

# WELCOME TP DOCUMENTATION



# Transfer Pricing (documentation): Latvia in an EU perspective Quo Vadis?

*Remi Troch*  
*Director International Tax*

*Riga, 25 January 2012*

# Latvia in an EU perspective: Quo vadis?

## ORIGIN:

- 1976 trial for a Directive, resulting in the
- 23 July 1990 **Convention on the elimination of double taxation in connection with the *adjustment of profits* of associated enterprises** (“Arbitration Convention”)
- 2006 *Code of conduct* and 2009 Revised *Code of conduct* for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises
- **Resolution of 1 December 1997** on a “*Code of conduct* for business taxation” and 2006 code for its effective implementation

# Latvia in an EU perspective: Quo vadis?

## Agenda, ctd:

- Resolution of 27 June 2006 on a “Code of conduct on *transfer pricing documentation* for associated enterprises in the EU”
- Proposed *amendments* to the Latvian “Law on Taxes and Fees”
- XBRL
- Q&A

# Latvia in an EU perspective: Quo vadis?

## Origin:

- the 1976 proposal for a Directive to eliminate intercompany double taxation, refused by the governments because of “the collective hesitation of the Member States to surrender a significant part of their fiscal sovereignty in matters of transfer pricing where there had not been any common rules”.

# Latvia in an EU perspective: Quo vadis?

## Origin, ctd:

- European compromise: inter-governmental **Convention** signed on 23 July 1990 (Convention 90/436/EEC) based on article 220 of the Treaty of Rome
- Convention = “an agreement between States for the regulation of matters affecting all of them/a general agreement about basic principles or procedures”
- Not enforceable like a Directive: “an authoritative instrument issued by a high-level body or official, with direct effect”

# Latvia in an EU perspective: Quo vadis?

## 1990 “Arbitration Convention”

- 12 countries, multinational, thus higher in hierarchy than a bilateral treaty
- applies to profits which are included in the results of an enterprise/permanent establishment of one of the contracting states and are also included **or likely to be included** in the profits of an enterprise/permanent establishment of the other contracting state
- applies also when one of the tax payers made a loss rather than a profit
- applies to personal and corporate income tax

# Latvia in an EU perspective: Quo vadis?

## 1990 “Arbitration Convention”

- The idea is based on the OECD Model Treaty articles on the “arm’s length principle”
- The DTT’s specify: “The competent authority shall **endeavour**, .... to resolve the case by mutual agreement with the competent authority of the other Contracting State”
- However, article 12 of the Convention is quite clear: “The competent authorities...**shall**,....., take a decision **which will eliminate** the double taxation .....” “either by taxing the profit only in 1 state or by giving a tax credit” (art. 14)
- This procedure applies the competent authorities failing to reach a decision.

# Latvia in an EU perspective: Quo vadis?

## 1990 “Arbitration Convention”

- first entry into force: from 1 January 1995 to 31 December 1999
- a protocol of 25 May 1999 amends the Convention providing for its automatic extension by periods of 5 years, unless a contracting state opposes
- this protocol was only ratified by all 15 countries in ...2004, but it re-entered into force on 1 November 2004 retroactive from 1 January 2000
- Currently applicable in all EU Member States (Latvia signed on 2 March 2007, so that it is applicable as from 1 June 2007)

# Latvia in an EU perspective: Quo vadis?

## 1990 “Arbitration Convention”

### - definition of related parties

- direct or indirect participation by an enterprise of a contracting state in the management, control or capital of an enterprise of the other contracting state  
or
- the same persons participate directly or indirectly in the management, control or capital of an enterprise of one contracting state and an enterprise of another contracting state

# Latvia in an EU perspective: Quo vadis?

## Revised “Arbitration Convention” of 2009

- applies to triangular TP cases, where an associated enterprise located in a third member State had a significant influence in contributing to a non-arm's length result in a chain of relevant transactions or commercial/financial relations
- thin capitalisation restrictions are not covered by the convention
- cases should be resolved within two years of the date on which the case was first submitted to one of the competent authorities

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct for business taxation.

