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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Amendments to the Value Added Tax Act became effective on 1 July

On April 20 the Parliament passed the law amending the Value Added Tax Act (VATA) with certain provisions coming into effect on July 1.

Inter alia, the third sentence of VATA § 11 (4) regulating the time of declaring a supply in case of provision of a long term (longer than 1 year) cross-border service, if the services are not paid for and the provision of services is not completed within the period, was amended. According to the Ministry of Finance, the amendment is in line with Art 64 (2) second paragraph of the VAT Directive. The current wording was unclear, because the time of receiving the service was not regulated and neither was the time of supply in cases of provision of services for a longer period of time if the services are continued to be carried out during ensuing periods also.

In case of provision of services as described above, supply or the obligation to apply the reverse charge mechanism is declared on December 31 of each calendar year since commencement of the provision of service, ie in the December VAT return of each respective calendar year. For example, if the provision of a long-term service commences in September 2016, no payments are made as of 31 December 2016 and the provision of services is completed in 2017, then the supply is deemed to have taken place on 31 December 2016 and a new period of taxation starts with 2017. Therefore the service provider must find an estimated value for reporting the supply. Under the previous wording the supply in the example described would have been deemed to have occurred on 31 December 2017.

EU Agreement on the Anti-Tax Avoidance Directive

The EU-28 Finance Ministers reached political agreement on 21 June 2016 on the Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (also known as ATAD). The ATAD sets out certain minimum standards that Member States need to adhere to in several areas also covered by the OECD work on BEPS. Whereas the ATAD stipulates minimum standards to be applied to all taxpayers subject to corporate tax in one or more Member States, it does not prohibit other anti-avoidance rules designed to give greater protection to the corporate tax base.

The measures which are based on OECD rules are the interest deductibility limitation, controlled foreign company (CFC) rules and hybrid mismatch rules. The ATAD, however, goes further and also sets out rules for exit taxation and a general anti-abuse rule.

Generating excessive interest costs is a method of aggressive tax-planning which allows shifting profits from a high tax jurisdiction to a low tax jurisdiction. Therefore the deductibility of interest rule limits the deductibility of excessive use of debt by linking the right of deduction to

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the company's earnings before interest, taxes, depreciation and amortization (EBITDA) or the debt burden of the whole group.

The rules mostly affect larger companies belonging to multinational groups since Member States are not expected to impose rules on stand-alone companies and on excessive interest payments that do not exceed EUR 3 million per year. Member States may exclude loans concluded before 17 June 2016. A grand-fathering clause that will end at the latest on 1 January 2024 was agreed for national targeted rules which are "as effective as the fixed ratio rules".

Estonia currently has no interest deductibility rules, these will be implemented as of 2019.

Controlled foreign company rules have only applied to individual taxpayers in Estonia (ITA § 22) and stipulate that all profits of an off-shore entity that is controlled by an Estonian resident must be attributed to and taxed at the hands of Estonian residents.

Under the directive, entities of which the voting/capital/profit rights are (in) directly owned for more than 50% and non-taxed PEs are CFCs if their actual corporate tax paid is lower than the difference between the corporate tax that would have been charged in the Member State of the taxpayer and the actual corporate tax paid by the entity or PE. Upon future distribution or disposal, there is a deduction of previously included income. Member States may apply certain 'de minimis' carve outs and there are certain exceptions for cases of substantive economic activity and for genuine or non-tax driven arrangements.

Hybrid mismatches occur in cross-border situations where states treat a hybrid entity or a hybrid instrument differently from a tax perspective, thus resulting in double deduction or non-inclusion. The hybrid mismatch rules coordinate activities of EU Member States by granting the right of deduction to only one state at a time. Currently the rules of the directive do not cover third countries, but it will be subject to discussions after a proposal that is to be made in autumn of 2016.

Anti abuse provision denies Member States the possibility to take into account transactions or structures undertaken for the main purpose of gaining a tax advantage. A similar principle (Taxation Act §84) has been in force in Estonia for years now, but the need for a uniform standard surfaced since some Member States do not have such a general anti abuse rule. The aim of the provision is to cover abusive situations where special rules fall short.

Exit taxation safeguards a country's right to tax the economic value of a capital gain arising in its territory in cases where the taxpayer transfers assets to another jurisdiction or changes its residency even if the profits have not been realized at the moment of emigration. Exit taxation is mostly employed by states where companies are allowed to decrease their taxable profits on account of tax amortization of fixed assets, but the state later loses its power of taxation if such assets are

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transferred. Based on the case law of the European Court of Justice, any restriction of free movement must be prevented and therefore the directive also provides for a deferral of exit tax until realization of capital gains and payment in instalments, but for no longer than 5 years.

Since the Estonian corporate income tax system operates differently from traditional regimes, then an exception is provided for Estonia in the directive disallowing the postponement of taxation of assets taken out of a permanent establishment of a non-resident since in the meaning of the Estonian Income Tax Act it is seen as a profit distribution.

Member States are required to adopt and publish ATAD-compliant provisions by 31 December 2018 at the latest (exceptions are provided), with the provisions applying from 1 January 2019. These deadlines will be extended with one year for the rules on exit taxation.