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Holding companies in Latvia

Although Latvia is not renowned as a holding company location, Latvian laws contain a number of tax and legal provisions that make Latvia an excellent location for setting up holding companies, headquarters or shared service centres.

This article briefly discusses an investor's considerations when deciding where to place a holding company and how this is treated under Latvian legislation.

Business considerations

Contacts:

Zlata Elksniņa-Zaščirinska
Tax Director
E-mail: zlata.elksnina@lv.pwc.com
Tel: + 371 7094400

Artūrs Breicis
Tax Consultant
E-mail: arturs.breicis@lv.pwc.com
Tel: + 371 7094400

PricewaterhouseCoopers
Kr.Valdemara iela 19
Riga LV 1010
LATVIA
Tel: + 371 7094400

www.mindlink.lv
www.pwc.lv

A holding company is usually set up to improve the capital flow (including receiving dividends from its subsidiaries and paying dividends to its shareholders with improved tax effect) and to optimise costs at group level, thus the primary consideration is participation exemption rules, then other tax considerations (tax rate, treaty network coverage, etc) and finally non-tax considerations (regulatory environment, administrative costs, etc).

Although the basic function of a holding company is to hold shares in subsidiaries, it may also fulfil other functions, such as subsidiary financing, management services, etc. Thus an investor's decision is usually based on a set of tax and non-tax considerations.

Latvian legislation does not contain specific holding company rules, i.e. holding companies are governed by the same rules as regular companies.

Holding activities may be carried out either through a private limited company ('*Sabiedrība ar ierobežotu sabiedrību*'), which is normally established for business operations, or through a public limited company ('*Akciju sabiedrība*'), which is usually established to satisfy specific business requirements (e.g. banks, insurance companies and certain other businesses must by law be set up as public companies) or because the particular entity intends to trade its shares publicly.

Setting up a holding company in Latvia requires a minimum share capital of LVL 2,000 (for private limited company) and no great expense is involved in its ongoing maintenance. Unlike other countries, Latvia charges no stamp duty on share capital payments, apart from small fees to the Enterprise Registry. It usually takes about a week to set up a holding company.

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Tax considerations

The most important tax issue is the availability of participation exemption rules.

Exemption for incoming dividends

As the main purpose of a holding company is to improve capital flows, the most important tax issue is the availability of participation exemption (i.e. tax-free dividend) rules. Latvian legislation contains participation exemption rules similar to those offered by most of the countries having a favourable holding company regime, i.e. a Latvian holding company may receive tax-free dividends from its resident subsidiaries and from qualifying non-resident subsidiaries.

To qualify for participation exemption, a holding company must hold at least 25% of voting shares in the non-resident subsidiary, which must not be incorporated in any of the tax havens blacklisted by the Latvian Government. Some of the jurisdictions favourable for holding companies do not offer participation exemption to foreign entities.

As a fully-fledged member of the European Union ('EU'), Latvia has implemented provisions of the Parent/Subsidiary Directive, i.e. participation exemption applies to subsidiaries that are resident in, and have been established under, the laws of an EU Member State and in which the Latvian company holds at least 20% (15% from 1 January 2007 and 10% from 2009 onwards) of voting shares.

Dividend payments – withholding tax

When dividends are paid to a non-resident shareholder, the standard rate of withholding tax is 10%, which is very low compared to tax rates set out in the domestic laws of other EU countries. Latvia's double tax treaties may further reduce this rate to 5%, provided that the Latvian company holds an approved tax residency certificate for the treaty country resident concerned, before making the payment. Dividends paid to a Member State company whose shareholding in the Latvian company has been 15% (10% from 2009 onwards) for at least two years before the date of dividend payment inclusive are exempt from withholding tax.

Low corporate tax rate

The relatively low rate of corporate income tax (15%) makes Latvia attractive as a country for setting up a holding company. With the exception of Cyprus, Lithuania and Ireland, the Latvian effective corporate tax rate is the lowest in the EU, where some Member States have rates as high as 40%.

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Sale of investments and exit strategies

A holding company's capital gains are taxable at 15%, which may be regarded as a downside in terms of holding activities. Most of the countries with a favourable holding company regime (e.g. Netherlands, Luxembourg, Ireland and Spain) offer an exemption for capital gains on the sale of investments.

However, if the sale of investments (other than public securities) results in a loss, this can be offset against regular taxable income in the subsequent five tax periods, provided that the holding company does not sell investments more often than once in a tax period and has held the securities sold for longer than 12 months. This provision can be regarded as a positive sign because it reflects similar treatment for losses as for gains and this even-handedness is not always available.

Share transfers are not subject to any tax or duty other than negligible duties for registration with the Enterprise Registry.

Another advantage is that share transfers are not subject to any tax or duty other than negligible duties for registration with the Enterprise Registry.

Furthermore, should an investor decide to wind up holding operations, there are certain exit strategies available under Latvian legislation allowing a transfer of investments without realising taxable capital gains in Latvia.

Capital allowances

Fixed assets are depreciated for tax purposes at relatively high rates varying from 10% for real estate to 70% for computers and software.

Low withholding tax rates and treaty network

In general, the efficient operation of a holding company requires a significant number of double tax treaties with favourable rates of withholding tax on royalties, interest and dividends. Latvia currently has 39 effective double tax treaties, with another 13 in preparation. For comparison, the Netherlands has more than 70 double tax treaties, Ireland ranking second with over 40.

However, Latvia has relatively low withholding tax rates: 10% on dividends and interest payments to related parties, 15% on royalties for works of literature or art, and 5% on other copyrights.

Group relief

A group company incorporated in Latvia may surrender its tax losses to another Latvian company within the same group, provided that certain preconditions are met. Group relief allows a Latvian holding company to utilise efficiently any tax losses surrendered if it has several Latvian subsidiaries with different profiles or, for instance, utilises losses on the sale of investments to cover taxable profits of another subsidiary.

Deductibility of holding company expenses

Any costs that a Latvian holding company incurs in setting up and running its subsidiaries are fully deductible for corporate tax purposes. This is a certain advantage over other jurisdictions where participation exemption rules do not allow a tax deduction for operating expenses. For example, a Latvian holding company may deduct expenses incurred in providing management services to its subsidiaries.

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Holding company financing structure

Certain holding company jurisdictions operate thin capitalisation rules whereby a high debt-equity ratio may prevent the holding company from being regarded as a structure governed by participation exemption rules.

Latvian legislation also imposes a debt-equity ratio and does not allow a tax deduction for any interest expenses incurred over the threshold, but this does not affect participation exemption rules. Furthermore, thin capitalisation rules do not apply to loans from EU-resident banks.

Non-tax considerations

Regulatory environment

Latvia joined the EU on 1 May 2004 and the majority of EU regulations and directives have already been passed into domestic law, making Latvia's regulatory environment consistent with EU law and practice.

Industrial environment

Latvia has undertaken a steady transition from a planned economy to a market economy. The industrial and investment climate is characterised by a relatively low rate of inflation, a stable national currency pegged to the Euro, low manufacturing costs, knowledge of and traditional trade links with Russia, CIS and Western business culture.

Investment incentives

Investing in certain regions of Latvia (Liepaja, Rezekne, Riga and Ventspils) may benefit from a more favourable tax treatment. Concessions are given in the form of partial exemptions from corporate income tax and/or real estate tax.

Trade policy

Government trade policy is essentially based on the principles of free trade. The declared priorities are closely linked with Latvia's EU membership. Trade legislation complies with GAAP/WTO regulations and international trade law principles