- resolution: a formal expression of opinion or intention made, usually after voting, by a formal organization, a legislature, or other group
- “concerns those measures which affect, or may affect, in a **significant way** the location of business activity in the Community”
- only concerns business taxation
- directed at measures which provide for a significantly lower effective level of taxation, including zero taxation, either by virtue of the nominal rate, the tax base or any other relevant factor

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct for business taxation.

- advantages only granted to non-residents
- even granted without real/substantial economic activity in the country granting the advantage
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base
- **rules in a multinational group depart from internationally accepted principles (OECD) (e.g. Belgian co-ordination centres)**
- measures lack transparency
- does not refer to State aid - “de minimis” rule

# Latvia in an EU perspective: Quo vadis?

## Worldwide

Examples of countries which have TP documentation requirements



# Latvia in an EU perspective: Quo vadis?

## Trend until 2008

| 1994/1995 | 1996                | 1997                                    | 1998                                                       | 1999                                                                                       | 2000                                                                                                                 | 2001                                                                                                                                                           | 2002                                                                                                                                                                                                              | 2003/2004                                                                                                                                                                                                                                                                                           | 2005                                                                                                                                                                                                                                                                                                                     | 2006                                                                                                                                                                                                                                                                                                                              | 2007                                                                                                                                                                                                                                                                                                                                         | 2008 (New)                                   |
|-----------|---------------------|-----------------------------------------|------------------------------------------------------------|--------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------|
| U.S.      | U.S.                | U.S.                                    | U.S.                                                       | U.S.                                                                                       | U.S.                                                                                                                 | U.S.                                                                                                                                                           | U.S.                                                                                                                                                                                                              | U.S.                                                                                                                                                                                                                                                                                                | U.S.                                                                                                                                                                                                                                                                                                                     | U.S.                                                                                                                                                                                                                                                                                                                              | U.S.                                                                                                                                                                                                                                                                                                                                         | Norway                                       |
| Australia | Australia<br>France | Australia<br>France<br>Mexico<br>Brazil | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India<br>Argentina<br>Austria<br>Netherlands<br>Thailand | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India<br>Argentina<br>Austria<br>Netherlands<br>Thailand<br>Germany<br>Colombia<br>Hungary<br>Malaysia<br>Peru<br>Portugal<br>South Africa | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India<br>Argentina<br>Austria<br>Netherlands<br>Thailand<br>Germany<br>Colombia<br>Hungary<br>Malaysia<br>Peru<br>Portugal<br>South Africa<br>Taiwan<br>Vietnam | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India<br>Argentina<br>Austria<br>Netherlands<br>Thailand<br>Germany<br>Colombia<br>Hungary<br>Malaysia<br>Peru<br>Portugal<br>South Africa<br>Taiwan<br>Vietnam<br>Spain | Australia<br>France<br>Mexico<br>Brazil<br>Canada<br>Korea<br>U.K.<br>Denmark<br>Venezuela<br>Belgium<br>New Zealand<br>Japan<br>Poland<br>Kazakhstan<br>India<br>Argentina<br>Austria<br>Netherlands<br>Thailand<br>Germany<br>Colombia<br>Hungary<br>Malaysia<br>Peru<br>Portugal<br>South Africa<br>Taiwan<br>Vietnam<br>Spain<br>Finland | Slovak Republic<br>China<br>Russia (pending) |

