Taxation of branch dividends 3/5/22

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A company's shareholders in a general meeting may decide to pay a dividend once the annual accounts showing a profit have been approved. If the company's articles of association provide for this, the Commerce Act permits an interim dividend to be declared and paid halfway through the financial year. This article explores the legislation and corporate income tax (CIT) treatment of dividends a Latvian branch pays to its foreign head office.

A Lithuanian company has a branch in Latvia that plans to distribute a profit. Is the branch allowed to pay a dividend halfway through the financial year before the profit for the year has been computed? What is the CIT treatment?

The legal framework

The branch is considered a separate domestic taxpayer under section 14(6) of the Taxes and Duties Act.

When profits are distributed in dividends, we should generally look at sections 161 and 161.1 of the Commerce Act, which describe how dividends (including interim dividends) may be computed and paid. However, this law does not deal with profit distributions in the case of foreign branches, so its provision for interim dividends is not binding on the branch.

Since the branch is taxable under section 2(1)(2) of the CIT Act, it must comply with the Act's provision for computing CIT in a permanent establishment (PE).

CIT treatment

Section 1(8)(4) of the CIT Act states that any payment a PE makes to its non-resident head office, other than expenses the non-resident has necessarily incurred for the PE's business, is a dividend equivalent.

In our case the payment made to the Lithuanian company does not qualify as an expense related to the branch's business, so that is a dividend equivalent chargeable to CIT.

In summary, the Latvian branch is allowed to pay a dividend to the Lithuanian company halfway through the financial year. This will require the branch to include that dividend in the taxable base and charge a 25% CIT. Also, if the branch decides to use the dividend amount for settling mutual accounts with the Lithuanian company, instead of paying it out, CIT must be computed and paid before the set-off takes place.

In this situation you might also wonder if the CIT Act specifies when you have to report the dividend payout on the CIT return and charge the tax. The answer is yes. Section 4(13) of the CIT Act states the branch must report the dividend on the CIT return in the month it is paid.