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Tax alert

Estonia, Issue 23, November 2016

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Special tax alert – the new coalition government's tax policy package for the period of 2016-2019

There has been a shift in the Estonian government and the long-standing major force in the government, the Estonian Reform Party has found itself in the opposition. The new government coalition has been formed by the Estonian Centre Party, Social Democratic Party and the Union of Pro Patria and Res Publica who have published the government coalition's basic principles for the period of 2016-2019, which inter alia cover tax policy.

Below we provide an overview of these key tax policy principles that will be implemented in the near future. The amendments are planned to be enforced as of 1 January 2018, with the exception of reversing amendments.

Income tax reform

The personal income tax rate remains at 20% and the minimum monthly tax allowance is raised from 170 euros to 500 euros, but it is set to decrease as the gross income increases. Therefore personal tax allowances will become progressive in nature. As a result the net income of low and medium income earners will increase. For individuals earning more than the average salary, the tax allowance is gradually reduced until it becomes inapplicable to income of 2,100 euros or more. It has been calculated that the net income will increase up to the gross salary of 1,758 euros and those earning over 2,100 euros will be paying more tax up to the amount of maximum 38 euros.

The mortgage interest deductions are limited by lowering the amount to 300 euros and the possibility for spouses submitting a joint income declaration is repealed. The tax exemption applicable to personal savings interest income is abolished.

Corporate income tax reform

The corporate income tax rate is lowered from 20% to 14% (-6%) for companies paying dividends on a regular basis, but only in cases where dividends are paid to legal persons. The objective is to encourage profit distributions and to make the applicable tax rate more attractive than it is in Latvia or Lithuania (15%).

It is planned to implement certain measures to tackle granting loans which are viewed as hidden profit distributions – most likely it will be enforced by way of deposits (the first receipt, however, is not expected until year 2020).

Reform of the employer car's mixed use

The taxation of mixed use (including for personal use) of employer's cars with fringe benefits taxation will be simplified by linking it to the car's engine

Legal acts

power (kW) and age. A 25% discount is envisioned for cars which are older than 5 years and the tax basis for 1 kW will likely be 1.96 euros. The requirement of keeping log books for cars in mixed use will be abolished. As a result the employer's tax burden on the use of cars with small or average engine power is relieved.

The temporary reduction of payroll taxes

A repayment or credit system of payroll taxes will be applied to starting or fast-growing companies to temporarily reduce their employment costs.

Reversing amendments which have already been adopted

The previous government coalition decided to raise the value added tax rate applied to accommodation services to 14% (+5%) and to reduce the social tax rate from 33% to 32.5% as of 1 January 2017. The new government believes that these amendments are not necessary. It is planned to keep the accommodation VAT rate at the same level (9%). The cancellation of the decrease of social tax by 0.5% starting from 1 January 2017 is, however, uncertain since the legal chancellor has expressed the opinion that it might not be in line with the principle of legitimate expectation taking into account that amendments that are burdensome for the taxpayer must be known at least 6 months in advance.

Changes in the excise duty policy and a soda tax

The 2018 diesel fuel excise duty raise is cancelled since compared to neighbouring states (Latvia, Lithuania), the Estonian excise duty is 36% higher. The natural gas excise duty will be raised also in years 2018, 2019 and 2020 (until now, the duty was agreed to rise only until the end of 2017). The excise duty raise applied to light alcoholic drinks – wine, cider and beer – will be significantly accelerated. In order to reduce excessive consumption of sugar, beverages with added sugar will be taxed with a separate surcharge (the so called soda tax).

Bank levy

A so-called bank levy is to be implemented to financial institutions and it is hoped to help collect 28 million euros annually during the period 2018-2020. The levy will be 0.04%-0.4% on the assets and the objective is to "increase the solidary contribution banks make into the Estonian society".