

Tax Alert

Estonia, Issue 9, September 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.



TAX TREATIES

Estonia and Georgia concluded a protocol amending the tax treaty

On 17 July 2010 Estonia and Georgia concluded the protocol amending the existing treaty for the avoidance of double taxation with respect of taxes on income and capital. The protocol will enter into force after the parties have notified each other about the completion of the respective domestic constitutional procedures (e.g. ratification in Estonia). As a general rule, the protocol would become effective from January 1 of the year following that in which protocol enters into force. Most important changes the protocol introduces can be summarized as follows:

- A building site or construction or installation project will constitute a permanent establishment only if it lasts for more than 9 months (in the existing treaty - 6 months);
- In respect of dividends, interest and royalties, the exclusive taxing right will be provided to the state where the recipient is a resident. In practice this means that the source state would give up its right to withhold taxes on those types of payments;
- Existing treaty gives right to the source state to tax the gains that are received from alienation of shares in a company, the assets of which consist mainly of the immovable property located in that state. Protocol clarifies the meaning of the term "consists mainly of immovable property".

Under the new wording the source state may tax gains from alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the source state;

- Credit method currently used to relieve double taxation is replaced by exemption method. Where a resident of Estonia derives income which has been taxed in Georgia, Estonia will exempt such income from tax;
- New protocol also specifies the rules for exchange of information. Exchange of information is no more limited to the residents of the contracting states or the taxes listed in the treaty and will also cover banking information.

The text of the protocol (in English and in Estonian) can be found at:
http://eogus.just.ee/?act=6&subact=1&OTSIDOC_W=301100

LEGAL ACTS

Sales tax and boat tax to be abolished as of 1 January 2012

Estonian parliament adopted on 23 September 2010 the law amending the Local Taxes Act and Taxation Act, which will abolish two local taxes - sales tax and boat tax - as of 1 January 2012.

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CASE LAW

Case 3-3-1-45-10: Late payment interest as taxable income

On 17 September 2010 the Administrative Chamber of the Supreme Court made a decision in the case no 3-3-1-45-10. The case related to the situation where the tax authorities had collected income tax under a decision with no proper legal basis. As a result, authorities refunded the income tax previously collected as well as had to pay interest on the amount pursuant to the Article 116 of the Taxation Act. The dispute arose on the question whether such late payment interest paid by authorities is a taxable income for a taxpayer or not.

Court ruled that the interest paid pursuant to the Article 116 of the Taxation Act should

be treated for income tax purposes similarly to the interest on arrears paid under contracts concluded under law on obligations. Thus, such interest paid by the tax authorities is taxable income for individuals.

However, court also found that such late interest may partly have a character of a compensation for direct proprietary damage. If unlawfully issued tax decision by the tax authorities causes direct proprietary damage to the taxpayer (e.g. taxpayer has to take loan to fulfill the obligations and pay interest on that loan; it has to make expenditures for guarantee, etc.), the amount of interest relating to such documented damages may be excluded from the taxable base of the individual. If the damages exceed the interest received, the excess part can be claimed by the taxpayer from the state under the State Liability Act.

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