Taxation of services acquired from non-residents (2) 3/26/21

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This article completes what we wrote a couple of weeks ago.

Personal income tax ("PIT") treatment of management and consulting services

If a Latvian company needs some advice from an individual there may be an obligation to withhold PIT. Let us look at the PIT treatment of consulting services that are acquired from a non-resident individual who is a trader. This article is not about using an in-house (or intragroup) consultant under an employment contract.

If management, consulting or any other services are rendered by a trader, then under general procedure it is the consultant's responsibility to pay PIT and mandatory national social insurance contributions ("NSIC"). However, the person has to provide the payer of income with evidence of registration as a trader (or similar status abroad).

Under paragraph 105 of the Cabinet of Ministers' Rule No. 899, *Application of Provisions of the Personal Income Tax Act*, this evidence includes a taxpayer's registration certificate or a sole trader's registration certificate. If the trader registration details entered on the register of taxpayers are available to the public, such as the register of taxpayers of the State Revenue Service ("SRS"), the trader need not provide such information to the customer. However, when it comes to paying a fee to such a trader, the customer has to make sure that the person is entered on the register of taxpayers as a trader when the payment is made. This applies to a foreign consultant. If the service provider resides in a treaty country and carries on business in their country of residence, the trader can provide the payer of income with their residency certificate in order to avoid Latvian PIT being charged.

The SRS website provides a link to other member states' registers of personal taxpayer numbers where the existence of the taxpayer number given by the service provider can be verified in order to early identify someone who provides false personal details. However, the data of that register cannot be used for checking that the taxpayer is registered as a trader in their country.

Otherwise the payer of income will have to charge PIT and NSIC on fees paid to an unregistered trader (like employment pay). Should an SRS tax audit find that the company was required but failed to withhold PIT and NSIC on the fees paid to the individual, the company itself will have to pay these taxes, which would have been the trader's responsibility.

Additional considerations

Management and consulting fees can also attract PIT if paid to a non-resident entity. This issue arises if a

service provider sends its employees to Latvia to work for the customer. Such situations should be assessed under section 17.1 of the PIT Act to establish whether this arrangement amounts to a staff lease (e.g. the invoiced fee is based on the number of hours worked, with the Latvian company directing and coordinating the work of the leased staff). In the case of a staff lease, the lessee (i.e. the Latvian customer) is required to charge Latvian payroll taxes on the workers' salaries included in the management and consulting fees. Similarly, when allocating the income of the Latvian company's board member to Latvia, we should evaluate the provisions of section 3(3)(4) of the PIT Act and article 16 of the double tax treaty.

In this situation the management and consulting fees the Latvian company pays to the non-resident will not attract PIT and CIT at the same time. Thus the part of the fees considered to be the income of leased staff for tax purposes is not treated as the non-resident's management and consulting fees. This might raise some questions, so the business arrangement has to be accurately documented in order to match the real situation and avoid additional tax risks.

Conclusion

Although the provision of services will always involve individuals, for tax purposes it is important to establish whether the company has entered into a business relationship with an entity, with a trader, or with a personal consultant that is not registered as a trader. In the case of an entity, the obligation to withhold CIT may arise where a treaty exemption cannot be claimed. The invoice for services should also be checked to see if it includes the salaries of workers posted to Latvia that would be treated as a staff lease or a board member's remuneration and would rather attract payroll taxes. PIT will be payable in transactions with an individual (a trader or a personal consultant) and it is important to understand whether the company has to do this or whether the person will do it.