



# Estonian tax overview

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**The Taxation Act is one of the most important laws of the Estonian tax system. The main principles of the legal regulation of taxation, such as the various procedures for paying taxes, submitting tax returns, the main pre-trial procedure for resolving disputes concerning taxes, an exhaustive list of taxes and the rights and obligations of taxpayers and tax authorities are all provided in the Taxation Act.**

The Taxation Act, adopted in 2002, has become the foundation of the tax system in Estonia. The Estonian tax system is made up of state taxes and local taxes. State taxes include: income tax, value-added tax, social tax, land tax, gambling tax, customs duties and excise duties (including heavy

goods vehicle tax). Local authorities are authorised to impose local taxes, including: sales tax, motor vehicle tax, boat tax, entertainment tax, parking charges and other similar taxes.

According to the Taxation Act, the 'substance over form' rule is applicable in Estonia. The tax obligations depend on the economic substance of the transaction rather than on its chosen legal form. Although this principle was implemented earlier, pursuant to the precedent set by the Supreme Court of Estonia, it was introduced expressis verbis in the latest Taxation Act, which came into force in 2002.

According to the Estonian constitution, general administrative rules and the Taxation Act, the

following main principles of taxation are implemented in the Estonian tax environment:

- The principle of legality – tax liability can only arise from the law directly and not from the regulations subordinated to law;
- The principle of equality – every person in the same situation has to be treated equally;
- The principle of proportionality – the actions of the state have to be in correlation with the requested objective and they cannot distort the substance of the rights and freedoms concerned. Unauthorised intervention into the sphere of the rights of the individual has to be prevented and every taxpayer is under the protection of the state against such unauthorised intervention;
- The principle of legal certainty – retroactive (*ex tunc*) application of tax laws is not allowed in case the retroactive application increases the tax liability. The taxpayer is entitled to expect that the laws shall remain valid.

## Income tax

In 2000, Estonia introduced an entirely new corporate income tax

regime, according to which the earned profits of a legal entity were not subject to taxation unless they were distributed to the shareholders. Whether reinvested or merely retained, earned profits were taxable only if they were directly or indirectly distributed for personal use or transferred abroad (distribution tax). Today, the system has altered slightly and income tax is imposed on earned profits at the time of their distribution, regardless of whether the beneficiary is a resident, non-resident, corporate entity or individual. There are also special provisions to avoid double taxation when distributing profits through several legal entities.

## Companies

Corporate taxpayers pay income tax on their distributed profits as well as on hidden profit distributions. In particular, income tax is charged on the following:

- Employee fringe benefits;
- Gifts, donations and entertainment costs;
- Dividends and other profit distributions and adjustments;
- Expenses and other payments not related to the taxpayers' business.

Currently the tax rate is 23/77th of the net amount of distributed profit (which constitutes 23% of the gross payment). The rate of the distribution tax will be reduced to 22/78th for 2007, 21/79th for 2008 and 20/80th for 2009 (22%, 21% and 20% of the gross distribution amount respectively).

Resident legal persons and registered permanent establishments of foreign entities (branch offices) are subject to corporate income tax. The taxable period for corporate income tax is one calendar month, with tax returns due and taxes to be paid to the bank account of Estonian Tax and Customs Board on the tenth day of the month following the taxable period.

In addition to the distribution tax described, there is also a 23% rate withholding tax on dividends that is mostly applicable to non-resident corporate shareholders holding less than 20% (15% valid from 1 January 2007) of the shares or votes in the distributing company.

## Individuals

Resident individuals pay income tax on their worldwide income.

The main principle is that the taxpayers are allowed to make deductions that are needed for earning a taxable income. Deductions are not allowed from the income derived from employment. The tax rate of the earned income is usually currently 23% of the taxable amount and it shall continue diminishing by 1% per year until the rate of 20% in the year 2009.

