Estonia

Tax and Investment Facts

A Glimpse at Taxation and Investment in Estonia

2017

SORAINEN

Estonia

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1 Ways of Doing Business / Legal Forms of Companies

Estonia is renowned for its well-developed e-system and e-governance, which allows for fast and efficient administration and communication with the authorities. The Commercial Register and Tax and Customs Board have online interfaces coupled with an electronic personal identification system, as do all major banks – one can establish a company, submit annual accounts, file tax returns, make money transfers and sign all correspondence electronically from a personal computer.

Foreign companies may conduct business in Estonia through a company or a branch in Estonia or by entering into contractual arrangements with Estonian counterparties (e.g. agency, long-term distribution agreements). Foreign companies may also establish a representative office in Estonia performing such ancillary activities as advertising and preparing market surveys, but these activities shall not amount to carrying out business in Estonia.

The following legal forms of business are available in Estonia:

- limited liability company (osaühing, OÜ);
- joint stock company (aktsiaselts, AS);
- general partnership (täisühing, TÜ);
- limited liability partnership (usaldusühing, UÜ);
- European cooperative society (Societas Cooperativa Europaea, SCE);
- European public limited liability company (Societas Europaea, SE); and
- sole proprietor (füüsilisest isikust ettevõtja, FIE).

A private limited liability company (osaühing/OÜ) is a widespread limited liability business form in Estonia that most resembles the German GmbH. The Estonian public limited liability company (aktsiaselts/AS), on the other hand, mostly resembles the German AG.

A private limited liability company is better suited for smaller businesses or a limited number of shareholders, having smaller share capital requirements (minimum EUR 2,500) and a simpler corporate structure; for example, forming a supervisory board and electing an auditor are optional.

In the case of a public limited liability company, the share capital requirement is higher (minimum EUR 25,000) and the corporate structure is more complex – forming a supervisory board, auditing the annual accounts and registering the shares at the Estonian Central Register of Securities is compulsory (the latter is not the listing of the company's shares on the local stock exchange).

2 Corporate Taxation

Estonia has a unique corporate income tax (CIT) system. All undistributed corporate profits are tax-exempted. Estonia levies corporate income tax only on profits that are distributed as dividends, share buy-backs, capital reductions, liquidation proceeds or deemed to be profit distributions (such as transfer pricing adjustments, expenses and payments not related to business, gifts, donations and entertainment expenses). Fringe benefits are taxable at the employer level with income tax and social tax.

2.1 Applicable Taxes / Tax Rates

Profit distributions of Estonian companies are taxed at a rate of 20% on gross amounts. For the purposes of technical calculations, a 20/80 split (25%) is used. Here, 20% is applied to gross payments, and 20/80 is calculated on the basis of net payments.

2.2 Resident Companies

A legal person is a resident if it is incorporated according to Estonian law. European Companies (SE) and European Cooperative Societies (SCE) are regarded to be residents if their place of establishment is registered in Estonia.

2.2.1 Computation of Taxable Income

Resident companies are taxed on their worldwide income. The tax is declared and paid as of the moment of distribution. The taxable income is calculated on the basis of distributed profits, capital reductions or costs deemed to be profit distributions (see chapter 2). The taxpayer is obliged to declare and calculate the applicable tax amount and submit it to the tax authorities by the 15th of following month.

2.2.2 Taxation of Dividends

Resident legal persons and non-resident legal persons acting through permanent establishments registered in Estonia and distributing profits have to pay 20/80 CIT on the amount of profits distributed.

There is no withholding income tax from dividends in Estonia. Dividends paid to non-residents are not subject to withholding tax, irrespective of their participation in the share capital of the distributing Estonian company. Transactions between related parties can be re-qualified as profit distributions if arms-length principles are not met.

The Estonian participation exemption rule allows dividends from most foreign subsidiaries to pass through without taxation in Estonia (defined as companies where an Estonian company holds at least 10% of shares or votes when the dividends are issued). Dividends from low-tax territories (tax havens) do not qualify for the exemption.

2.2.3 Capital Gains and Losses (including Capital Gains and Losses from Sales of Shares)

Capital gains earned by Estonian companies are not taxable in Estonia.

