



Valsts ieņēmumu
dienests

Methodological Material

On Elimination of Double Taxation to Profits and Capital of Enterprises, and Mutual Agreement Procedures

(MAP)



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Double taxation is the application of taxes in Latvia and another country to the same taxable income or capital, if these taxes are subject to international treaties stipulating the elimination of double taxation to income and capital, and if taxation causes at least one of the following circumstances:

- 1) tax to be paid additionally;
- 2) increase of tax obligations;
- 3) non-recognition or reduction of costs, which can be used to reduce the taxable income.

The elimination of double taxation is a set of procedures implemented by the State Revenue Service (hereinafter referred to as the 'SRS') to coordinate the tax collection rights of the countries involved¹. Mutual agreement procedures with EU Member States are performed in accordance with Chapter XV of the Law On Taxes and Duties.

International Tools Applied to Disputes Arising from Adjustments of Profits of Associated Enterprises (Hereinafter Also 'Transfer Prices')

• Provisions on the elimination of double taxation in international treaties

Article 9 of the treaties entered into by the Government of the Republic of Latvia on the elimination of double taxation and the prevention of fiscal evasion with regard to taxes on income and capital² (hereinafter referred to as 'tax conventions') includes special provisions with regard to the adjustments of profits between associated enterprises. Article 9 usually consists of two paragraphs.

1. Paragraph one determines that the transaction price in transactions between associated enterprises must comply with the principle of non-associated (independent) enterprises or the arm's length price. If the transaction price differs from the price, which would have been determined in a transaction between associated enterprises, any profit, which would form between two non-associated enterprises, yet had not formed under the influence of created provisions (different from the provisions, which would have been applied between non-associated enterprises), might be included in the profits of these non-associated enterprises and accordingly subjected to taxes (hereinafter referred to as the 'transfer pricing adjustment'). **Namely, paragraph one of Article 9 grants the competent authority the right to adjust taxpayer's profit and income subject to corporate income tax in cases where the price of transactions with an associated enterprise does not correspond to the arm's length price or the principle of transactions of non-associated enterprises.**

¹ Section 18, Paragraph one, Clause 32 of the Law On Taxes and Duties.

² Information published by the Ministry of Finance of the Republic of Latvia on the status of conventions signed by the Republic of Latvia on the elimination of double taxation and the prevention of fiscal evasion. Available at

https://www.fm.gov.lv/lv/sadala/nodoklu_politika/nodoklu_konvencijas/divpusejo_konvenciju_statuss/

2. Paragraph two determines that in case of a transfer pricing adjustment, the double application of corporate income tax must be eliminated. The competent authority is granted the right to eliminate double taxation without the dispute of involved competent authorities. The competent authority, which eliminates double taxation unilaterally, agrees to the conclusions made by the competent authority of the other state, which has initially resulted in double taxation. To eliminate double taxation unilaterally, the competent authority may refer to paragraph two of Article 9 of the tax convention in its decision on the elimination of double taxation. The competent authority, exercising the right granted by this paragraph, does not need to initiate a mutual agreement procedure.

- **Advance Pricing Agreement ('APA')**

Paragraph three of Article 25 of signed tax conventions usually grants the competent authority an opportunity to resolve any complications or eliminate any doubts, which might occur in applying the tax convention, via mutual agreement with the competent authority of the involved state. In addition, this paragraph grants competent authorities an opportunity to mutually consult for the purposes of eliminating double taxation. The SRS, based on a taxpayer's application³, which contains a request for the elimination of double taxation, may, agreeing with the jurisdiction involved in a dispute, apply paragraph three of Article 25 of the tax convention to eliminate the double application of corporate income tax under a voluntary, multilateral advance pricing agreement procedure. Starting from 2019, the SRS may implement the elimination of double taxation with regard to advance agreement documents on the determination of the arm's length price (value), which were signed in previous years (up to five years).⁴

Provisions on the Elimination of Double Taxation, Included in Laws and Regulations of the Republic of Latvia

- **In cases of a transfer pricing adjustment for transactions performed before 2018**

The elimination of the double application of corporate income tax under the double taxation elimination procedure on a non-contestation basis was determined in Section 12, Paragraph six of the Law On Corporate Income Tax.

The taxable income of a taxpayer can be reduced if a counterparty is:

- a resident of Latvia;
- a resident of the other European Union Member State;
- a resident of a European Economic Area country, with which Latvia has signed a convention on the elimination of double taxation and the prevention of fiscal

³ The application must comply with requirements set in Part III of Cabinet Regulation No 802 of 18 January 2018 "Procedures for the Conclusion of an Advance Ruling for the Determination of the Arm's Length Price (Value) for a Transaction or Type of Transactions Between a Taxpayer and the Tax Administration".

⁴Section 16, Paragraph one, Clause 6 and Section 16¹, Paragraph 1¹ of the Law On Taxes and Duties.

taxation, if this convention has entered into force and if the taxpayer has increased the taxable income because the transaction price with an associated enterprise did not correspond to the arm's length price, and if the taxpayer has submitted the confirmation of the competent authority of the respective foreign state on the increase of the taxable income to the SRS along with the annual report.

