**Study on Aggressive Tax Planning**

*Specific contract No13 under FWC TAXUD/2012/CC116*

**Appendix 1 - Questionnaire to national tax experts**

**Filled in for Latvia**





**QUESTIONNAIRE**

**Latvia**

## Abbreviations

**CIT Act – Latvian Corporate income tax Act**

|  |  |
| --- | --- |
| Questions | Answers |
| *Corporate tax rate* | |
| 1. What is the standard rate of corporate income tax applicable for the fiscal year 2015? | 15%. |
| 1. Some states offer special offshore tax regimes, providing for corporate tax-exemption of certain mobile income types (e.g. royalty) from abroad. Does your MS offer such a tax regime? If yes, please briefly explain, including the conditions to be met. | No |
| *Dividends received* | |
| 1. Is it possible for a company in your MS to receive dividends from a foreign company free of tax (or at a greatly reduced rate of tax, e.g. 95% tax-exemption)? | For taxable periods beginning in 2013, all dividends except for those originating from companies resident in “blacklisted” jurisdictions are exempt from corporate income tax.[[1]](#footnote-2) |
| 1. If yes to question 3: |  |
| 1. Does this apply regardless of the tax residence of the distributing company, e.g. Member State, treaty state, tax haven? | Dividends paid from companies resident in “blacklisted” jurisdictions (tax haven jurisdictions like Cayman islands, Seychelles, etc.) are subject to 15% withholding tax (Article 3(4)(8) of the CIT Act).  Currently 68 jurisdictions are blacklisted (Regulation No. 276). The list is maintained and updated by the Ministry of Finance and the State Revenue Service. The list may be updated by Cabinet of Ministers.[[2]](#footnote-3) |
| 1. Does this apply regardless of the level of shareholding or voting rights held in the distributing company? | Yes, the exemption is not subject to any ownership requirements. |
| 1. Does this also apply if the dividends have been deducted by the distributing company in its taxable income? | Yes. |
| 1. If yes to b, how will the recent amendment of Article 4 of the EU Parent/Subsidiary Directive, which requires Member States to tax dividends if they have been deducted by the subsidiary, affect your answer? | Latvia considers that its tax legislation is in line with the recent amendments to the EU Parent/Subsidiary Directive, as under generally applicable rules dividends shall not be treated as deductible expense, as well as CIT Act provides interest income definition, which stipulates that interest income is income from any debt obligations, income from government emitted securities, and income from bonds or promissory notes, including premiums and bonuses pertaining to such securities, bonds or promissory notes (Article 1 (7)) and accurate definition of dividends which does not allow different interpretation options (see answer to question 8). |
| *Dividends paid* | |
| 1. Is it possible for a company in your MS to distribute dividends to a foreign company without any withholding tax? | Yes, except if dividend is distributed to blacklisted countries or jurisdictions (se answer to 6 b)) |
| 1. If yes to 5, |  |
| 1. Does this apply regardless of the amount or percentage of shares, which the foreign company holds? | Yes, the exemption is not subject to any ownership requirements. |
| 1. Does this apply regardless of the tax residence of the foreign company, e.g. member state, treaty state, tax haven? | Dividends paid to non-resident companies are exempt from withholding tax, unless paid to persons resident, established or incorporated in “blacklisted” jurisdictions (see under 3a above), in which case they will be subject to withholding tax of 15%.  Extraordinary (i.e. interim) dividends paid to persons resident or established in “blacklisted” jurisdictions are subject to withholding tax of 30% (Article 3(4)(8.2) of the CIT Act). |
| 1. Is the withholding tax exemption subject to a beneficial ownership requirement similar to that of the OECD model tax convention? | No. |
| 1. Is the withholding tax exemption subject to any other anti-avoidance requirements, e.g. based on substance of the recipient? If yes, please briefly explain. | No. |
| 1. Is any other tax levied upon a distribution of a dividend by a company in your MS? | No, except as described in 6 b) above. |
| 1. Are dividend equivalents (typically a buy-back of shares, a capital reduction-payment or a payment of liquidation proceeds) treated in a similar way as dividends and subject to withholding tax when paid to a foreign company? Please refer to question 4 and 5 above. | These payments are unlikely to be considered dividends. Qualification as dividends is only possible if the dividend definition is interpreted broadly. The dividend definition as per Article 1 (6) of the Latvian CIT Act:   * Dividends – income in cash or in kind from capital shares or stocks of a commercial company or co-operative society co-operative shares, or other rights, not resulting from debt obligations, to participate in the distribution of profits of such commercial company or co-operative society. This term shall not apply to income in cash or in kind received in the event of liquidation of the commercial company or co-operative society, as well as the distribution of the profits a partnership.   Qualification as dividends usually is interpreted narrowly. [[3]](#footnote-4) |
