Introduction of Advance Pricing Arrangement Legislation

New legislation is now in force that allows taxpayers to conclude advance pricing arrangements. The authors analyse the new legislation and the process to apply for such an agreement.

1. Introduction

On 1 January 2013, new legislation entered into force in Latvia which allows taxpayers to conclude advance pricing arrangements (APA) with the Latvian State Revenue Service (SRS). The purpose of the APA legislation is to encourage cooperation between the taxpayer and the SRS, as well as to create a positive effect on the business environment.

An APA is a mutually binding contract between the SRS and the taxpayer that determines and establishes a specific transfer pricing methodology for related-party transactions to be carried out by the taxpayer. Such agreements may be entered into by local legal entities, as well as by Latvian branches of foreign companies. Although an APA produces effects for the future, taxpayers may apply for an APA with regard to transactions that have already been carried out, as well as for future transactions, provided that the expected annual amount exceeds LVL 1 million.

2. Envisaged Benefits

Once concluded, an APA provides a high degree of certainty to the taxpayer that the selected methodology, including agreed pricing, will not be challenged by the SRS in future transfer pricing investigations. Specifically, provided that the taxpayer abides by all terms and conditions agreed in the APA, the SRS may not adjust the pricing agreed for covered related-party transactions. This significantly reduces the risk of additional corporate income tax payable, including penalties or late payment charges being assessed for the taxpayer.

3. Time Frame and Fees Payable to the SRS

Once the application is submitted, the SRS must provide within a one-month period its official response as to whether the APA procedure will be launched. If the SRS agrees with the request, it will provide its ruling within this period, although additional information may be requested.

If approved, an APA is valid for a period of three years, provided that no changes have occurred in the nature, substance or methodology of the transactions covered by the APA.

The fee for filing an APA application is LVL 5,000 (down from LVL 8,000 as had been proposed), subject to the following revised terms of payment:
- 20% is payable before filing an application; and
- 80% is due after receiving confirmation from the SRS that an APA procedure has been launched.

If the SRS refuses to initiate the APA procedure with the taxpayer, it reserves the right not to refund the 20% of the APA fee.

4. Documentation Requirements

A taxpayer seeking an APA must prepare and file with the SRS documentation containing the following information, although additional information may be requested:

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<th>Documents</th>
<th>Description</th>
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| Application | - name of the taxpayer, its registration number and legal address  
- related foreign enterprise involved in the transaction(s)  
- the type(s) of transaction that will be covered by the APA  
- transfer pricing method for determining the market value of the transaction(s)  
- period to be covered by the APA  
- legal justification for the chosen transfer pricing method, as well as for the submission of the application |
| Industry analysis | - information on the industry within which the taxpayer conducts its operations (e.g. development trends, characteristics)  
- economic and legal factors affecting the prices of the taxpayer’s goods or services  
- a description of the business environment (competition, scope for sales and other market factors)  
- the role of intangible property  
- main transaction flows among the members of the group’s organizational structure that could affect the related-party transaction  
- functions, risks and assets undertaken by the companies in a particular industry |

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1. Likums Par nodokļiem un nodevām (Taxes and Duties Act) published in Latvijas Vēstnesis.
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<tr>
<td>Company analysis</td>
<td>- taxpayer’s key areas of commercial or entrepreneurial activities&lt;br&gt;- venues the taxpayer uses for performing these activities&lt;br&gt;- organizational and legal structure of the taxpayer and its global related entities, indicating the ties among these entities&lt;br&gt;- information on the foreign related entity involved in the transaction(s) relevant to the APA&lt;br&gt;- financial and tax-related data, including:&lt;br&gt;  - CIT returns, financial and annual reports for the last three years of the foreign related entity involved in the transaction&lt;br&gt;  - existing agreements among the related enterprises and persons pertaining to price determination and cost allocation&lt;br&gt;  - description of the organization of the bookkeeping&lt;br&gt;  - marketing or finance reports, budgetary projects, commercial or entrepreneurial plans and overviews on the global product assortment and commercial segments&lt;br&gt;- corporate strategy, including marketing and management strategy that can affect transfer prices&lt;br&gt;- a description of the related-party transaction(s) (contractual terms and goods or services)&lt;br&gt;- flow of goods, services and products, as well as financial flows and the currency utilized&lt;br&gt;- economic circumstances affecting the price of the transaction and the specifics of the applied commercial strategy&lt;br&gt;- proportion of remuneration from investments of intangible property attributable to each participant, its calculation method and substantiation if the expenses incurred in carrying out the transaction involve the use of intangible property</td>
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<td>Functional analysis</td>
<td>- functional analysis of every participant (includes a description of each participant’s function, assumed risks and assets utilized)</td>
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<td>Economic analysis</td>
<td>- a description of how the transfer pricing method was selected&lt;br&gt;- a benchmarking study</td>
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<td>Other information</td>
<td>- a list of agreements that the foreign related entity has concluded with tax administrations, if these are concluded in relation to this transaction or other similar transactions&lt;br&gt;- if the foreign related enterprise is undergoing a tax audit or is in the process of appealing a judgment in a case related to associated party transactions – the description of any such events&lt;br&gt;- documentary evidence that the taxpayer has paid the APA application fee</td>
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