

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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Dedicated to taxation of cars

Draft law for amending the Value Added Tax Act and Income Tax Act

The Ministry of Finance has sent the draft law for amending the Value Added Tax Act and Income Tax Act for rounds of approval to amend the redactions of the laws coming into force on 1 January 2018. This can be viewed via the draft law directory (reference number RAM 17-0510).

In order for the changes to come into force on 1 January 2018, these must be passed by 30 June 2017 the latest, making the draft law of urgent nature.

Taxation of employer's car which is used for business and private purposes (mixed use)

The draft law proposes changes to the taxation of private use of employer's cars.

The current system allows for taxing the private use of employer owned cars based on kilometres driven, but this requires keeping logbooks for declaring both private and business use which is burdensome and complicated as these are often

difficult to distinguish from each other. The price per kilometre of private use for a car that is older than 5 years and with a cylinder capacity of up to 2000 cm³ is deemed to be EUR 0,2 and in other instances 0,3 EUR. If a logbook is not kept, but private trips are nevertheless made, then regardless of actual kilometrage, the estimated taxable base per car is EUR 256 per month, on which income and social tax of approximately EUR 170 is due.

Kilometre based calculation to be replaced by kilowatt based calculation

Under the planned amendments to the Income Tax Act, going forward the cost of private use would not depend on kilometres according to logbooks, but the power of the car. The only possibility of declaring private rides will be a kilowatt based tax base calculation regardless of if and how much a company car was *de facto* in private use. Since there will not be a kilometre based record-keeping, then reimbursement of private use to the employer will not help avoid the tax obligation. The kilometre based calculation will become impossible as the respective regulation of the Minister of Finance of 13 January 2011 §2 (1) will be abolished (currently allowing for a kilometre based record-keeping with a logbook).

If from now on the employer allows for private use of a car, then the taxable base for the purposes of fringe benefits taxation will be **1,96 EUR per kW**, based on information available in the traffic

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register. As a result the cost for a car below 130 kW will become cheaper and for cars exceeding 130 kW power will be more expensive. A majority of company cars are in the range of 50-130 kW. According to the Ministry of Finance the capacity based calculation is the best solution for strengthening the connection between the benefit deriving from private use and the taxable base of a fringe benefit, whilst maintaining the simplicity of the system as linkage to the market price of the vehicle would be complicated and burdensome to administer.

Since generally the value of assets decreases in time, then similarly to the current system, a lower tax base is foreseen for cars older than five years which will be **1.47 EUR per kW**, making it 25% less than for new vehicles.

Income and social tax liability

The income and social tax liability is approximately **1.3 EUR per kilowatt per month**, if the taxable base being 1.96 EUR per kW. As an example, the taxable base of private use of a 111kW Toyota RAV4 first registered in 2015 would be 217.56 EUR, with a monthly tax cost of 144 EUR (currently without a logbook the respective figures would be 256 EUR and 170 EUR).

Exemption from fringe benefit taxes

If a car has been temporarily deleted from the traffic register for a certain period (possible from 1 month to 24 months), then it is assumed that the vehicle is not in use and for that period the obligation to pay fringe benefit taxes does not arise.

If the employer does not allow private use of a car, then it must notify the Road Administration, who will then make note of it in the traffic register, which will become public information. The plans for special markings are dropped (stickers, distinct colours for licence plates). The Ministry of Finance expects that for such cars that are only meant for business use, the employer must ensure that these are not used for non-business related purposes. The Tax and Customs Board is to issue guidelines with applicable recommendations. If the respective note is absent from the traffic register, then the car is considered to be in mixed use.

Mixed use of vans

For vans in mixed use (N1-category necessity vehicles) the draft law provides for the possibility of opting for the use of the same kilowatt based calculation for calculating the taxable base of a fringe benefit. If this possibility is used, then the same taxable base applies for VAT purposes, whereby the taxable base of a fringe benefit includes VAT for the purposes of VAT.

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Changes in the Value Added Tax Act

Amendments are planned to the VAT Act.

A special provision is introduced for determining the taxable base for private use of N1 category vans, not exceeding the mass of 3500 kg (for example a Volkswagen Amarok with a carriage body) and certain specific cars (taxis and cars used by driving schools).

At the moment it is possible to deduct 100% input VAT on acquiring or using such vehicles 100% and as an exception, private use is taxed through the provisions on **self-supply**. Going forward, the taxable base (containing VAT) will not be the cost of the private ride, but the kW based cost of the private use. For vans, this principle only applies in case the company has voluntarily opted for using the kilowatt based calculation for determining the taxable base of the fringe benefit – for example 132 kW capacity mixed use newer van would additionally result in a monthly VAT of 43.12 EUR ($132 \times 1,96 = 258,72$ and $258,72 : 1.20 \times 0,20$).

Guarantee obligation

The implementation of a so-called guarantee obligation can be considered an important change. According to the draft law, a VAT registered person, who has deducted 100% input VAT on the costs related to the purchase or use of a car must ensure that the vehicle is solely used for business

purposes. The explanatory memorandum makes refers that the way of fulfilling the obligation is decided by the company itself and both a logbook and an electronic GPS-record are accepted.

Guidelines from the Tax and Customs Board are expected.

Non-compliance with the two-year rule will become more costly

In addition, the principles of adjusting input VAT will become more stringent in instances where the purpose of a car originally declared and that granted a 100% right of deduction changes within two years from business to private use. Under the new rule, the limitation on deducting input VAT will become applicable retroactively from the beginning and therefore 50% of the initially returned input VAT must be paid back. The currently applicable rules provide for a proportional calculation for determining the amount to be returned during a 24 month period, which is more beneficial.

According to the draft law and as estimated by the Ministry of Finance, in addition to the VAT that must be returned, the obligation to pay late payment interest will arise, meaning that taxpayers will likely not be interested in voluntarily making adjustments, should the obligation arise.

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