

Tax Alert

Estonia, April 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.



Contacts:

Villi Tõntson

E-mail: villi.tontson@ee.pwc.com

Ain Veide

E-mail: ain.veide@ee.pwc.com

Erki Uustalu

E-mail: erki.uustalu@ee.pwc.com

AS PricewaterhouseCoopers
Tax Services

Pärnu mnt 15, 10141 Tallinn

Tel: 614 1800

E-mail: tallinn@ee.pwc.com

www.pwc.ee

Legal Disclaimer: The material contained in this alert is provided for general information purposes only and does not contain a comprehensive analysis of each item described. Before taking (or not taking) any action, readers should seek professional advice specific to their situation. No liability is accepted for acts or omissions taken in reliance upon the contents of this alert.

© 2009 AS PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to the Estonian firm of AS PricewaterhouseCoopers or, as the context requires, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

The minimum rate of loan interest is decreased

On 26 March, the Minister of Finance adopted a regulation whereby from 1 April 2009 the minimum rate of interest calculated on a loan granted by the employer to the employee is decreased to 3% (before the minimum rate was 5%). According to the income tax act § 48 section 4 point 6 loans given to employees with lower interest than the minimum rate established by the Minister of Finance are treated as fringe benefits.

Per diem for domestic business trip

As of 1 July 2009 the Income Tax Act will be amended in respect of the taxation of business trip expenses.

One of the most significant changes is the abolishment of tax exempt daily allowances in case of domestic business trips. Currently, the tax-exempt limit for daily allowances in domestic business trips is EEK 80 per day. Tax exempt limit of daily allowances of business trips abroad will remain continuously EEK 500 per day. Tax exempt limits of accommodation costs are transferred from the Regulation to the Income Tax Act, but the limits remain the same EEK 1200 per day in case of domestic business trips and EEK 2000 per day in case of business trips abroad (Income Tax Act § 13 section 3 point 1).

The tax authorities are investigating transactions related to capital reductions

During the previous months, the tax authorities have focused their attention on the transactions related to capital reductions (including share buy-backs) that have taken place in 2006-2008. On 17 March, the tax authorities announced in the newspaper Äripäev that they have suspicions about 93 companies and thorough review have been initiated in 7 companies.

Unlike dividends that have always been taxed at the level of the company making the payments, according to the Income Tax Act effective until 31 December 2008 the payments upon capital reductions were taxed at the level of the shareholder. These provisions in combination with the double tax treaties generally caused the shifting of taxing right from Estonia to the residence country of the shareholder and therefore limited Estonia's right to tax such payments.

Despite the amendments to the Income Tax Act whereby from 1 January 2009 the payments upon capital reductions became taxable at the level of the company making the payments, the tax authorities still try to enforce the interpretation whereby such payments could be taxed in Estonia before the amendments to the Income Tax Act. It seems that the tax authorities try to push Through such interpretation referring to the

"substance over form" principle claiming that if the share buy-backs did not have any specific economic substance and transactions were made knowing that the Income Tax Act will change, the payments could be reclassified from capital gains to dividends that could be then taxed at the level of company making the payment.

If your company has concluded transactions that involve capital reductions (including share buy-backs) in 2006-2008 and there are indications that such transactions may become subject to control by the tax authorities, we recommend reviewing the existing documentation and prepare the potential defence arguments, involving the tax consultants, if necessary.

The summaries of binding rulings have been made public

As of 1 January 2008 the taxpayers have had the opportunity to request for binding advance rulings from Estonian Tax and Customs Board regarding taxation of a specific transaction or set of transactions. The purpose of these rulings is to enable the taxpayer to obtain certainty of the tax consequences before concluding the transaction.

At the beginning of this year, the tax authorities have published the summaries of rulings of a general importance related to the transactions repeatedly described in the rulings. The publication of the binding rulings should help to ensure the uniform application of the tax laws and to give taxpayers additional information about the practice the Tax and Customs Board implements.

The topics addressed in the binding rulings are as follows:

1. Provision of fringe benefits in circumstances where the company sponsors a sports club where most of the members are the employees of the same company.
2. Taxation of liquidation proceeds paid to a non-resident in the light of the Income Tax Act and the tax treaties.
3. Taxation of a property transferred in the case of a division of a company.
4. Implementing the tax exemption related to the disposal of a dwelling which was used by the taxpayer as his or her permanent or primary place of residence in the circumstances where the taxpayer uses simultaneously two dwellings as his or her permanent or primary place of residence.
5. Whether a contribution of an immovable property as a contribution in kind to the capital of a formed company is a VAT

exempt supply on circumstances where an immovable property belongs to a sole proprietor?

6. Taxation of payments made as a result of repurchase of own shares.
7. Taxation of stock options arranged by a parent company to employees of a subsidiary.
8. Implementing VAT exemption on transfer of a real estate in case the investments made to the building are less than 50% of the real estate's initial cost of acquisition.

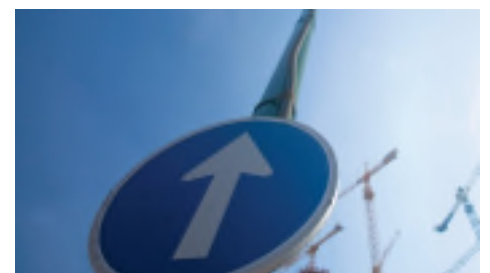
The complete texts of these summaries are available in Estonian on Tax and Customs Board homepage:
<http://www.emta.ee/?id=22578>.

These summaries are primarily of an explanatory nature. The rulings issued by the tax authorities are generally binding only to the authorities and only the applicant can fully rely on those rulings. The advance ruling is not binding to the taxable person. In case of a disagreement with tax authorities in respect of the ruling, the taxpayer may still implement the transaction as initially planned and later resolve potential disputes in the Court.

Unemployment insurance limits may increase to maximum rates as of 1 July 2009

In conjunction with the enforcement of the new Labour Act, the Estonian Unemployment Insurance Fund is considering proposing to the government to increase the rates of unemployment insurance contributions as of 1 July 2009 to maximum rates. According to the law, the rates can range from 0.5% to 2% for employees and from 0.25% to 1% for employers.

As a result of increasing unemployment and the new obligations deriving from the new Labour Act, the unemployment insurance premiums will most likely be raised to maximum rates as of 1 July 2009. In case of the government's approval, the unemployment insurance premiums will increase more than initially planned - to 2% for employees and to 1% for employers.



Legal Disclaimer: The material contained in this alert is provided for general information purposes only and does not contain a comprehensive analysis of each item described. Before taking (or not taking) any action, readers should seek professional advice specific to their situation. No liability is accepted for acts or omissions taken in reliance upon the contents of this alert.

© 2009 AS PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to the Estonian firm of AS PricewaterhouseCoopers or, as the context requires, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.