Management and consulting services (2/9/17)

To pick up where we left off about payments to non-residents, this article explores management and consulting fees, a common type of payment that is subject to a 10% withholding tax.

Tax must be withheld when management or consulting fees are paid to a non-resident, unless it is possible to claim double tax treaty relief on the basis of the payee's residency certificate. If the payer knows that such a certificate will not be available, then tax must be withheld at the time of making payment or any other settlement (such as converting debt into equity or offsetting one debt against another). Where tax should have been withheld at source and a valid residency certificate is not available at the time of payment, the taxpayer must add the fees paid to the non-resident back to taxable income on the annual corporate income tax (CIT) return. As a result, the payments will be taxed at a rate of 15% instead of 10%.

What are management and consulting services?

Management and consulting services are defined by section 3(6) of the CIT Act as a set of activities that a non-resident performs either directly or through hired personnel to ensure the running of a domestic (resident) company or of another non-resident's permanent establishment (PE) in Latvia, or to provide a domestic (resident) company or PE with necessary consulting services.

Paragraph 19 of Cabinet Regulation No. 556 describes consulting services in more detail. Under section 3(6) of the CIT Act, consulting services are taken to mean any consulting services supplied to a Latvian taxpayer or PE, such as giving advice, preparing various datasets and materials (estimates, designs or business plans), providing information about changes to accounting software, market research, advertising, the equipment and manufacturing technology market, and other matters concerning the trader's strategic development, production and sales, or a study of the trader's economic activities. For statutory purposes a service is treated as a consulting service by reference to its economic content and substance, not only its legal form.

In addition to the above, the State Revenue Service (SRS) has expressed the opinion that if consulting services are supplied to a company which needs that advice for providing services to customers and pays fees to a non-resident entity, then section 3(4)(2) of the CIT Act applies, under which a 10% tax must be withheld at source, regardless of how that advice is used later on (i.e. to carry out business activities or to provide services to customers). For example, if a company orders a market research from a non-resident for inserting it in their report to a customer, the fee payable for that market research will attract a 10% withholding tax, even though the company will not be using the study in its trade or business.

Aspects to consider

The SRS tends to scrutinise management services on tax audits. The SRS takes the view that management services are aimed at profit shifting, and so the company must prove that they are connected with the distribution of business functions between group companies. For this reason, companies should prepare documents detailing the substance of their transactions and proving that services have actually been received (the benefit test). The taxpayer should assess whether services fit the definition of management and consulting services and whether it is possible to invoke a double tax treaty and obtain a residency certificate for claiming treaty relief. The taxpayer should also be able to prove that the service fee is arm's

length (in related-party transactions).