

Tax Alert

Estonia, Issue 1, January 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.



NEW TAX TREATIES

Tax treaties with Macedonia, Isle of Man and Israel as well as new protocol to the treaty with Netherlands have become effective as of 2010

As of 1 January 2010 the treaties with Macedonia, Isle of Man and Israel are effective bringing the total count of effective Estonian tax treaties to 44.

Treaty with Macedonia was concluded on 20 November 2008 and entered into force on 21 May 2009. The treaty generally follows the wording of the OECD Model Tax Convention, which is a basis also for the rest of the Estonian tax treaties. The treaty generally limits withholding taxes: (a) on dividends to 0% provided that the shareholder is a company holding directly 25% of the capital of the company paying the dividends and 5% in all other cases; (b) on interest to 5%; (c) on license fees to 5%.

Treaty text (in Estonian and in English) is available at:

<https://www.riigiteataja.ee/ert/act.jsp?id=13175716>

Treaty with Isle of Man was concluded on 8 May 2009 and entered into force on 21 December 2009. The treaty generally follows the wording of the OECD Model Tax Convention, which is a basis also for the rest of the Estonian tax treaties. The treaty generally limits withholding taxes on dividends, interest and royalties to 0%. More detailed overview of the treaty was brought to you in our tax alert May 2009.

Treaty text (in Estonian and in English) is available at:

<https://www.riigiteataja.ee/ert/act.jsp?id=13240219>

Treaty with Israel was concluded on 29 June 2009 and it entered into force on 28 December 2009. The treaty generally follows the wording of the OECD Model Tax Convention, which is a basis also for the rest of the Estonian tax treaties. The treaty generally limits withholding taxes (a) on dividends to 0% provided that the shareholder is a company holding directly 10% of the capital of the company paying the dividends and 5% in all other cases; (b) on interest to 5%; (c) on license fees to 0%. More detailed overview of the treaty was brought to you in our tax alert No 12 from August 2009.

Treaty text (in Estonian and in English) is available at:

<https://www.riigiteataja.ee/ert/act.jsp?id=13240231>

The new protocol to the tax treaty between Estonia and the Netherlands was concluded on 26 June 2008 and entered into force on 22 May 2009. The treaty provides a replacement of the exemption method for the avoidance of double taxation by the credit method for artists and sportsmen resident in Estonia. The purpose of the amendment is an avoidance of non-taxation by either of the contracting states.

The text of the Protocol (in Estonian and in English) is available at:

<http://www.riigiteataja.ee/ert/act.jsp?id=13163254>

TAX LEGISLATION

The minimum monthly tax base for social tax calculation remains unchanged

According to the State Budget of 2010, the minimum monthly rate for social tax base has been fixed to 4350 kroons also in 2010. The monthly rate is the minimum

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amount on which employers are obligated, with several exceptions, to pay social tax per employee per calendar month. Thus, the minimum social tax payable in 2010 is 1436 kroons.

The new cross-border VAT refund system

On 18 December 2009 the Minister of Finance issued a regulation No 66 that introduces new procedures for VAT refund in cross border situations. The regulation entered into force on 1 January 2010. The purpose of the amendment was to align the VAT refund procedures with the Directive 2008/9/EC and to reduce the administrative burden by implementing electronic system that simplifies the VAT refund procedure within EU.

The guidelines issued by the Tax and Customs Board are available at:
<http://www.emta.ee/index.php?id=26515>.

The Land Tax Act amended

On 17 December 2009 the amendments to the Land Tax Act were adopted that entered into force on 1 January 2010. We provided a detailed overview on the planned amendments in our Tax Alert No 13, from September 2009; hereby a short overview on the most significant amendments is brought to you.

From hereon the tax notice will be issued by 15 February and only if the land tax payable exceeds EEK 50. Also, the land tax will be payable in two instalments, instead of the three instalments applicable until now. The deadline for paying the first instalment is moved forth to 31 March, to the same date as the deadline for submitting the personal income tax return. The idea of the amendment is that it will become possible to instantly offset the land tax payable against the possible refund of personal income tax. The second instalment is due by 1 October, but only if the tax payable exceeds EEK 1000. Land tax up to 1000 EEK will be fully payable by 31 March.

