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# Recent Developments in International Taxation

## Estonia

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Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, ATAD. Estonia was obligated to amend corresponding changes to domestic law till the end of 2018.

**1. Corporate income tax**.

1.1. Changes caused by the measures against income tax avoidance provided for by Council Directive 2016/1164.

A new article was added to the Income Tax Act:

- Article $5^1$ "An arrangement put into place for the purpose of obtaining a tax advantage"

and new Chapter $10^1$ which includes five new Articles:

- Article $54^1$ "Income tax on an arrangement put into place for the purpose of obtaining a tax advantage"
- Article $54^2$ "Income tax on exceeding borrowing costs"
- Article $54^3$ "Income tax on the profits of a controlled foreign legal entity"
- Article $54^4$ "Declaration and payment of income tax"
- Article $54^5$"Exit taxation (becomes effective on January 1, 2020)

General anti-abuse rule

According to a new anti-abuse rule (Article $5^1$ of the Income Tax Act), for the purposes of income taxation, there shall be ignored an arrangement or a series of arrangements,

1. the main purpose or one of the main purposes of which is to obtain a tax advantage that defeats the object or purpose of the applicable tax law or international agreement, and
2. which is not genuine having regard to all relevant facts and circumstances.

**For this rule to be applied, both criteria must be met.**

A series of arrangements may comprise more than one intermediate step or part (paragraph 1 of Article $5^1$ of the Income Tax Act). An arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality (paragraph 2 of Article $5^1$ of the Income Tax Act). Valid commercial reasons are all other significant circumstances apart from circumstances related to taxation.

A tax advantage is allowed, if having regard to all valid commercial circumstances an arrangement or a series thereof would also have been put into place without obtaining any tax advantage. A tax advantage is not allowed, if having regard to all circumstances an arrangement or a series thereof would not have been put into place if no tax advantage had been obtained.

- Article $5^1$ of the Income Tax Act establishes the general anti-abuse rule. According to this rule, for the purposes of income taxation, there shall be ignored an arrangement or a series of arrangements the main purpose or one of the main purposes of which is to obtain a tax advantage that defeats the object or purpose of the applicable tax law or international agreement, and which is not genuine having regard to all relevant facts and circumstances;
- paragraph $1^4$ of Article 50 of the Income Tax Act is abolished, which up to now has regulated dividend taxation schemes created for the purposes of obtaining tax exemptions;
- Article $54^1$ of the Income Tax Act is introduced, which regulates the taxation of an income not earned at the result of schemes created for the purposes of obtaining a tax advantage.

The purpose of these rules is to introduce the above changes occurring in the way of thinking/viewing at the international level into the tax policy and legal framework of Estonia. The limits of the legal optimization of taxes are being narrowed and a greater focus is being placed on obtaining any tax advantage and not only on tax avoidance.

**Article $54^1$ of the Income Tax Act** regulates the application of the general anti-abuse rule with respect to the taxation of income of a legal entity from among residents. If it has been established that an arrangement or a series of arrangements had taken place

- the main purpose or one of the main purposes of which is to obtain a tax advantage that defeats
- the object or purpose of the applicable tax law or international agreement, and
- which is not genuine having regard to all relevant facts and circumstances, and
- as the result of which a taxpayer loses its income or incurs exceeding costs, then

the income tax shall be imposed on the amount which the taxpayer would have earned as an income, or on the amount which the taxpayer would not have incurred as costs, if there had been no arrangement or series of arrangements that meet the criteria mentioned in Article $5^1$ of the Income Tax Act.

**Article $54^2$ of the Income Tax Act "Income tax on exceeding borrowing costs"**
In accordance with paragraph 1 of Article $54^2$ of the Income Tax Act, the income tax shall be imposed on exceeding borrowing costs of an Estonian resident legal entity other than a financial undertaking which exceed

1. an amount of EUR 3 000 000, and
2. 30 percent of the earnings of an Estonian resident legal entity before interest, tax, depreciation and amortization (EBITDA),

in respect of the part which exceeds the losses of a legal entity, except to the extent that:

1. a resident legal entity is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment, or
2. a loan is used to fund a long-term public infrastructure project where the project operator, loan, assets and income are all in the Union, or
3. a resident legal entity which is part of a consolidated group for financial accounting purposes chooses to apply paragraph 8.