Source: International Tax Review 2009 5

# Latvia in an EU perspective: Quo vadis?

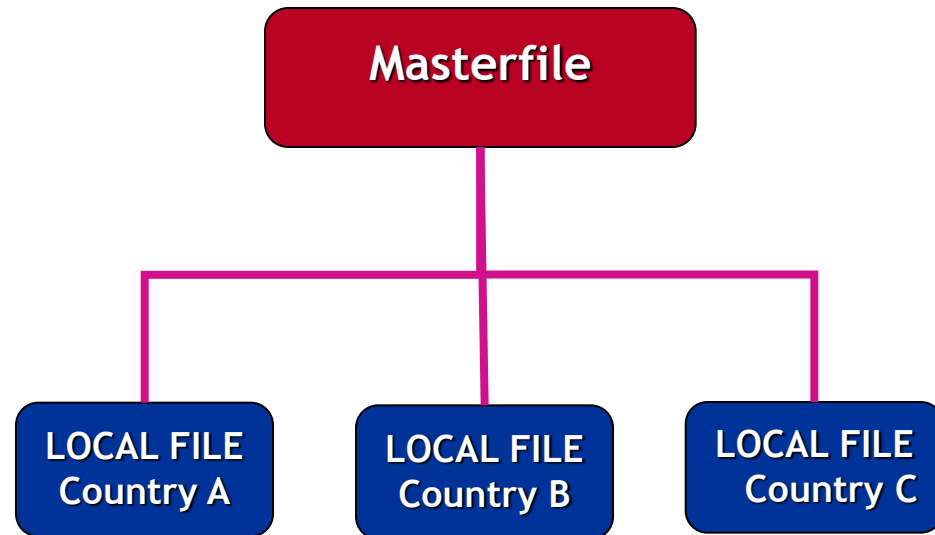
## Resolution on a code of conduct on transfer pricing documentation (“TPD”).

- Based on OECD transfer pricing guidelines
- “Member States will accept standardised and partially centralised TP documentation.... and consider it as a basic set of information for the assessment of a multinational enterprise group’s transfer prices”
- The use of the EU TPD is optional
- SME’s are not expected to produce such complex documentation as might be expected from larger enterprises

# Latvia in an EU perspective: Quo vadis?

- EU TPD should contain:

- The Master file - one set of information containing common standardised information relevant for all EU group members
- Local files - Several sets of standardised documentation each containing country-specific information



# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”). Masterfile

- description of and changes (previous year) in the business and its strategy
- description of organisational, legal and operational structure
- identification of the associated enterprises
- general description of the controlled transactions, including:
  - i. Flows of transactions (tangible, intangible assets, services, financial)
  - ii. Invoice flows
  - iii. Amounts of transaction flows
- description of and changes in functions performed, risks assumed
- ownership of intangibles/royalties paid and received

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”). Masterfile, ctd.

- inter-company transfer pricing policy explaining the arm’s length nature of the company’s transfer prices
- list of cost contribution agreements, Advanced Pricing Agreements (“APA’s”)
- undertaking by each domestic taxpayer to provide supplementary information upon request and within a reasonable time frame in accordance with national rules

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”). Country-specific documentation

- detailed description of and changes in the business and its strategy
- information on country-specific transactions, including:
  - i. Flows of transactions (tangible, intangible assets, services, financial)
  - ii. Invoice flows
  - iii. Amounts of transaction flows
- explanation of the selection and application of the TP method(s): why selected and how applied
- relevant information on internal and/or external comparables, if available
- description on the implementation of the intercompany TP policy

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”). Country-specific documentation

- a comparability analysis, i.e.:
  - (i) characteristics of property and services
  - (ii) functional analysis (functions performed, assets used, risks assumed)
  - (iii) contractual terms
  - (iv) economic circumstances
  - (v) specific business strategies

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”).

