

Increasing and reducing share capital: corporate tax treatment 2/8/23



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To ensure a company's capital adequacy or business growth, its shareholders may decide to increase its share capital and later make a reduction. This article explores some corporate income tax (CIT) aspects that should be considered when it comes to changing the size of share capital.

The legal framework

The CIT Act names deemed dividends among taxable items. A deemed dividend is the portion of profits (retained earnings for the current year and prior years, including any portion from which a reserve was made) that a domestic company or a permanent establishment uses to increase the contribution to its share capital or any equivalent capital, or the number of shares. The portion of profits is taken to mean the portion of share capital increased out of profits that arose after 2017 and remain untaxed ("new profits").

A deemed dividend may arise if the company reduces the portion of share capital that was increased out of new profits. The deemed dividend must be reported in the tax period in which the reduction was made.

An increase

Increasing the company's share capital has no CIT implications for its shareholders. The rules for applying provisions of the CIT Act explain that where share capital is increased out of new profits (or out of a reserve made from those) the CIT charge is postponed until share capital is reduced or the company goes into liquidation.

However, if share capital is increased out of new profits, the company must complete line (table) 5.1 of the CIT return for the period in which the increase was made, giving its details to ensure information on the changes in share capital appears on the CIT return in the case of a reduction.

A reduction

A deemed dividend (a taxable item) may arise if the company reduces share capital increased out of new profits. The CIT Act assumes that share capital is first reduced by the portion that was increased out of new profits.

Thus, if share capital has been increased also by any other cash or property contributions (e.g. by converting loans into equity or bringing some real estate into business), then on a reduction, share capital is always treated as first reduced by the portion that was increased out of new profits. If share capital was not increased out of new profits, the reduction has no CIT implications.

If the company reduces the portion of share capital increased out of new profits, it must report a deemed

dividend on line (table) 5.1 of the CIT return for the tax month in which share capital was reduced (rather than paid out in cash) and pay the tax due.

Accordingly, an increase in share capital has no CIT implications for the company, but a reduction may give rise to a deemed dividend (a taxable item) if share capital was increased out of new profits.