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ESTABLISHING A BUSINESS ENTITY IN LATVIA

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ESTABLISHING A BUSINESS ENTITY IN LATVIA



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1. Types of Business Entities

Foreign investors may choose from the types of business entities:

- Limited liability company
- Joint stock company
- Individual merchant
- General partnership
- Limited liability partnership
- Branch
- Entities under European Law
- Representative office

The most common types of business entities in Latvia are limited liability company and joint stock company.

1.1 Limited liability company

Due to its closed composition of shareholders and simple management structure, limited liability company (in Latvian - “SIA”) is the most common type of a company in Latvia. The main reason why most businesses opt for SIA is that the minimum share capital requirement is only EUR 2,800 (and may be even less in certain cases as described below).

Before registration of a limited liability company, amount of share capital not less than 50% of the subscribed share capital, i.e. at least EUR 1,400, shall be paid in full. The rest amount of subscribed share capital shall be paid up within a period of 1 year after registration of the company.

If the share capital of a limited liability company amounts to at least EUR 2,800, then it can be paid-up by money or property contributions. Items of property contributions may be tangible or intangible property valued in terms of money, which may be used in the commercial activities of a company, except for property which in accordance with the law may not be the subject of collection. If the share capital is paid up by property contributions, a document certifying the value of each property contribution item is necessary. Property contributions must be evaluated, and an opinion must be provided by a person, who is included in the list of valuers approved by the Register of Enterprises. If the total value of property contributions does not exceed EUR 5,700, and the property contributions together are less than one-half of the share capital, then the valuation of the property contributions and the submission of an opinion may be made by the founders themselves. In such case, all founders will have to sign the opinion.

Additionally, as an incentive to start up business, there is a possibility to establish a SIA with minimised share capital (the share capital of such SIA is from EUR 1 to EUR 2,799). In such case the number of founders may not exceed 5 private individuals, one or several whereof simultaneously serve as the management board members. Furthermore, the founders may not be shareholders of another SIA with minimised share capital. If the share capital is less than EUR

2,800, only monetary investment can be made into the share capital.

SIA may be owned by one or more individuals or legal entities. The list of the shareholders of SIA is publicly available to third parties.

The administrative bodies of SIA are the meeting of shareholders, the management board, and the supervisory board (NB! SIA is not obliged to have a supervisory board, but the shareholders may establish one, if they wish so). The supervisory board, if established, shall consist of at least 3 members; the maximum number of supervisory board members is 20. The management board shall consist of at least 1 member. Members of the management board and the supervisory board may not be the same persons.

1.2 Joint stock company

A joint stock company (in Latvian - "AS") is a type of company more suitable for a larger number of shareholders, and its administrative structure is stricter than in case of SIA. AS may be established as a public or private company. In case of a public AS its shares may be publicly traded.

The minimum share capital of a joint stock company is EUR 35,000. Before the submission of the registration application the amount of the paid-up share capital may not be less than the said minimum equity capital or less than 25% of the subscribed equity capital (if the share capital is larger than the minimum).

Shares of AS are securities and may exist in a form of registered shares of bearer shares. Registered shares are registered by the management board in the register of shareholders. Bearer shares, in their turn, are registered in the financial instrument account by the Latvian Central Depository.

AS may be owned by one or more individuals or legal entities. In contrast to SIA, the list of the

shareholders of AS is not publicly available to third parties.

The administrative structure of AS is three-tier: a general meeting of shareholders, a supervisory board, and a management board. The supervisory board shall consist of at least 3 members and at least of 5 members if the shares of AS are publicly traded; the maximum number of supervisory board members is 20. The management board shall consist of at least 1 member. Members of the management board and the supervisory board may not be the same persons. There are no requirements for their place of residence.

1.3 Ultimate beneficial owner

Any legal entity registered in the Republic of Latvia has an obligation to disclose its beneficial owner to the Register of Enterprises. Ultimate beneficial owner is a private individual who directly or indirectly controls at least 25% of capital shares of the legal entity registered in Latvia. The beneficial owner has an obligation to disclose the information with the management board by submitting the following documents:

- Document proving the identity of the beneficial owner (passport copy certified by notary);
- Documents proving the executed control (in case there are other companies registered between the company in Latvia and the beneficial owner). Such documents can be a shareholder's register, official extract from the foreign Commercial Register, notary's certification etc.

