

# Tax loss transfer on reorganisation (1/13/19)

The Corporate Income Tax (CIT) Act lays down rules for how any unused tax losses at 31 December 2017 may be used in later tax periods. Yet practice raises the question of whether the acquiring company may claim any unused tax losses of the merging companies in a reorganisation carried out after 2017.

## The CIT Act

Rules for claiming unused tax losses are included in paragraphs 13 and 14 of the transitional provisions of the CIT Act. Those rules imply that a company whose CIT return shows a loss at 31 December 2017 may deduct an amount equal to 15% of the total unused loss from the CIT charged on dividends in the financial year 2018. If this amount is not fully claimed in 2018, the remaining loss may be applied to the tax chargeable on dividends in the next four financial years. This tax deduction is capped at 50% of the tax charged on dividends in the financial year.

Section 18 of the CIT Act lays down special conditions for a reorganisation. Yet the CIT Act and the Cabinet of Ministers' Regulation No. 677, *Applying provisions of the CIT Act*, are silent about tax loss transfer in a reorganisation.

## Practice

In advance rulings issued to taxpayers, the State Revenue Service (SRS) explains that since the CIT Act does not authorise the acquiring company to deduct the merging company's unused tax losses from the tax charged on dividends in accordance with paragraphs 13 and 14 of the transitional provisions of the CIT Act, the acquiring company may carry forward only its own prior-year losses equal to 15% of the total unused tax loss at 31 December 2017. The SRS has also indicated this approach in example 22 of their guidance on completing the CIT return posted on their website.

The Ministry of Finance has confirmed to us that the SRS comment has received the ministry's approval.

The SRS comment and the absence of tax loss transfer rules applicable or interpretable in a reorganisation lead to the conclusion that Latvian legislation does not authorise the acquiring company to claim any unused tax losses of the merging companies. So any companies in reorganisation, planning to merge with a company reporting an unused tax loss at 31 December 2017 that remains unclaimed in 2018, should remember that they cannot take over the merging company's loss.

## Contradiction to the Commercial Code

Section 335 of the Commercial Code provides that in a merger, the merging company's rights and obligations will pass to the acquiring company.

Thus, assessing this matter in conjunction with the Commercial Code implies that applying the rules of the CIT Act contradicts the principle of taking over obligations prescribed by the Commercial Code.

In summary, the CIT Act is silent about tax loss transfer in a reorganisation, but the SRS comment is unfavourable to the acquiring company and contradicts the Commercial Code. So an acquiring company

that claims the merging company's tax loss is likely to enter into a dispute with the SRS, which might eventually lead to a precedent on this issue.