

Tax review and payment 3/26/23



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Rights and obligations of taxpayers and the State Revenue Service (SRS)

In Latvia the rights and obligations of taxpayers and tax authorities, including the SRS, are prescribed by the Taxes and Duties Act and the State Revenue Service Act. Under this legislation, the primary onus is on the taxpayer to compute and pay their taxes to the government.

The Taxes and Duties Act permits the taxpayer to file a tax return adjustment within three years, or five years for transfer pricing, after the filing deadline unless a tax audit has been started or completed during that period. It's the job of the tax authority to recover overdue taxes, late fees, penalties and other national charges using undisputed enforcement.

This means the taxpayer may duly adjust his tax returns more than once if any errors or inaccuracies are found in them. On the other hand, the lawmaker has empowered and required the tax authority to ensure that taxpayers carry out their obligations, and has empowered the tax authority to recover tax arrears using undisputed enforcement.

Permissible types of taxpayer reviews the SRS can undertake

The Taxes and Duties Act permits three types of taxpayer reviews:

- Tax audit
- Thematic review
- Data compliance review

Yet in the near future the lawmaker plans to make changes regarding these three types of reviews.

Under general procedure, tax arrears are subject to a late fee of 0.05% for each day overdue. However, payment of tax arrears can be facilitated, depending on whether those arrears result from filing a tax return or from the SRS's control measures.

Since voluntary payment of taxes is not something people often talk about, let us now take a closer look at it and explain what steps the taxpayer can take if he finds that taxes are overdue or the information given on his tax returns needs adjusting.

Solutions for voluntary payment of taxes

Taxpayers that have fallen into tax arrears, have overdue tax returns, or have found inaccurate tax treatment, are permitted by Latvian law to come clean voluntarily, file tax returns, make tax payments, and avoid penalties.

Situation 1. Tax arrears for which recovery has not yet started

Before the SRS has launched one of the three types of taxpayer reviews, the taxpayer has more room for manoeuvre and may choose one of three ways of approaching the SRS to facilitate voluntary payment of tax arrears:

- Extending the deadline (for up to five years)
- Postponing the deadline
- Entering into an agreement with the SRS

Which of the statutory options the taxpayer can take will depend on the cause and duration of tax arrears and on whether debt recovery activities have been started. It's important to observe the filing deadline and file an application with the SRS typically no later than a month after the tax became due.

Situation 2. An SRS audit or review finds tax arrears

Where the SRS has already conducted an audit or one of those reviews, the taxpayer can take one of two options:

1. Three days before the due date for payment, filing a well-reasoned request with the SRS to extend the deadline for paying a tax, late fee and penalty resulting from a control measure. The resulting payment may be split into instalments for up to five years.
2. Entering into an agreement with the SRS to end a legal dispute over an overstated refund or an additional assessment resulting from a control measure. On entering into an agreement, the penalty may be reduced by up to 50%, with considerable savings in time and money, which would otherwise be spent on litigation.

Situation 3. The SRS has started recovery of tax arrears

Where the SRS has already started recovery, the taxpayer may draft a written application setting out the facts and circumstances, describing his ability to pay the tax arrears and asking the SRS to accept voluntary payment of overdue taxes within a time limit of up to three years.

PwC Latvia's experience

PwC Latvia has been involved in several voluntary tax payment disclosure processes where customers voluntarily disclosed historical tax risk to the SRS by filing a written application and settled their past tax liabilities by adjusting their tax returns before the SRS started a review.

Our experience suggests that the main tax areas where the risk of tax evasion is detected are the correct calculation and payment of payroll taxes (i.e. income tax and national insurance contributions) and VAT. This is mainly because payroll taxes affect workers' pay and social security. VAT risks are detected because the SRS is carefully monitoring VAT treatment. If any discrepancies are found in transactions and VAT treatment compared to another territory, the SRS will come to the taxpayer with questions about why that situation arose.

Our experience suggests that instead of resulting from deliberate action with tax being intentionally left unpaid, such situations often arise where, for instance, the taxpayer pays taxes according to the generally known tax treatment practice over a long period and ignores changes to this practice, for instance, by missing important amendments to tax treatment and filing procedures that came into force during the tax

assessment period.

Taxpayers have mainly chosen their tax returns in an area where practice has changed and is now treated as aggressive tax planning. Taxpayers often take this option of voluntary tax payment and adjust their tax returns from a reputational perspective and in terms of future transactions to ensure that these potential tax implications do not change, say, the transaction price if the company is up for sale.

This highlights another important point – how important it is for investors to conduct a due diligence assessment of the target company before the M&A transaction in order to disclose such potential future tax implications and penalties, which directly affect the transaction price. We have seen cases where investors bought a company without conducting a due diligence assessment and found that taxes had been incorrectly charged. These are situations in which voluntary disclosure is used and past tax liabilities are settled by adjusting historical tax returns to ensure the company carries on its business conscientiously under the control of the new investors.

So, if you have found some past tax arrears running into several tens or hundreds of thousands of euros, you are advised to proactively use statutory solutions and make voluntary disclosure to the SRS before a tax audit. The SRS will assign you a tax inspector who will help you accurately adjust your tax returns for the period.

The SRS and PwC urge taxpayers to pay their taxes responsibly and in complicated situations approach the SRS and certified tax consultants to find the best solution and minimise the penalty that may be charged for late payment.