

2 March 2020

Global Tax Alert

Latvia publishes draft proposal to implement Mandatory Disclosure Rules

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Executive summary

The Ministry of Finance of the Republic of Latvia submitted to the meeting of State Secretaries, on 19 December 2019, the draft regulation "Rules on automatic exchange of information on reportable cross-border arrangements" implementing the *European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements* (referred to as DAC6 or the Directive).

The Latvian draft legislation is now subject to the formal legislative process and may be amended before the final enactment. If implemented as currently proposed, the Cabinet Regulation on Latvian Mandatory Disclosure Rules (MDR) will, in principle, closely align with the requirements of the Directive. The explanation attached to the draft regulation outlines the purpose and scope of the Directive and the draft Latvian regulation.

The Latvian legislation is planned to take effect from 1 July 2020 and reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020.

Detailed discussion

Background

The Council of the European Union Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation (the Directive or DAC6), entered into force on 25 June 2018.¹

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions.² Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, [Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers](#), dated 14 March 2018.

EU Member States were to adopt and publish national laws required to comply with the Directive by 31 December 2019. To comply with the requirements set out in the Directive, Latvia will introduce domestic legislation, which is planned to take effect from 1 July 2020.

A comparison between the draft Latvian legislation and the Directive is summarized below.

Scope of taxes covered

The scope of taxes covered under the Latvian draft legislation is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions.

Reportable arrangements

Under the Directive, an arrangement is reportable if:

- ▶ The arrangement meets the definition of a cross-border arrangement; and
- ▶ The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be

distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

The Latvian draft MDR legislation provides the same definition with respect to reportable cross-border arrangements as the Directive. In line with the Directive, the Latvian MDR legislation does not apply to domestic arrangements.

Hallmarks A-E of the Directive

Most elements of the hallmarks included in Annex IV of DAC6 are not expressly defined. The Latvian draft legislation does not provide any additional clarification or guidance on these elements. The draft legislation describes the hallmarks in the same manner as the Directive.

Main benefit test

In accordance with DAC6, the MBT will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, is the obtaining of a tax advantage.

The MBT is described in the same manner in the Latvian draft regulation. No additional clarification is provided on whether the tax advantage must arise in respect of EU taxes or in respect of worldwide taxes.

Intermediaries

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach legal professional privilege (LPP). If there are no intermediaries which can report, the obligation will shift to the taxpayers.

The Latvian draft legislation does not provide for an exemption from reporting for intermediaries where the obligation would breach LPP. The explanation attached to the draft regulation indicates that since there are no LPP regulations in Latvia, to ensure fair competition between intermediaries, the optional exemption provided for in Article 8ab, Paragraph 5 of the Directive has not been included in the draft Latvian legislation.

DAC6 defines two categories of intermediaries: promoters and service providers. The Latvian draft legislation defines intermediaries by reference to the same two categories.

According to the Latvian draft legislation, an intermediary is a person who meets at least one of the following conditions:

- ▶ The person is a tax resident of Latvia
- ▶ The person has a permanent establishment in Latvia through which services are provided in connection with the cross-border arrangement
- ▶ The person is established in Latvia or its activities are regulated by the regulatory enactments Latvia
- ▶ The person is a member of a professional association, foundation or board related to legal, tax or advisory services in Latvia

Therefore, only intermediaries with nexus to Latvia are expected to have a reporting obligation in Latvia. According to the explanation attached to the draft legislation, the obligation to report cross-border arrangements is primarily imposed on the intermediary, but in the absence of an intermediary, the reporting obligations shifts to the relevant taxpayer in respect of the cross-border arrangement.

The Latvian draft legislation does not explicitly comment on whether employees or partners of a legal entity which is acting as an intermediary could themselves be regarded as intermediaries for the purposes of the MDR legislation.

The Latvian draft legislation also does not provide explanation on whether an entity housing a so-called “in-house” tax team could be regarded as an intermediary in circumstances where it undertakes intermediary type activities for another group entity.

Reporting deadlines

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is “made available for implementation”; or when the reportable arrangement is “ready for implementation”; or when “the first step of implementation has been made.” The same trigger events apply in the Latvian draft legislation.

Under the Directive, reporting starts from 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020. The reporting deadlines as currently stated in the Latvian draft legislation fully align with DAC6 reporting deadlines.

Article 8ab, paragraph 11 of the Directive gives Member States the option to require relevant taxpayers to file information about their use of the cross-border arrangement on an annual basis. The Latvian draft regulation does not impose such annual reporting obligations on relevant taxpayers.

Penalties

The penalties for non-compliance with the reporting requirements are provided for in the amendments to the Law on Taxes and Duties of the Republic of Latvia.

The draft amendments indicate the imposition of fines of up to €3,200 if the relevant taxpayer or intermediary has not complied with the reporting requirements within the prescribed time limits or in circumstances where the intermediary or relevant taxpayer has failed to comply with the prescribed preparation and filing procedure.

Next steps

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Taxpayers and intermediaries who have operations in Latvia should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their obligations.

Endnotes

1. For background on MDR, see EY Global Tax Alert, [EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers](#), dated 5 June 2018.
2. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.

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EYG no. 000939-20Gbl

1508-1600216 NY
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