

Tax Alert

Estonia, Issue 16, December 2009

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 LEGISLATION

The Estonian Parliament adopted amendments to the Income Tax Act

The Estonian Parliament adopted the draft law amending the Income Tax Act on 26 November 2009 (586 SE and 553SE), which will become effective from 1 January 2010 (a more detailed overview on the amendments is provided in our 14th Tax Alert).

Accordingly the income tax rate of 21% to individuals and 21/79 to companies does not change in 2010. No changes are applicable to basic exemption (27 000 EEK or 2259 EEK per month) to resident individuals. Similarly to year 2009, resident individuals will be allowed an increased basic exemption (27 000 EEK) for each child of up to 17 years of age, starting from the second child.

The full text of the amended Income Tax act is available at:
<https://www.riigiteataja.ee/ert/act.jsp?id=13240207>

The amendments to the VAT Act

On 11 November 2009, the Estonian Parliament adopted the Law Amending the VAT Act and Related Laws which for the most part will become effective from 1 January 2010. As a result businesses who are engaged in cross-border transactions will have more opportunities to apply the 0% VAT rate.

Starting from the next year it will be allowed to tax services provided from Estonia to businesses established in the Community and as well outside the Community with 0% VAT, since the place

of supply of the service will be deemed the location of the customer. However, there will still be several exceptions to the general rule, for example services connected with immovable property located in Estonia, catering services, concerts and passenger transport in Estonia.

For example invoices with 0% VAT can be issued to a taxable person in another Member State or a business established outside the Community in connection with the following services:

- ▶ long term (over 30 days) vehicle lease;
- ▶ work on movable goods (warranty repairs, processing or installation etc);
- ▶ domestic transport of goods and ancillary transport activities;
- ▶ management services;
- ▶ other services to which exceptions do not apply.

EC Sales Lists are currently required for B2B intra-EC supplies of goods. From 1 January 2010 EC Sales List will also be required for intra-Community supplies of services and therefore the reporting forms (VD and VDP) will change. In future businesses will be obliged to submit a report of intra-Community supplies to VAT registered customers. For that it is necessary to know the customers valid VAT registration number. Tax free services (financial services) do not have to be reported.

We would recommend businesses reading the approved VAT Act, examine their cross-border transactions and assess if it is necessary to make changes in tax rates. For further information, please contact Ain Veide (ain.veide@ee.pwc.com, tel + 372 6141 978).

The full text of the amended act is available at:
<https://www.riigiteataja.ee/ert/act.jsp?id=13236840>

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Unemployment insurance contribution rates will not change from 2010

On 19 November 2009, the Government adopted Regulation No 175 which establishes the unemployment insurance contribution rates for employees and employers for the year 2010. Accordingly the maximum rates of unemployment insurance contributions allowed by law (implemented in 1 August 2009 - 2.8% for employees and 1.4% for employers) will remain effective.

The full text of the Regulation is available at:

<https://www.riigiteataja.ee/ert/act.jsp?id=13236066>

The Estonian Parliament approved the increase of the excise tax rate

The Estonian Parliament adopted the draft law amending the Excise Tax Acts (585 SE) on 25 November 2009, which provides increase for alcohol and fuel excise starting from 1 January 2010, increase for electricity excise starting from 1 March 2010 and increase for tobacco excise from 1 January 2011.

The full text of the law is available:

<https://www.riigiteataja.ee/ert/act.jsp?id=13240194>

Tax exempt private car compensation is extended to Supervisory Board Members

As of 1 July 2009, the monthly tax exempt allowance and reimbursement rates for the use of a private car for business purposes also applies to members of supervisory board of a legal entity. Previously, the non-taxable rates were only applicable to allowances or reimbursements paid to employees or members of management board.

The incentive itself is provided in the Income Tax Act and the specifics on the calculation and management of the tax exempt reimbursements are provided by the Regulation No 164 of the Government which was finally brought in line with the described amendment as of 27 November 2009.

The tax exempt rates remain unchanged - the monthly maximum for a mileage reimbursement is 4000 EEK and for cash allowance 1000 EEK.

CASE LAW

Case No 3-2-1-122-09: It is possible to rehabilitate tax arrears

On 18 November 2009, the Supreme Court delivered ruling in case No 3-2-1-122-09 (Loksa Ravikeskus), concerning the rehabilitation of the tax arrears.

The Estonian tax authorities claimed that tax liability is a public liability, which cannot be rehabilitated.

The Supreme Court decided that the Rehabilitation Law excludes only the claims that are based on employment contract. Rehabilitation Law is regarded as a special law for Taxation Act. If a tax claim would not be rehabilitative this would result in preference of tax claim to other claims, which would lead to a violation of creditors' equal treatment principle. Preference of tax claims would result in a situation where a reorganization of a company through rehabilitation would be practically impossible and cause bankruptcy proceedings to be initiated regarding the company's shareholder.

