

Lawful opportunity to revise your local transfer pricing file and benchmarking study every three years 3/47/22



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Several sections of the Taxes and Duties Act define a taxpayer's obligations. Section 15.2 requires the taxpayer to prepare a local transfer pricing (TP) file within 12 months after the end of the financial period and, depending on the circumstances, to submit it to the State Revenue Service (SRS) for the financial period:

Situation 1 – within 12 months after the end of the financial period; or

Situation 2 – within one month after receiving a request from the SRS.

This article is meant just for you if you are interested in learning more about a crucial relief in Situation 2. The taxpayer has the right to revise his local TP file every three years if he satisfies a certain condition and meets one annual requirement.

The taxpayer's obligation

If the amount of your controlled transactions (ACT) for the financial year exceeds EUR 5 million, you find yourself in Situation 1.¹ You are liable to prepare a local TP file and submit it to the SRS within 12 months after the end of the financial year.

However, if your ACT for the financial year is between EUR 250,000 and EUR 5 million, then you are in Situation 2.² You are liable to prepare a local TP file within 12 months after the end of the financial year and, only if the SRS requests this, to submit your local file within a month after receiving the SRS's request.

The taxpayer's rights

It's important to know that Situation 2³ gives the taxpayer an exceptional right to relief. This means he may revise his local TP file every three years as long as the conditions affecting his TP methodology remain substantially unchanged, i.e. the conditions of his controlled transactions stay consistent and there is no substantial change to the economic conditions in the relevant industry.

Yet there is a certain requirement the taxpayer has to meet in this situation. Each year the taxpayer must revise the financial comparables included in his local TP file, which means that each year he must update:

1. The profitability of the tested party (i.e. the company whose financials are being analysed) in the controlled transaction(s) by performing a segmentation of the income statement;
2. The comparable financials in uncontrolled transactions, which could be internal data (e.g. the taxpayer's own transactions with unrelated parties) or external data commonly obtained from TP Catalyst, a commercial database.

When it comes to updating comparable company financials on TP Catalyst, there is one piece of good news. Some time ago we were discussing benchmarking studies with the SRS, and they recognised as lawful the following approach in Situation 2:

- The taxpayer annually updates the financials of comparable companies identified earlier (the roll-forward approach);
- The taxpayer develops a new benchmarking study every three years when he revises his local TP file.

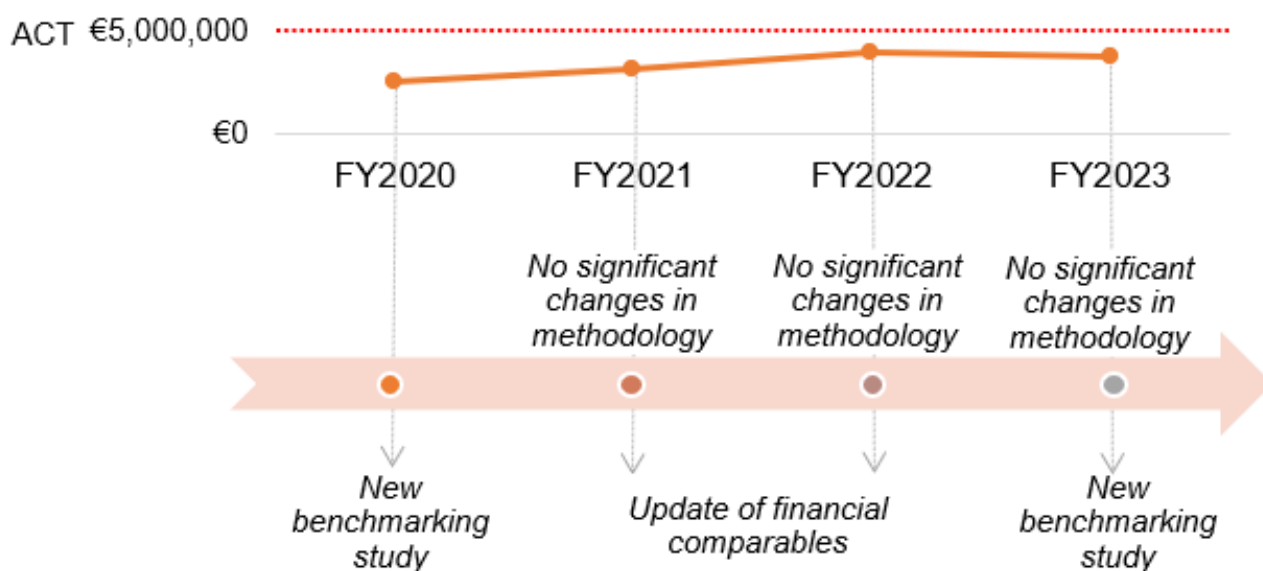
This combination will ease the taxpayer's administrative burden (cost) arising from benchmarking studies.

A theoretical example for Situation 2

In 2020, Latvian-registered company X Ltd made a single-category transaction (sale of goods) with Y Ltd, a foreign related company. For TP validation purposes, X Ltd selected the transactional net margin method, chose to analyse its own financials as a tested party, and carried out a benchmarking study on TP Catalyst.

If the conditions affecting the TP methodology, i.e. X's functional analysis for the transaction with related party Y Ltd, remain substantially unchanged and there is no substantial change to the industry's economic conditions in 2021 and 2022, then X Ltd should for FY21 and FY22:

- Update his financial data (determine the net margin in the controlled transaction with Y Ltd);
- Take the roll-forward approach and only update the financial data of external comparable companies identified earlier, without undertaking a new benchmarking study.



If you need any help in preparing or revising your TP file or if you wish to discuss relevant TP matters, please reach out to our TP team.

¹Section 15.2(3)(2) of the Taxes and Duties Act

²Section 15.2(4)(2) of the Taxes and Duties Act

³Section 15.2(5) of the Taxes and Duties Act