As a general rule, capital gains derived by non-residents from the sale of Estonian company shares are not taxable in Estonia. An exception to this rule is income derived from the sale of shares in a real estate company. A real estate company is a company, investment fund, or any pool of assets where over the past two years at least 50% of all assets have comprised real estate located in Estonia, directly or indirectly. The precondition for taxation is at least a 10% participation in the real estate company. The sale of shares by non-residents in a real estate company is taxable with 20% income tax. At the same time, certain tax treaties contain a provision whereby such income cannot be taxed in Estonia. This tax planning opportunity is available depending on the treaty country involved.

2.2.4 Depreciation / Capital Allowances

According to the Estonian CIT system there is no need for tax depreciation/amortisation rules. However, the actual outcome is similar to a situation where there is unlimited depreciation for tax purposes.

Depreciation for accounting purposes does not affect depreciation for tax purposes. For tax purposes the taxpayer can choose the period over which to depreciate the assets.

2.2.5 Loss Carry Over (including Potential Loss of Tax Loss Carry Forward in case of Restructuring)

Estonia is tax neutral for loss carry overs. Losses may be carried forward indefinitely.

2.2.6 Group Taxation

There are no group taxation rules for CIT purposes. Transactions between associated companies that form a group should be adjusted if the transactions are not at arm’s length.

2.2.7 Relief from Double Taxation (Tax Credit / Tax Exemption)

Double taxation is normally eliminated according to the ordinary credit method. In certain cases, however, the exemption method applies (e.g. participation exemption). Tax treaty provisions on the elimination of double taxation prevail over unilateral relief under domestic tax law, unless unilateral relief is more beneficial to the taxpayer.

2.2.8 Incentives

Estonia has no incentives (there are no benefits for special territories or economic fields, long-term investments, research or development, as all profit is tax exempt while held or reinvested). All taxpayers are treated the same way.

2.3 Non Resident Companies

Non-resident legal persons have a limited tax liability in Estonia, only the Estonian income is taxed. If the residency prescribed on the basis of a tax treaty differs from the residency prescribed pursuant to the Estonian Income Tax Act, the provisions of the international agreement apply. Estonia mainly follows the OECD model convention. This means that a person deemed to be a resident of another country according to article 4 of the tax treaty is deemed to be a non-resident according to Estonian law.

2.3.1 Concept of Permanent Establishment / Doing Business

A non-resident's permanent establishment is taxed in a manner similar to a resident. The Estonian Income Tax Act (EITA) as well as double taxation agreements (DTA) include an article defining permanent establishments.

- Art 5 (1) DTA term "permanent establishment" means a fixed place of business through which the business of an enterprise is carried out in whole or in part.
- EITA § 7 (1) Permanent establishment means a business entity through which the permanent economic activity of a non-resident is carried out in Estonia.

Regardless of the small divergence between those two definitions, it is clear that in both cases the element of “permanence” must be present in the activities of the non-resident.

In general, 6 months is considered to be sufficient to create a PE in Estonia. Certain activities do not create a PE, such as “auxiliary or preparatory” activities like promotion, advertising, financial and accounting support services, quality control, research and information collection.

Permanent establishments of non-resident legal persons should be registered at the Estonian Tax and Customs Board.

2.3.2 Withholding Taxes

Estonia does not apply withholding income tax on dividend and interest payments.

Estonia imposes withholding income tax on the following income of non-residents:

- salaries, wages and other remuneration paid to a non-resident if the place of work is Estonia;
- remuneration of the management and controlling bodies of a resident legal person;
- interest in connection with a holding in a contractual investment fund or other pool of assets, where, at the time of the interest payment or during a period of two years prior to that, more than 50 percent of the assets was directly or indirectly made up of immovables or structures as movables located in Estonia);
- insurance indemnities, pensions, payments from a pension fund, scholarships and grants, gambling winnings and benefits;
- rental fees;
- royalties (exempt from withholding income tax if the recipient is an associated company resident in another Member State or Switzerland. Two companies are associated if one of them directly holds at least 25% of the capital of the other or if a third EU or Swiss company directly holds at least 25% of the capital of the two companies. In both cases, a minimum holding period of 24 months is required. Exemption is not granted for the amount which exceeds the sum that would be paid to a non-associated party);
- payments made to a non-resident artist or athlete for activities conducted in Estonia;
- payments to a non-resident for services provided in Estonia;
- payments to a person registered in a low-tax territory.