The taxable period is a calendar year in general; in some cases, income tax has to be withheld by the person making a payment (eg income of the employees). The taxable period for the income tax of registered entrepreneurs is one year, with no exceptions; the tax returns are to be submitted to the Tax and Customs Board by 31 March of the year following the taxable period. Income from which the income tax has already been paid (special object of income tax – on profit distribution, fringe benefits, gifts, donations, etc) is not considered taxable income of a resident natural person and is exempted from income tax.

## Value added tax

Estonia has managed to implement most of the principles

specified in the Sixth Council Directive 77/388/EEC of May 17, 1977 on the harmonisation of the laws of the member states relating to turnover taxes: common system of value added tax: uniform basis of assessment.

## Obligation to register

Persons with a turnover of EEK250,000 (approx €16,000) per calendar year are obligated to register themselves as VAT-liable, which gives them the right to deduct input VAT from registration onwards. Voluntary registration is also possible if the relevant application is submitted to the tax authorities and the businesses activities (whether in the past or in the future) are disclosed. The tax authorities may refuse to register the person as VAT-liable if additional evidence of business activities is not submitted.

The taxable period is one calendar month. A VAT-liable person is required to submit monthly VAT returns by the 20th day of the month following the taxable period.

It is possible to register a person VAT-liable with limited liability. The aforementioned registration is needed for easier administration of

the reverse charge mechanism of VAT. There is an obligation to register a person as a limited VAT-liable person in case the value of the goods of intra-Community acquisition exceeds EEK160,000 (approx €10,300).

## Tax rates

The standard VAT rate is 18%. The reduced rate of 5% is applied to books, newspapers, certain pieces of medical equipment, certain tickets to cultural events, accommodation services and a few more goods and services of social nature. 0% tax rate is applied to exported goods, services of which the place of supply is not Estonia and certain services concerning international transportation.

A considerable amount of services are exempt from VAT, including health services, postal services, particular social services, insurance services and financial services. By default, the sale and rental of real estate, securities and the turnover of financial services are also exempt, although VAT may be added to this turnover if certain requirements have been met.

Unlike the goods and services exempt from VAT, the 0% rate goods and services allow the

taxpayer to deduct the respective amount of input VAT.

## Social tax

The object of this taxation is that the payments made by an employer to individuals (ie fringe benefits etc) are taxed. The current tax rate is 33% of the gross payment. Sole proprietors calculate the amount of their social tax due on yearly basis and submit the declarations by 31 March following the taxable period.

## Unemployment payments

The purpose of this payment is very similar to that of social tax. Currently, the employer is required to withhold 0.6% of the remuneration paid to employees (from which social tax is calculated) and pay 0.3% of their own. The payments are forwarded to an Unemployment Insurance Fund that provides social guarantees (unemployment insurance payments) for persons who become unemployed.

Unemployment payments are declared and paid once a month, together with income tax and social tax. Sole proprietors and legal representatives of the companies (members of the management board and supervisory council) are

exempt from the unemployment payments and they are not covered by the unemployment insurance.

## Funded pensions

Tax-resident employees in Estonia have an obligation to make payments to the mandatory pensions fund to the amount of 2% of the remuneration received. The employer has an obligation to withhold the respective amount from the remuneration and forward the payments to the tax authorities, who forward the payments to the pension fund. This is solely the obligation of the employer and the employee is not liable for making the payments. The taxable period is one calendar month and the sums have to be declared together with the social tax and unemployment payments.

## Excise taxes

Excise taxes are imposed on certain kinds of goods, such as alcoholic beverages, tobacco and fuel.

## Land tax

Land tax is levied on the land owned by a taxpayer. The amount of tax to be paid is usually in correlation with the value of the land. The tax rate is 0.1% to 2.5%

per year of the assessed value of the land.

