Tax alert

Estonia, Issue 16, April 2016

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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Legal acts

Decision of the Supreme Court on value added tax

On March 2 2016 the Chamber of Administrative law of the Supreme Court rendered an important judgement (no 3-3-1-47-15, OÜ Kemtal) in a VAT dispute ruling in favour of the taxpayer. The dispute involved the right to deduct input VAT upon purchasing an apartment.

The dispute was initiated due to the conclusion of a contract of sale concluded in December 2013 for acquiring a number of expensive apartments in a building to be constructed in the city centre along with contingent parking spaces and storage rooms.

The property developer issued an invoice to the VAT registered buyer for partial settlement of the sales price. The invoice was paid and VAT was deducted in the VAT return as input tax by the buyer.

The buyer argued that it had a right of deduction as according to business plan it was intended to rent the apartments to a known hotel operator in Tallinn who would in turn rent these as exclusive accommodation and business meetings premises. The apartments were built with private staircases to serve these purposes. The buyer had already concluded a rental agreement with the hotel operator, had a business plan for the said activities and notified the tax administrator about levying VAT on the transaction as prescribed by §16 (3) 1 of the Value Added Tax Act (VATA).

The Tax and Customs Board (TA) did not allow for a deduction of input VAT and decided not to satisfy the claim for overpaid VAT. The TA found that the apartments to be built were dwellings (ie intended solely for permanent living) according to the construction permit and renting these out could only be exempt from VAT and without the option to convert the exempt supply into taxable.

Resolution of the Supreme Court

The Supreme Court held that deciding on the use of the building based only from a construction law point of view might not lead to the correct result. In the context of the VATA, it is reasonable to interpret the meaning of business space and living space by adhering to the terms stipulated in the Law of Obligations Act according to which a living space is a building or apartment used for permanent habitation and a business space is a place used for economic activities.

It follows from the said definitions that when distinguishing between living and business spaces, the conclusions based on architectural planning and the construction permit or use permit's purpose of use of the building is not sufficient. In addition, intent and actual possibility to use the rooms for either purpose must be taken into account.

Legal acts

For houses under construction, business plan is key

If the building is ready and rooms built as living spaces have been taken into use, then the actual use of the rooms should be followed for taxation purposes. Therefore, if the living spaces are intended to be used for economic activities by the lessee, then consequently it is possible to tax the rent with VAT under the said option to tax.

Since a building still under construction (in the given case) cannot be used yet, then the TA must allow the taxpayer to present supporting proof regarding the intended economic activities – basically a business plan - when deciding if the right of deduction exists. The TA must then assess whether the said activities give rise to output VAT and whether the submitted business plan is plausible.

Proposed amendments to the Income Tax Act

The parliament has initiated proceedings for passing the draft Law on Amendments to the Income Tax Act (184 SE).

The Draft Law aims to transpose amendments of the EU Parent & Subsidiary Directive 2011/96/EL into domestic legislation. It establishes limitations to the application of participation exemption upon on distribution of dividends received from a subsidiary, if there has been abuse of law. In addition, double non-taxation arising from the use of hybrid loans is eliminated.

We will comment on the draft legislation in more detail once the final version has been announced.