sale of shares in the company where 50% of assets consists of Latvian real estate.

5.3 Is there a participation exemption or relief for reinvestment?

There is an exemption from taxation for a dividend received by the Latvian company, which owns at least 25% of capital and voting the non-resident payer if the payer does not reside in the low tax country.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary, except for state fees LVL 20-60 (approx. EUR 30-90) and notary fees. There is no percentage fee for the investment of the share capital.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Taxable income for branches is income obtained independently during a taxation period in Latvia and foreign countries. The tax shall be 15% of such taxable income.

If a non-resident directly carries on economic activity in Latvia, including trade or providing of services, which is the same economic activity as that carried on by the branch of such non-resident in Latvia, the directly obtained income of such non-resident as has been obtained in Latvia shall be included in the income of the branch located in Latvia and corporate income tax shall be imposed thereon at the rate of 15%.

6.3 How would the taxable profits of a local branch be determined?

There are two methods for determining the taxable income of a

branch. According to the first method, taxable income is determined based on information specified in a corporate income tax declaration which, along with a balance sheet and a profit and loss statement, must be submitted to the tax authorities within four months of the end of the taxation period (year).

Where the branch office has been active for less than 12 months, a simplified method may be used to calculate taxable income. According to this method, costs are 80% of income. As a result, the taxable income is 20% of revenue subject to a corporate income tax 15% for 2007. Therefore, this method of calculation determines an effective tax rate of 3% for 2007. A payer may, upon agreement with a branch office, withhold tax on behalf of the branch. If there are no more than three payers and an agreement is concluded between the payers on withholding of the tax, neither a profit or loss statement nor a balance sheet need to be submitted to tax authorities.

Non-deductible expenses for corporate income tax purposes applicable to branches comprise payments to a head office for royalties, any services such as consultancy, management, etc. and interest payments (exceptions apply to branches of banks). Deductible costs comprise head office costs supported by documents relating to the branch office. This rule eliminates limitations on the deduction of overhead costs borne by the head office, but deductible in the branch only in proportion to the income of the branch office measured against the income of the head office.

The simple method of calculation may not be applied to branches of entities resident in low tax countries.

Interest, royalties, rent and payments for services that are paid to the head office are corporate income tax non-deductible expenses.

The taxable income of permanent establishment may be reduced by costs borne by the parent company, if those expenses are actually connected to the permanent establishment.

Expenses related to the acquisition of intellectual property, interest payments and administration costs that are deductible are subject to the appropriate withholding taxes.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Branches are subject to general corporate income tax rules.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

According to tax treaties concluded with Latvia, foreign branches are treated in the same way as resident companies.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

There will not be any withholding tax for remittance of profits by the branch.

7 Anti-avoidance

7.1 How does your jurisdiction address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

As related parties will be considered two or more companies Latvia addresses the issue of preventing tax avoidance, if between these companies in addition to a contract regarding a specific transaction, an agreement in any form has been entered into (including an agreement that has not been made public) regarding whatsoever additional remuneration not foreseen in the contract, or also such companies perform other types of concerted activities with intent to reduce taxes. Payments to low tax countries are ordinarily subject to 15% withholding tax.



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