| *Interest income* | |
| 1. Is interest income from a loan granted by a company in your MS to a foreign group member company taxable? | Yes. |
| 1. If such a loan is granted free of interest (i.e. on non-arm’s length-conditions), would the creditor company resident in your MS have to include any deemed interest income in its taxable income? When responding, please consider Model ATP-Structure no. 4 and assume that FinanceCo B is tax resident in your MS. | Yes, the Latvian company (creditor) has to make transfer pricing adjustment of its taxable income (Article 12 (2) of the CIT Act). Thus deemed interest income is taxable in Latvia. |
| 1. Is it possible that an interest bearing financial instrument (hybrid loan) granted by a company resident in your MS to a foreign group member company could be qualified as an equity investment in your MS with the result that the return on the investment (treated as deductible interest in the state of the debtor company) is considered a tax exempt dividend or similar? When responding, please consider Model ATP-Structure no. 2 and assume that B Holdco is tax resident in your MS (regardless of the non-MS assumption in the description of the Model). | No, these payments are not considered dividends as defined for CIT purposes. Please see our considerations in point 8 above. |
| 1. If yes to 11, |  |
| 1. Please briefly explain which requirements should be fulfilled. | N/A |
| 1. How will the amendment of Article 4 of the EU Parent/Subsidiary Directive affect your answer? | N/A |
| *Interest costs* | |
| 1. Are inter-group interest payments on a loan granted by a foreign group member company tax deductible to a resident in your MS? | Yes. |
| 1. If yes to 13, |  |
| 1. Does the tax deductibility depend on how the interest income is qualified for tax purposes in the creditor’s state? If yes, please briefly explain. | No. |
| 1. In particular, would your MS still allow a tax deduction if the creditor state treats the corresponding interest income as a non-taxable dividend or similar, i.e. if the loan is a hybrid loan? When responding, please consider Model ATP-Structure no. 2 and assume that C Holdco is tax resident in your MS. | Yes, such interest payment (just in case if they are related to economic activity, as provided in Article 1 (9) CIT Act) will be tax deductible.  Please note that upon tax audit, tax authorities are to analyse the transactions not only based on their legal form, but also economic substance. |
| 1. Is the tax deduction of interest cost on inter-group debt subject to any thin capitalisation-rules or other interest deduction limitations-rules? | Yes. There are two interest limitation rules as described below. |
| 1. If yes to 15 |  |
| 1. Please briefly explain the general scope and mechanism of the rules. | The first interest limitation rule is intended to counter excessive interest payments. The amount of interest that may be deducted is limited to the principal outstanding multiplied by a rate equal to 1.57 times the average weighted interest rate on loans issued to domestic non-finance companies for the last month of the taxable period, as determined by the Bank of Latvia. It is not possible to carry forward excess interest for deduction in following tax years.  The second interest limitation rule is a thin capitalization rules. According to the thin capitalization rule, interest payable by a company is only deductible to the extent that the average value of interest-bearing loans during the taxation year do not exceed four times a company’s equity capital as stated in the balance sheet at the beginning of the period (4:1).  (Article 6.4 of the CIT Act) |
| 1. In particular, do the rules apply only to interest costs on inter-group debt or more generally to all interest costs? | Thin capitalisation rules apply not only on inter-group debt, but generally to all interest costs, except:   * financial institutions which are resident in EU/EEA country and countries which Latvia has a double tax treaty with, * Latvian Treasury, * Latvian Development Finance Institution, * Nordic Investment Bank, * European Bank for Reconstruction and Development * European Investment Bank, and * World Bank group.   (Article 6.4 (4.1) of the CIT Act) |
| 1. Do the rules take into account the worldwide debt ratio of the group of companies? | No. |
| 1. In general, how effective do you consider these rules in countering ATP? When responding, please consider Model ATP-Structures 1 – 4 and assume that C Holdco, B Hybrid and OpCo are tax resident in your MS. | Since the thin capitalisation rules limit the amount of tax deductible interest, they must be considered as effective measure to counter unreasonably high interest deductions. |