In case the ultimate beneficial owner is not disclosed with the Register of Enterprises, incorporation of a legal entity will be denied until the documentation shall be submitted.

If a legal entity is already registered, however the ultimate beneficial owner is not disclosed, any changes in management board or

shareholder structure shall be denied until the documentation shall be submitted.

2. Steps and Timing for Establishing a Company

There are two options for becoming a shareholder of a company, namely, buying shares of an already existing company or establishing a new one. To establish a new company (in the context of the most common business entities - SIA and AS) the founders must take the following steps:

- Sign a memorandum of association among them (in case of a sole shareholder this document is replaced by a decision) and develop the articles of association of the company;
- Set up the administrative institutions of the company;
- Open a temporary bank account in the name of the company to be founded, pay up share capital and receive a notice from the bank confirming the amount of the paid-up share capital;
- Organise the valuation of property contributions (if such is provided for);
- Pay the State fee for entering in the Commercial Register (EUR 150,00 for SIA and EUR 350,00 for AS) and the payment for the publication concerning making of the entry in the Register (EUR 27.03); additional EUR 4,00 fee is applied if the application for registration is submitted in person in the Register of Enterprises;
- Sign and apply to the Register of Enterprises together with other documents (such as memorandum of association, articles of association, consents of the management and supervisory board members, notice from the bank, management board notice on the registered address, register of

shareholders (for SIA only), consent of the immovable property owner to the registration of the registered address, document confirming payments of the state and publication fees, etc.);

- Additional information in the registration application form must be indicated with regards to the beneficial owner (a private individual directly or indirectly owning more than 25% of capital shares or otherwise controlling the legal entity). The founders are obliged to submit documents proving the identity of the beneficial owner (passport copy certified by notary) and the executed control (in case there are other companies registered between the company in Latvia and the beneficial owner).

When the Company is registered with the Register of Enterprises, the management board must change the temporary bank account to a fully functioning permanent bank account and register signature rights with the respective bank.

The company is obliged to reveal to the bank and the Register of Enterprises its beneficial owners (private individuals).

All documents in foreign languages must be translated into Latvian and the translation must be notarised. In some cases, documents regarding a foreign company or individual establishing a business entity in Latvia also must be apostilled or legalised.

Companies are usually registered within three business days from submission of respective documents to the Register of Enterprises; however, it is also possible to pay a state fee in triple amount to speed up the registration procedure and to register a business entity within one business day.

3. Governance, Regulation and Ongoing Maintenance

3.1 Corporate Governance

Members of the management and supervisory boards must be private individuals with active legal capacity. They are required to perform their obligations with the diligence of an honest and careful manager and to be loyal to the company.

The management board is the legal representative of the company (i.e., the executive body). Only management board is entitled to represent the company in relations with third parties and act on behalf of the company. If there are several members in the management board, then the management decisions must be taken by all the management board members jointly. However, the representation (signature) rights may be joint (i.e., all or several management board members together must represent the company) or individual (i.e., each management board member is entitled to represent the company). The representation rights are set by the shareholders in the articles of association.

The supervisory board, in its turn, is the supervisory body of the company, which represents the shareholders during the time periods between the meetings of shareholders and supervises the activities of the management within the scope specified in the Commercial Law and the articles of association. It may be specified in the articles of association that the management board is obliged to require the consent of the supervisory board to decide on issues of major importance. However, the supervisory board may not decide on issues, which are within the competence of the management board.

Members of a management or supervisory board who cause losses to the company due to non-fulfilment of their duties (e.g. by breaching

their duty of care) are jointly and severally liable to the company. A member of the management or supervisory board will not suffer liability, if he or she acts pursuant to a lawful resolution of the general meeting or any other competent body or if he or she proves that he or she performed his or her obligations with due diligence. A claim for payment of compensation to the company for damage may also be submitted by a creditor of the company if the assets of the company are not sufficient to satisfy the claims of the creditor.

