

# Tax Alert

Estonia, Issue 10, October 2010

AS PricewaterhouseCoopers in Estonia helps clients in finding tax efficient business solutions and managing tax risks.

We work together with our colleagues in other PricewaterhouseCoopers' offices world-wide and use our access to international know-how and long-term experience to quickly and efficiently solve tax issues that arise both locally and in foreign jurisdictions.

For more information, please see our contact details below.



## LEGAL ACTS

### Amendments in the Income Tax Act

On 20 October 2010 the Estonian Parliament adopted the amendments to the Income Tax Act. Amendments will enter into force as of 1 January 2011. Overview of the more significant changes are listed below:

#### Taxation of companies:

- The definition of related parties will be extended so that persons, who have mutual economic interests or where one person has a control over the other person, are also deemed to be related parties;
- The scope of persons deemed as receivers of fringe benefit will be extended by employee's co-habitant, persons in direct and collateral blood relationship and to situations where benefit is granted by a person belonging to the same group with the employer;
- The granting of stock options will no longer be treated as a taxable fringe benefit if the exercise of the options by the employee will take place for at least 3 years from the date of grant;
- It will become possible to grant tax exempt donations to the non-profit institutions of EEA countries, but it will be no longer possible to grant tax exempt donations to public universities and certain local and state institutions;
- The rules regarding avoidance of double taxation will be clarified in situations where interest paid between related parties does not correspond to the market value;
- Definition of persons deemed to be

located in a low tax territory is amended so that the specific list of business activities which automatically exclude a person from being a resident of a low tax territory is abandoned. Instead, active business test or availability of exchange of information between tax authorities of the countries is provided as a preliminary requirement for exclusion.

#### Taxation of a permanent establishment:

- The domestic definition of a permanent establishment will no more follow the OECD Model Convention based definition and will be made slightly broader. This might affect the permanent establishments from countries with whom Estonia does not have effective tax treaty;
- In connection with the infringement procedure started by the European Commission, the principles of allocation and taxation of a permanent establishment's profits will be clarified.

#### Taxation of individuals:

- The new restrictive rules will be applied to the exemption of gains derived from the sale of residential property. Tax exemption will only apply to one residential property sold within two years. At the same time, however, such tax exemption is extended to non-residents;
- The change of individual's tax residence must be notified to the Tax and Customs Board;
- The scope of deductions from taxable income by the qualified non-resident individual will be extended. For example, the unemployment insurance contributions will be deductible for withholding taxation by the employer. Also, the deductions from taxable income will be allowed for qualified

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- New restrictive ratio will be applied to tax deductions allowed to the individual, if the tax exempt foreign employment income constitutes at least 75% of the total taxable income of that individual;
- The principles of taxation of alimonies will be completely changed - these will be tax exempt for the recipient and no longer deductible for the payer;
- The exemption on gifts and donations will be extended also to gifts and donations received from the non-resident legal entities, provided that the foreign income tax has been paid either on the level of the payer or respective individual;
- The tax deduction in the established limits will be no longer applied to donations which are made to public universities and certain local and state institutions. However, the deduction from the taxable income will become available for donations made to the non-profit institutions of EEA countries (currently deductions are allowed only to listed Estonian non-profit institutions).
- The auditing requirement will be relaxed. Under the current law the auditing must be carried out always when a non-monetary contribution exceeds EUR 2 500 or if all non-monetary contributions exceed half of the share capital. Under the new system the auditor must be engaged to the evaluation of non-monetary contribution only if the share capital is at least EUR 25 000 and the non-monetary contribution exceeds 1/10 of the share capital or if all non-monetary contributions exceed half of the share capital;
- The rules for sale of shareholding are simplified. Under the current law, on the sale of shareholding the other shareholders have a right of pre-emption. The amendments to the Commercial Code provide the possibility to indicate in the Articles of Association that the right of pre-emption cannot be applied;
- Under the amended Code, the members of the management board can be elected without a specific term.

### Rules for Private Limited Companies are simplified

On 19 October 2010 the Estonian Parliament adopted the amendments to the Commercial Code. Amendments will enter into force as of 1 January 2011. Overview of the more significant changes are listed below:

- It will become possible to establish a private limited company (Osäühing, OÜ) without minimum capital requirement, provided that the founders are individuals only and the planned minimum capital does not exceed EUR 25 000. The capital of such company will consist of claims against the shareholders, who are liable with all of their assets up to the amount they have promised to pay to the capital of the company;

### OTHER USEFUL INFORMATION

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