| 1. If a loan is granted free of interest (non-arm’s length-condition) by a foreign group member company, could a debtor company resident in your MS claim any tax deduction for a hypothetical (deemed) interest cost? When responding, please consider Model ATP-Structure no. 4 and assume that FinanceCo D is tax resident in your MS. Moreover, please explain whether any deemed deduction would be contingent on a corresponding adjustment in the foreign state. | Yes. The debtor company may deduct an arm’s length interest cost (a deemed interest) from its taxable income only if he has a confirmation from the other party’s tax administration that the corresponding adjustment of the taxable income of the creditor company was made. Such deduction is only possible if the contracting party is resident in EU/EEA country or other country with which Latvia has a double tax treaty (Article 12 (5) and (6) of the CIT Act).  The deemed interest cost is subject to the interest limitations rules as mentioned in point 16. |
| 1. Would the benefit of such a loan compared to a normal interest-bearing loan on arm’s length conditions be taxable to the debtor company in your MS? If yes, how? | No. |
| 1. Does your MS levy any withholding tax on interest payments? | Yes. |
| 1. If yes to 19 |  |
| 1. What is the rate of withholding tax (ignoring tax treaties)? | 15%, and 5% provided that they are disbursed by credit institutions registered in the Republic of Latvia |
| 1. Are there special withholding tax rules for interest paid on a loan from a group member company? | No. |
| 1. Does this apply regardless of the tax residence of the creditor company, e.g. member state, treaty state, tax haven? | A withholding tax is only levied on interest paid to recipients resident in a blacklisted jurisdiction (tax havens) (Article 3(4)(8) of the CIT Act). |
| 1. In connection with an exemption, reduction or refund of withholding tax under a tax treaty or the EU Interest/Royalty Directive, is it common tax practice to apply a beneficial ownership requirement similar to that of the OECD model tax convention? | No. |
| 1. Is such exemption, reduction or refund subject to other anti-avoidance requirements? If yes, please explain briefly. | No. |
| *Allowance for corporate equity* | |
| 1. Does your MS offer any tax deduction for a notional (fictitious) interest cost on the share capital of a company? If yes, please briefly explain and include any anti-avoidance provisions. In particular, can the deduction be claimed against financial income? | No. |
| 1. Does your MS offer any tax deduction for dividends declared or paid? If yes, please briefly explain. | No. |
| *Royalty and other income from intangible property* | |
| 1. Please consider Model ATP-Structure no. 5 and assume that Company B is tax resident in your MS. Does your MS offer any preferential tax regime (compared to the standard corporate income tax) for income from patents and other intellectual property rights? If yes, please briefly explain its main scope, characteristics and any anti-avoidance provisions. In particular, can the preferential tax treatment be applied to income from patents or other IP which has not been developed by the taxpayer (company) itself? Must the company have its own substantial R&D activities? Can the preferential tax treatment be applied also to income from other taxpayers in your MS? | Latvian tax law does not provide a special regime for income from patents or IP. |
| 1. Can a company in your MS obtain R&D tax credits (typically enhanced tax deduction or tax refund) for costs incurred, e.g. in developing IP rights? | A triple deduction for particular R&D costs is allowed for qualifying R&D projects (Article 6.6 of the CIT Act). |
| 1. If yes to 24, |  |
| 1. Please briefly explain the requirements which have to be met, e.g. requirements for certain activity or successful development, etc. | Under tax law definition (Article 1 (29) of the CIT Act) R&D is creative work, which is systematically performed with the aim of increasing knowledge and applying the knowledge for creating new developments, and which qualifies as one of the following types:   1. **Industrial research** – research aimed at acquiring new knowledge and approaches for development of new products, technologies or substantial improvement of existing products or technologies; or 2. **Experimental development** – combining, modelling or applying the existing scientific, technologic, commercial or other results with the aim to create new or substantially improved products or technologies; or activities aimed at conceptual definition, planning and documentation of new products or technologies.   The expected result of R&D activities must be (Cabinet Regulation No. 373, para 7):   * a novelty element or * removal of scientific or technical uncertainty.   In order to apply the triple R&D costs deduction, the taxpayer has to prepare documentation for the specific R&D project. (Article 6.6 (2) of the CIT Act) |
| 1. Can such credits also be obtained for costs that are ultimately reimbursed by a group member company to the company in your MS? | Yes provided that the Latvian company remains the owner of the R&D project results and does not alienate the developed intellectual property for at least three years since the last R&D costs have been deducted (Article 6.6 (4) of the CIT Act). |