A shareholder is not liable for the liabilities of the company and vice versa. If the shareholders adopt a resolution on a matter that would normally be in the capacity of the management or supervisory boards, they may be liable as if they were members of the management or supervisory board.

Additionally, a person, who influences a member of a management or supervisory board to act in a manner that is contrary to the interests of the company, may be liable for compensation damages.

3.2 Reporting requirements

During their commercial activity, companies must comply with certain reporting requirements. For instance, the majority of the corporate changes (such as change of the registered address, changes in the composition of the management and supervisory boards, change of company name, etc.) must be registered with the Register of Enterprises within a certain period of time determined in the Commercial Law.

Furthermore, after the end of the accounting year, the management board of the company is obliged to compile an annual account of the company. The annual report must be further approved by the meeting of shareholders and then submitted electronically to the State Revenue Service together with an auditor's report, if compulsory.

3.3 Requirements for local shareholding / directors

There are no particular requirements for the shareholders of a company (unless it is considered a financial institution) in respect of their legal form or nationality. Namely, any local or foreign legal entity or private individual may become a shareholder of a company.

There are also no particular requirements for the management or supervisory board members (except for the management and supervisory boards of financial institutions) in respect of their nationality, education, experience, place of residence, etc. However, only private individuals with the capacity to act may become the members of a management or supervisory boards.

3.4 Protection of minority shareholders

The rights of shareholders mostly depend on the number of shares owned by the shareholder. However, the Commercial Law also provides for the minority shareholder protection rules, according to which some of the most important minority shareholder rights are as follows:

- Shareholders who represent not less than 5% of the share capital with voting rights have the right, within one year from the date of registration of the company, to request that the Register of Enterprises approves one or several experts selected by the shareholders to perform an examination of the founding of the company;
- Shareholders that represent not less than 10% of the share capital, may, during a meeting of shareholders or no later than two months after the meeting of shareholders, raise substantiated objections to the elected auditor;
- Shareholders that represent at least 10% of the share capital have the right to

request postponing approval of an annual account, disputing the correctness of separate positions in the annual account;

- Shareholders, who represent not less than 5% of the equity capital, may request the conduct of an internal audit, if there is a substantiated reason for that;
- Shareholders of SIA, who represent not less than 10% of the share capital may request convocation of the shareholder meeting;
- Shareholders of AS, who represent not less than 5% of the share capital may request convocation of an extraordinary shareholder meeting;
- Shareholders, who represent not less than 5% of the share capital may request bringing an action against management and supervisory board members, founders, and the auditor;
- Shareholders, who represent at least 5% of the share capital may request the institution convening the shareholders' meeting of AS to include additional issues in the agenda of the meeting;
- Each shareholder has the right to request the court to declare the decision of a shareholder void, if such decision or procedure for taking it is in contradiction to law or the articles of association, or a significant violation has been allowed in the convening of the shareholders' meeting or the taking of the decision;
- Each shareholder, who does not agree to the reorganization rights, may request the acquiring company to redeem shares for money.

Shareholders may conclude a shareholder agreement, regulating the relationship among them (NB! Such agreement is optional, does not

have to be submitted to the Register of Enterprises and thus is not publicly available to third parties), including but not limited to the agreement on voting in the shareholders' meeting. Such agreement of shareholders may include various provisions beneficial for minority shareholders. Provisions protecting the rights of the minority shareholders may also be provided for in the articles of association of a company.

4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

4.1. Thin Capitalization rule

As a rule, the corporate income tax (CIT) shall be applied only if the distributions of the company's income are made.

Under the thin capitalization rules, interest payments shall be included in the CIT taxable base (CIT shall be paid) if:

- 1) the debt/equity ratio exceeds 4 to 1;
- 2) the amount of interest paid exceeds EUR 3 million and it exceeds 30% of EBITDA.

If any of the thin capitalization rules is exceeded, the interest payment shall be treated as deemed dividends and shall be subject to 25% CIT.

The thin capitalization rules do not apply to interest on loans obtained from credit institutions that are residents of the EU or the European Economic Area (EEA) or a country with which Latvia has entered into a double tax treaty and the relevant financial institution provides crediting or financial leasing services and is under the supervision of credit institutions or financial monitoring agency.