- the country-specific information should be prepared in a language prescribed by the Member State concerned
- where TP information should be submitted together with the tax return, it should be no more than a short questionnaire or an appropriate risk assessment form
- Member States should accept documents in a foreign language as far as possible; tax administrations should be prepared to accept the masterfile in a commonly understood language in the Member States concerned; translations should be made available only if strictly necessary and upon specific request
- the use of non-domestic comparables should be allowed

# Latvia in an EU perspective: Quo vadis?

## Resolution on a code of conduct on transfer pricing documentation (“TPD”).

- it should be irrelevant where the documentation is prepared and stored (centralised or decentralised), as long as the information is supplied in a timely matter, and how it is stored: on paper, electronically or in any other way
- remember: it is **only a resolution**, not binding, but quite good adhered to

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

The taxpayer is obliged to provide information on transactions with **RELATED PARTIES**:

- Parent and subsidiary
- The participation of one company in the other is between 20 and 50 %, and it does not have the majority of the votes
- More than 50 % of the equity or the shares belongs to one and the same person, the kin of such person to the 3<sup>rd</sup> degree or the spouse of such person, or the affines of such person to the 2<sup>nd</sup> degree, or by contract or otherwise this person has a deciding influence in these companies

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- More than 50 % of the equity or the shares is owned by a group of persons, but not more than 10, or by contract or otherwise these persons have a deciding influence in these companies
- More than 50 % of the equity or the shares is owned by a an undertaking in which a natural person , the kin of such person to the 3<sup>rd</sup> degree or the spouse of such person, or the affines of such person to the 2<sup>nd</sup> degree, own more than 50% of the equity or the shares, or by contract or otherwise this undertaking has a deciding influence in these companies

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- One and the same person has the majority of votes in the Board of Directors

OR

- These persons have entered into a contract (even if not made public) for any additional remuneration not provided for in the contract or the undertaking perform other co-ordinated activities in order to reduce the taxes.

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- The market price refers to the CIT law and concerns taxpayers who deal with:
  - ✓ Related parties, foreign companies
  - ✓ Related parties which form part of a Group according to the CIT Law
  - ✓ Entities which are exempt from Corporate Income Tax or which use income tax deductions as foreseen in the Latvian legislation
  - ✓ Related parties who are natural persons
  - ✓ Other companies or individuals which are located, have been created or established in low tax or zero tax countries or territories

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- When the annual turnover of the taxpayer exceeds LVL 1 million, the TP documentation should comprise the following elements:
  - 1) General business description, the latest financial statements, short description of the activities during the previous years, including:
    - a) Information on the sector (trends, specific requirements) in which the taxpayer is active;
    - b) Economic and legal analysis of the factors affecting the price of the goods and/or services;
    - c) Characteristics of the business environment: competition, marketing opportunities, other market factors;
    - d) A description of the intangible property which could impact the transaction price;
    - e) Business functions performed, risks taken, assets used in the transaction.

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- 2) Organization chart of the Group, its legal structure and the intercompany relations;
- 3) information on the taxpayer's business and market strategy, products and services, distribution marketing and management strategies;
- 4) information on the functions exercised by the related party members, the corresponding risks, the assets used, the role and responsibilities of the parties involved, information on the operational reorganization when affiliates are transferred or business functions taken over, assets or risks influencing the market price;
- 5) description of the products or services;

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- 6) description of the transactions with related parties and the contractual obligations;
- 7) forecast of future operations resulting from the operations entered into;
- 8) the preferred method of determining the transaction price and its relation to the market price;
- 9) depending on the method for determination of the transaction price and its relation to the market price: analysis of the financial indicators of comparable non-related enterprises or prices of comparable transactions used by non-related enterprises and the transaction price used by the taxpayer;
- 10) other documents justifying the price: mutual agreements, supporting documentation of the costs, Minutes of the meeting of the board, the shareholders, the Council and others.

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

The information has to be kept for 5 years and presented to the tax authorities within one month.

When the information is not presented on time, the authorities have the right to determine the market price based on their own information.

There is no specific requirement in the draft law that the documents should be in Latvian

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

### Advanced Pricing Agreements (“APA’s”)

When the value of a particular transaction or a class of transactions exceeds or is expected to exceed LVL 1 million per year, the taxpayer, while performing such a transaction or before commencing, can conclude an agreement with the tax authorities on the fair market value of the transaction(s), according to a procedure to be prescribed by the Cabinet of Ministers.

