

*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.

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# Tax alert

Estonia, Issue 33, October 2017



## Legal acts

### *Tax Alert October 2017*

#### *Tax allowance depends on annual income*

As of 1st January 2018 the amendments to the Income Tax Act (ITA) come into force, according to which the general tax allowance **6000 EUR** per year (500 EUR per month) is applicable only if the annual income of the resident taxpayer is **up to 14 400 EUR** (incl.). The current rate of **2160 EUR** (180 EUR per month) is significantly lower, however, it applies to all irrespective of the annual income. If ITA had not been amended, the tax exempt income would have been 2280 EUR (190 EUR per month) in 2018. Due to the abovementioned, current tax allowance on pensions and compensations for accidents at work will be also abolished as of 1st of January.

#### *If the annual income exceeds 14 400 EUR*

In case the annual income exceeds 14 400 EUR, the tax allowance shall be gradually reduced using the following formula:  **$6000 - 6000 \div 10\,800 \times (\text{annual revenue} - 14\,400)$** . The formula was introduced to the ITA on June 19 when the Parliament passed a number of laws amending the ITA and other laws (458 SE)

#### *If the annual revenue exceeds 25 200 EUR*

In case the annual income exceeds 25 200 EUR, the tax allowance is zero due to the fact that by applying the formula, the tax allowance would be lower than zero and therefore is considered to be equal to zero.

#### *Calculation*

For example in case the annual income is 22 400 EUR, the calculation of tax allowance is as follows:

$$\begin{aligned} 22\,400 - 14\,400 &= 8000 \\ 6000 \div 10800 &= 0,5555 \text{ (quotient is not rounded)} \\ 0,5555 \times 8000 &= 4444,44 \\ 6000 - 4444,44 &= 1555,56 \text{ EUR (tax allowance, rounded up to two decimals after comma)} \end{aligned}$$

#### *Which revenues are included in the annual income?*

The following income declared in the income tax return of an individual is included in the annual income:

- taxable income, including taxable income from abroad, such as income from work, employment income and other remunerations received under the Law of Obligations Act, business income, profit from disposal of property, lease and rental income, interests, scholarships, pension etc;

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- the following income from abroad not taxed in Estonia:
  - the salary received from employment abroad, management board fees and other remunerations received under the Law of Obligations Act;
  - dividends from a foreign legal person;
- dividends from Estonian companies;
- disbursement of equity received from an Estonian company (which are subject to taxation at company level);
- income subject to taxation under the Law for the Simplified Taxation of Business Income less the social tax paid Under the same law.

### *Which revenues are excluded from the annual income?*

Annual income does not include income that is not subject to declaration in individuals' income tax return.

The following revenues are excluded from the annual income:

- tax exempt compensations (compensation for usage of personal vehicle for business purpose.);
- tax exempt scholarships (scholarship paid by a non-profit organization);
- tax exempt income from disposal of property (e.g. profit from disposal of benefits from the sale of housing or movable property held in personal consumption);
- fringe benefits that are taxed at the level of the

employer.

### *Applying tax allowance on a monthly basis*

Tax allowance can be applied on a monthly basis only by one withholding agent based on a written application of the beneficiary (the same principle as now). Usually the withholding agent is the employer who pays the salary. If there are several employers, the employee has to choose which one of them applies the tax allowance. Without an application the tax allowance cannot be applied to a specific payment.

### *Application*

Therefore, the employer's activity to apply the tax allowance on a monthly basis is based on a written application from the employee (e-mail is acceptable). If an employer files an application **in which he asks to apply the tax allowance to the extent provided by law**, then before calculating the amount of the income tax to be withhold, the employer deducts the tax allowance from the gross income in accordance with § 42 (1) of the ITA using the following formula:  **$500 - 500 / 900 \times (\text{payment} - 1200)$** . The payment in the formula is a gross amount.

The formula was introduced to the ITA on June 19 when the Parliament passed a number of laws amending the ITA and other laws (458 SE). By law the tax allowance may not be less than zero.

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## Tax allowance rates per month

For example

- the gross salary per month up to 500 EUR is tax exempt;
- the gross salary per month 501-1200 EUR, the tax allowance is 500 EUR;
- the gross salary is in the range of 1201-2100 EUR, the rate of tax allowance can be found using the formula and it depends on the volume of the income (decreasing as it grows);
- the gross salary per month is more than 2100 EUR, the tax allowance is equivalent to zero based on the formula.

## With an application a lower tax allowance can be selected

The recipient of the income may in his application to the withholding agent express his will to use lower tax allowance than calculated using the formula (a certain amount) or fully waive the right to apply tax allowance on a monthly basis. However, it is not allowed to apply higher tax allowance than calculated using the formula.

## Additional tax due

If the tax allowance applied is higher than allowed based on the formula, the individual is required to pay additional tax in his income tax return.

## One or more applications

It is recommended to submit one application per year to the selected withholding agent. Upon receiving additional unforeseeable income (for example dividends in significant amount or taxable gain from disposal of land or non-residence) the application may be amended or withdrawn in order to apply lower tax allowance than calculated using the formula or to fully waive the right to apply tax allowance on a monthly basis. The application can be amended once a month

## Can it be checked?

Individuals can check their tax allowance rate in the middle of the year from E-Tax/E-Customs subdivision „Data from employers” -> „Data from form TSD” -> „Väljamaksete andmete vaatamine”

## Tax and Customs Board guide

We also recommend to check the guidelines prepared by the Tax and Customs Board for further details:

<https://www.emta.ee/et/eraklient/tulu-deklareerimine/maksuvaba-tulu-alates-1-jaanuarist-2018>

<https://www.emta.ee/et/ariklient/tulu-kulukaive-kasum/maksuvaba-tulu-arvestamine-maksudeklaratsioonil-tds-alates-1>