If the SRS as the competent authority disagrees to the reduction of the taxpayer's taxable income, which has formed as the result of a transfer pricing adjustment, double taxation can be eliminated under a mutual agreement procedure (hereinafter also referred to as 'MAP').

- **For transactions performed after 2017**

If the transaction price between associated enterprises does not correspond to the arm's length price, double taxation is eliminated applying paragraph three of Article 9 of the tax convention.

If the SRS disagrees to the reduction of the taxpayer's taxable income in Latvia, which has formed as the result of a transfer pricing adjustment of the involved state, double taxation can be eliminated under a mutual agreement procedure.

Mutual agreement procedure is a procedure, under which a dispute between the competent authorities of the Republic of Latvia and the other state (also jurisdiction), which occurs in interpreting and applying international treaties providing for eliminating double taxation to income and capital, is resolved.

- No additional tax surcharges are performed under the mutual agreement procedure.
- Mutual agreement procedure does not interfere with the sovereignty of countries with regard to the regulation of tax matters.
- To eliminate double taxation, competent authorities agree on the single transfer pricing practice *ad hoc*. Namely, only exclusive tools for the determination of tax collection rights, which are applied in a mutual agreement procedure, for example, new proof, can be used in the agreement process; likewise, secret comparable data, i.e., data that are not publicly available and cannot be used in the tax audit process, but can be used in a mutual agreement procedure, can be used to eliminate double taxation.
- Mutual agreement procedure is a process separable from the performance of an audit.
- During the mutual agreement procedure, the competent authority cannot recognise the audit decision as illegal or subject to cancellation, as the mutual agreement procedure is the agreement of competent authorities on the elimination of double taxation and can include wider use of proof as compared to audits.
- Competent authorities may not agree on a single solution and double taxation persists.

- During the mutual agreement procedure, the Republic of Latvia does not automatically stop the collection of taxes, late payment charges or fines for the respective taxation period.
- During the mutual agreement procedure, a taxpayer may apply for a tax support measure⁵.

The competent authority, which ensures the implementation of a mutual agreement procedure in Latvia, is the SRS⁶; information on the competent authorities of other countries is available in the respective tax convention and the website of the Organisation for Economic Co-operation and Development.

Taxpayers have the right to submit an application on the dispute to the SRS and competent authorities of other involved countries. In the Republic of Latvia, MAP is usually performed between two countries; however, there are no impediments for initiating a multilateral MAP.

What is the legal basis for the MAP application?

MAP application is submitted based on the following:

- 1) agreements entered into by the Government of the Republic of Latvia on the elimination of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital⁷;
Latvia has entered into tax conventions with all EU Member States; the total number of tax conventions signed by Latvia is 61, covering a total of 62 jurisdictions;
- 2) Convention of 8 December 2004 on the Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic⁸ to the Convention of 7 July 1990 on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises No 90/436/EEC⁹ (hereinafter referred to as the 'Arbitration Convention');
- 3) Chapter XV of the Law On Taxes and Duties "Resolution of Disputes, Which Have Occurred with the Competent Authorities of Other European Union Member States with regard to the Interpretation and Application of International Agreement Providing for the Elimination of Double Taxation to Income and Capital". This chapter includes legal norms arising from Council

⁵ Cabinet Regulation No 600 of 28 August 2012 "Procedure for Application of a Tax Support Measure". Available at <https://likumi.lv/ta/id/251370-nodoklu-atbalsta-pasakuma-istenosanas-kartiba>

⁶ Section 18, Paragraph one, Clause 32 of the Law On Taxes and Duties.

⁷ Information published by the Ministry of Finance of the Republic of Latvia on the status of conventions signed by the Republic of Latvia on the elimination of double taxation and the prevention of fiscal evasion. Available at

https://www.fm.gov.lv/lv/sadalas/nodoklu_politika/nodoklu_konvencijas/divpusejo_konvenciju_statuss/

⁸ Convention on the Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the Convention on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises. Available at <https://likumi.lv/ta/lv/starptautiskie-likumi/id/1694>

⁹ *Official Journal of the European Union*. Convention on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises C 160/11. Available at <https://eur-lex.europa.eu/legal-content/LV/TXT/HTML/?uri=CELEX:41990A0436&from=LV>

Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union (hereinafter referred to as 'Directive (EU) 2017/1852').

In accordance with the Law On Taxes and Duties, the MAP application can be submitted starting from 1 July 2019 regarding disputes in connection with income or capital obtained in European Union Member States during the taxation year, which starts on 1 January 2018 or after the said date. If a dispute does not comply to these criteria, the competent authorities of Member States may agree on applying the provisions of Directive (EU) 2017/1852 also with regard to any other dispute complaint submitted prior to the said date or for earlier taxation years. In turn, if Member States fail to agree, the dispute is resolved in accordance with a tax convention and/or the Arbitration Convention.

