Latvia

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The acquisition (from the buyer's perspective)

1 Are there differences in tax treatment between an acquisition of stock in a company in your jurisdiction and the acquisitions of business assets and liabilities and, if so, what are those differences?

In case stock is sold, the transaction is not subject to VAT. Stamp duty of 10 lats (approximately €15) shall be paid for the registration of changes in the shareholders register of limited liability companies. No stamp duty shall be paid where stock in a public limited company is sold. In case business assets are sold, depending on the type of business asset, it may be necessary to pay stamp duty to register the change of title. If the acquirer of business assets and liabilities becomes the successor to the transferor in whole or regarding the respective transferred assets and liabilities, no VAT shall be paid. For these reasons, usually stock is sold.

2 In what circumstances does a purchaser get a step up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

According to the Latvian Corporate Income Tax Act, the results of the re-evaluation of the assets and liabilities transferred as a result of the reorganisation process shall not be taken into account in determining taxable income.

This rule applies to:

- the transfer of business activity existing in Latvia or another member state of the European Union if both the transferee, merged or divided company and the acquiring company are Latvian residents;
- the transfer of business activity existing in Latvia if the transferee, merged or divided company is a resident of a member state of the European Union and the acquiring company is a Latvian resident and if the assets and liabilities after the transfer thereof are not attributable to the permanent establishment of the acquiring company outside of Latvia; and
- cases where the acquiring company is a resident of a member state of the European Union and the transferee, merged or divided company is a resident of Latvia or of a member state of the European Union and if the assets and liabilities after the transfer are attributable to the permanent establishment of the acquiring company in Latvia.

This rule shall not be applied if the stocks of the acquiring company received by the transferee, merged or divided company have not been in their ownership for at least three years after the transfer, unless the transferee, merged or divided company provides credible proof that the disposal of such stock has not been performed for the purpose of reducing payable tax or avoiding payment of tax in Latvia.

Regarding companies registered in the European Union, these rules are not yet effective. Special laws will specify the date on which these rules become effective.

3 Is it preferable for an acquisition to be executed by an acquisition company established in your jurisdiction or by an acquisition company established outside your jurisdiction? Explain why.

If an acquisition takes place through a stock purchase transaction, there is no substantial difference as regards whether the acquisition company is in Latvia or outside Latvia. If the acquisition takes place through a merger, a company established in Latvia shall be used, since cross-border mergers are not currently possible. The situation will change after Latvia implements Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

4 Are company mergers or share exchanges common forms of acquisition in your jurisdiction? Explain why.

The most common form of acquisition used in Latvia is a purchase of stock in a company. Company mergers are rarely used because of their complicated procedure which may take long time and involve unnecessary costs. Share exchanges are possible and there are no burdensome procedures, however, share exchanges as a form of acquisition are unusual in Latvia.

5 Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

According to the Latvian Commercial Law, in case of reorganisation, cash as a consideration can be paid only in addition to stock or as a consideration to those shareholders of the company taken over that voted against the reorganisation process.

There are no special tax incentives or exemptions that would make the issuing of stock as a consideration more attractive than payment of cash.

6 Are documentary taxes such as stamp duties payable on the acquisition of stock or business assets and, if so, what are the rates and who is the accountable person? Are any other transaction taxes payable?

In case of the acquisition of stock in a public limited company, no stamp duties shall be paid. If shares in a limited liability company are acquired, the change of shareholders shall be notified to the

commercial register and stamp duty of 10 lats (approximately €15) shall be paid.

In case real estate forms part of the business assets acquired, it is necessary to pay stamp duty at a rate of 2 per cent on the purchase price of the real estate, up to a maximum of 30,000 lats (approximately €43,000) to register the acquirer as the new owner in the land register. If the purchase price paid for the real estate is not stated separately in the agreement, there is a risk that stamp duty will be determined on the basis of the total purchase price of all the business assets sold. Therefore, it is important to state in the agreement which part of the total purchase price is attributable to the real estate.

If vehicles registered with the Road Traffic Safety Directorate of the Republic of Latvia are among the business assets acquired, stamp duty shall be paid to register the acquirer as the new owner of vehicles. The amount of stamp duty depends on the type of vehicle.

Usually the acquirer pays these stamp duties but the parties are free to agree otherwise.

A sale of stock is not subject to VAT. If assets and liabilities are transferred and the acquirer becomes the successor to the transferor in whole or regarding the respective transferred assets and liabilities, the transfer is not subject to VAT. However, if the acquirer does not become the successor of the transferor, the transaction is subject to VAT. VAT is determined by the type of business assets transferred.

