

CIT Act to be amended: permanent establishment (2/39/19)

We have informed our MindLink.lv subscribers about proposals for amending the Corporate Income Tax (CIT) Act. This article explores only proposals relating to a permanent establishment (PE).

The Latvian taxpayer's CIT base excludes a foreign PE's deemed profit distributions

The proposals provide that a Latvian taxpayer's CIT base should exclude a foreign PE's deemed profit distributions if the taxpayer's own transactions are recorded separately from the PE's transactions and the PE pays foreign tax on its income or foreign tax has been withheld on its income.

Exit tax

The proposals provide that the tax base should include the value of an asset the taxpayer transfers to its foreign PE for doing business if the transfer results in the Latvian tax authority forfeiting the right to tax the asset transferred. This rule will also apply to the portion of the asset value deducted from the PE's taxable item but will not apply to assets transferred for a period of up to 12 months –

1. for financing securities,
2. as collateral,
3. to meet capital adequacy requirements (so-called prudential capital),
4. for liquidity management.

The proposals provide that if the book value of an asset is different from its market value, the tax base should include the relevant portion of the market value. If the taxpayer's own transactions are recorded separately from the PE's transactions, CIT will be payable when the taxpayer distributes its foreign PE's income. However, if a PE transfers its business activity to the head office or to another PE of the same entity, the tax base should include the market value of transferred assets on the transfer date after deducting any liabilities transferred with the assets in the course of reorganisation (except for any accrued liabilities attributable to future expenses). Accordingly, no CIT will be payable on the transferred assets if another taxpayer continues to use them for doing business in Latvia.

Filing and adjusting CIT returns

The PE will still be required to file a CIT return on or before the 20th day of the following month. However, to enable the PE to prepare a balance sheet and a profit and loss account like the other taxpayers, the proposals provide that the PE should file the balance sheet and the profit and loss account within four months after the end of the financial year.

The proposals also provide that where an additional tax liability arises after the PE's tax return for the last month of the financial year is adjusted, a late fee will be waived if the adjustments were made to the profit and loss account and the balance sheet, and the adjusted tax return is filed with the Latvian tax authority within four months after the last month of the financial year. However, the late fee waiver will not apply to a PE that ceases trading in Latvia.

Hybrid mismatches

The proposals for neutralising hybrid mismatches we discussed earlier relate also to a PE. A hybrid PE mismatch arises when the jurisdiction of the PE and the jurisdiction of its head office's residence have different rules for distributing income and expenditure between units of the same entity. This includes cases where a mismatch arises because there is no PE under the law of the PE's jurisdiction while the law of the head office's residence jurisdiction considers that a foreign PE exists in this situation (an unrecognised PE). As a result the taxpayer will be required to add the income of its foreign unrecognised PE to its tax base.