# Practical tips for preparing corporate tax return for 2016 (cont.) (3/12/17)

We continue the article we posted on 21 February 2017 to look at common adjustments and mistakes in preparing the corporate income tax (CIT) return. This article explores adjustments related to claiming tax relief in respect of foreign tax paid, bad debts, and deductible interest.

Tax relief in respect of foreign tax paid

Taxpayers can claim CIT relief, i.e. deduct from taxable income the amount of foreign tax paid, not exceeding the Latvian tax charge on their foreign-source income.

It happens in practice that the foreign tax charge being offset against the Latvian tax charge doesn't relate to the same financial period. This often involves foreign withholding tax and the fact that foreign tax authorities might issue a certificate confirming the amount of tax paid in a period that doesn't match the Latvian tax payment period.

We've also noticed that Latvian companies tend to include in revenues their net income (i.e. what they've received) rather than gross income.

Mistakes in claiming CIT relief also appear where a Latvian company with foreign branches deducts the foreign tax paid from the Latvian tax charge, without recalculating the CIT charged on the foreign branch's revenues and expenses on the CIT return in line with Latvian legislation. In other words, the foreign branch's revenues and expenses arising from its foreign business activities should be taken to the Latvian taxpayer's profit and loss account, and CIT adjustments should be made in line with Latvian legislation and double tax treaties.

Bad debts

Taxpayers are allowed to deduct their bad debts from taxable income if they meet the conditions laid down by section 9(1) of the CIT Act. The rules of section 9(1.1–1.2) permit taxpayers to expense their bad debts on easy terms, but in such cases the taxpayer is first of all required to take all reasonable measures to collect and recover their debts.

For example, a taxpayer's lack of CIT adjustment for bad debt is often based only on Lursoft data showing that the entity has gone into insolvency. In that case the taxpayer has failed to meet the condition of collection and recovery measures. And a Lursoft printout is no substitute for a court ruling on completion of the insolvency procedure.

There are also cases where a company doesn't know whether there's a court ruling to recover an account receivable from the debtor and a bailiff's statement that recovery is impossible. Such a ruling is available only to creditors that have come forward and been entered on the register of creditor claims. An entry on this register is additional evidence that the taxpayer has taken all reasonable measures to collect and recover debts.

If the taxpayer fails to meet the conditions of section 9, the amount of bad debt must be added back to taxable income on line 9 of the CIT return.

Calculating deductible interest

Section 6.4 of the CIT Act restricts how much of the interest expense is deductible for CIT purposes. Accordingly, the difference between the amount of interest expensed to the profit and loss account and the statutory allowable amount may have to be added back to taxable income.

Deductible interest calculated incorrectly may cause taxable income to be understated. We have noticed that companies commonly make the following mistakes:

- Interest-free borrowings are included in both the average debt calculation and the deductible interest calculation;
- The average borrowing is calculated incorrectly. If the borrowing is for only a few months of the entire financial year, say, for five months out of 12, the average borrowing should be calculated only for the months in which it existed, not for the whole year;
- There isn't a separate calculation for borrowing in each currency. Since different currencies attract different average short-term rates published by the Central Statistical Office, calculations should be performed for each currency separately and the results added up.

Our next article in this series will look at common mistakes in making adjustments associated with capital allowances, payments to non-residents, changes in provisions, and donations.