

Taxation of services from non-resident providers

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Latvian companies often approach foreign organisations or individuals to draw on their expertise and receive advice on matters that are crucial for the Latvian company's growth. This assistance is best received from a group company in the form of management services or consulting services but the Latvian company may have to hire an unrelated foreign company or personal consultant. This article explores Latvian tax implications (including for the Latvian company) and how to tell whether it is personal income tax ("PIT") or corporate income tax ("CIT") that is chargeable primarily.

Applicable law: CIT or PIT?

Section 5(1)(1) of the Latvian CIT Act provides that non-resident persons are taxed on their Latvian-source income from business or related activities. CIT must be withheld on payments that resident entities and permanent establishments ("PEs") make to non-residents unless PIT has been withheld on them.

So, in assessing whether a non-resident person's income paid by a Latvian company or PE is taxable we should consider not only the CIT Act but also the PIT Act. The CIT Act implies that CIT on a non-resident person's fee must be withheld unless PIT is chargeable on it under the PIT Act. Thus, if it is an individual who receives income then PIT must be charged in accordance with the PIT Act (below we assume that CIT is chargeable on fees payable to a non-resident that is not an individual).

Under section 5(1) of the CIT Act, CIT must only be withheld on certain payments to non-residents, for instance, management and consulting fees or proceeds from selling real estate in Latvia. This article focuses on the CIT treatment of management and consulting services so we will not look at the CIT treatment of any other types of income a non-resident might derive in Latvia.

The definition of a non-resident person

The Taxes and Duties Act implies that a non-resident person for tax purposes is either –

- an entity incorporated abroad (not in Latvia), or
- an individual who has not declared a place of residence in Latvia and does not live here permanently (i.e. more than 183 days in any consecutive 12 months).

When relocating abroad, an individual does not automatically lose their Latvian tax-resident status – for this purpose certain formalities have to be settled with the Latvian State Revenue Service.

The definition of management and consulting services

Section 5(5) of the CIT Act defines management and consulting services as activities a non-resident person

carries out directly or through contractors to ensure the management of a Latvian company or PE or to provide them with any necessary advice. A service is recognised as a consulting service if it fits the definition according to its economic content and substance, not its legal form. Examples of management and consulting services include preparing various documents (calculations, projects or business plans), providing information on changes in accounting software, market research and advertising, in the equipment and manufacturing technology market, and on other matters related to the trader's strategic development, production and sales, or research on the trader's economic activities.

When evaluating the substance of services, it is important to establish whether the non-resident person not only prepares numerical or statistical data based on the actual accounting data, industry data and other data, but also carries out an analysis, offers and explains available solutions, conducts any research necessary for decision-making, prepares detailed information for decision-making that is different in each situation etc. If a non-resident person's services do not involve giving advice and are not related to decision-making then they are not treated as management and consulting services (e.g. legal services that are limited to performing statutory activities to achieve a goal set by the company such as registration, preparing contracts, taking part in litigation, protecting the company's legal interests, obtaining and compiling necessary evidence, settling disputes out of court, or preparing documents for lawsuits).

CIT treatment of management and consulting services

A 20% tax must be withheld on fees payable to a non-resident person. The CIT withheld is the non-resident's expense, meaning the fee received is 20% less than what has been agreed.

If the Latvian company pays the CIT due to the government out of its own funds instead of deducting 20% from the fee, this amount must be included on the company's monthly CIT return as a non-business expense.

To avoid withholding, a foreign company resident in a country that has an effective double tax treaty with Latvia has to provide the Latvian company with a residency certificate issued by the foreign tax authority, which must be available when the Latvian company files its CIT return. If the fee payable to the non-resident exceeds EUR 5,000 for the tax year, the certificate must be confirmed by the State Revenue Service. Any payment made to non-residents without an appropriate certificate must be included on the Latvian company's CIT return for the last month of the tax period, effectively paying a 25% tax (because the payment must be divided by 0.8 before being multiplied by 20%).

When payment is made to a country that does not have a double tax treaty with Latvia (including a tax haven) the CIT liability will be either the 20% withheld on the fee or the 25% actually appearing on the last tax return for the period.

(to be completed)