Adjusting corporate tax return for last reporting month (1/5/20)

Last week saw most of the companies whose financial year runs from January to December in a hurry to prepare and file their tax return for the last reporting month. The final return must include some tax-base elements that could be ignored when preparing monthly returns. This article will help you figure out whether any adjustment needs to be made to your tax return being submitted with your annual report.

An opportunity to adjust the tax return

Since you can adjust some of the information in the course of preparing your annual report, the Corporate Income Tax (CIT) Act allows you to adjust data on your last tax return for the year without incurring a late fee on a possible extra tax liability. In practice, however, we find it impossible to tell whether the tax return is being adjusted because of any changes that arose in the course of preparing the annual report or in order to correct a mistake spotted in the data reported for December.

If you find in preparing your annual report that your company had incurred some extra non-business costs during the year, then adjustments should be made to the tax return for the month in which the liability arose, not the tax return for December. If more tax becomes payable when adjusting tax returns for other periods, the tax authority's system will charge a late fee.

Special rules for branches

The CIT Act does not allow branches to adjust their last tax return for the year without incurring a late fee. However, amendments to the CIT Act are to be debated on 30 January to allow branches (permanent establishments) to do so if adjustments are made by updating their profit and loss account and balance sheet and if the adjusted return is filed within four months after the last month of the year. A late fee will still be charged if a permanent establishment ceases trading in Latvia.

Tax-base elements to be reported in the last month only

Line 6.2. Bad debts

Debts arising before 2018 and those arising after 2017 are treated differently for CIT purposes. This line may show only debts arising after 2017 because the old debts may give a tax base reduction only if they meet exemption criteria listed by section 9(3) of the CIT Act. By December 2019, 36 months will not have passed for debts arising after 2017 and companies are likely to take the opportunity to make a provision for bad debts instead of immediately expensing them, so this line does not need completing on the tax return for December 2019.

Line 6.3. Interest charges

This line should be considered by taxpayers that had borrowed from a company other than a credit institution in 2019 or had accounts payable to individuals on which interest was charged in the tax period. Companies with annual interest charges of up to EUR 3 million should use only one method for CIT purposes, i.e. the tax base must be increased proportionally by interest whose average liability exceeds four times shareholders' equity (excluding reserves) at the beginning of the year. This method is not used for interest charges on loans from financial institutions specified by the CIT Act.

It is important to note that related-party transactions are still subject to transfer pricing principles, but the CIT Act is silent as to whether a non-arm's length price requires a further adjustment if interest charges will have already been added to the tax base after applying this method.

Companies with their annual interest charges exceeding EUR 3 million must perform an extra calculation for an interest charge that exceeds 30% of profit before tax after adding interest and depreciation charges. If both methods produce an increase, the higher amount should be added to the tax base.

Line 6.4. Loans to related parties

If a Latvian company is operating at a profit and has good cash flows, then its free cash is likely to have been used for financing the operations of other group companies. The new CIT system includes an anti-avoidance rule that restricts the scope for shifting profits away as a loan instead of distributing dividends and charging CIT.

Section 11 of the CIT Act lists eight exclusions when a loan to a related party is not a deemed profit distribution, and meeting a single exclusion is enough. So you need to examine newly made loans in 2019, the scope for applying one of the exclusions, and which of them suits your company best. If none of the exclusions is met, the total of all loans made should appear on line 6.4 and will attract CIT.

Line 6.5. Transfer pricing adjustments

This line is to show any required transfer pricing adjustments for reporting the arm's length outcome of your company's related-party transactions for CIT purposes. If your related-party transactions meet the arm's length standard, this line can remain blank, but you should still complete informational line 6.5.1. for all your related-party transactions.

Line 6.6. Benefits granted to a non-resident

This line (*Benefits granted to employees or board members of a non-resident company allocated to its permanent establishment in Latvia*) should be completed by branches and permanent establishments (PEs) registered only with the tax authority if the non-resident company's employees or board members have received benefits from the company. Because the branch/PE is treated as part of the non-resident company, in measuring profit where its employees have performed some functions for the benefit of the PE, any related costs should be allocated to Latvia. Accordingly, the PE will have made a deemed distribution attracting Latvian CIT. If branches/PEs are to measure their deemed distributions correctly, information should be obtained from the non-resident company about benefits granted to its employees or board members and allocated to Latvia.