

# Tax Alert

Estonia, Issue 13, September 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 Treaty between Estonia and Macedonia entered into force

On 20 November 2008 Estonia and Macedonia signed the treaty for avoidance of double taxation. The treaty came into force on 21 May 2009 and will be effective from 1 January 2010. A detailed overview of the treaty is provided in our Tax Alert from this year's May, which is available at: <http://www.pwc.com/ee/en/insights/maksuteade.jhtml>

The full text of the treaty is available at: <https://www.riigiteataja.ee/ert/act.jsp?id=13175716>

- Tax return for July may be submitted to the tax authorities by 30 September (instead of 20 August as provided in the law) without the negative consequences from the tax authorities;
- Tax payers are entitled to submit a motivated petition to the Ministry of Finance until 31 October 2009 in order to receive compensation for the additional employment cost incurred, the Ministry of Finance will make a decision within 30 days.

Please see our Tax Alert from this year's August for additional background information: <http://www.pwc.com/ee/en/insights/maksuteade.jhtml>

## The draft law providing implementation rules for a rapid increase of the VAT rate was passed

In early September the law providing implementation rules to soften the harmful effects arising from the rapid increase of VAT rate was passed. Most of its provisions will be applied retroactively from 1 July 2009.

Among other measures the law provides the following options:

- If the services are provided for the period longer than the taxable period, it is allowed until 31 December 2009 to invoice and account for VAT for services provided until 30 June 2009 using the 18% tax rate. This provision will be beneficial in case of construction services where construction works started before 30 June 2009 will be completed after 1 July 2009 and invoiced after that;

## Planned amendments to the Income Tax Act

On 17 August 2009 the Ministry of Finance published a draft law amending the Income Tax Act. If the draft law will be approved by the Parliament, it will become effective from 1 January 2010. Overview of the more significant planned amendments is listed following:

### 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 deemed to be related parties;
- The definition of "a gift" is made broader so that sale of property at a preferential price will also be included. It is specified that as a general rule gifts are taxed based on their market value and in case of sale at a preferential price the amount between market value and actual sales price will be subject to tax as a gift;

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- The rules for calculating fringe benefit on a loan granted to an employee at preferential terms will be amended;
- The scope of persons deemed as receivers of fringe benefit will be extended by employee's spouse, parent, child and to situations where benefit is not granted by an employer but a person related to employer;
- 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 specified in situations where interest paid between related parties does not correspond to the market value;
- Dividends payable on account of profits accumulated before year 2000 are no longer payable tax exempt;
- 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 and requirement for information exchange between 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 based definition and will be made slightly broader;
- 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 private individuals:**

- The new restrictive rules will be applied to exemption of gains derived from the sale of residential property.
- 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 non-residents of EEA countries.
- 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 (which is currently limited only to listed Estonian non-profit institutions).

## **Planned amendments to the Land Tax Act**

On 18 August the Ministry of Finance published a new draft law which introduces amendments to the Land Tax Act. If the draft law will be approved by the Parliament, the amendments are expected to come into effect from 1 January 2010. The amendments are described below.

According to the current law, land tax notices are issued to taxpayers when land tax payable exceeds EEK 20, this lower rate will be increased to EEK 50.

There would only be one tax notice issued in a calendar year, by 15 February whereby the land tax will be payable by the owner, usufructuary or superficiary of the immovable according to information entered in the Land Register at 1 January. This means that if the owner of the immovable would change during a calendar year, the tax authorities would no longer issue a new tax notice to the new owner; instead settling could take place upon such agreement between the parties.

The land tax will be payable in two instalments, by 31 March and 31 August. At least half of land tax exceeding EEK 1000, but in any case not less than EEK 1000, will be payable by 31 March and the remaining half by 31 August. Land tax below EEK 1000 will be payable in total by 31 March.

The tax authorities will increase electronic delivering of the tax notice.

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