The withholding entities for income tax are all resident legal entities, as well as state and local government agencies and employers that are natural persons and non-residents. An income tax withholding entity must withhold income tax on distributions taxed on the basis of the gross principle, transfer the withheld income tax to the tax authority by the 10th day of the month following the distribution, and file the tax return (Form TSD).

If a person making a distribution as an income tax withholding entity fails to comply with the obligations and fails to declare and transfer the income tax withheld to the tax authority, the income tax will be recovered from the person making the distribution.
If income is received from a person that is not subject to the obligation to withhold income tax (for instance, the renting of an apartment from one private individual to another), the recipient of the income must declare their income and pay their own income tax.

2.3.3 Capital Gains

In Estonia, capital gains are treated as ordinary income of Estonian resident companies and are only taxed as profit distributions.

2.4 Tax Compliance

The taxable period of corporate entities is a calendar month, the income tax shall be returned and paid monthly by the 10th of the following month. Taxpayers are obliged to calculate and declare their income. Usually no tax assessment notice is given.

2.4.1 Employment Register

All natural and legal persons providing work are required to register the people they employ in the employment register. The employment of all natural persons whose work creates a tax liability in Estonia, irrespective of the form of contract, must be recorded in the employment register. The commencement of the employment must be recorded no later than when an employee starts working.

3 Double Taxation Agreements

As of 1 January 2017 Estonia has 57 bilateral double taxation agreements in force, mainly following the OECD model convention. In the context of Estonia the treaties usually include only income tax, as Estonia does not levy other taxes on capital income.

Unilateral relief for double taxation in respect of income derived abroad is available in the form of ordinary tax credits with country limitations. The credit is limited to the Estonian tax computed on the item of income.

If the price of a transaction concluded between a resident legal person and a person associated with the resident legal person differs from the market value of the transaction, income tax is imposed on the amount which the taxpayer would have received as income or the amount which the taxpayer would not have incurred as expense if the transfer price had conformed to the market value of the transaction (transfer pricing; TP).

Estonia has a non-exhaustive list of related parties. Persons are deemed to be associated if they have common economic interests or if one person has a dominant influence over the other. In all cases, the following shall be regarded as associated:

- Companies belonging to one group;
- Legal persons and natural persons owning at least 10 percent of the share capital, total number of votes or rights to the profits of the legal person;
- Legal persons where more than 50 percent of the share capital, total number of votes or rights to the profits belong to one and the same person or associated persons;
- Legal persons where all members of the management boards or the bodies substituting for the management boards are the same persons.

Applicable transfer pricing methods are:

- comparable price method;
- resale price method;
- expense method;
- distributed profit method;
- transaction yield method.

There is no compulsory hierarchy among these methods and it is up to the taxpayer to choose the method, but the choice needs to be appropriate. If the circumstances related to the transaction do not allow for using the above-mentioned 5 methods, another method may be used to determine the market value of the transfer price. Justification must be given for such use of another method.

All Estonian group companies and permanent establishments are obliged to prepare transfer pricing documentation. Exemption applies to small and medium-size enterprises (SME) unless they have conducted transactions with entities located in low-tax territories. A company or permanent establishment is considered an SME for TP purposes if its annual sales are less than EUR 50 million, the balance sheet is less than EUR 43 million and the number of employees is less than 250.

To implementation of transfer pricing rules a resident company is required to submit additional information on the transactions with associated persons, activities of companies belonging to the same group, and the structure of the group at the request of a tax authority. The tax authority must grant the company a term of at least sixty days to submit such information.

In Estonia, it is not currently possible to ask tax authorities for Advance Pricing Agreements (APA).

5 Anti-avoidance Measures

The main anti-avoidance measures in Estonia are as follows: substance over form principle, deemed transaction principle, transfer pricing provision, and from 1 November 2016, the mandatory general anti-abuse rule based on the EU Parent Subsidiary Directive changes approved by the ECOFIN Council in January 2015.

From 2016 on the exemption method can be excluded for payments of dividends received from a foreign subsidiary in cases where the exemption method was deemed to be abused. The explanatory material to the amendments gives an example of abuse – a situation where the subsidiary paying the dividends is established or acquired for no business reason other than to distribute the profit of the subsidiary in the form of dividends or payments from equity without paying taxes.

