Latvian transfer pricing rules to be amended (2/47/17)

On 26 October 2017, the meeting of state secretaries heard an announcement of proposals for amending the Taxes and Duties Act, which include a number of new and important rules relating to the legal framework for transfer pricing (TP) in Latvia. This article explores some of the key changes that will affect taxpayers to be governed by the requirements for preparing mandatory TP documentation, as well as the form of TP documentation, the information it should include, mandatory filing, and penalties.

The purpose of the Bill

The Bill has been prepared to bring Latvian TP requirements into line with –

- the OECD guidelines for preparing TP documentation, and
- the new CIT Act adopted as part Latvia's tax reform.

We have already informed MindLink subscribers that new TP documentation requirements were incorporated into the OECD guidelines in September 2015 to give tax authorities access to three levels of TP documentation. According to the new standard, TP documentation consists of the following levels:

1. the country-by-country report;
2. the master file; and
3. the local file.

Latvia adopted the country-by-country reporting requirements in July 2017, when those were incorporated into section 15(9) of the Taxes and Duties Act and into the Cabinet of Ministers' Regulation No. 397 on country-by-country reporting.

The Bill is to introduce the master file and the local file.

Key changes

As a result of achieving these goals, the TP requirements face a number of changes, of which the following three are the most important:

1. a modified range of taxpayers governed by the requirements for preparing mandatory TP documentation;
2. a substantially increased amount of information to be disclosed; and
3. an obligation to file annual TP documentation with the State Revenue Service (SRS) if certain criteria are met.

Requirements for preparing and filing mandatory TP documentation

As you may know, a taxpayer is currently required to prepare TP documentation if its net revenue for the financial year exceeds €1,430,000 and if the value of a related-party transaction exceeds €14,300.

The Bill no longer includes the annual revenue criterion. Instead, it provides that a taxpayer (a resident or a permanent establishment) must prepare TP documentation if the amount of a controlled transaction exceeds €250,000 for the year. The Bill also provides that if certain criteria are met, the taxpayer must file

TP documentation with the SRS at the same time as the CIT return, without waiting for an SRS request.

It is important to note here that the Bill is still at a developmental stage and these rules may change, including the filing deadline. The SRS has explained off the record that the filing deadline was meant to be the due date for filing the annual report. However, since the current wording of the Bill relating to the filing deadline gives the due date for filing the CIT return, we stick to the text of the Bill.

So for transactions carried out in the financial period that starts on 1 January 2018 and in later periods, TP documentation (including the master file and the local file) must be prepared and filed with the SRS by a Latvian taxpayer (a resident or a permanent establishment) that meets the following criteria:

Counterparty	Transaction amount	Filing deadline
1) a related foreign entity; 2) an entity enjoying CIT relief or exemption; 3) a related individual; 4) an entity registered in a tax haven; 5) a related Latvian-resident person and the transaction is economically linked to transactions with a related foreign entity or with an entity registered in a tax haven	over €1,000,000	each year simultaneously with CIT return
	€500,000–€1,000,000 and counterparty must prepare master file under its residence country’s law	each year simultaneously with CIT return
	€500,000–€1,000,000 and counterparty need not prepare master file under its residence country’s law	within one month after receiving SRS request
	€250,000–€500,000	within one month after receiving SRS request

The Bill makes an interesting exclusion for transactions with a related Latvian-resident person (if the transaction is economically linked to transactions with a related foreign entity or with an entity registered in a tax haven), which provides that if the SRS requests TP documentation for transactions with such a related party, the taxpayer should prepare the local file only. The available version of the Bill implies that this covers only a case where the transaction amount is €250,000–€500,000. However, since the Bill is not clear about cases that qualify for the exclusion, this understanding may change.

To motivate taxpayers to comply with the requirements for preparing and filing TP documentation, the Bill provides that failure to submit TP documentation on or before the filing deadline attracts a fine of up to 2% of the amount of a controlled transaction.

All other Latvian taxpayers that carry out related-party transactions are required to comply with the arm’s length principle, but preparing TP documentation is optional.

We’ll be writing about these and other changes to the TP documentation rules soon.