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Tax alert

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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

Coalition agreement signed: what to expect in the field of tax?

The coalition of three parties - the Reform Party, the Social Democratic Party and the Pro Patria and Res Publica Union - has finally agreed on its programme for government for the next four years. This issue of our newsletter focuses on key tax measures set out in the coalition agreement.

Modest cuts in wage taxes

The parties of the coalition have agreed to increase the personal tax allowance from 154 euros up to 205 euros per month. However, there is no clear indication as from when the new quota will take effect. It has also been agreed that the social tax rate, which is currently 33%, will be decreased by 1%. Unfortunately the coalition programme papers do not discuss the long-awaited social tax cap.

Good news for multinational businesses

Probably the most remarkable tax change the new coalition has agreed to implement during its reign is the plan to apply corporate tax exemption on capital gains from the sale of shares in a foreign subsidiary. This would be a big step towards enhancing Estonia's attractiveness as a holding location for multinational groups.
For example, if an Estonian holding company would sell today its majority shareholding in a Latvian subsidiary, the net profit from this transaction would be subject to Estonian corporate tax upon subsequent distribution (such as dividend). However, in many European countries the holding companies would enjoy in a similar situation either full or limited participation exemption. Clearly Estonia has fell behind in attracting multinational holding companies. We are looking forward to detailed draft law from the Ministry of Finance in a very near future and hopefully the respective qualification conditions will allow Estonia to enter the tight competition.

Income tax system and tax rates remain unchanged

Estonia's somewhat unusual corporate tax system, as well as application of flat tax rate on individual earnings have been lately subject to harsh criticism from the political opponents of the Reform Party – the creator and devoted protector of the current tax system.
Those supporting the existing tax system may feel relieved as the coalition agreement pledges to refrain from applying corporate income tax on reinvested profits. In principle, this means that the corporate tax system should remain as it is and, at least for now, there is no threat of the traditional corporate tax system being reinstated.
The coalition agreement does not set out changes in income tax rates. However, it does include general framework of a completely new tax refund system to individuals with low income level.

Other interesting action points

One of the key priorities of the new government is to increase efficiency of tax collection, success in which would not only raise state revenues but would also promote a competitive economy, all important ambitions that are difficult to argue with. However, this means the Tax and Customs Board's performance is under additional pressure. We certainly hope that any disciplining measures aimed at taxpayers will be fair and proportionate.
The group companies should watch out for coalition's intention to sharpen focus on transactions between a parent company and its subsidiaries. Proposed tracking improvements include mandatory monthly reporting of all intragroup loans and deposits along with the interests and yield.
It should be also mentioned that the long-term actions include thoroughly modernizing the online tax reporting application and introduction of an automatic tax compliance system.

Proposals for consideration

In addition to clear action points in the field of tax, several measures have been subjected to further discussions and analysis. As an example, the parties of the coalition commit to analyse whether or not they should abolish double taxation of the dividends in the cases the corporate recipient has a holding lesser than 10%. Currently, further distribution of such dividend would be taxed again. It is difficult to predict the results of the planned analysis as in the past the Ministry of Finance as well as the Chancellor of Justice have found such discrimination acceptable, whereas the Supreme Court has held any double taxation may be permitted under exceptional circumstances only.
Among others, the proposed tax discussions include:

- possible tax and compliance reliefs for the self-employed individuals;
- tax exemption for employer costs promoting healthy lifestyle among the employees;
- introducing road user charges on heavy duty trucks;
- exempting the royalties paid to non-residents from withholding tax (currently 10 %);
- establishing excise duty on energy drinks, etc.

How the tax cuts will be financed?

The coalition agreement does not disclose the sources of funds necessary to offset tax cuts. According to the speculations of the local media, once again indirect taxes come to government's rescue. It is possible that the above tax measures will be funded with increases of various excise rates (such as fuel and alcohol excises), as well as with increase of VAT on accommodation services (from 9% to 20%, expected enforcement on 1 January 2017).