The other amendment concerns hybrid loans, which are considered to be loans in one country but capital contributions in another country. Previously, it was possible for certain payments related to hybrid loans to enjoy exemption in the country of the payer (where payments are deductible from taxable profit) and also in Estonia (where use of the exemption method was allowed). Since November, this kind of double non-taxation is no longer permitted.

The Estonian Income Tax Act is amended with following rule starting from November 2016 – tax exemption for dividend redistribution and capital reduction is not applied to transactions where the main or one of the main reasons is obtaining a tax advantage.

5.1 General Anti-avoidance Rule

The general anti-avoidance rule in Estonian taxation is the substance over form principle, according to which if it is evident from the content of a transaction or act that the transaction or act is performed for the purposes of tax avoidance, conditions that correspond to the actual economic content of the transaction or act shall apply for taxation.

Also, ostensible transactions shall not be taken into account upon taxation. If an ostensible transaction is entered into in order to conceal another transaction, the provisions concerning the concealed transaction shall apply for taxation.

5.2 Thin Capitalisation Rules

Estonia has no thin capitalisation rules. Interest deductibility is relevant in a situation where interest is paid to a related party in an amount not compatible with the arm's length principle, and which may therefore constitute hidden profit distribution.

5.3 Controlled Foreign Company Provisions

Estonia has no CFC rules. Still, all the payments to a person registered in a low-tax territory are subject to withholding income tax. Also, resident taxpayers are obliged to declare and pay income tax from their participations in persons in a low-tax territory.

6 Taxation of Individuals / Social Security Contributions

Individuals are subject to personal income tax and mandatory state social security contributions (SC).

6.1 Residency Rules

A natural person is an Estonian resident if at least one of the following requirements is met:

- the person's place of residence is in Estonia;
- the person stays in Estonia for at least 183 days over the course of 12 consecutive calendar months;
- the person is an Estonian state public servant who is serving abroad.

A person shall be deemed a resident as of the date of his or her arrival in Estonia.

6.2 Income Liable for Tax

Estonian tax residents are liable for tax on their worldwide income. Non-residents are liable for tax on their income derived from sources in Estonia. Taxable income includes both active and passive income. Most personal income is taxed on a gross basis (withholding at source), but capital gains and business income are taxed on a net basis.

6.3 Allowable Deductions

A resident natural person may deduct a non-taxable allowance of EUR 2,160 in 2017.

The minimum amount exempt from income tax is EUR 500 on a gross salary of less than EUR 1,200 a month until 2018. From a gross wage exceeding EUR 1,200 a month, the minimum amount exempt from income tax starts to decrease, and from EUR 2,100 the gross wage minimum exempt from income tax is 0.

Taxpayers can deduct their mortgage interest, training expenses and certain charitable gifts and donations too, up to EUR 1,200 per year, but no more than 50% of their taxable income.

Contributions to supplementary funded pension systems are deductible up to EUR 6,000 or 15% of taxable income. Mandatory social security contributions are fully deductible (unemployment insurance payments and mandatory funded pension payments).

The same deductions are available for certain non-resident individuals earning most of their taxable income in Estonia (75%).

6.4 Tax Rates

Income is subject to personal income tax at a general rate of 20%. Certain funded pension payouts are subject to 10% income tax.

6.5 Tax Compliance

Individuals have to file a personal income tax return by 31 March of the year after the income was received. Resident individuals receive an income tax assessment based on their returns, filed at least 30 days before the tax payment is due. Based on the tax assessment received from the tax authorities, resident individuals must pay the final amount of income tax due by 1 July of the year following the period of taxation. Resident taxpayers reporting business income or capital gains in their tax returns must pay the final amount of income tax due by 1 October of the year following the period of taxation.

Non-residents have to file personal tax returns by 31 March of the year after the income was received. Still, when transferring immovables, the income tax return shall be submitted after receiving the gains. If payments for a transferred immovable are made by instalment, a tax return concerning the agreed transaction price is also submitted within one month of receiving the first instalment.