The full text of the Court decision (in Estonian) is available at:

<http://www.riigikohus.ee/?id=11&tekst=RK/3-2-1-122-09>

Case No 3-3-1-73-09: Specification of the concept of fringe benefits

On 18 November 2009, the Supreme Court delivered ruling in case No 3-3-1-73-09 (OÜ Mobius Turundusinvesteeringud), concerning the concept of fringe benefits. The Court ruled in favour of the taxpayers.

According to the case a sole shareholder and a board member of a company sold his real estate to his company in 2002. The company renovated it, purchased new furnishing and consequently sold it back to the board member in 2004. The Estonian tax authorities claimed that since the sale price of the real estate was lower than the market price, the difference between the market price of the real estate and the actual sales price is fringe benefit pursuant to the Income Tax Act § 48 art 4 s. 7.

The Supreme Court specified that if the employee compensates the received benefit to the employer, it is not a fringe benefit. For identifying potential fringe benefit in case of a transaction where a company sells something to the employee from who it is purchased earlier it is necessary to look at both transactions together not separately. An employee is not deemed to receive a monetarily valued benefit if the employee purchases the item back with the same price it was earlier sold to the employer and compensates all the expenses the employer made to repair the object to the employer, since the employee's financial position has not changed on the account of the employer.

The full text of the decision (in Estonian) is available at: <http://www.nc.ee/?id=11&tekst=RK/3-3-1-73-09>

Case no 3-3-1-75-09: Liability decision to a board member

On 4 December 2009, the Supreme Court delivered ruling in case No 3-3-1-75-09

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(Katrin Tasamäe), concerning making a liability decision to a board member after the company has been deleted from the Commercial Register. The Court ruled in favour of the taxpayer.

The Estonian tax authorities claimed that the board member had intentionally violated the company's legal representative's obligations and as a result the tax liabilities of the company remained unpaid. For that reason the tax authorities claimed that the board member was obliged to pay the company's tax arrears.

The Supreme Court explained that the joint and several liability of the board member for the tax arrears of the company is by nature appurtenant secondary liability which means that for the validity of the secondary liability the primary liability has to be valid and the secondary liability shares the status of the primary liability. Since given in the present case the company had been removed from the Commercial Register on 19 March 2007 and the liability decision had been made on 20 July 2008, the liability decision is illegal because there was no valid tax debt for making the liability decision. The court specified that the liability decision has to be made before the legal capacity of a legal person, as to whose tax arrears the liability decision is made, ends. Provisions regulating the liquidation of a legal person generally exclude removing a legal person from the Commercial Register without tax authorities' knowledge.

The full text of the decision (in Estonian) is available at:
<http://www.nc.ee/?id=11&tekst=RK/3-3-1-75-09>

Case No 3-3-1-67-09: Employment relationship or a sole proprietor

On 9 December 2009, the Supreme Court delivered ruling in case No 3-3-1-67-09 (AS Eesti Post), concerning reclassification of the income of postmen providing services as sole proprietors into a salary received under employment relationship. The Court ruled in favour of the taxpayers.

The Estonian tax authorities claimed that the contracts of services and authorisation agreements between AS Eesti Post and sole proprietors are de facto contracts of employment. Therefore the tax authorities stated that the remuneration paid to the sole proprietors for their work can be interpreted as a salary from employment relationship and has to be taxed correspondingly.

The Supreme Court stated that the tax authorities have not motivated their opinion enough to apply the substance over form principle. The Court additionally explained that based on the principles of proceedings economics and proportionality the requalification of an

authorisation agreement to an employment agreement and as a consequence the correction of the tax liability may substantially influence the sole proprietors and cause retroactive recalculation of taxes. Not involving sole proprietors in the tax proceedings is this kind of violation of procedure rules that causes cancellation of notice of assessment. According to the principle of investigation in Taxation Act § 11 the tax authorities have the obligation to confirm a collateral tax liability decrease for another person in case of an increase of one's tax liability.

The full text of the decision (in Estonian) is available at:
<http://www.nc.ee/?id=11&tekst=RK/3-3-1-67-09>

APPLICATION OF EC LAW

The District Court ruled that the withholding of the income tax on dividend is a violation to the Treaty Establishing the European Community

On 25 November 2009, Tallinn District Court delivered ruling in case No 3-06-389, concerning withholding income tax on dividends paid to non-resident in 2004 and 2005.

According to the circumstances a legal person registered in Luxembourg as an investment fund received in 2004 and 2005 dividends from a company registered in Estonia. The fund's share in the company was less than 20% and therefore the income tax was withheld from the dividend paid to the fund. The Fund stated that withholding income tax from dividends paid to a non-resident fund while there is no withholding tax for dividends paid to Estonian resident funds is a violation of the principle of free movement of capital laid down in the articles of 56 and 58 of the Treaty Establishing the European Community.

The District Court confirmed that the different treatment is not justifiable and is therefore in violation to the Treaty Establishing the European Community. The decision has not yet come into force because the tax authorities have time until 28 December to submit a reversal of judgement to the Supreme Court. We will provide a more detailed overview of the case after the decision has come to force.

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