The first sale of unused or reconstructed real estate is subject to VAT at a rate of 18 per cent. The transfer of land is exempt from VAT without the right to input VAT recovery. However, land that is sold together with unused real estate as an ideal part is also subject to VAT at a rate of 18 per cent.

7 Do net operating losses survive a change in control of the target? If not, are there techniques for preserving them?

According to the Latvian Corporate Income Tax Act, it is possible to carry tax losses forward for five years. Where a change in the 'control' of a company occurs, the right to existing losses is lost unless the company continues the same fundamental business activity for the next five years that it undertook during the previous two years.

There are special rules for the transfer of losses in case of a formal reorganisation procedure:

- If a company is reorganised through a merger, and both companies prior to reorganisation and the acquiring company after reorganisation are controlled by one and the same person or group of persons, the acquiring company after reorganisation is entitled to take over the losses of the target company.
- The acquiring company is entitled to take over the losses of the transferring company which are related to the type of economic activity transferred.
- If in the course of reorganisation, a company is split up and the company that is split up has losses, the losses may be used by the companies created as a result of the split in proportion to the assets transferred to them.

8 Does an acquisition company in your jurisdiction get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? If so, please outline. Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved in your jurisdiction?

There is no tax relief for interest payments on loans taken to acquire the target.

Deductibility

Latvian tax legislation provides that interest payments can be deducted from the company's taxable income, however the deductible amount is restricted. Interest payments that are not deducted in the taxation year cannot be carried forward and deducted in future taxation years.

The calculation of deductible interest must be done on an annual basis. According to the thin capitalisation rules, two calculations for determining the amount of deductible interest must be made:

- According to the first method of calculation, the principal amount upon which interest was paid during the year is multiplied by 1.2 times the average short-term interest rate for the last month of the taxation period as determined by the Central Statistical Bureau of Latvia. If the interest payment for the tax year exceeds this amount, the excess is not deductible for taxation purposes.
- According to the second method of calculation, the deduction of interest paid is not allowed proportionally to the amount by which the average principal amount outstanding during the year exceeds a multiple of four times the company's equity as stated in its annual financial statements at the beginning of the year, reduced by any amounts that are long term investment re-evaluation reserves or other reserves that have not been reflected in the profit and loss statement.

If taxable income shall be increased under both these methods, the income shall be increased only by the largest amount determined.

These restrictions are not applied to credit institutions and insurance companies, or to interest payments for credit and loans which are received from credit institutions registered in the Republic of Latvia or in another member state of the European Union, from the Treasury of the Republic of Latvia, the Nordic Investment Bank or from the World Bank group.

In case of related parties, the arm's-length principle shall be observed, which means that the interest rate shall comply with the market rate, otherwise there can be a risk of abusing the transfer pricing rules.

In Latvia there are no specific anti-debt pushdown rules. Therefore, general rules apply.

Withholding

Corporate income tax shall be withheld from interest payments paid by a resident to a non-resident if the payer and the recipient are related parties (10 per cent of such payments); but regarding interest payments that are paid by commercial banks registered in the Republic of Latvia to their related parties a rate of 5 per cent of such payments applies.

Starting from 1 July 2013, no withholding tax will be applied on interest payments which a company that is a resident of the Republic of Latvia pays out to a related company in a member state of the European Union or to a permanent establishment which is located in another member state of the European Union. Until 30 June 2009, interest payments to related companies in a member state of the European Union or to a permanent establishment will be subject to withholding tax at a rate of 10 per cent. From 1 July 2009 until 30 June 2013, withholding tax at the rate of 5 per cent will be applied.

In case there is a double taxation avoidance treaty with the

country of the recipient of interest payments, more favourable rules can be applied or withholding tax can be avoided altogether. However, in such cases a special procedure shall be observed.

9 What protections are generally sought in your country for stock acquisitions and business asset acquisitions? How are these documented?

In general, before the transaction takes place, tax and legal due diligence is carried out to identify possible risks. Furthermore, warranties and representations regarding tax issues are included in the agreement. In case these warranties or representations are false or are breached, contractual penalties can be claimed. The agreement may also provide the buyer with the right to unilaterally terminate the agreement if the warranties or representations are breached. Usually the seller also undertakes to indemnify the buyer in case of any losses or penalties imposed due to any tax liabilities that are discovered after the acquisition has taken place.

If real estate forms part of the business assets sold, registration of the title to the real estate in the land register is possible only if there is a confirmation from the relevant municipality that real estate tax has been paid as required by law.

Post-acquisition planning

10 What post-acquisition restructuring, if any, is typically done in your country and why?

Normally, post-acquisition restructuring, if any, takes place for corporate or business reasons. Post-acquisition restructuring owing to tax considerations is rare and may be caused by changes to the way the company is financed.

