Tax Alert

Estonia, January 2024

PwC helps its clients in finding tax efficient business solutions and managing tax risks.

Our team of experts in Baltic States keeps you updated on most recent and most relevant changes in tax legislation. We work closely with our PwC colleagues 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.

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Tax changes from 01.01.2024

From 1 January 2024, **the standard rate of VAT in Estonia is 22%** instead of the current 20%. In connection with this amendment, the VAT Act contains two transitional provisions.

• Until 31 December 2025, provided that the goods or services supplied are subject to a standard VAT rate, the user of cash accounting of VAT may pay VAT at the rate of 20% on the supply of the goods or services generated after 31 December 2023 if an invoice was issued to the purchaser and the goods were dispatched or made available or the service was supplied before 1 January 2024.

• The second transitional provision concerns transactions relating to long-term contracts, in particular transactions relating to immovables. Until 31 December 2025, a taxable person will be entitled, on the basis of a written contract concluded before 1 May 2023, to apply the 20% VAT rate applicable on the supply of goods or services until 31 December 2023, provided that the relevant contract provides that the price of the goods or services includes VAT at a rate of 20% or VAT at the rate of 20% is added to the price and the contract does not provide for a change in the price resulting from a possible change in the rate of VAT.

Tax scheme

As of 1 January 2024, the concept of a tax scheme has been specified (subsection 19 of § 546 of the Income Tax Act).

A tax scheme is **a transaction or chain of transactions** which presupposes the existence of a tax mismatch or which is designed to create a tax mismatch. A transaction or chain of transactions which fulfils these conditions shall not be regarded as a tax scheme if it is reasonable to assume that the parties to the transactions did not have to be aware of the inconsistency and did not receive a tax advantage resulting from the tax inconsistency.

The wording ‘transaction chain’ in the current Income Tax Act indicates that the tax scheme consists of several transactions. The wording of the ATAD2 Directive may also constitute a tax scheme for a single transaction.

Income tax liability of hybrid unit

As of 1 January 2024, the wording of subsection 1 of § 548 of the Income Tax Act has been specified.

A trust fund or the fund manager thereof shall pay income tax on income which would have been attributed to a partner of the trust fund in proportion to its share in the trust fund if such income is not subject to taxation pursuant to subsection 11 or 12 of § 29 or legislation of another jurisdiction and if at least one partner of the trust fund is a non-resident related company who directly or indirectly owns at least 50% of the holding of the trust fund and who is located in a jurisdiction which considers the trust fund to be liable to income tax.

The amendment clarifies that 50% of the trust fund’s shareholding should be held by all related undertakings in total in accordance with Article 9a(1) of Directive 2016/1164 as inserted under Article 1(5) of the ATAD2 Directive. According to the current wording of the Income Tax Act, 50% of the trust fund's shareholding should be held by a single affiliated company.

Deductions from the income of natural persons

As of 1 January 2024, a natural person will no longer have the right to deduct from his or her taxable income:

• increased basic exemption upon provision of maintenance to child,
• increased basic exemption for spouse and
• housing loan interest.
This means that in the income tax return of a natural person:
• for the year 2023 submitted between February and May 2024, a person still has the right to make the deductions, but in the income tax return;
• for the year 2024 submitted between February and May 2025, the person will no longer have the right to make such deductions.

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The right to deduct from taxable income the following will remain:
• training expenses and
• donations
limited to 1200 euros in total and to no more than 50 per cent of the taxpayer’s income taxable in Estonia (subsection 1 of § 282 of the Income Tax Act).
The right to deduct contributions to supplementary funded pension (third pillar) in the amount of up to 15 per cent of the taxable income but not more than 6000 euros per year from taxable income also remains.

Funded pension

As of 1 January 2024, persons who have joined the II pillar will have the opportunity to increase their 2% funded pension contribution rate to 4% or 6% if they wish. For this purpose, a corresponding application must be submitted to the registrar of the pension register or to the account administrator (from 1 January 2024 until 30 November 2024), and the new contribution rate will be applied from 1 January 2025.

What's new from tax jurisprudence?

When is a board member responsible for the company’s tax debt?

