

Tax reform: new corporate tax calculation model

(2) (1/33/17)

Last week we outlined some of the latest developments in corporate income tax (CIT) treatment. This article continues exploring key changes.

Share disposal and dividend income

Latvia has so far had a very favourable regime for holding companies, notably a CIT exemption on profits from share disposals. Certain restrictions will apply going forward, and only shares that have been held for a minimum of three years by the time of sale will qualify for an exemption. Shares in an entity that is located, established or incorporated in a tax haven will still be ineligible for these favourable rules.

A dividend received from a foreign subsidiary and distributed to a shareholder will not attract CIT again, provided the company paying that dividend is subject to CIT in the country where it belongs, which is not a tax haven.

Payments to non-residents

The new law also provides for changes that affect withholding tax on payments to non-residents. For example, management and consulting fees will attract a 20% tax instead of the current 10% (unless double tax treaty relief is available). Real estate sales will attract a 3% tax instead of the current 2%. Payments for using property in Latvia will be exempt from withholding tax.

A non-resident selling real estate to another non-resident will have to report and pay a 3% withholding tax on the consideration within 30 days of the transaction. A seller resident in an EU member state or in a treaty country can later file an additional tax return and opt to charge a 20% tax on the profit.

Interest charges

The current CIT Act prescribes two methods for calculating non-deductible interest charges that must be added back to taxable income.

The new law introduces a new method for capping the exempt amount of interest. The cap will still not apply to interest charges on loans from lending institutions and other qualifying institutions established in an EU/EEA member state or in a country that has an effective double tax treaty with Latvia.

Up to €3m in interest charges

Companies with an annual interest charge of up to €3m will have to use only one of the current methods for CIT purposes, meaning the taxable base will have to be increased proportionally by interest charged on an average liability that exceeds four times shareholders' equity (excluding reserves) at the beginning of the year.

This method will not apply to interest charges on loans from the following financial institutions:

1. resident in Latvia, in an EU/EEA member state, or in a country that has an effective double tax treaty with Latvia; and
2. provide supervised lending or finance lease services.

Transfer pricing principles will still apply to transactions between related parties.

Interest charges exceeding €3m

Companies with an annual interest charge exceeding €3m will have to pay CIT on the excess under these two methods:

1. interest charges on a loan that exceeds four times shareholders' equity (excluding reserves);
2. an interest charge that exceeds 30% of profit before CIT after adding interest charges and depreciation charges.

If both methods result in an increase, then only the higher amount applies.

Tax relief on donations

After a lengthy debate about keeping tax relief on donations, donors will be allowed to take this relief in one of the following three ways:

1. exclude donations from the taxable base at 5% of the profit for the past year; or
2. exclude donations from the taxable base at 2% of total gross pay for the past year on which national insurance contributions have been paid; or
3. reduce the CIT charge by declared dividends at 75% of the donated amount, capped at 20% of the CIT charge on dividends.

There are still a number of conditions the taxpayer must satisfy if he is to claim donation relief.

(to be continued)