Scope of transfer pricing rules for domestic transactions (1/28/20)

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The standard transfer pricing ("TP") documentation requirements mainly apply to Latvian companies that belong to a multinational group and enter into transactions with foreign related companies within the group.

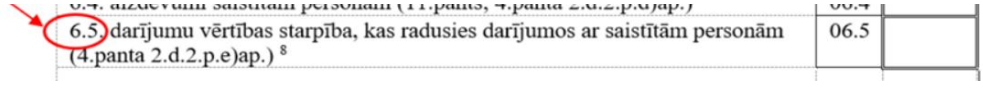
Relaxed requirements and exclusions

According to the amendments to section 15.2 of the Taxes and Duties Act that modified the TP documentation requirements, they do not apply to transactions that a taxpayer makes with a Latvian-resident related party from the financial period beginning in 2018. This eases the TP documentation burden where a Latvian-resident company or a non-Latvian resident company's permanent establishment ("PE") in Latvia enters into a transaction with a Latvian-resident company.

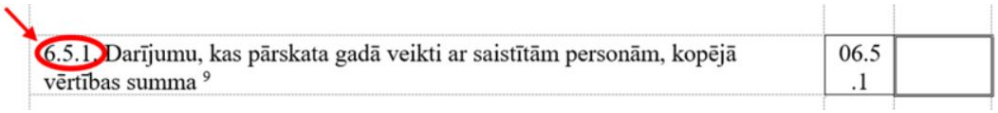
If, however, such transactions (including any commercial or financial relationships according to the functions performed, risks assumed or controlled, or assets used) are economically linked to the resident company's or PE's transaction with a foreign company (carried out consecutively within a chain of supplies), and the transaction exceeds EUR 250,000[1] in the financial year, and there is a risk that profits will be shifted outside Latvia, the tax authority has the power to request TP documentation relating to transactions between Latvian residents. At the tax authority's request, this documentation should be prepared also for a transaction between two or more Latvian-resident companies or between a PE and a Latvian-resident company.

Section 4(2)(2)(e) of the Corporate Income Tax (CIT) Act lays down the arm's length principle, which, in line with the prescribed delegation, provides that for the purpose of calculating the taxable base and administering CIT, the taxpayer has to verify that all of its transactions (including with a Latvian-resident related party) conducted in the financial year are arm's length, even though there is no requirement for preparing TP documentation for transactions conducted by Latvian-resident companies (with the above exception).

This rule provides that any income arising from related-party transactions must not be below the market price (value) and any expense incurred in related-party transactions must not be above the market price (value). This TP adjustment (deficit or excess) is a deemed profit distribution that must be included in the taxable base. The Cabinet of Ministers' Regulation No. 93 provides that information on profit distributions must be reported on line 6.5 of the CIT return for the last tax period of the financial year:



The requirement for reporting the total value of transactions between related parties in the financial year on line 6.5.1 of the CIT return for the last tax period of the financial year extends to domestic transactions between related parties, and financial data on those transactions should be included in the total:



Preparation of transaction documents is advisable

As the tax authority has the power to conduct a TP audit (covering also domestic related-party transactions) within five years after the statutory deadline for paying CIT, it is advisable to duly prepare written information on the facts and circumstances of the transaction, on each party's activities in performing relevant functions, and on any related income or expenses, and to assess whether the price of the transaction matches its market price (value). These steps are necessary to avoid any disagreement with the tax authority and to verify that the price (value) of the transaction between related parties remains unaffected by their relationship and meets the arm's length standard.

Each taxpayer has discretion to analyse their transactions with a Latvian-resident related party and support their arm's length nature in free form, but it is advisable to draw up a transaction document (documentation) to mitigate TP risk.

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[1] An exception: sections 15.2 (2)(4) and 15.2(7) of the Taxes and Duties Act