4.2. Related-parties' transactions

Latvian law requires the arm's-length principle to be followed in all related-party transactions (that is, by applying fair market prices). The tax

authorities may reassess transactions between related parties and recalculate the tax base if the prices applied in related-party transactions are not fair market prices.

The following transfer pricing methods: the comparable uncontrolled price, resale price, cost-plus, profit-split, and transactional net margin methods, may be used to assess whether the prices applied in controlled transactions are consistent with the arm's-length principle.

Until 2018, taxpayers with annual net turnover exceeding EUR 1,430,000 were required to prepare transfer pricing documentation containing industry, company, functional and economic analysis. The documentation requirements applied to all related-party transactions with an annual value over EUR 14,300.

As of 1 January 2018, the following transfer pricing documentation must be prepared and submitted to the tax authorities within 12 months after the end of financial year:

- The Base Erosion and Profit Shifting (BEPS) Master File (prepared and submitted if the annual amount of related-party cross-border transactions exceeds EUR 5 million and the taxpayer's net turnover exceeds EUR 50 million or if the annual amount of related-party cross-border transactions exceeds EUR 15 million.
- The BEPS Local File (prepared and submitted if the amount of related party cross-border transactions exceeds EUR 5 million.

For transactions carried out after 1 January 2018, the following transfer pricing documentation must be prepared within 12 months after the end of the financial year (documentation must be submitted to the tax authorities within 1 month after request):

- The BEPS Master File must be prepared and filed after request if the annual amount of related party cross-border transactions does not exceed EUR 15 million and the taxpayer's net turnover does not exceed EUR 50 million, but the annual amount of related-party cross-border transactions exceeds EUR 5 million.
- The BEPS Local File must be prepared and filed after request if the amount of related party cross-border transactions exceeds EUR 250,000 but does not exceed EUR 5 million.

The Country-by-Country Report notification applies to all Latvian entities that are part of a qualifying group (the threshold is EUR 750 million).

The generally accepted practice for transfer pricing issues is based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Taxpayers can also enter into an advance pricing agreement (APA) with the tax administration on the establishment of an arm's-length price for a transaction conducted with a related foreign company.

In case a taxpayer complies with an APA, the tax administration during a tax review may not adjust the arm's-length price established for the transaction.

4.3. Permanent establishment

It shall be considered that a non-resident (foreign merchant) has a permanent establishment in Latvia if all the following conditions are met:

- 1) the non-resident (foreign merchant) uses a fixed place of business in Latvia;
- 2) the place of business is used permanently or has been established for the purpose of being utilised permanently;

- 3) the place of business is used for carrying on a business.

A place of management, a branch, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources are considered fixed places of business.

Providing consultancy, management or technical services will create a permanent establishment if the services are provided for the period totally exceeding 30 days in any consecutive six-month period (unless a double tax treaty states otherwise).

Non-resident companies operating through a permanent establishment in Latvia are subject to tax on income derived by the permanent establishment in Latvia as well as on income independently derived abroad by the permanent establishment. If a non-resident company engages directly in business activities in Latvia that are like the business activities performed by its permanent establishment or subsidiary in Latvia, income derived from the non-resident company's activities is included in the taxable income of the permanent establishment or the subsidiary.

4.4. Withholding taxes

Latvia has concluded 61 double tax treaties (DTT), which provide favourable withholding tax rates on payments made by entities also outside European Union. Most of the DTT ensures that withholding tax levied by the subsidiary does not exceed 5% on dividend payments provided that Latvian company owns at least 25% of capital of another company.

No withholding tax is levied on dividends paid by Latvian company to non-residents. However, this rule does not apply for dividend payments to companies established in tax havens; these dividends would be taxed with Corporate Income Tax of 20% rate.

No withholding tax shall be applied for Latvian company's interest and royalties paid to foreign companies, excluding the ones made in tax havens territory.

Withholding tax of 20% is levied on management and consulting fees. It is possible to obtain exemption from 20% withholding tax under the provisions of DTTs.

3% withholding tax is levied on payments for the transfer of real estate or shares in company owning real estate located in Latvia.

