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Transfer Pricing Documentation Rules Introduced

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COUNTRY DIGEST

Transfer Pricing Documentation Rules Introduced

Latvia's Law on Taxes and Fees (LTF) was amended on July 26 to establish, for the first time, transfer pricing documentation requirements for transactions between related entities. The new requirements are effective as of January 1, 2013.

The law defines the term ''transfer price'' as the price applied to goods or services bought or sold in transactions between affiliated undertakings (as defined in the Law on Enterprise Income Tax), one of which is a nonresident.

The new requirement to document compliance with the arm's-length principle applies to residents and permanent establishments doing business with:

- affiliated foreign entities, including those that are part of a consolidated group that includes the taxpayer;
- commercial companies or cooperative societies that are exempt from enterprise income tax or that are eligible for tax allowances under Latvian law;
- related natural persons, as defined in the LTF; or
- any other companies or persons located or established in low-tax or tax-free countries or territories.

The amended LTF establishes that if, in any of the situations mentioned above, the taxpayer's net turnover in the relevant accounting year exceeds LVL 1 million (about $1.75 million) and the transaction amount exceeds LVL 10,000 (about $17,540), the transfer price's comparability with the market price must be based on:

- a general description of the taxpayer's business area, as well as documentation for the past few years, including:
  - — information about the industry;
  - — an economic and legal analysis of the factors that affect the prices of the taxpayer's goods and services;
  - — the characteristics of the business environment (for example, competition, marketing opportunities, and other market factors);
  - — a description of intangible contributions that can affect the transaction price; and
  - — information about the business functions performed, the risk taken, and the assets involved
- the organizational and legal structure and interrelationships between the taxpayer and a related group of persons;
- information about the taxpayers' business strategy;
- explanatory information about affiliates' business processes;
- a description of the subject of the transaction;
- the conditions of the agreement;
- a projection of the taxpayer's future operations based on the concluded transaction;
- a description of the method used to establish the transfer price in compliance with arm's-length standards and, depending on the method used, an analysis of the financial indicators of comparable unrelated companies; and
- other documents to justify the price established in the transaction.

The information must be kept by the taxpayer for five years and submitted to the tax administration within one month after receiving a request. If the information is not submitted, the tax administration will determine the transfer price based on the information at its disposal. Within five years from the date of payment in the transaction, the tax administration will be entitled to check the transaction's transfer pricing compliance.

Another important element of the amended LTF is the option for a taxpayer to conclude with the tax administration (for a fee) an advance pricing agreement for a particular transaction or form of transaction with a related foreign entity if the value of the transaction or proposed transaction exceeds LVL 1 million per year. Specific procedures for concluding an agreement and the fee to be charged will be established in rules issued by the Cabinet of Ministers.

If a taxpayer has concluded an APA and acted in compliance with the agreement, the tax administration will not be entitled during the tax audit to specify a different market price for the particular transaction. ◆

♦ *Valters Gencs, tax attorney and founding partner, Gencs Valters Law Firm, Riga*