

Transfer pricing requirement for low value adding services 2/5/24



Senior Manager, Transfer Pricing, PwC
Latvia
Andis Vitols

Setting an arm's length fee for your intragroup services is one of the transfer pricing (TP) challenges you might face. In 2018 Latvia decided to offer relief for low value-adding services (LVAS) to facilitate this process for companies. If certain criteria are met, LVAS can be analysed under a simplified procedure, meaning the service provider can apply a 5% markup on costs without undertaking a detailed benchmarking study. This article serves to remind you of a key requirement when it comes to taking the simplified approach to LVAS.

The OECD TP guidelines provide for a simplified approach to intragroup LVAS that allows the service provider to apply a 5% markup without undertaking a benchmarking study. LVAS are usually supplied by one or more members of a multinational enterprise (MNE) group to other members. If the service is to be analysed under a simplified procedure, it must meet the criteria set out below:

- The service is supportive in nature.
- The service is not part of the MNE's core business activity.
- Supplying the service neither involves using nor results in creating a unique and valuable intangible property.
- The service provider does not take or control any materials risks associated with the service, and supplying it does not result in the taxpayer facing such risks.

The simplified approach to LVAS is intended to ease the administrative burden and mitigate risks for taxpayers and tax authorities.

The simplified approach to LVAS is not mandatory, though, and each country has discretion to pass it into its national TP rules. Latvia applies the simplified approach to LVAS only if the foreign company that supplies the service to or acquires it from a Latvian company is based in a country that has passed the simplified approach into its national law. This requirement is made in paragraph 18.6.2 of the Cabinet of Ministers' Rule No. 677, "Application of Provisions of the Corporate Income Tax Act".

Now let's look at an example to illustrate this.

Y, a Latvian company owning a retail chain with a number of shops, decided to launch a new loyalty programme that accrues bonuses for purchases. Customer purchase data has to be entered and processed for this programme to function efficiently. Company Y acquired administrative services from Z, a related Lithuanian company, which carried out the following activities: data entry, processing and analysis, as well as preparing reports and statements. This administrative service provides essential technical support to ensure the loyalty programme is functioning properly and customers receive bonuses. These services can be treated as LVAS because they are supportive in nature and are not associated with the group's core business activity – retail.

Company Y can take the simplified approach to LVAS under Latvian TP rules because Lithuanian company Z is allowed to take the simplified approach in its home country. In this case a 5% markup can be justified

under a simplified procedure without a benchmarking study of comparable administrative service providers. It's important to note that if the service provider were based in a country that has not passed the simplified approach, such as France or Spain, Latvian company Y could not take the simplified approach and would have to undertake a benchmarking study to show the markup is arm's length.

Latvian companies involved in LVAS transactions are advised to verify that their business partners are based in countries that have passed the simplified approach into their national TP rules. The OECD offers a list of member states according to their status of the simplified approach to LVAS:

Simplified approach to LVAS in national law

Passed

Austria
Belgium
Croatia
Czechia
Denmark
Estonia
Finland
Germany
Hungary
Ireland
Italy
Latvia
Lithuania
Netherlands
Poland
Slovenia
Sweden

Not passed

Bulgaria
France
Greece
Luxembourg
Malta
Portugal
Romania
Slovakia
Spain

The simplified approach to LVAS can be useful to ease the TP-related administrative burden and minimise costs incurred in preparing benchmarking studies for various types of services. However, Latvian companies wishing to take the simplified approach should be aware of the relevant conditions and verify the status of the simplified approach in the countries of their business partners.