

# State Revenue Service's silent cooperation in obtaining information on related party transactions 2/19/23



Senior Manager, Transfer Pricing, PwC  
Latvia  
Zane Smutova

To trace related-party transactions and particular steps they include, as well as the initiator of those transactions, the State Revenue Service (SRS) uses a variety of methods for obtaining information. We have discovered that as part of tax controls, silent administrative cooperation appears to occur in how information on the actual existence of transactions is exchanged. To obtain objective arguments and evidence and to identify the actual proceedings of transactions, the SRS requests explanations from persons named in documents supporting the transactions, including from the taxpayer's former employees. In this article we explore how this cooperation takes place.

## Silent administrative cooperation

When launching a control measure, the SRS will take all the opportunities to obtain a comprehensive view of cross-border transactions with related parties and make sure the prices are arm's length.

We have recently observed that the SRS is not satisfied with information provided by the local taxpayer. There is an established practice of cooperating with the tax authorities of countries where the local taxpayer's related parties reside.

How does this work? On identifying risks associated with controlled transactions, the SRS will request the foreign tax authority to interview the taxpayer's counterparty, i.e. a related party. The foreign tax authority then takes the necessary steps, surveys the aspects the SRS is interested in, aggregates the information and presents it to the SRS.

The SRS summarises the information obtained and evaluates the need to take the next step of seeking explanations from particular persons.

## Interviewing persons named in a document supporting the transaction

To trace related-party transactions and particular steps they include, the SRS tends to approach the individuals named on the invoice for the transaction and the taxpayer's former employees in order to receive more details of the transaction and of the steps taken as part of it.

In practice, we see that former employees, whose employment relationship with the taxpayer was terminated in an undesirable manner, are keen to provide the SRS with a detailed description of how the transaction proceeded and an explanation of its true nature. Such cases are not uncommon, especially in significant related-party transactions.

## Don't forget about persons to whom reports are provided

Latvian transfer pricing rules require taxpayers who are preparing a local transfer pricing file, to provide information about individuals to whom the company's management presents reports, financial statements, etc.

When you provide such information in your transfer pricing documentation, remember that the SRS may refer to this information and start a conversation with those persons about matters of interest. If the persons are in Latvia, the SRS has the opportunity to contact them directly. If the persons are employed by a foreign related company, the conversation will be conducted through the foreign tax authority.

## Transactions commonly checked by the SRS cooperating silently

Our experience suggests that in order to obtain information, the SRS tends to use these forms of cooperation when checking related-party intragroup service costs, because Latvian taxpayers are the recipients of intragroup services more often than not, and there is a *prima facie* risk that service costs help shift profits to another tax jurisdiction.

The SRS's practice of evaluating and challenging such services is evolving rapidly. For intragroup services, the first thing the SRS will examine is not the arm's length nature of the price but rather the actual existence of the service and the economic or commercial benefit for the taxpayer receiving the service – how this improves his commercial position.

To assess the scope for applying the Corporate Income Tax Act, section 8, "Non-business expenses", the SRS will often try to find out whether the taxpayer is taking part in services on his own initiative and based on a self-evident business need, or at the shareholder's instructions.

It's also worth mentioning that the SRS will pay special attention to the service provider's capacity to provide this service.

## The takeaway

We recommend putting together documentation for your related-party transactions – preparing the statutory form of documentation in good time and giving details about the economic substance of your transaction, the functions performed, risks assumed and assets used, because the burden an SRS inspection places on the taxpayer is disproportionately heavy and it's not always easy to defend your position on your own.

If you would like to learn more, you are welcome to apply for our Baltic Transfer Pricing webinar running online on 23 May in English. PwC experts from Latvia, Lithuania and Estonia will be discussing the latest developments in transfer pricing audit practices and market trends in financial transactions, as well as conducting practical case studies to examine some of the issues companies face when handling financial transactions. For details [click here](#).