# Latvia in an EU perspective: Quo vadis?

## Proposed changes in the Law re. TP documentation

- When a taxpayer has acted in accordance with the agreement and his business has not changed, the tax authorities are **NOT** entitled to audit/tax a particular transaction or class of transactions from the market price of view
- The tax authorities have the right to unilaterally terminate the agreement if the taxpayer fails to comply or his business change, contrary to the pre-agreed terms
- The procedure and fee will be decided upon later by the Cabinet of Ministers
- A TP audit can be carried out within a period of 5 years from the date when the tax was due

# Latvia in an EU perspective: Quo vadis?

## What is XBRL?

### ➤ eXtensible Business Reporting Language:

an: open

free

international

standard

for the timely, accurate, efficient and cost-effective electronic storage, manipulation, repurposing and communication of financial and reporting data.

# Latvia in an EU perspective: Quo vadis?

## What is XBRL?

- It is a language with its own set of special words concerning business reporting
- Its vocabulary can be easily extended to suit the changing needs of the economy
- It is a unique format for different reporting purposes, allowing representation, simultaneous multiple file access and electronic data interchange. It reduces repeated data inputting and transfer errors
- It can be used for depositing the financial statements electronically, filing the e tax return, by analysts, banks, investors, suppliers, customers, the Central Bank, etc
- It allows a very easy comparison between different years, but also between different companies operating in the same sector

# Latvia in an EU perspective: Quo vadis?

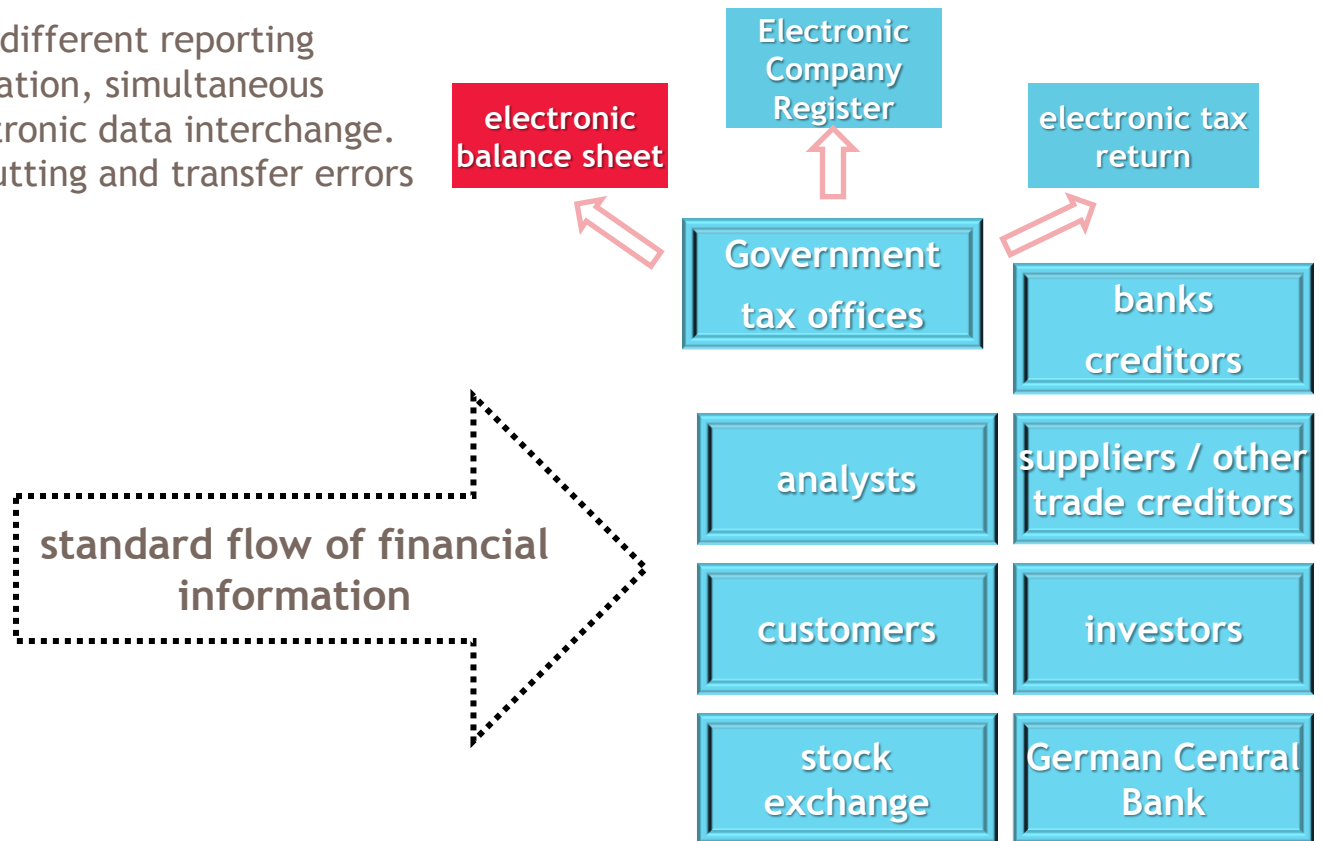
## What is XBRL?