Under Latvian law if real estate constitutes more than 50% of company's assets (at the beginning of the financial year) it is considered as the disposal of real estate and therefore attracts described 3% withholding tax.

4.5. Further corporate tax exemptions

Full tax exemptions for dividends and profit of share distributions paid to a Latvian entity shall be applied if the shares are held for more than 3 years.

4.6. Harmonization with EU tax legislation

In relation to the accession of the Latvian Republic to the EU on 1 May 2004 EU Directives concerning direct taxation (income taxation) were incorporated into the ITA.

Based on the so-called Parent Subsidiary Directive (and related amending Directives), dividends and other profit share distributions between Latvian and EU companies which meet the definition of a parent company and its subsidiary are not subject to corporate income tax. To qualify as parent and subsidiary companies, companies must fulfil the following conditions:

- the companies must take a legal form listed in the respective EU Directives,
- the minimum capital holding in the subsidiary is 10% and is held by the parent company for an uninterrupted period of at

least 12 months (can be fulfilled subsequently),

- the companies must be EU member state tax residents,
- the companies must be subject to corporate income tax as stated in the respective EU Directives.

Similar conditions also apply if dividends are paid by a Latvian subsidiary to its mother company if it is a tax resident of the EU or Switzerland.

Latvia is a member of the OECD since 1 July 2016.

4.7 Residency and visas

Latvia is a member of the European Union and it is a Schengen country. The basic rules regarding EU and non-EU nationals are as follows:

4.7.1 Citizens of the European Union

Citizens of European Union, persons from the member states of the European Economic Area and the Swiss Confederation (Union citizens) have the right to enter and stay in Latvia based on a valid travel document.

Union citizens may enter Latvia without a visa and stay in Latvia for up to 90 days within a six-month period, counting from the day of entry. If a Union citizen wishes to stay for a period exceeding 90 days, counting from the day of entry, the citizen shall register with the Office of Citizenship and Migration Affairs (OCMA) and shall receive a registration certificate. The registration is not required if the citizen stays up to six months annually, if the aim is to establish employment relationship or a person is employed in Latvia, but actually resides in another member state, where he or she returns at least once a week, or a person is a student in one of the Latvian educational institutions and his expected stay in Latvia shall not exceed one year.

Union citizens have rights to acquire permanent residence permits if they have continuously legally resided for a period of five years.

4.7.2 Visa Requirements

Citizens of certain countries may enter Latvia without a visa and stay for a period 90 days within a six-month period. A list of these countries may be found at <http://www.pmlp.gov.lv/en/home/services/visas-and-invitations/>. If a visa is required, generally the visa applicant must apply to the appropriate Latvian embassy or consulate in person.

The application package normally includes a valid travel document, a visa application form filled out and signed, a photo, a copy of a document confirming that the applicant has a health insurance policy, document conforming that the applicant has financial means of subsistence (usually an extract from a bank account signed by a representative of the bank), documents verifying the reason for entry and the anticipated place of residence, or documents indicating that a letter of invitation has been approved by the OCMA (the invitation is valid for six months from the date of approval), a receipt confirming the fee payment. A state duty of between EUR 35 - 85, depending on the type of the visa, must be also paid. Visas may be issued for a single, double, or multiple entries and for transit. A transit visa entitles a person to stay in Latvia for a period not exceeding three days. A short-term visa entitles a person to stay in Schengen area for up to 90 days within a six-month period, counting from the day of entry. However, if a person wishes to stay for a longer period, a long-term visa shall be acquired.

4.7.3 Residence Permits

A residence permit is not required to own a business; it is possible to apply for a temporary residence permit to operate a business. In any case a residence permit is necessary if the

person wishes to reside in Latvia for a period of time exceeding 90 days within a six-month period counting from the first day of entrance.

Such temporary residence permit may be issued to a foreigner who is registered as an individual business person, is self-employed, or is registered as a management board member, supervisory board member, procura holder, representative of a branch or representative office of a foreign merchant, if the undertaking is performing active activity and its activity provides economic benefit for Latvia or promotes the development of economy of Latvia.