| 1. Can a company in your MS transfer ownership of a patent, trademark or other IP right to a foreign group member company without incurring capital gains tax? When responding, please consider Model ATP-Structure no. 5 and assume that MNE Group is tax resident in your MS. Please also assume that the IP has no significant fair market value at the time it is transferred but it becomes highly valuable shortly (1-2 years) after. | No. Capital gains from sale of IP are part of ordinary income and taxed at 15% CIT in Latvia.  Taxation would be based on the fair market value of the IP at the time of the transfer (based on OECD’s TP Guidelines). A later increase in fair market value will not result in tax assessment unless there are strong indications that the fair market value was higher already at the time of the transfer. |
| 1. If no to 26, i.e. your MS would impose tax on the disposal, |  |
| 1. Is the relevant capital gains tax rate lower than the standard rate? | No. |
| 1. Does taxation arise as a result of an anti-abuse provision or similar? | No. Taxation arises as a result of general rules. However transfer pricing provisions apply meaning that the transfer of IP rights between related parties should be priced in accordance with the arm’s length principle (Article 12 of the CIT Act). |
| 1. Would any R&D tax credits obtained in the past be reversed upon a disposal? | Yes, if IP rights resulting from the R&D project are alienated within three years after the last costs are deducted for the specific project (Article 6.6 (4) of the CIT Act). |
| 1. Can a ruling confirming the value of the IP be obtained? | Yes, the IP value can be confirmed in an advance pricing agreement (APA) with tax authorities. APAs are available for transactions (or type of transactions) which exceed EUR 1 430 000 annually (Article 16.1 of the Taxes and Duties Act). |
| *Royalty and other IP costs* | |
| 1. Is royalty paid by a company in your MS to a group member company in another MS or for utilization of IP tax deductible? | Yes. Royalty payments are deductible for corporate income tax purposes, provided that their payment is related to the business operations of the taxable person. |
| 1. If yes to 28, |  |
| 1. Is the tax deduction dependent on whether the royalty income is taxed in the hands of the IP-licensor/IP-owner? | No. |
| 1. Are there types of royalty payments which cannot be deducted? | No. |
| 1. Does your MS levy any withholding tax on royalty payments? | No, unless royalty is paid to any person located, founded or incorporated in a blacklisted territory (Article 3(4)(8) of the CIT Act).  Any other royalty payments are not subject to withholding tax. |
| 1. If yes to 30, |  |
| 1. What is the rate of withholding tax (ignoring tax treaties)? | No withholding. 15% if paid to black listed jurisdiction. |
| 1. Are there types of royalty payments which are not subject to withholding tax? | No withholding tax applies to any royalty payments, except if paid to any person located, founded or incorporated in a blacklisted territory as mentioned in question 30. |
| 1. In connection with an exemption, reduction or refund of withholding tax under a tax treaty or the EU Interest/Royalty Directive, is it common tax practice to apply a beneficial ownership requirement similar to that of the OECD model tax convention? | No. |
| 1. Is the tax exemption/reduction/refund subject to any other anti-avoidance requirements, e.g. based on a test of the substance of the recipient? If yes, please explain briefly. | No. |
| *Group taxation* | |
| 1. Does your MS allow for group taxation of local group member companies with the effect that profits and losses of different companies are set-off against each other? If yes, please briefly explain. (Please note that group taxation also includes other standard arrangements offered to replicate the benefits of group taxation, e.g. group contributions from a profitable company to a loss-making group member company). | No. |
| 1. If yes to 32, is group taxation restricted in situations where a (holding) company has solely been inserted in connection with a leveraged acquisition of the operating company (so-called debt push-down)? When responding, please consider Model ATP-Structures no. 1 – 3 and assume that C Holdco and B Hybrid are tax resident in your MS. | N/A |
| *CFC rules* | |
| 1. Does your MS apply CFC rules to foreign subsidiaries of a parent company in your MS? | No. |
| 1. If yes to 34, please briefly explain the rules and their scope. | N/A |
| 1. Please consider the attached Model ATP-Structures no. 1, 2 and 4 - 6. Assuming that MNE Group is tax resident in your MS, would your MS’s CFC-rules be applied to the structures? If yes, what would be the likely effects? | N/A |
| *Mismatch in qualification of legal entities* | |
| 1. Does your MS’s tax qualification of a foreign legal entity (e.g. a partnership) follow that of the foreign state, or does it apply its own criteria? Please briefly explain. When responding, please consider Model ATP-Structure no. 3 and assume that MNE Group is tax resident in your MS. | Latvia applies own criteria. There are no provisions stating that qualification of a foreign legal entity should be followed. |