Thus, the income tax on exceeding borrowing costs shall not be paid by a financing undertaking and a legal entity which is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment or if a loan is used to fund a long-term public infrastructure project.

**Article $54^3$ of the Income Tax Act "Income tax paid on the profits of a foreign legal entity controlled by a Estonian resident legal entity"**
The profits of a foreign controlled legal entity

- resulting from the use of such assets and the assumption of such risks as associated with key employees of the controlled legal entity and
- arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage shall be attributed to a resident legal entity and taxed as profits (paragraph 1 of Article $54^3$ of the Income Tax Act).

The profits of a foreign controlled legal entity which are attributed to a resident legal entity shall be calculated in accordance with the market value principle. An arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a legal entity where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled legal entity's income (paragraph 2 of Article $54^3$ of the Income Tax Act).

**Article $54^5$"Exit taxation (becomes effective on January 1, 2020)**
The income tax shall be imposed on an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes, if a resident legal entity transfers

assets to its permanent establishment in another EU member state or in a country which is not a EU member state (paragraph 1 of Article $54^5$ of the Income Tax Act).
The income tax shall not apply to asset transfers related to the financing of securities, or where the asset transfer takes place in order to meet prudential capital requirements or for the purpose of liquidity management. (paragraph 2 of Article $54^5$ of the Income Tax Act).
A taxpayer shall be given the right to defer the payment of the income tax by paying it in installments over five years, in any of the following circumstances:

1. a resident legal entity transfers assets to its permanent establishment in another country that is party to the Agreement on the European Economic Area; or
2. a resident legal entity becomes a resident in another country that is party to the Agreement on the European Economic Area (paragraph 3 of Article $54^5$ of the Income Tax Act).

The terms of paying in installments are set forth in paragraphs 4-7 of Article $54^5$ of the Income Tax Act.

### 1.2. Dividends

Since the beginning of this year, a decreased income tax rate of 14% has been applied in respect of dividends. The standard tax rate is 20%. The new tax rate will be applied to dividends paid since 2019 and later.

The 14% corporate tax rate is applied in Estonia in accordance with the following principles:

- The decreased rate is applied to the average amount of the distributed income for the last three years. Anything beyond that is subject to a 20% tax rate.
- Dividends from subsidiaries and profits from foreign representative offices will not be included in the calculation of the decreased tax rate.
- Any dividends paid to individuals (including non-resident individuals) from the profits of an Estonian company at the decreased tax rate are taxed with an additional 7% income tax. For non-residents, the corporate tax rate in Estonia is determined in accordance with an existing tax agreement. Accordingly, this change will not decrease the tax burden for shareholders.
- In 2019, the decreased tax rate will be applied to 1/3 distributed income for 2018. In 2020, to 1/3 distributed income for 2018 and 2019.

## 2. VAT

2.1. On January 1 and February 1, 2019, amendments to the Value-Added Tax Act become effective, extending the scope of persons who have the right to declare in their turnover declaration the value-added tax calculated on imports of goods, and simplifying the terms of use of that right. The value-added tax is not paid, but is declared as a due import tax. Importers get a simpler opportunity of using import reverse taxation**.**

2.2. On January 1, 2019, an amendment to the Value-Added Tax Act becomes effective, enabling **small businesses which provide cross-border digital services to apply taxation rules of the country where they are located.** A threshold of EUR 10 000 is established for the services rendered for cross-border services where the country of residence of a consumer is regarded as a place where the turnover has emerged. Until the limit is reached, a company has the right to comply with the rules of its member state of registration. Billing rules are simplified for services of electronic communication and electronic services which are taxed using a special VAT scheme.

2.3 On January 1, 2019, amendments to the Value-Added Tax Act become effective, establishing the **notion of a "voucher"** and the moment **when a voucher-related turnover emerges in respect of goods alienated or services provided**. The Value-Added Tax Act distinguishes between monofunctional and multifunctional vouchers. In the former case, the turnover emerges when a voucher is sold, and in the latter, when it is exercised.