

Doing business with non-cooperative jurisdictions: corporate tax treatment (2) 2/33/23



Senior Consultant, Tax, PwC Latvia
Tatjana Klimovica

Last week we wrote about the Cabinet of Ministers' new Rule No. 333, *List of Tax Havens*, and about the changes made to this list – four jurisdictions have been added from 1 July 2023, including Russia. This article explores some aspects of corporate income tax (CIT) treatment you need to consider if you continue doing business with a company from Russia or any other jurisdiction that refuses to cooperate for tax purposes.

CIT rules

Let us look at how the CIT Act regulates payments to persons that are located or established in tax havens, and what tax implications arise in the following situations:

1. A Latvian company makes payments to a Russian company for a supply of goods.
2. A Latvian company makes payments to a Russian company for a supply of services.
3. A Latvian company writes off an account receivable from a Russian company.

Section 5(6) of the CIT Act states that tax must be withheld by charging a 20% CIT on all payments and dividends that Latvian residents or permanent establishments of non-residents pay to entities, individuals and other persons located or established in tax havens. Exceptions are payments for supplies of goods and purchases of EU/EEA public securities at arm's length prices.

Section 5(8) of the CIT Act states that without prejudice to its provisions, any interest payments and royalties, including payments to representatives of those persons or payments into third-party bank accounts and payments made as a set-off of mutual accounts, are subject to a 20% CIT unless there is an obligation to withhold personal income tax.

Tax implications

Payments for goods

When making payments to a Russian company for a supply of goods, the Latvian company can take a CIT exemption if the price is arm's length. However, if the sale of goods is not arm's length, then CIT must be charged and reported to the SRS by filing the "Corporate income tax report on income gained and tax paid by a non-resident in the Republic of Latvia".

Tax must be withheld and the CIT report filed with the SRS within 20 days after the end of the month in which the payment was made. If the payer of fees has failed to duly withhold and pay tax to the government, the amount of CIT due must be calculated by charging an effective 25% CIT on the payment and must be reported on the CIT return for the last month of the financial year.

Payments for services

When making payments to a Russian company for services, the Latvian company should charge a 20% CIT and notify the SRS by filing the CIT report unless the taxpayer has received permission from the SRS not to withhold tax. Section 5(9) of the CIT Act gives the SRS the power to exempt tax on payments on which tax must be withheld, if the payer of fees is able to reasonably demonstrate that the payment is not aimed at evading taxes. It is important to note that the SRS will never exempt tax on the following payments:

- Consulting fees
- Dividends
- Interest
- Royalties

The procedures for completing and considering an application for CIT exemption are prescribed by the Cabinet of Ministers' Rule No. 677, *Application of Provisions of the Corporate Income Tax Act*, paragraphs 38-49.

Please note that the exemption can be taken only after receiving SRS permission and only for payments mentioned in it.

Writing off bad debts

Section 9 of the CIT Act contains rules on the tax treatment of doubtful receivables. If a receivable is recognised as doubtful, the company may make a provision. If the debt remains unpaid within 36 months (or 60 months if the debtor has gone into insolvency) after the provision was made, the company must include the debt in the taxable base and pay the tax due.

Section 9 of the CIT Act also states that when it comes to writing off a receivable, the taxpayer should assess whether the criteria listed in section 9(3) are met. One of the conditions for a CIT exemption is that the debtor must be a resident of Latvia or another EU/EEA member state, or a country that has an effective double tax treaty with Latvia. Since the treaty between Latvia and Russia has been suspended since 16 May 2022, the section 9(3) exemption is not available for Russian debtors. Accordingly, when writing off a receivable appearing on the balance sheet after 1 January 2018, the debt must be included in the taxable base because none of the section 9(3) exemptions is available.