## Future developments

**Income Tax:** Corporate income tax (distribution tax), as described in the companies section of this overview, has been found to be in breach of the Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (EC Parent-Subsidiary Directive, 90/435/EEC) regarding the distributions of profit to parent legal entities in EU member states. After Estonia's accession to the EU on 1 May 2004, Estonia was granted a transitional period to harmonise its income tax regime with the EC Parent-Subsidiary Directive by the end of 2008. Although it appears that this can only partly be achieved by amending Estonian income tax regulations, there are political discussions going on to re-introduce the previous tax regime by imposing the income tax on earned profits instead of the current system where only distributed profits are being taxed. As the discussions are at a very early stage at the moment, it is impossible to assess more precisely whether, or to what extent, such

adjustments of the corporate income tax regime may be implemented in the near future.

**Advance rulings:** Currently both resident and non-resident taxpayers have been able to ask for non-binding guidelines on most aspects of taxation but it is impossible to request a binding ruling in advance from the tax authorities. Due to several recent cases and precedents, the need for binding advance rulings has increased significantly amongst taxpayers in Estonia. The Ministry of Finance is said to have been considering the possibility of implementing the regulation for legally binding advance rulings in all taxation matters. As the idea itself is at quite an early stage, the Ministry of Finance has not agreed to comment on their intentions any further.

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LUIGA MODY HÄÄL BORENIUS



**Law Office Aivar Pilv** is among the leading Estonian firms for tax issues; the Customs and Tax Board receives regular advice from this firm on interpretation of tax law. The firm has thorough expertise in this area and has contributed to the development of judicial practice on several principal issues. Recognised lawyers include sworn advocates Aivar Pilv, Erki Kergandberg and Margus Lentsius.

**Lepik & Luhaäär LAWIN** offers extensive experience, having handled a number of complex international issues. Tax specialist Rolan Jankelevitsh offers comprehensive expertise. The tax department at the firm recently advised

the Estonian government in a dispute with the European Commission regarding surplus sugar stocks. Esteemed clients include Hoffman-La Roche and Electrolux.

Marti Hääl of **Luiga Mody Hääl Borenius** is one of Estonia's top tax law experts. Tax litigation is a key practice area at the firm, gaining it remarkable recognition. Several significant cases have been secured in court against the Estonian Tax Board. Last year the firm acted on behalf of a leading Estonian investment bank in carrying out complex analysis of alternative investment structures covering the local and international taxation structure and recommending the optimal fund structure.

The addition of tax expert Luc Nijs in 2005 significantly upped

## THE TDH RATINGS – ESTONIA

Aivar Pilv, Law Office

Lepik & Luhaäär LAWIN ①

Luiga Mody Hääl Borenius ①

Sorainen Law Offices

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Aare Raigi Advokaadibüroo

Aavik, Arvisto & Partners, Law Office

Hedman Osborne Clarke Alliance

HETA, Advokaadibüroo

Hough, Hübner, Hütt & Partners

Keevallik & Partners, Law Office

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continued

the profile of **Sorainen Law Offices'** tax department. Last year the firm provided pan-Baltic advice to a capital markets provider on tax issues related to stock borrowing and equity derivatives. The firm also advised a real estate investment company on tax planning for the acquisition of hotels.

Lawyers at **Aare Raigi Advokaadibüroo** have developed in-depth expertise in Estonian tax laws and partner Aare-Heino Raig is renowned in this arena. A significant transaction last year involved representing a large Estonian bank in a dispute with Estonian tax authorities. Clients believe the firm 'understands the big picture and the social implications and developments of business'.

**Hedman Osborne Clarke Alliance** offers experienced, multi-lingual tax services to domestic and foreign clients. Mari-Liis Liinat is an adept tax lawyer.

**Law Office Keevallik & Partners** endeavours to provide sophisticated legal services and has increased its tax-related work in the past year advising both corporate and private clients. The firm is constantly growing with new areas of expertise appearing

every year and a rapidly increasing client base.

**Lextal Law Firm** showcased its tax capabilities last year when representing a client against the tax authorities in a highly significant transaction. The firm impresses clients with its 'rapid turnaround skills and extremely good accessibility'.

