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Areas covered by voluntary transfer pricing risk reviews (2) (1/7/19)

This article completes what we wrote last week.

Services acquired from related parties

This issue has been topical during tax audits conducted by the State Revenue Service (SRS) in recent years. For service purchases, the SRS has been focusing on whether there is evidence that the Latvian company has received any services and how it benefits from those services. Such questions mainly relate to services such as management, marketing and consulting.

When tax officers start examining such services for compliance with the arm's length standard, they will first request information on the customer's service costs and cost allocation keys (for services rendered to two or more group companies). If the Latvian company is unable to provide such information, this immediately gives the SRS grounds for questioning not only the level of service fees but also whether the services were ever supplied.

Since supplier cost details with complex allocation keys may be a lot of information, it is advisable to prepare it each year because during a voluntary transfer pricing (TP) risk analysis the SRS has the power to request this information all at once for a period of up to five years.

Related-party lending

When scrutinising amounts borrowed from related parties, the SRS will not only check interest charges for compliance with the arm's length standard but also request an explanation of the purpose and economic substance of the borrowing transaction.

For example, the Latvian company is a low-risk wholesaler that in fact makes no independent decisions and merely complies with the group guidelines for buying goods from group companies but has been operating at a loss and borrows from a related party because the Latvian company is unable to pay for the goods. In this case, the SRS's first question will not be about the level of interest charges but rather about whether the company should borrow and pay interest if it is unable to control its costs and revenues.

Conclusions

To complete a TP control process initiated by the SRS successfully, it is advisable to raise all those questions early on and discuss your arm's length pricing with your related companies, as well as preparing exhaustive answers to possible SRS questions.

A company that is well prepared for any review will be able to exchange information and views with SRS officers in a more productive way, which may help convince them the company has no TP risk.

If a company that has evaluated its controlled transactions and verified its financial indicators finds any TP risk, the company will be able to eliminate it in good time by issuing appropriate adjusting invoices to avoid overpaying taxes at group level.