2022, No. 3-20-2325.

The member of the board was given a liability decision in connection with the tax debt of the company he managed. The tax debt arose from the operation of the company and the declared tax liability.

• According to the tax authority, the board member is (relatively) automatically responsible for the tax debt and blamed him for (i) continuing business activities in the event of the risk of insolvency, switching to cash settlement and giving preference to other creditors, and (iii) tax debt.
• Result: The liability decision was cancelled.

Lessons:
• A board member is not jointly and severally liable for the company's obligations (including tax liability).
• The decision of liability cannot be made automatically to a member of the management board for the company's tax debt.
• The tax administrator must prove the intent or gross negligence of the board member in complying with tax laws.
• In a simplified way, a decision on liability can be submitted to the board if the purpose of this action is to avoid paying taxes.
• The tax administrator has a heightened obligation to provide reasons when preparing a decision on liability.
• In this case, the board member wanted to save the company's economic activity (gave a loan to the company, declared taxes correctly, etc.).

Market value of equity contribution

2023, No. 3-19-2244

The dispute concerned the price of equity contribution in a situation where equity contribution was made with equipment purchased two months ago, but it was worth eight times more than the purchase price of the equipment.
• The tax authorities did not accept the value of the contribution and taxed the difference as a transfer pricing adjustment.
• Result: The appeal was satisfied, the tax ruling was annulled, but the tax authorities have the right to make a new tax ruling, in which it can reduce the amount of the declared equity contribution (Income Tax Act Section 50 (4) vs. Section 50 (2)).

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Lessons:

- Section 50(4) of Income Tax Act is not applicable to the transaction of non-monetary contribution, because no income or expense is obtained from such a transaction.
- Capital contributions are taxed only when the capital is reduced on the basis of Section 50(2) of the Income Tax Act.
- Tax authorities have the right to adjust the values of the declared contributions with a tax decision, which, however, does not lead to business law consequences and does not affect the relations between shareholders.

EU Legislation

European Commission has issued a transfer pricing directive proposal

European Commission has issued a transfer pricing directive proposal which integrates key transfer pricing principles into the EU law with the aim of putting forward certain common approaches for Member States. The rationale of the proposal derives from the fact that almost all Member States are also members of the OECD and therefore committed to follow the OECD principles and recommendations. However, despite the political commitment by the majority of Member States, the status and role of the OECD Transfer Pricing Guidelines currently differs from Member State to Member State.

For example, domestic legislation of Member States shows differences in the definition of 'associated enterprises' and in particular, on the notion of 'control' which is normally the precondition to apply transfer pricing. Certain Member States apply a threshold of 25% while others apply a threshold of 50% shareholding when it comes to determining whether the control criterion is met. It translates into businesses facing tax uncertainty, high compliance costs as well as frequent, time-consuming legal disputes leading, amongst others, to considerable amounts of legal fees and creating barriers to cross-border operations and high risks of double and/or over-taxation.

The proposal aims at simplifying tax rules through increasing tax certainty for businesses in the EU, thereby reducing the risk of litigation and double taxation and the corresponding compliance costs and thus improve competitiveness and efficiency of the single market. The proposal would provide a gradual development of common and consistent approaches among Member States' tax authorities to the interpretation and application of transfer pricing rules through the incorporation of the arm's length principle into Union law and the clarification of the role and status of the OECD Transfer Pricing Guidelines. Furthermore, the prospect for establishing common binding rules for Member States on specific transactions within the framework of the OECD Transfer Pricing Guidelines should improve businesses' resilience in the Union, reduce distortions and contribute towards a level playing field in the single market.

Additional bureaucratic measures coming from the EU

In the future, Estonian entrepreneurs will have to annually assess whether their holding companies have sufficient economic substance and, if not, inform the tax authority about it. Namely, in January of this year, the European Parliament approved and sent the new tax directive (ATAD III) to the Council of Europe for approval and enforcement, which stipulates the requirements for the economic substance of companies. In the fight against tax evasion, the main purpose of the directive is to identify those shell companies that do not engage in real economic activity, but whose purpose is to create tax advantages and to deny them tax benefits resulting from directives and tax treaties.