

Controlled transactions and transfer pricing documentation for loans (3/29/18)

This article explores the term “amount of controlled transactions” and the obscure requirement for transfer pricing (TP) documentation for intragroup loans, included in proposals for amending section 15.2 of the Taxes and Duties Act.

As part of Latvia’s ongoing tax reform, the Ministry of Finance (MOF) has drafted amendments to the TP rules to modify the requirements for preparing and filing TP documentation with the State Revenue Service (SRS) and to adjust the range of companies subject to those requirements.

Current thresholds for providing information on related-party transactions

Section 15.2(2) lays down an obligation to provide information about related-party transactions if the taxpayer meets the following two criteria at the same time:

- net revenue exceeds 1.43 million euros in the financial year; and
- the amount of transactions exceeds 14.3 thousand euros.

Proposed thresholds for preparing TP documentation

The proposals significantly change the way of measuring the thresholds that will make taxpayers to prepare TP documentation in the form of a master file and a local file, or a local file alone, to prove that their controlled transactions are arm’s length.

The current wording of the proposals provides that when it comes to determining an obligation to prepare TP documentation, a taxpayer involved in controlled transactions will have to assess the following:

- Does revenue exceed 50 million euros for the financial year?
- Does the amount of controlled transactions exceed 15 million, 5 million or 250 thousand euros for the financial year?

A public debate held in the course of drafting the proposals raised a question about applying the term “amount of controlled transactions.” Should all controlled transactions for the year be added up in the calculation, e.g. sales of goods (revenues) plus acquired services (expenses)? To avoid the risk that the taxpayer fails to prepare a compliant TP documentation file, the MOF was asked to clarify the definition of the term.

How the “amount of controlled transactions” is explained in the proposals

An agreement on this issue was reached and, interestingly, an addition was made to section 15.2(12), which describes the taxpayer’s motivation (responsibility) to prepare TP documentation. The proposals provide that the taxpayer’s liability is measured as a percentage of the amount of the controlled transaction for which TP documentation should be prepared, which should be included in revenues or expenses for the year.

We conclude from the addition that the “amount of controlled transactions” should be calculated by adding up all the controlled transactions included in revenues or expenses of the taxpayer’s profit and loss

account for the year and that this amount could be the threshold the taxpayer should assess to prepare TP documentation for their controlled transactions in 2018 and later.

However, given the significant threshold jump from 14.3 thousand to 15 million, 5 million or 250 thousand euros, it is not clear what exactly should be examined in intragroup loans nor how to measure the threshold correctly. Should the calculation be limited to the amount of the transaction (i.e. the interest included in revenues or expenses for the year) or include the loans and borrowings, or should they be added up? And how will the calculation be affected by amending, continuing or terminating these transactions in subsequent years?

The new form of the CIT return is already available, as well as the SRS's instructions for completing it, which provide that line 6.5.1 should disclose the total amount of related-party transactions in the financial year.

Since the proposals raise many questions about intragroup loans, PwC consultants have received an unofficial opinion from the SRS that both the loan and the interest should be taken into account for TP documentation purposes. A more detailed explanation is due from the MOF soon.