11 Can tax neutral spin-offs of businesses be executed in your country and, if so, can the net operating losses of the spun-off business be preserved?

If in the course of reorganisation a company which has losses is split up, the companies created as a result of the split may use the losses in proportion to the assets transferred to each. No VAT shall be paid if the companies created as a result of the reorganisation are successors to the split company.

12 Is it possible to migrate the residence of the acquisition company or target company from your country without tax consequences?

According to the current version of the Latvian Commercial Law, it is not possible to transfer the registered address of a Latvian company out of Latvia without liquidating it (except in case of Societas Europea). The situation may change after Latvia implements Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

13 Are interest and dividend payments made out of your country subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Taxation of dividends

In general, dividends paid to non-residents are subject to a 10 per cent withholding tax. This tax rate may be lower if there is a double taxation avoidance treaty with the respective country. Furthermore, no withholding tax is applied if the beneficial owner of the dividends is a company registered in a member state of the European Union that holds at least 20 per cent (15 per cent from 1 January 2007, 10 per cent from 1 January 2009) of the capital and voting rights of the payer of dividends for at least two years.

Taxation of interest

Corporate income tax shall be withheld from interest payments paid by a resident to a non-resident if the payer and recipient thereof are related parties (10 per cent of such payments); but regarding interest payments that are paid by commercial banks registered in the Republic of Latvia to their related parties a rate of 5 per cent of such payments is applicable.

Starting from 1 July 2013, no withholding tax will be applied to interest payments which a capital company that is a resident of the Republic of Latvia pays out to a related company or a permanent establishment which is located in a member state of the European Union. Until 30 June 2009, interest payments to related companies in a member state of the European Union or to a permanent establishment will be subject to withholding tax at a rate of 10 per cent. From 1 July 2009 until 30 June 2013, withholding tax at a rate of 5 per cent will be applied.

In case there is a double taxation avoidance treaty with the country of the recipient of the interest payments, more favourable rules can be applied or the withholding tax can be avoided altogether. However, in such case a special procedure shall be observed.

It should be emphasised that any payments to residents of low-tax jurisdictions (the list is approved by the Latvian government) are subject to a 15 per cent withholding tax.

14 What other tax efficient means are adopted for extracting profits from your jurisdiction?

Usually transactions are structured so that the benefits under double taxation avoidance treaties can be used. If this is not possible or the provisions are not favourable enough, offshore companies in Malta, Cyprus or elsewhere may be involved. Quite frequently, holding companies in Sweden or the Netherlands are used.

Since in Latvia income from the sale of listed stock is not subject to corporate income tax, this is also used for the purposes of tax planning.

Disposals (from the seller's perspective)

15 How are disposals most commonly carried out in your jurisdiction – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

The disposal of business assets rarely happens because of the stamp duty payable upon disposal of real estate. Usually stock is disposed. Sometimes, due to tax considerations, the stock in a foreign holding company, rather than the stock in the local company, is disposed.

16 Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax in your country? Are there special rules in your country dealing with the disposal of stock in real estate, energy and natural resource companies?

Capital gains are not taxed separately, but are included in the profits subject to corporate income tax. Therefore no tax shall be withheld on the disposal of stock, even if it is disposed of by

Update and trends

As mentioned above, discussions are taking place regarding the taxation of gains related to real estate transactions. Currently, capital gains are not taxed, but are included in the profits subject to corporate income tax. Furthermore, if the shares of a real estate company are sold, no stamp duty shall be paid (if the real estate is sold directly, stamp duty of 2 per cent of the purchase price to a maximum of 30,000 lats (approximately €43,000) shall be paid). For these reasons, there is a view that it would be useful to subject capital gains from the sale of Latvian real estate holding companies to capital gains tax as is done in Estonia.

a non-resident company. Currently there are no special rules in Latvia dealing with the disposal of stock in real estate, energy or natural resources companies. However, for some time already there have been discussions on possible amendments to the law to ensure that profit realised on transactions involving real estate are more efficiently taxed.

17 If a gain is taxable on the disposal either of the shares in the local company or on the disposal of the business assets by the local company, are there any methods for deferring or avoiding the tax? Please outline.

Corporate income tax shall be withheld from the remuneration paid by a resident to a non-resident upon disposal of a real estate located in Latvia at a rate of 2 per cent.

In case there is a double taxation avoidance treaty with the country of the recipient of the remuneration, a lower tax rate may be applied or the withholding tax can be avoided altogether. However, in such case a special procedure set out in the regulations of the government of Latvia shall be observed.

Tax can also be avoided if the shares in the company owning the real estate are sold. As mentioned above, in case stock (shares) in the company owning the real estate is sold, no capital gains tax is applied.

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