The person liable to pay the land tax is the owner, usufructuary or superficiary of the immovable according to information entered in the Land Register at 1 January.

CASE LAW

Case No 3-4-1-25-09: Overly high state fee may be unconstitutional

On 15 December 2009 the Constitutional Review Chamber of the Supreme Court delivered a ruling in case 3-4-1-25-09 that relates to the payment of the state fee on a claim to acknowledge the decision of general meeting of a housing cooperative void.

According to the factual circumstances the Circuit Court (Court of Appeal) decided that an obligation to pay state fee of EEK 75000 on the claim of EEK 1000000 is not proportional with the purpose of procedural efficiency and referred the case to the constitutional review.

The Constitutional Review Chamber of the Supreme Court stated that fundamental right for efficient legal protection (art 15 of the Constitution) is not absolute and legislator may limit this right in order to secure the achievement of another fundamental freedom. However, according to the art 11 of the Constitution such limitations must also meet the principle of proportionality i.e. they must be appropriate, necessary and proportional to the stated objectives.

The Supreme Court stated that state fee of EEK 75000 is an appropriate and necessary measure to achieve the procedural efficiency - i.e. to avoid excessive, malevolent and clearly unreasonable claims - but is not proportional if it does not allow the person to exercise his rights in the Court. Under the specific circumstances of this case, the Court stated that the state fee is unproportionally high and therefore unconstitutional as both claimants had to pay the state fee in the amount that was equal to three Estonian average salaries and eight and half Estonian minimum salaries.

Among other arguments the Supreme Court referred to the European Court of Human Rights case from 17 July 2007 *Mehmet and Suna Yigit vs Turkey*.

Case No 3-3-1-72-08: The concept of income was specified

On 17 December 2009 the Administrative Law Chamber of the Supreme Court delivered a ruling in case 3-3-1-72-09 (Hermo Taal) where the concept of income was specified. The case relates to the payment of compensation for the damages caused by unjust deprivation of liberty.

The Court argued that it is necessary to make distinction between compensation for loss of income and compensation for non-proprietary damage. Compensation for the loss of income is by character an income in the meaning of art 12 sec 1 of the Income Tax Act and is therefore taxable income. If there would not have been an unjust deprivation of liberty, a person would have earned an income that would have been taxable. To guarantee the equal treatment of persons, also the compensation for loss of income should therefore be taxed similarly. However, the compensation for non-proprietary damage is by character an income of a casual nature as such income cannot be earned in ordinary circumstances where damages were not caused. As non-proprietary

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damages cannot be measured in monetary form and compensation for damages can only be of an estimated value, it is not possible to measure whether and how much the proprietary position of the person has changed compared to the situation where non-proprietary damage would not have been caused. According to the court, the income of a casual nature, that has not arisen as a result of an ordinary economic activities, cannot be considered as income that would be taxable.

OTHER USEFUL INFORMATION

New global website on EU direct taxation

On the recent years the European Commission has initiated several infringement procedures against Estonia as well as there are first cases in Estonian courts that relate to the incompatibility of

provisions of Income Tax Law with fundamental freedoms stipulated in the EC Treaty. Therefore, the rapid developments in EC tax law have increasingly more impact on the development of tax legislation in Estonia.

The European Union direct tax law is generally understood as including the EC Treaty fundamental freedoms, the EU Directives and the EU's State aid rules related to direct taxation. This presents taxpayers, in particular groups and multinational corporations that have an EU or European Economic Area (EEA) presence, with various opportunities, but also risks.

Based on the above, the PwC EU Direct Tax Working Group (PWC EU DTG) has launched the website that brings regularly relevant information to the entrepreneurs.

The website can be found at:
www.pwc.com/eudirecttax.

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