Ways of reducing tax on profit distribution 2/23/21

Increasingly more companies have distributed their profits accrued before 2018 without paying corporate income tax ("CIT") on the dividends under the new CIT regime. When it comes to distributing "new" profits, the shareholders may wonder about ways of cutting the tax charge on dividends. This article explores some of the possibilities, suggestions, and the latest developments.

Available relief

To begin with, there are two types of income that can be excluded from the CIT base for dividends: (1) income arising on the disposal of shares held more than 36 months if the conditions of section 13 of the CIT Act are satisfied, and (2) dividends received under section 6 of the CIT Act (flow-through dividends).

Once the tax due on the profit distribution has already been assessed, the following items can be deducted from the tax charge:

- Donations up to 85% of the amount donated but not to exceed 30% of the CIT charge on dividends (over the period from 1 January 2020 to 31 December 2022);
- Excess provisions for 2017 times 0.75 if the provisions made in 2017 exceed those made in 2016;
- Tax loss at 15% of the total accrued loss appearing on the CIT return at 31 December 2017 but not to exceed 50% of the CIT charge on dividends. This relief is available only during the period of transition up to and including 2022!
- Special economic zone relief up to 80% of the CIT charge on dividends declared for the fiscal year;
- Any unclaimed CIT rebate for investment projects approved before 2018; and
- Foreign tax paid if there is documentary evidence of payment, but not to exceed an amount that would equal the Latvian tax charge.

Things to consider by the end of 2022

Since a company's tax loss arising before 2018 can only be utilised by the end of 2022, we would recommend distributing as much profit as possible this year and next year to claim the available 50% reduction on the tax charge. The CIT liability arises when the shareholders pass the resolution, but the dividends can be paid gradually. If the entire profit has already been distributed, then in 2022 the company might consider paying interim dividends out of the profit for the current year.

If the company is part of a larger group with multiple subsidiaries, the order in which reliefs are taken may come into play. In other words, if the company has generated income from share disposals or received dividends from subsidiaries and this income is consistent with the type that is excluded from the CIT base, must the company exercise this right as soon as it arises or can this action be deferred beyond 2022 to help the company maximise the claim of accrued tax loss?

In our opinion, since companies have rights to take relief on income from share disposals and on dividends received, companies should also have a right to choose the order in which they exercise those rights. And in both cases the CIT Act permits the taxpayer to carry any unclaimed relief forward to future tax periods in chronological order and reduce the amount of dividends to be included in the CIT base. So a company can first utilise its accrued tax loss and then claim one of the available reliefs. However, we would recommend seeking the SRS's approval for this approach, especially for dividends received because (1) on the CIT return those come before the line for using a tax loss and (2) section 6(2) of the CIT Act, when read literally, may be taken to mean that the relief on dividends received takes priority, i.e. it must be utilised before any other relief can be claimed.

If your company has an opportunity to claim one of those reliefs and you have questions, we are happy to help.