There are no other laws and regulations, which would provide for MAP; therefore, Latvian taxpayers must consider that MAP can be initiated only with 62 jurisdictions (topical data as at 03.12.2020). Most tax conventions do not stipulate the duration of MAP. The stipulated term of MAP initiated in accordance with the Arbitration Convention or legal norms arising from Directive (EU) 2017/1852 is two years with a possibility of prolonging the time of performance of MAP by one more year.

Whom must the MAP application be addressed?

MAP application is submitted to the SRS:

- using the Electronic Declaration System <https://eds.vid.gov.lv>;
- sending by e-mail to vid@vid.gov.lv — documents must be signed with a secure electronic signature, which complies with the requirements of Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014;
- sending by post to the address Talejas iela 1, Riga, Latvia LV-1978.

Phone for additional information +371 67120000 (consultation hotline).

What information must be included in the MAP application?

MAP application shall include information determined in Section 120, Paragraph three of the Law On Taxes and Duties. In the event the other contracting state of the tax convention is a non-EU country, the taxpayer, for the purposes of applying Chapter XV of the Law On Taxes and Duties, may use the recommendations provided in the SRS Methodological Material "On Dispute Resolution under a Mutual Agreement Procedure with Non-EU Countries"¹⁰.

MAP application shall generally include the following information:

- identification information of the taxpayer and of the person involved in the disputable transaction, i.e., name, registration code, address;
- reporting periods, to which the dispute applies;
- a reference to applicable laws and regulations, inter alia, to the respective international treaty (tax convention or the Arbitration Convention). If more than one international treaty is applied, the taxpayer shall specify the

¹⁰ <https://www.vid.gov.lv/lv/informativie-un-metodiskie-materiali/>.

international treaty, which is interpreted or applied with regard to the respective dispute;

- an explanation as to why the taxpayer considers that, referring to applicable laws and regulations, there is a dispute;
- detailed information on the actual circumstances of the respective case (including detailed information on the structure of transactions and relations between the taxpayer and other parties to the respective transactions, as well as description and the date for actions, which result in the dispute (inter alia, in the respective case – detailed information on the same income received in the other Member State and on the inclusion of this income in the taxable base in the other Member State, as well as information on the tax, which was or will be paid for this income in the other Member State)), as well as related amounts in the currency of the respective Member States and copies of payment-certifying documents;
- information on all appeal and contestation proceedings related to and initiated with regard to the dispute, as well as court rulings;
- taxpayer's confirmation that he/she undertakes to answer to all SRS inquiries to the fullest and fastest extent possible and submit all documents requested by the SRS with regard to the dispute;
- a decision of the tax administration of the other country (copies) on the results of the tax review (audit) or copies of another document related to the dispute, as well as copies of the documents issued by tax administrations of other countries with regard to the dispute, if such decisions have been adopted or documents have been prepared;
- information on all applications submitted by the taxpayer in accordance with another mutual agreement procedure or another dispute resolution procedure.

If the *MAP* application is submitted by the taxpayer's representative, the power of attorney on representation shall be enclosed to the application.

To initiate the examination of the case on the merits, the SRS may ask for submitting the following in addition to that specified in Section 120 of the Law On Taxes and Duties:

- taxpayer's transfer pricing documentation for the reporting periods affected by the dispute, inter alia, a set of comparable data and agreements entered into by and between associated enterprises¹¹;
- the (direct and indirect) segmentation of revenue and expenditure included in the income statement in breakdown by associated enterprises and non-associated enterprises, as well as by types of income;
- the list of gained income and eligible costs, specifying the types of costs (costs of materials, personnel costs, transport costs, marketing costs, depreciation of non-current assets, etc.) and their share in the total costs, as well as the profit (gross, operational and before taxes) efficiency;
- any other information.

¹¹ Paragraphs 2, 3 and 4 of Cabinet Regulation No 802 of 18 January 2018 "Procedures for the Conclusion of an Advance Ruling for the Determination of the Arm's Length Price (Value) for a Transaction or Type of Transactions Between a Taxpayer and the Tax Administration".

Arbitration

Certain tax conventions, the Arbitration Convention and the Law On Taxes and Duties stipulate a supplementary mutual agreement procedure, which can be used in the event competent authorities fail to agree on a single solution for the elimination of double taxation. This procedure is called dispute resolution in an advisory commission or the arbitration procedure (hereinafter referred to as the 'arbitration'), as the result of which the advisory commission or [alternative dispute resolution commission issues an opinion to the competent authorities of the countries. An opinion of the advisory commission or alternative dispute resolution commission is binding, if competent authorities are still unable or do not wish to agree on the final solution after the receipt of the opinion.](#)¹² Arbitration decision can differ from the agreement, which might be reached by the countries under the mutual agreement procedure, as arbitration includes also experts not related to the tax administrations of countries, as well as SRS officials, who were not involved in the MAP process.

¹² Section 131, Paragraph two of the Law On Taxes and Duties.