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TAXATION OF BRANCHES

Starting from January 1, 2003 new rules are introduced for corporate taxation of permanent establishments (branches).

There are two methods for determination of taxable income of a branch. According to the first method, taxable income is determined based on information specified in a corporate income tax declaration which along with a balance sheet and a loss and profit statement shall be submitted to tax authorities within four month after the end of a taxation period (year).

Our firm's web site at contains useful tips for doing business in Latvia as well as certain legal forms for intellectual property (patents and trademarks) registrations in the Baltic countries (Latvia, Lithuania and Estonia).

Simplified method of calculation

In case activities of the branch office are less than 12 months, simplified method of calculation may be chosen in calculation of its taxable income. According to the method, costs are 80 % of income. As a result, the taxable income is 20% of revenues subject to a corporate income tax 19% for 2003 and 15% for 2004. Therefore, this method of calculation determines effective tax rate of 3% for 2004. A payer may upon agreement with a branch office withhold tax instead of the branch. If there are not more than three payers and the agreement is concluded with the payers regarding

withholding of the tax, a loss or profit statement as well as a balance sheet shall not be submitted to tax authorities.

Deductibility of costs

Non-deductible expenses for corporate income tax purposes applicable to branches comprise payments to a head office for royalties, any services such as consultancy, management, etc. and interest payments (exception applies to branches of banks). Deductible costs comprise costs of the head office supported by documents related to the branch office. By this rule are eliminated limitations

in deduction of overhead costs suffered by the head office, but deductible in the branch only in amount of ratio of income of the branch office in relation to income of the head office.

Rule of “transfer of tax payers burden” also is eliminated by the new regulations. The rule was applied in instances when, in fact, permanent establishment was incurred, but a corporate tax was not possible to levy from it. In this instance a resident of Latvia from whom permanent establishment has derived income was obliged to withhold and pay corporate income tax.

Exception from the simplified method

The simple method of calculation may not be applied to branches of residents of low tax countries list of which is mentioned below.

List of low tax countries

Antilles (The Netherlands),
Andorra,
Anguilla,
Antigua & Barbuda,
Aruba (The Netherlands),
Bahamas,
Bahrain,
Barbados,
Belize,
Bermuda,
British Virgin Islands,
Brunei Darussalam,
Cayman Islands,
Cook Islands (New Zealand),
Costa Rica,
Cyprus,
Dominican Republic,
Ecuador,
Gibraltar,
Grenada,
Guama,
Guatemala,
Guernsey,
Hong Kong (Sjangana),
Island of Men,
Jamaica,

Jersey,
Jordan,
Jisbuty,
Kampione,
Katara,
Kenya,
Kuwait,
Labuana (Malaysia),
Lebanon,
Liechtenstein,
Liberia,
Maldives,
Macao,
Madeira (Portugal),
Mauricia,
Marshall Islands,
Monaco,
Montserrat,
Nauru,
New Caledonia,
Niue (New Zealand),
Olderne,
Panama,
San Marino,
Seychelles,
St. Helens,
St. Kitts and Nevis,
St. Maria Island (Portugal),
St. Pjer and Michael (France),
Samoa,
Santome and Prinsipi Republic,
St. Lusia,
St. Vincent and Grenada,
Tahiti (French Polynesia),
Tonga,
Turks and Caicos Islands,
United Arab Emirates,
Uruguay East Republic,
Vanuatu,
Venezuela,
Virgin Islands (USA) and
Zanzibar Islands (Tan Zania).

TAX AUDITS

According to amendments to the law „On taxes and duties” effective July 1, 2003, tax administration shall make a decision on audit results on assessing additional tax and penalties payable

by companies not later than 90 days from the day when the audit was started. This term may be extended in addition to 30 days or for another 30 days in instances when information exchange is requested from foreign tax offices. Therefore, the total length of audit is limited to 150 days.

Delay of VAT refund

Setting 150 days for tax audit means that tax office can delay for additional 150 days overpaid VAT refund to business as the law “On value added tax” determines that overpaid VAT shall be repaid within 30 days from request day unless tax audit is started.

Deemed income

According to the new amendments tax administration is entitled to assess tax on deemed income if at least one of the following criteria is present:

- Unproportional increase of wealth is detected;
- Lack of information on other contracting party is present;
- Failure to register as tax payer, but earning income;
- Failure to submit tax reports;
- Accounting of a company does not correspond to information being at tax administration’s disposal;
- Existence of information of tax office on transactions which are not reflected in accounting;
- Bank account print-outs contradicts to actual business activity;
- Bookkeeping is not maintained;
- Transaction of support documents are not available;
- Ownership of assets like good, securities, money that indicates possibility of other kind of business;
- Financial data, including income, differs from statistical data;
- Tax payer income does not correspond to amounts and costs shown in declarations.



Transfer price

Transfer price can be adjusted by tax office for related party transactions, barter and set off transactions, export, and import or in cases if the deviation of price exceeds 20% from the price used short term before for identical goods. Price may dependent on change on demand quality or disappearance of certain qualities of goods, term of expiration goods, marketing policy on new products or development of those new products in new markets.

Determination of transfer price

Transfer price shall be set taking into account price which is used by a tax payer in a similar transactions or price used by other companies in similar transactions.

Further, “cost plus” method may be used by adding to the self-cost are average profitability of the business according to the State Statistical Information data base or information which can be at disposal of tax authorities of average profitability for certain businesses. At last, statistical average transaction value or value given by independent expert is used.