- As it allows a very easy comparison between the different years, and between different companies operating in the same sector, it is an ideal tool for the tax authorities to compare data from year to year and from company to company, and may thus become an ideal tool in analysing transfer prices
- The system allows up to 5.000 positions to be filled out, so that a very detailed Balance Sheet and Profit and Loss statement can be obtained
- <http://www.xbrl.org/>

# Latvia in an EU perspective: Quo vadis?

## Why do we need XBRL?

XBRL is a unique format for different reporting purposes. It allows representation, simultaneous multiple file access and electronic data interchange. It reduces repeated data inputting and transfer errors



# Latvia in an EU perspective: Quo vadis?

## XBRL in Europe:

- National Bank of Belgium accepts since 2007 to file the statutory annual accounts drawn up in accordance with Belgian GAAP in XBRL format
- Denmark: deposit of financial statements with the Danish Commerce and Companies Agency (> 200.000 in 2011)
- Italy: 1.200.000 filings in 2011
- Spain: 600.000 filings
- UK: XBRL filing of tax return and accounts
- France: 2.000.000 filings
- Voluntary in the Netherlands and Sweden
- Projects in Ireland, Luxembourg, Poland

# Latvia in an EU perspective: Quo vadis?

## XBRL in Germany:

- As from 2011 all companies must file their Corporate Income Tax return in XBRL
- As from 2012 all entities, individual enterprises, partnerships, i.e. all legal forms must file their balance sheet and profit and loss statement in XBRL
- As from 2014 all permanent establishments (outbound: the whole company - inbound only the permanent establishment) must file their balance sheet and profit and loss statement in XBRL

## XBRL in Latvia:

???????????????

# Latvia in an EU perspective: Quo vadis?

## Where is XBRL in use?



# Latvia in an EU perspective: Quo vadis?



# RESPONSIBILITY

Please be aware that the present analysis contains general information and does not respond to particular circumstances that are unknown to us. Consequently this presentation is to be used only as a guideline and is applicable only as a general consultation.

If you believe that the commentary and conclusions are not complete, precise or true, please inform us as soon as possible. We trust that this presentation met your expectations.

In case you have additional questions or you need assistance, please do not hesitate to contact us and we will be happy to help you.

# CONTACTS

## Remi Troch

**Director International Tax**

“BDO Zelmenis & Liberte”

Attorneys at law

Alberta street 1-2, Riga, LV-1010

Phone: (+371) 67222237

Fax: (+371) 67222236

E-mail: [remi.troch@bdolegal.lv](mailto:remi.troch@bdolegal.lv)