Corporate tax treatment of profits from property sales (3/5/20)

If we look at the Latvian corporate income tax (CIT) treatment of real estate (RE) sales, foreign companies are still governed by different rules when selling shares in a Latvian company whose assets are mostly RE. This article explores key differences in CIT treatment depending on whether the seller is a Latvian or a foreign company and whether they sell RE or shares in an RE company, as well as outlining some proposed changes that will affect Latvian companies.

Key differences

Let us analyse four different scenarios where the seller is a foreign or Latvian company that sells either RE in Latvia or shares in a company owning RE in Latvia if the RE, whether alone or combined with some other RE, represents more than 50% of the company's assets ("RE Co") under section 5(2) of the CIT Act. It is important to note that this rule applies to direct participation as well as indirect participation where the RE Co is owned through shares in one or more Latvian or foreign registered companies. The buyer will be a Latvian company in all our scenarios.

The seller is a foreign company

A Latvian company buying Latvian RE from a foreign company is required to withhold a 3% tax on the selling price under section 5(1)(2) of the CIT Act. The same applies to buying shares in an RE Co.

Yet section 5(4) of the CIT Act provides that a foreign company resident in an EU member state or in a country that has an effective double tax treaty with Latvia may go for a recalculation and instead of a 3% withholding tax, pay a 20% CIT on profits from such transactions if the company holds all statutory supporting documents. This applies to profits arising on the sale of Latvian RE and RE Co shares.

It is important to note that double tax treaties offer no other advantages nor a more generous tax regime in RE transactions.

The seller is a Latvian company

A transaction between two Latvian companies does not attract a 3% withholding tax, and the Latvian company has no tax base. Yet the company will in fact pay a 25% CIT when distributing the profit from the Latvian RE sale for the year and taking it to the profit and loss account.

A Latvian company selling RE Co shares again has no tax base. The company may have to pay a 25% CIT when distributing the profit from the RE Co sale for the year and taking it to the profit and loss account if the shares were held for less than 36 months. This is because the current wording of section 13(1) of the CIT Act allows the company to reduce dividends included in its tax base to the extent it gained income from selling shares held for at least 36 months.

It is important to note that amendments to the CIT Act to be debated by Parliament on 30 January 2020 in their third reading provide that this relief will no longer be available on the sale of RE Co shares. Currently this relief is not available on shares in a tax-haven company.

Summary

Seller Item	Latvian company	Foreign company*
Latvian RE	No tax base A 25% CIT is payable when the profit is distributed	3% of selling price or 20% of profit
RE Co shares	No tax base A 25% CIT is payable when the profit is distributed if the shares were held for less than 36 months or if the RE Co is a tax-haven company Income arising on the sale of shares held for at least 36 months may be deducted from dividends included in the tax base**	3% of selling price or 20% of profit

** Resident in an EU member state or in a country that has an effective double tax treaty with Latvia*
*** Parliament is to debate amendments which provide that this relief will no longer be available on the sale of RE Co shares.*

Adoption of the proposed amendments will equalise the CIT treatment of sales of Latvian RE and RE Co shares, as well as minimising the scope for tax planning.