A residence permit may be issued to a foreigner, if the person has made a payment in the amount of EUR 10,000 to the state budget and has invested EUR 100,000 in the share capital of a capital company, which employs more than 50 employees, the yearly turn-over of which or annual report (balance sheet) is more than EUR 10,000,000 or has made a payment in the amount of EUR 10,000 to the state budget and has invested no less than EUR 50,000 in the share capital of a capital company, which employs no more than 50 employees, the yearly turn-over of which or annual report (balance sheet) is less than EUR 10,000,000 (during such investment in the share capital, a residence permit may be acquired by no more than 10 foreigners), or if the person has acquired or owns one or several real properties with the transaction value of EUR 250,000, provided that all statutory conditions are met. A residence permit may be issued to a foreigner who has made a financial investment in a credit institution of no less than EUR 280,000 in the subordinated capital and has made a payment in the amount of EUR 25,000 to the state budget, the term for such investment must be at least five years. A foreigner may also apply for a residence permit, if he/she has purchased interest-free state securities in the amount of

EUR 250,000 and has made a payment in the amount of EUR 38,000 to the state budget. Foreigners who intend to create or develop an innovative product can apply for residence permit for up to 3 years, if within three months after receiving the residence permit the foreigner will be registered as the board member of a capital company and qualified venture capital investor shall make investment in the share capital of the same company in amount of EUR 30 000 within 6 months after issuance of residence permit and at least EUR 60 000 shall be invested within 18 months of issuance of temporary residence permit.

Consequently, a temporary residence permit may be exchanged to a permanent residence permit by a foreigner who has continuously resided on the grounds of a temporary residence permit for at least five years in Latvia.

Persons from countries of the visa regime with Latvia may apply for a residence permit in the respective Latvian embassy or consulate in person.

4.7.4 Work Permits

If a Union citizen or his or her family members have established employment relationship or are self-employed in Latvia, no work permit is required. All other persons must obtain a work permit in such cases, which would also include a foreign person, who engages in operational management of a Latvian company. In the latter case, the entry "Business" in a person's visa or the entry "Commercial activity" in a residence permit confirms the existence of a work permit and it is not required to process a separate work permit.

A work permit is issued to a foreigner by the OCMA based on a visa or residence permit. If a businessperson wishes to employ a foreigner on the grounds of an employment agreement, a vacancy shall be announced in the Employment State Agency at least one month before applying

for visa or residency permit. If it is intended to engage the foreigner on the grounds of a service agreement, no vacancy shall be announced.

A work permit shall not be required if a foreigner is lawfully staying in the Republic of Latvia in relation to:

- 1) performance on tour (concert on tour) as a creative artist or performing artist, or as an, administrative or technical worker involved in ensuring of the performances (concerts) and the intended length of stay in the Republic of Latvia does not exceed 14 days;
- 2) an invitation from an educational institution or scientific institution, or individual scientist for conducting of scientific research or participation in the implementation of educational programs and the intended length of stay in the Republic of Latvia does not exceed 14 days;
- 3) performing of scientific activity in accordance with a scientific co-operation agreement, which has been concluded with a scientific institution included in the Register of Scientific Institutions of the Republic of Latvia;
- 4) being a crew member of the ship, which performs international voyages and is registered in the Latvian Ship Register;
- 5) being a crew member of a vehicle, which performs international voyages and is registered in a foreign state;
- 6) being lawfully employed in another European Union Member State, Member State of the European Economic Area or in the Swiss Confederation and the employer appoints him or her for provision of services in Latvia for a period not exceeding 90 days within six months;

- 7) being an individual merchant registered in the Commercial Register, a member of the board of directors or council, a procuration holder, an administrator, a liquidator or a member of a partnership who has the right to represent the partnership, or a person who is authorised to represent a merchant (foreign merchant) in activities related to the branch, or a self-employed person, and the duration of stay does not exceed 90 days within six months;
- 8) being an employee that has been transferred within the company (employee working for company that is registered outside the EU and sends its workers to a company which concludes commercial activity in Republic of Latvia) and whose stay in Republic of Latvia does not exceed 90 days in any 180-day period and has a valid temporary residence permit issued by another EU member state;
- 9) the fact that he/she is employed in the Republic of Latvia and his/her stay in Latvia does not exceed 14 days in any 180-day period.