Anti Tax Avoidance Directive's rules passed into new CIT Act (3/25/18)

In our Flash News edition of 12 June 2018 we wrote about some of the rules of the Anti-Tax Avoidance Directive (2016/1164) that Estonia plans to pass into its Income Tax Act. When putting together the new CIT Act, Latvia allowed for the need to transpose the directive's rules and made them applicable from 1 January 2018. In this article we take a look at how the directive has been passed into the CIT Act.

Prevention of aggressive tax planning

The Anti-Tax Avoidance Directive lays down legally binding measures to prevent aggressive tax planning. In particular the directive aims to address situations where mismatches in the tax systems of different countries are abused by multinational enterprises to minimise their tax liabilities. The rules adopted to fight aggressive tax planning affect a number of areas.

Limitations on the deductibility of interest

Section 10(3) of the CIT Act fully transposes the interest limitation rule. In other words, where a taxpayer's interest expenses for the financial year exceed 3 million euros on borrowings or finance leases from parties that are not credit institutions (financial institutions) of Latvia, the EEA or a country that has an effective double treaty with Latvia, the CIT base should include any interest charges exceeding 30% of the taxpayer's EBITDA.

Exit tax

According to its annotation, the CIT Act essentially ensures that the directive's rules are transposed. We feel, however, that the CIT Act is not specific enough about transposing those rules, unlike countries such as Estonia.

Controlled foreign companies

Latvia has not transposed and is not enforcing the controlled foreign company rules. Latvian holding companies are not required to pay Latvian taxes on profits of their subsidiaries because Latvia emphasises withholding tax.

However, flow-through dividends received from a person that is located, set up or incorporated in a tax haven are ineligible for a CIT exemption available under section 6(1) of the CIT Act.

A general anti-abuse rule

Under section 6(5) of the CIT Act, flow-through dividends are not exempt from CIT where the taxpayer's main intention, or the main reason a related party was set up or exists, or the main purpose of the transaction, was to claim a tax exemption on dividends available under the CIT Act or the PIT Act.

Rules to tackle hybrid mismatches

Section 6(3) of the CIT Act places a restriction on flow-through dividends. In other words, the taxpayer is allowed to reduce the amount of dividends included in his CIT base for the tax period only by dividends their payer has not deducted from taxable income in his country of residence.

Please note that the rules of the directive, which was adopted on 12 July 2016, are to be passed by member states into their national legislation on or before 31 December 2018, with the exception of exit tax rules, which are to be passed on or before 31 December 2019.