

“Person related to company” under section 12 of CIT Act (2/21/17)

For calculating taxes on transactions between related companies and determining their prices, the lawmaker has laid down special rules in section 12 of the Corporate Income Tax (CIT) Act. This article explores the term “person related to company.”

Requirements of section 12

Section 12 of the CIT Act states that in determining a taxpayer’s taxable income, profit should be increased by the transfer pricing difference that arises if any of the transactions listed in this section are not arm’s length with –

- foreign related companies;
- a related company that is part of the same group with the taxpayer;
- companies or cooperative societies that are exempt from CIT or enjoy any CIT relief available under other Latvian laws; or
- persons related to the company.

Section 1 of the CIT Act defines both “person” and “person related to company.”

Defining the term “person”

Section 1(4) of the CIT Act states that a “person” is an individual or entity, or a group of such persons associated by contract, or representatives of such persons or groups. This means that the definition of “person” covers both an individual and an entity as well as a group of such persons or their representatives.

Defining the term “person related to company”

Under section 1(5) of the CIT Act, a “person related to the company” is –

- a person that (in the case of an individual, including their relatives up to the third degree or their spouse, or their relatives by marriage up to the second degree) owns more than 50% of share capital in the company or cooperative society; or
- a person that (in the case of an individual, including their relatives up to the third degree or their spouse, or their relatives by marriage up to the second degree) has decisive influence in the company or cooperative society by contract or otherwise.

It is important that this definition includes special explanations for the case of an individual.

“Person related to company”: an individual

An evaluation of these terms may lead to a difference of opinion about whether a “person related to the company” is an individual or entity or only an individual, because the definition in section 1(5) of the CIT Act is not clear enough.

A clarification to section 1(5) is given in the Cabinet of Ministers’ Regulation No. 556 of 4 July 2006,

Application of Provisions of the Corporate Income Tax Act. Paragraph 2 of this regulation makes it clear that a “person related to the company” as defined in section 1(5) of the CIT Act is an individual.

A “person related to the company” is an individual who owns more than
☒ 50% of the company’s share capital or has decisive influence in the
company by contract or otherwise.