6.6 Social Security Contributions

In Estonia, social tax is an employer obligation only. Employers pay social tax on payments in cash and in kind made to natural persons. Sole proprietors pay tax on their business income. Employers and sole proprietors are both obliged to pay social tax amounting to no less than the sum calculated from the monthly rate (in 2016, the minimum monthly basis for social tax is EUR 390). Sole proprietors also have an upper limit – calculated from the basis of fifteen times the minimum wage (in 2016 the minimum wage is EUR 430 per month, and the maximum basis for social tax payable by sole proprietors is thus 15 x 12 months x EUR 430).

The social tax rate is 33% (comprising a 20% social security contribution and a 13% health insurance contribution) and is paid by employers on top of gross salaries. From 2017 the social tax rate will be 32.5%, falling to 32% from 2018.

Social security contributions are declared and paid by the 10th of the following month together with CIT (in the same return, Form TSD). The taxable period for business income of sole proprietors is a calendar year, whereas quarterly advance payments of tax are due.

6.6.1 Unemployment Insurance

Estonia also applies an obligatory insurance system for unemployment. The aim of the unemployment insurance premium is to insure employees against unemployment, the collective termination of employment contracts or the insolvency of the employer.

The obligation to pay insurance payments is divided between employees and employers. Old-age pensioners and members of the company's management or supervisory body and sole entrepreneurs are not subject to unemployment insurance premiums.

Employers calculate and pay unemployment insurance premiums at a rate of 0.8% (employer's unemployment insurance premium) of the employee's gross earnings. In addition, employers are required to withhold and pay the employee's unemployment insurance premium at a rate of 1.6% of gross earnings from the employee's salary.

The tax is declared and transferred by the employer to the tax authority by the 10th of the following month (declared in the same return form as CIT and SC).

6.6.2 Mandatory Funded Pension Payments

The mandatory funded pension payment is a payment calculated from employees' gross income, which is used to fund the second pension pillar. Employers must withhold a funded pension payment from the employee's salary, declare and transfer it to the tax authority. Since not all employees have joined the funded pension, employers need to check with the Pension Centre to be sure that a funded pension agreement exists.

The mandatory funded pension payment rate is 2% or 3% of an employee's gross salary. Withheld payments must be paid to an employee by the 10th of the following month (declared in the same return form as CIT and SC).

7 Indirect Taxes

Estonia levies the following indirect taxes: VAT, excise duties and customs duty.

7.1 Value Added Tax / Goods and Services Tax

The European Union (EU) VAT Directive is implemented in Estonia through the Value Added Tax (VAT) Law (in Estonian: käibemaksuseadus).

Value-added tax is charged on all supplies of goods and services in the course of business activities and self-supply of goods and services. Goods are things, livestock, gas, electric power, heat and refrigeration. Services mean the provision, in the course of business activities, of benefits or transfer of rights, including securities, which are not goods. An obligation to refrain from economic activity, to waive the exercise of rights or to tolerate a situation for a charge are also regarded as services.

If the total value of taxable supplies exceeds EUR 16,000 (EUR 40,000 from January 2018) as calculated from the beginning of a calendar year, the person is obliged to register as a taxable person for VAT purposes from the date the supply reaches that amount. The application should be presented to the tax authority within 3 working days.

There is no registration threshold for foreign persons. If a foreign business with no fixed establishment in Estonia makes a taxable supply in Estonia, and such supply VAT is not payable by the customer (by applying the reverse charge mechanism), the foreign person is obliged to register as a taxable person for VAT purposes as of the date the taxable supply was made.

A taxable person of another EU country may appoint a fiscal representative, but this is not obligatory. A taxable person of a non-EU country, which has no fixed establishment in Estonia, must appoint a fiscal representative when registering for VAT. The standard VAT rate in Estonia is 20%. The reduced rate of 9% is applicable to the supply of books and workbooks used as learning materials, medicinal products, contraceptive preparations, sanitary and toiletry products, and medical equipment or medical devices intended for the personal use of disabled persons, periodic publications, excluding publications mainly containing advertisements or personal announcements, or publications whose content is mainly erotic or pornographic; and accommodation services or accommodation services with breakfast (from 1 January 2017 the applicable VAT rate for accommodation services is 14%).

VAT returns must be filed monthly. VAT returns should be submitted to the tax authority and VAT must be paid by the twentieth day of the month following the period of taxation. VAT returns must be submitted electronically, if the person has been a taxable person for at least twelve months.

