

Practical tips for preparing corporate tax return for 2016 (cont. 2) (1/13/17)

This article continues to explore common adjustments and mistakes in preparing the CIT return that are associated with capital allowances, payments to non-residents, movements in provisions, and donations.

Capital allowances

Section 13 of the CIT Act requires that capital allowances be calculated for each non-current asset separately in the following classes:

- buildings, structures, and perennial plantations;
- platforms and ships for oil exploration and extraction;
- new plant and equipment;
- light-duty vehicles, motorcycles, watercraft and aircraft purchased after 11 June 2007;
- assets that are only partly used in trade or business or not used at all; and
- intangible assets.

Capital allowances for any other assets should be calculated for the whole class.

In practice, taxpayers do not always book capital allowances for each asset separately in the above classes, and so a mistake is made when it comes to disposing of an asset.

When a separately booked asset is disposed of, or when a class has no asset left in it, taxable income should be adjusted for the difference between the tax written-down value of the asset at the beginning of the year and its net book value at the time of disposal (the difference between depreciation charges and capital allowances):

- it should be increased if the difference is negative under section 13(1)(5) of the CIT Act; or
- it should be reduced if the difference is positive under section 13(1)(6) of the CIT Act.

If a company disposes of an asset not booked separately, then the difference between depreciation charges and capital allowances has not been calculated correctly, as the class still has some assets left in it.

Payments to non-residents

If a fee payable to a non-resident in respect of their Latvian-source income is subject to withholding tax, then CIT is paid to the government by the Latvian resident after withholding the amount of tax due, i.e. the non-resident receives their income after CIT has been withheld. However, if the Latvian company has not withheld CIT on the payment at source, then the gross payment should be added back to taxable income, unless double tax treaty relief is available.

Mistakes are found where a Latvian company pays CIT on behalf of a non-resident without making appropriate adjustments to taxable income. In other words, the amount of withholding tax the Latvian company has paid on behalf of the non-resident is a non-business expense to the company, and so this amount should be multiplied by a coefficient of 1.5 and reported on line 2.1 of the CIT return.

Movements in provisions

Taxable income should be adjusted for any increase or reduction in provisions. Provisions are obligations related to the financial year or previous years that are expected or known at the time of preparing the annual report, but neither their amount nor the date they will fall due or be paid is clearly known.

Latvian taxpayers often confuse provisions with accrued liabilities (because the two terms share the same root and prefix in Latvian).¹ For example, an accrued liability is a telecom invoice of December 2016 received in January 2017. Accrued liabilities are similar to provisions, but unlike provisions, their amount and due date can be determined more accurately. Taxable income is not adjusted for accrued liabilities.

When it comes to adjusting taxable income for movements in provisions, it is the increase or reduction actually taken to the profit and loss account that matters. However, taxpayers tend to adjust taxable income for their balance of provisions.

Donations

Taxpayers are allowed to deduct from their CIT charge up to 85% of amounts donated to any of the institutions and organisations listed in section 20.1(1) of the CIT Act. However, the total tax relief is capped at 20% of the CIT charge for the tax year.

Since donations are non-business expenses, any donation made should first be added back to taxable income on line 2.2 of the CIT return without applying the increasing coefficient of 1.5. In practice, however, companies often ignore this requirement and report their donations on line 83 only.

A company donating to an organisation that does not meet the conditions of section 20.1(1) is ineligible for relief on donations, and the donated amount should be reported as a non-business expense subject to a coefficient of 1.5.

It is also important to note that a company is ineligible for relief on donations if its total tax debt exceeds €150 on the 1st day of the second month of the tax period.

¹ An accrued liability is a present obligation that arises from a past event, and its amount as well as the date it will fall due or be paid are known quite accurately, but the transaction has yet to be confirmed with a document.