Appeals

Until now, after tax office has assessed additional tax, tax was payable within 30 days from the day after the decision was taken. If the assessed tax was not paid, in addition tax payer would pay from 31st day payment 3% per year which is the Bank of Latvia refinancing rate and 0.05% late payment fee per day. The late payment accruals stop when it reaches the basic debt.

Extension of term

According to the new rules, 30 day payment term is extended till the moment when the head of the State Revenue Service makes decision on

the appeal. Effectively, this adds 90 days more of non payment of assessed taxes of the period of time while the decision of the tax authorities is appealed to a higher level tax authority. The decision of the head from the SRS may be appealed to the court within 30 days after receipt the decision.

IMMIGRATION NEWS

As of May 1, 2003 new “Immigration law” is effective. The law abolishes special visas which were issued before in simplified manner to foreign shareholders of Latvian companies and to representatives of foreign companies in Latvia.

Residence permits

For those who already have valid residence permits and it’s term expires in order to obtain new residence permit it is requirement to apply for new residence permit not later than 30 days before the term expiration. If the term is missed then the person shall apply for new residence permit in Latvian embassy and shall leave Latvia.

The new law provides that free visa regime does not apply expiration of residence permit. If the residence permit ends when the person is still in Latvia he (she) shall leave the country upon expiration.

If a person with a Latvian residence permit stays out of Latvia for more than 3 month within a calendar year, Immigration authorities may terminate the said permit.

Renewals of permits

If the residence permit is valid for more than one year it shall be registered annually – for that a reference regarding person’s paid social tax is requested as well as an insurance policy.

GOVERNMENT CONTRACTS

Appeals

Contracts awarded by governmental and municipal authorities are appealable by a loosing party in accordance with law “On state and municipality procurement”.

The appeal may be submitted to the Procurement Surveillance Bureau (PSB), which shall convene a hearing on the issue within 30 days after the filing of appeal.

The competence of the PSB is not to decide on the loosing party possibilities to win a contract, but on issue if a contract with a winner will be concluded or the conclusion is prohibited.

If appeal is submitted to the PSB till the contract is not yet signed with the winner, the government and municipalities are obligated to freeze conclusion of the agreement until the appeal is decided by the PSB.

HOW TO PROTECT COMPANY’S NAME

Commercial law

The Commercial law determines that identical company names cannot be registered with the Commercial register after July 1, 2003. The priority rights to the name are determined by a day of earlier registration of the company’s name with the Commercial register.

Trademarks

Trademarks are registered with a Latvian Patent and Trademark office for a term of 10 years which may be renewed each term. No actual use is required for the renewals.

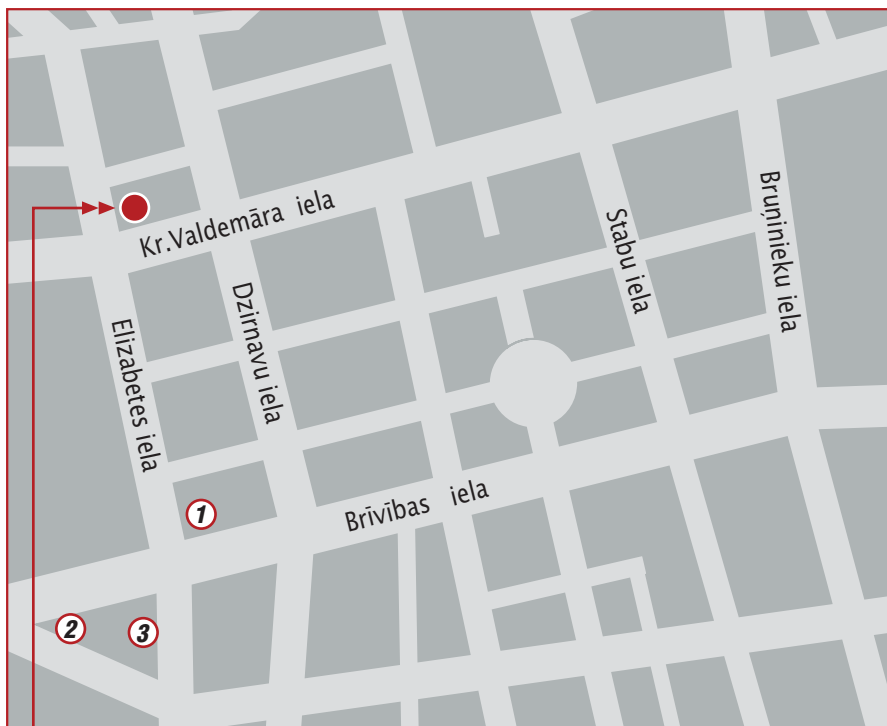


Conflicts between Community Trade Marks and Latvian trademarks

Community Trade Marks will be automatically extended to Latvia without any formal criteria upon Latvia will be joining the EU. The same applies to filed, but not yet registered Community Trade Marks.

Community Trade Marks also will enjoy protection on not being invalidated from grounds of invalidity set in the laws of the new EU member states. However, possible conflicts lie into a similarity of local and the Community Trade Marks. Acquired

prior rights of Latvian registered trademarks will be protected as determined in following example. If a German company has the Community Trade Mark on the name X, and the same is registered by a Latvian company in Latvia, the Latvian company will be able to ask prohibition of use in Latvia of the German companies owned trademark X.



Valdemara Center

- ① REVAL HOTEL
- ② RIGA REGIONAL COURT
- ③ SUPREME COURT

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