Exit tax: scope and treatment (2/28/20)

Recent amendments to the Corporate Income Tax ("CIT") Act, transposing Council Directive (EU) 2016/1164 of 12 July 2016 and Council Directive 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164, have introduced a number of new provisions. This article takes a look at exit tax, which is regulated by many of the new provisions.

What is exit tax?

To begin with, we are not talking about any new tax introduced to the Latvian tax system. The idea of exit tax is to charge CIT on capital gains accruing to a taxpayer that removes its assets or tax residence from Latvia to another country.

No direct reference to exit tax can be found in the CIT Act, as the exit tax rules of the directive are scattered across several sections of the CIT Act. Exit tax becomes chargeable when Latvia loses its taxation rights in these four situations:

> *Situation 1* – The head office in Latvia moves an asset to its permanent establishment ("PE") outside Latvia;
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> *Situation 2* – The PE in Latvia moves an asset to the head office or to its other PE outside Latvia;
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> *Situation 3* – The company changes its place of residence (the head office in Latvia is merged into a company outside Latvia without leaving a branch in Latvia in the course of reorganisation) and moves its assets accordingly;
>
> *Situation 4* – A line of business is transferred by moving assets from the PE in Latvia to the head office or its other PE outside Latvia.

An exception applies to any assets that a company removes from Latvia for a period of up to 12 months free of charge and makes available for financing securities, as collateral, for meeting capital adequacy (prudential capital) requirements, or for liquidity management.

The taxable amount

If assets are found to have left Latvia, the company may have to include a capital gain in the taxable base (reporting it in column 6.8 or 6.9 of the CIT return).

In situations 1 and 2 above, the taxable amount will be the market value of assets transferred at the time of transfer. In situations 3 and 4, however, the taxable amount will be the market value of assets transferred at the time of reorganisation less any liabilities attributable to them (except for any accrued liabilities attributable to future expenses that have been transferred to the acquiring company along with the assets in the course of reorganisation).

The legislation does not provide that any amount the company has invested in the assets being transferred could be deducted from their taxable market value.

The tax point

The CIT Act lays down the following tax point rules in the four situations.

Situation 1

CIT is chargeable in the tax period (month) in which the transfer of assets occurs, and must be included in the taxable base for the last tax period of the financial year (section 4(5) of the CIT Act).

If the company's transactions are recorded separately from the PE's transactions, the asset value must be included in the taxable base gradually to the extent an impairment of the asset has been attributed to the PE during the period after its transfer. The details must be included in the tax return for the last month of the financial year (section 16(4) of the CIT Act), but CIT on the assets transferred to the PE is actually due when a dividend is declared (section 4(8.2) of the CIT Act).

Situation 2

CIT is chargeable in the tax period (month) in which the asset transfer occurs, and CIT is payable regardless of dividend distribution by including the asset value in the taxable base for the last tax period of the financial year (section 4(5) of the CIT Act).

Situation 3

The asset value must be included in the taxable base in the tax period (month) in which the reorganisation (asset transfer) occurs, and CIT is payable regardless of dividend distribution (section 4(5) of the CIT Act).

Situation 4

CIT is chargeable in the tax period (month) in which the asset transfer occurs, and CIT is payable regardless of dividend distribution by including the value in the taxable base for the last tax period of the financial year (section 4(13.1) and (5) of the CIT Act).