



# Tax on Inbound Investment

in 34 jurisdictions worldwide

Contributing editors: Peter Maher and Lew Steinberg

# 2010



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# Latvia

Sandija Novicka and Elina Bedanova

Raidla Lejins & Norcouc

## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

If stock is sold, the transaction is not subject to VAT. Stamp duty of 10 lats 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. It is usual practice that the stock is sold.

### 2 Step-up in basis

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 Law on Corporate Income Tax, 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 EU member state 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 an EU member state 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 an EU member state and the transferee, merged or divided company is a resident of Latvia or of an EU member state 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 apply 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.

### 3 Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

If the target is not a real estate company (ie, a company more than 50 per cent of the value of whose assets directly or indirectly consist of real estate located in Latvia), there is no substantial difference as to whether the acquisition company is in Latvia or outside of Latvia. If the target is a real estate company then in case of further sale of the target, the purchase price will be subject to withholding tax at the rate of 2 per cent.

### 4 Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

The most common form of acquisition used in Latvia is the purchase of stock in a company. Company mergers are rarely used because of their complicated procedure, which may take a 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 Tax benefits in issuing stock

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 consideration can be paid only in addition to stock or as 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 consideration more attractive than payment of cash.

### 6 Transaction taxes

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

In the case of the acquisition of stock in a public limited company, no stamp duty 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 shall be paid.

If 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 property, up to a maximum of 30,000 lats to register the acquirer as the new owner in the land register. If the purchase price paid for the property 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 property. In addition, a chancellery fee of 9 lats shall be paid to the land registry for the registration.

If vehicles registered with the Road Traffic Safety Directorate of Latvia are among the business assets acquired, stamp duty shall be paid to register the acquirer as the new owner of the 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 21 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 21 per cent unless the price of the land is stated separately. Also the sale of 'building land' will be subject to VAT. Currently the law defines 'building land' as the land for which a building permit is issued after 31 December 2009.

## 7 Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses or other tax attributes subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

According to the Latvian Corporate Income Tax Act, it is possible to carry tax losses forward for eight 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 that are related to the type of economic activity transferred; and
- 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.

There are no special rules regulating transfer of losses in case of acquisition or reorganisation of insolvent companies. However, there is a special procedure for discharge of taxes or extension of the payment term of taxes in insolvency cases, including cases when the solvency of a taxpayer is restored.

## 8 Interest relief

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

There is no tax exemption or special 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 not deducted in the taxation year cannot be carried forward.

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; and
- 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 is 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 Latvia or in another EU member state, from the Treasury of the Republic of Latvia, the Nordic Investment Bank or from the World Bank group or residents of Latvia. There is an ongoing debate that this provision is discriminatory towards residents of other EU member states and that it shall be amended or at least applied equally to loans provided by residents of Latvia and residents of other EU member states.

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). If the related party receiving interest payments is resident in another EU member state, 5 per cent withholding tax applies. Regarding interest payments that are paid by commercial banks registered in 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 that a company that is a resident of Latvia pays out to a related company in an EU member state or to a permanent establishment that is located in another EU member state.

If 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 Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they 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.

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## Post-acquisition planning

### 10 Restructuring

What post-acquisition restructuring, if any, is typically carried out 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.

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### 11 Spin-offs

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

If in the course of reorganisation a company that 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.

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### 12 Migration of residence

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

Tax-neutral migration of the residence is possible in case of a *societas europaea*. In other situations tax-neutral migration of residence is possible in so far as that is allowed by Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies and Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states.

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### 13 Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction 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 agreement with the respective country. Furthermore, no withholding tax is applied if the dividends are paid to:

- a company which takes one of the forms listed in annex 1 to the Law on Corporate Income Tax: according to the tax laws of another EU member state is considered to be resident in that state for tax purposes and, under the terms of a double taxation agreement concluded with a third state, is not considered to be resident for tax purposes outside the EU; and is subject to one of the taxes listed in annex 2 to the Law on Corporate Income Tax, without the possibility of an option or of being exempt; or
- a company that according to the tax laws of another state of the European Economic Area (other than member states of the EU) is considered to be resident in that state for tax purposes and,

#### Update and trends

Due to economic crisis and limited resources in the state budget, the government of Latvia is considering several amendments to the tax laws. From the public information available so far, it seems that the amendments would mainly affect personal income tax and real estate tax. The government proposes amendments to include in the personal income tax base also capital gains and a 10 per cent tax on dividends. However, the government is also considering further increase of the VAT and excise tax rates. Furthermore, the government has asked the Finance Ministry to prepare propositions for the progressive income tax for enterprises.

under the terms of a double taxation agreement concluded with a third state, is not considered to be resident for tax purposes outside the EEA; and is subject to tax equivalent to the Latvian corporate income tax in the country of its residence, without the possibility of an option or of being exempt.

#### 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). If the related party receiving interest payments is resident in another EU member state, 5 per cent withholding tax applies. Regarding interest payments that are paid by commercial banks registered in 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 that a capital company that is a resident of Latvia pays out to a related company or a permanent establishment that is located in an EU member state.

If 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.

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#### 14 Tax-efficient extraction of profits

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 might also be used for the purposes of tax planning.

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#### Disposals (from the seller's perspective)

##### 15 Disposals

How are disposals most commonly carried out – 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, owing to tax considerations, the stock in a foreign holding company, rather than the stock in the local company, is disposed.

**16 Disposals of stock**

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, 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 a non-resident company, unless the stock in a real estate company is disposed. In such case the purchase price is subject to withholding tax at the rate of 2 per cent. A company is regarded as a real estate company if more than 50 per cent of the value of its assets directly or indirectly consists of a real estate located in Latvia. There are no special rules in Latvia dealing with the disposal of stock in energy or natural resources companies.

**17 Avoiding and deferring tax**

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

Corporate income tax shall be withheld from the remuneration paid by a resident to a non-resident upon disposal of property located in Latvia or upon disposal of stock in a real estate company at a rate of 2 per cent. Withholding tax shall also be applied in the case of the disposal of stock in a company registered outside Latvia that owns (directly or indirectly) real estate in Latvia. However, in practice it might be difficult for the Latvian State Revenue Service to find information on the disposals of stock in companies registered outside Latvia. Moreover there is no clear mechanism set for the Latvian State Revenue Service for the collection of tax if a non-resident has sold stock in a Latvian real estate company to a non-resident, even though theoretically tax should be paid in Latvia.

If 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.

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