| 1. Does your MS apply rules to counter another state’s mismatch in tax qualification of a legal entity (company) resident in your MS? If yes, please briefly explain the rules and their scope. When responding, please consider Model ATP-Structure no. 3 and assume that B Hybrid is established and tax resident in your MS. | No. |
| 1. Does your MS apply rules to counter another state’s mismatch in tax qualification of a transparent entity (partnership or similar) in your MS? If yes, please briefly explain the rules and their scope. | No. |
| *Tax residence of company* | |
| 1. Based on domestic tax rules, without the application of any tax treaty, can a company incorporated in your MS be considered non-tax resident if its management and control is situated in another state? If yes, please explain under which circumstances. | No. |
| 1. If yes to 40, please consider Model ATP-Structure no. 6. Would the Structure work if Company B1 is incorporated in your MS but managed and controlled abroad in an offshore-state? | N/A |
| *Tax ruling practices* | |
| 1. Some states offer tax rulings (incl. so-called APAs) that confirm non-arm’s length-transactions or the amount of spread between interest or royalty income and cost in various international flow through-structures. As an example, please refer to Model ATP-Structure no. 1. Does your MS offer this form of tax ruling practices or APAs? | No. Only arm’s length pricing can be confirmed in an APA. |
| 1. Do your local transfer pricing-rules allow for the stripping of income from a domestic company by taking away legal ownership of functions, assets and risks? In other word, is it accepted that relatively small amounts of the group’s income is taxed in your MS on the basis of low risk, few assets held and only few functions performed in your MS? | In theory yes, if the income assessment is in accordance with the arm’s length principle. However, there is no ruling or court practice in Latvia regarding this aspect. |
| 1. Can a company in your MS obtain a ruling or APA that a) provides for tax exemption of profits considered to exceed an arm’s length-income or considered to have been left to the company by its shareholders (capital contribution), or b) provides for the deduction of deemed expenses that would have been due under arm-‘s length conditions? | No to a).  Yes to b), provided that the taxpayer has a confirmation form the other party’s tax administration that the corresponding adjustment of the taxable income of the creditor company was made. Such deduction is only possible if the contracting party is resident in EU/EEA country or other country with which Latvia has a double tax treaty (Article 12 (5) and (6) of the CIT Act). |
| *GAAR/SAAR* | |
| 1. Please consider Model ATP-Structures no. 1-7. Are you aware of any general or specific anti-avoidance rules or practice in your MS which could impede or counter the ATP objective of any of the structures? If yes, please describe briefly the scope of the rules/practice and how they could be applied to each of the structures. | Latvia considers that currently, applicable tax regulation sufficiently is in line with the amended EU Parent/Subsidiary Directive. As mentioned, the tax administration should analyze the taxpayer’s transactions not only based on their legal form, but also economic substance.  Nevertheless, it was noted by the NTE that Latvia has introduced the general anti-avoidance regulation which states that the tax administration should analyses the taxpayer’s transactions not only based on their legal form, but also economic substance (Article 23 (14) of the Taxes and Duties Act). However, it is not fully clear how such provision would apply specifically in each of the ATP-Structures. |
| *Other ATP indicators* | |
| 1. Are you aware of any tax rules, tax practice or lack of tax rules (loopholes) – other than those discussed in the preceding answers - which could facilitate your MS’s role in ATP? If yes, please briefly explain. | No. |

1. The answer was validated by Latvian fiscal attaché and complemented with the following comment: “Under generally applicable rules, Latvia provides credit method for tax paid in foreign country (Article 15, 16 CIT Act). However, since dividends are not subject to tax, for tax on dividends withheld in other country, Latvia will not apply this provision.” [↑](#footnote-ref-2)
2. The answer was additionally amended by the Latvian fiscal attaché noting that “in accordance with Paragraph 2 of the Regulation (No.276), the countries or jurisdictions, notwithstanding that they still are listed under the Paragraph 1 of the Regulations, are not treated as uncooperative countries and jurisdictions, as soon as Double Tax Convention, Tax Information Exchange Agreement or the Convention on Mutual Administrative Assistance in Tax Matters enters into force between Latvia and respective country or jurisdiction. Thus, currently special provisions of the CIT Act are applied for 49 listed jurisdictions.” [↑](#footnote-ref-3)
3. The answer was amended by Latvian fiscal attaché noting that Article 161 of The Commercial Law stipulates that Dividends shall be paid out, based upon a decision on the division of profit. [↑](#footnote-ref-4)