

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

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Taxation of royalties

Pursuant to the Income Tax Act (ITA) royalties paid by an Estonian company to an unaffiliated non-resident are subject to 10% withholding tax. The concept of royalties includes consideration for the use or lease of industrial, commercial or scientific equipment. The Estonian translation of the word “equipment” has been clarified in the ITA as of January 2016 to replace the misleading term used so far. In case of leasing activities, it is important to ascertain whether the agreement is in essence a sale agreement or an agreement for operating. Fees paid under an operating agreement are taxed as royalties.

If an Estonian company has concluded an operating agreement whereby net fees are agreed (meaning withholding tax cannot reduce the agreed fee) then the income tax has to be calculated on top of the payment and remittance to the tax authorities will be an additional cost. The cost depends on whether the domestic 10% withholding tax rate applies or if a tax treaty could be applied to lower the tax rate to 5%. If the operating agreement provided for gross fees, then no additional tax cost arises for the Estonian company as the withholding tax would reduce the fees.

Protocol of the Estonia-Switzerland tax treaty

Could exemption from withholding tax on royalties' payments be available?

This could now be available under the protocol of the Estonia – Switzerland tax treaty which is effective from 01.01.2016. The Protocol limits the definition of a royalty by excluding fees received from the use of industrial, commercial or scientific equipment from its scope.

Thus, if payments for the use of industrial, commercial or scientific equipment are for example made to an unaffiliated Swiss tax resident company, the tax can no longer be withheld in Estonia.

It is important to note that there is a specific clause in a number of other tax treaties, which stipulates that should Estonia agree to limit the scope of royalties or the tax rate in the future with any other OECD Member State (in this case, Switzerland), such amendments automatically apply to the treaty with the respective contracting party. The countries to whom this amendment applies to, are the Netherlands, Belgium, Ireland, Iceland, Italy, Canada, Luxembourg, Norway, France, Sweden, Finland, United Kingdom, Denmark and Hungary. Therefore, royalties paid to tax residents of these countries for the use of industrial, commercial or scientific equipment are no longer subject to withholding tax.

Right of taxation of royalties

In addition to limiting the definition of royalties, the said protocol also changed the allocation of the taxing right: going forward, royalties shall only be taxed in the state of residence of the recipient.

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In addition to Switzerland, this amendment also applies to all the countries listed above. As an example, it follows that if an Estonian company pays royalties to a Finnish company for the use of a patent, withholding tax should not be levied.

For additional information please click on the link below:

<https://www.emta.ee/et/ariklient/tulud-kulud-kaive-kasum/valislepingud/tulu-ja-kapitalimaksuga-topeltnaksustamise-valtimise>

Amendments in the Taxation Act

The Ministry of Finance has sent amending drafts of the Taxation Act and of the Electronic Communications Act for harmonisation to the Ministry of Justice. The amendments should become effective from 1 July 2016. Some of the more significant changes are described below.

Tax and Customs Board to publish additional data

According to the draft law, the Tax and Customs Board is to publish the sum of taxable supplies reported on lines 1-3 (taxable transactions with the rate of 20%, 8% and 0%) of the VAT returns and the total number of persons entered in the employee register with respect to an employer on its webpage as of the last day of a quarter. Taxable turnover segregated by the applicable rate is not made

available, the sums of lines 1-3 are added up. The reported information is to be published quarterly by the 10th day of each month following a quarter.

Information about a client's invoices can be requested from telecommunications companies

The aim of the proposed amendments is to allow the tax administrator to collect information about relevant aspects of tax proceedings directly from telecommunications companies (e.g. Starman, Elisa Eesti, Telia etc) regarding the content of invoices issued to a taxpayer. However, requesting details of calls is prohibited. Under the currently effective Electronic Communications Act, the telecommunications companies are only obliged to provide such data in the course of a misdemeanour or surveillance proceedings.

The tax administrator is only allowed to request such data from the telecommunications companies if the taxpayer does not fulfil its cooperation obligation (does not present the requested invoices to the tax administrator) or the data is insufficient or contradictory.

What could be of interest to the Tax and Customs Board? For example, if the VAT registered person uses mobile communications services and has many numbers with different users who are listed on the invoices, but these persons are not associated with the company (are not members of

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the board nor employees). This could suggest that the company is making payments that do not have a business purpose or that the phone users are employees of the company de facto

Rules pertaining to inspection change

§ 72 (1) of the Taxation Act is amended to include a provision which allows the tax administrator to inspect a movable object at the disposal of the taxpayer (such as a car, ATV, equipment etc) and its use in the economic and professional activities even if the movable is not at the place of economic activity of the taxpayer. There are no limitations with respect to the timing of the inspection, so the inspection may be conducted outside regular working hours. Based on the explanatory memorandum to the draft law, the objective of the amendment is to improve the effectiveness of the tax administrator's work in determining the correctness of collecting taxes related to the use of property for business purposes.

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