7.2 Transfer Tax

There is no transfer tax in Estonia.

7.3 Others – Excises

Estonia applies excise duties on alcohol, tobacco, fuel, electricity and packages.

Alcohol

Excise duty shall be imposed on alcohol produced in Estonia, delivered from other Member States into Estonia or imported for release for free circulation in Estonia.

The excise duty is imposed on wine, beer, fermented beverages, intermediate products and other alcohol produced in Estonia or brought into Estonia. Alcoholic beverages with an ethanol content above 22% by volume and which are bottled in packages with a content of 0.05 litres or more must be revenue stamped. Revenue stamping means a special marking which conforms to special security requirements and is attached to excise goods or the sales packaging thereof indicating the payment of excise duty. Revenue stamps can be ordered from the Estonian Tax and Customs Board.

Tobacco
Excise duty is imposed on tobacco products produced in Estonia, transported to Estonia from another Member State or imported for free circulation.

Excise duty is imposed on smoking tobacco, cigarettes, cigars, cigarillos and chewing tobacco. Tobacco products must be revenue stamped before distribution. Revenue stamps can be ordered and excise duty is collected by the Tax and Customs Board.

Fuel
Excise is imposed on different kinds of liquid fuel, solid fuel and natural gas. In certain fields it is permitted to use fuel marked with a fiscal marker with a lower excise duty than usual.

Fuel is unleaded and leaded gasoline, aviation gasoline, petroleum, diesel fuel, a special diesel fuel, light heating oil, heavy fuel oil, shale oil and liquefied petroleum gas, coal, brown coal, coke and fuel-like products. Fuel, other than motor fuel, heating oil and fuels for various products like liquid combustible substances and biofuel, used, offered for sale or sold as motor fuel or heating fuel.

As a rule, a tax liability arises when importing excise goods outside an excise suspension arrangement, releasing them for consumption from an excise warehouse, and delivering excise goods subject to excise duty in another Member State of the EU to Estonia. Excise duty should be paid and declared by the 15th of the month following the month when the tax liability arises.

As a rule, entities must be registered at the Register of Economic Activities for handling the fuel released for consumption, and when selling such fuel, it is also required to provide a security deposit to the tax authority.

Electricity

Electricity has been taxed with excise duty in Estonia since 2008. Duty on electricity is paid by the companies that control the power networks, make transactions with, or produce the electric energy. Liability to pay excise duty on electricity arises when the electric power trader distributes electricity to the consumer.

Packages

Sales packaging, grouped packaging and also transport packaging are subject to excise duty. Excise duty shall be imposed on packaging upon the sale, exchange, transfer without charge, or use for self-consumption of packaging in Estonia. Excise duty is not imposed on packaging brought and exported into another Member State from Estonia.

Excise is paid by the importer of packages, by the user of packages, or by the person who acquired packaging from another Member State upon the sale, exchange, free transfer or use for self-consumption of packaging.

There is a possibility for payers of excise duty to transfer their obligations to recovery organisations established by the packaging undertakers and accredited by the Minister of the Environment.

8 Inheritance and Gift Tax

There is no inheritance or gift tax in Estonia. Transfers of title upon inheritance and donations, however, are subject to state duty and notary fees.

9 Wealth Tax

There is no wealth tax in Estonia.

10 Land Tax

Estonia applies a land tax. The taxation object is land without any buildings etc. and the taxable value is determined by the potential profitability. Land tax is paid by the owner of the land, in certain cases also by the user of the land.

The land tax rate is 0.1 - 2.5% of the taxable value of the land. The applicable tax rate is set by municipalities by 31 January each year. Land where economic activity is restricted by law is either exempt from tax completely or it is levied at 50% of the standard tax rate, depending on the nature of the restriction. Tax is paid once or twice a year on 31 March and 1 October.

11 Local Taxes

Estonia has given local municipalities the right to impose 6 local taxes. Local tax is imposed based on local municipality council regulations.

The 6 applicable local taxes are:

- advertisement tax;
- road and street closure tax;
- motor vehicle tax (not actually in use);
- animal tax;
- entertainment tax;
- parking charge (the most applied local tax).

Disclaimer

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