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New tax opinion on amount of related party loan for current year 1/50/19

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We have written[1] about the burning question of how to calculate the value of a related-party loan for the current year. This is crucial in determining whether the taxpayer is required to prepare and submit transfer pricing (TP) documentation to the State Revenue Service (SRS) within 12 months after the end of the financial year. As the deadline for 2018 is almost upon us (31 December 2019), PwC approached the Ministry of Finance and the SRS for comment. This article explores the opinion shared by the two bodies and PwC's understanding of their comment.

Measuring the value of a loan transaction

In quoting this interpretation for the purposes of applying section 15.2 of the Taxes and Duties Act, the value of the controlled (long-term, short-term, credit line or cash pool) loan transactions for the year is the value of the loan received and interest recognised. If no loan is received in the current year, but interest is recognised on a loan received in the previous period, the value of the controlled loan transaction for the current year will comprise only the interest charge recognised. There may be a situation where the value of the controlled loan transaction comprises only the loan, with no interest charge recognised in the current year.

Following the tax opinion, the table below shows PwC's understanding of how to calculate the amount of the controlled loan transaction for the year:

	Loan received in previous year	Loan received in current year	Interest due in current year	Loan transaction value in current year
Loan transaction 1	10,000,000	-	500,000	500,000
Loan transaction 2	-	5,000,000	-	5,000,000
Loan transaction 3	-	4,000,000	100,000	4,100,000
Amount of controlled transaction for current year:				9,600,000

In this example, according to the Taxes and Duties Act, the amount (or total) of the controlled loan transactions for the year is taken to mean the sum of the money loaned – the principal debt – and total interest charges: EUR 9,600,000.

Measuring the value of credit line and cash pool transactions

Aware of the peculiarities of credit line and cash pool transactions, the authorities find that where, after considering the facts and circumstances of each loan agreement, this interpretation fails to provide an objective view of the amount of money loaned (including TP risk) for the year because of the large number of transactions (borrowings and repayments) made during the year, the words “amount of transactions for the current year” in section 15.2 of the Taxes and Duties Act may be read by the taxpayer as follows:

> Amount of transactions for current year = Liability at beginning of period (e.g. amount of credit limit used) + Loan received in current year – Loan repaid in current year + Interest recognised in current year

Following the tax opinion, the table below shows PwC’s understanding of how to calculate the total amount of the controlled credit line and cash pool transactions for the year:

	Liability at beginning of year	Loan received in current year	Loan repaid in current year	Interest due in current year	Transaction value for current year
Credit line transaction 1	10,000,000	-	3,000,000	350,000	7,350,000
Cash pool transaction 2	10,000,000	5,000,000	15,000,000	200,000	200,000
Credit line transaction 3	-	5,000,000	1,000,000	150,000	4,150,000
	Amount of controlled transaction for current year				11,700,000

In this example, according to the Taxes and Duties Act, the amount of the controlled transaction for the year is EUR 11,700,000.

Applying this interpretation in practice

Having considered the tax authorities’ opinion on how to measure the amount or total of each type of loan transaction, we find there is still confusion about how to measure revolving loan (credit line/cash pool) transactions. The confusion lingers because it is not clear how the SRS will define an objective view of the value of money loaned (including TP risk). Is it the number of transactions per year? Or is it the facts and circumstances of each loan agreement that allow the taxpayer to use the formula described in the second part of this article rather than the transaction value principle prescribed for term loans in its first part?

This confusion suggests that the authorities, taxpayers and tax consultants are all likely to come back to this question again.

That said, the year is nearing its end, which is also the deadline for preparing and filing TP documentation that many taxpayers face so we recommend that the tax authorities’ opinion should be followed in calculating the amount of controlled loan transactions.

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[1] https://mindlink.lv/lv/aktuali/VID_skaidrojums_sagriez_visu_par_180/