**Advokaadibüroo Paul Varul** offers a specialised tax service. The busy department is headed by partner Helmut Pikmets who has more than 14 years of experience. The firm is able to work in an advisory capacity as well as having excellent litigation skills. Clients assert the firm 'has a good reputation and public image and shows outstanding competence'.

Asko Pohla and Taimar Ehrlich represent clients in tax disputes and planning at **Pohla & Hallmägi**.

**Law Firm Straus & Partners** is adept in tax practice. Last year partner Priit Lätt represented a large foods company in a high-profile case involving the Estonian Customs and Tax Board. Lätt has also been actively involved in disputes over the post-clearance recovery of import duties. Clients praise the firm's punctuality and thoroughness.

## THE TDH RATINGS – ESTONIA CONTINUED

Lextal Law Firm

Paul Varul, Advokaadibüroo

Raidla & Partners

Rödl & Partner ⓘ

Straus & Partners, Law Firm

Tark & Co

Teder, Glikman & Partnerid, Law Firm

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Firms are listed A-Z in tiers which are ranked in order of priority  
 ⓘ indicates that firms are listed in the directory section

**Tark & Co** boasts outstanding tax expertise. The firm counsels clients on all Estonian tax-related issues including tax planning and due diligence. The firm co-operates with **Baker & McKenzie LLP**, the Tax and Customs Board and the Ministry of Financial Affairs.

**Law Firm Teder, Glikman & Partnerid** advises clients on complex tax cases, working closely with national tax and customs authorities and aiming to provide the most current information on customs and tax policies.

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Chair of tax practice **Rolan Jankelevitsh**

Lepik & Luhaäär LAWIN is one of the leading and largest law firms in Estonia and the Baltic States. The firm advises in all major fields of business law and is distinguished by the excellence of its services, extensive experience and leading specialists in Estonia. The firm's specialists work in five practice groups: corporate and M&A; finance and tax; property and environment; trade and technology; dispute resolution and transport.

The firm is a member of LAWIN, a group of leading Baltic law firms that also includes Klavins & Slaidins LAWIN from Latvia and Lideika, Petrauskas, Valiunas ir partneriai LAWIN from Lithuania. With a team of around 90 lawyers, LAWIN is one of the largest legal presences in the Baltic States. All three firms are universally recognised as first-tier firms in their jurisdictions in all relevant areas of law.

The firm has the honour and responsibility of representing some of the world's leading companies in connection with their operations in Estonia across a wide range of industries. Clients include Coca-Cola, UBS, Deutsche Bank, Merrill Lynch, AT&T, General Electric, Electrolux, International Capital Markets Association, Schering Plough, Statoil and many others.

### Tax practice

The firm represents clients in a wide variety of aspects related to taxation, including tax planning and development of specific tax structures and project evaluation on legal and financial aspects, in order to diminish, within the legal framework, tax exposures on investments, mergers and acquisitions.

The tax practice includes tax litigation in Estonian courts and abroad, as well as the handling of complex international taxation issues. The firm has established an effective day-to-day co-operation with the Estonian tax authorities.

The tax department of Lepik & Luhaäär LAWIN has been engaged in numerous large-scale projects. In 2005, the tax department advised the Estonian government in the dispute with the European Commission regarding the potential fine for surplus sugar stock.

The tax practice of the firm is chaired by attorney-at-law Rolan Jankelevitsh. Rolan Jankelevitsh has advised several multinational companies on taxation issues related to the restructuring of their activities in Estonia. He has lectured its clients, as well as tax authorities, on several issues of international taxation.

LEPIK&LUHAÄÄR | LAWIN

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In August 2005, the attorneys of law offices Luiga, Mugu & Borenius and Mody & Hääl Glimstedt merged to form the office Luiga Mody Hääl Borenius, having operated separately since 1998. The firm has been constantly growing ever since the merger and is now working with more than 30 attorneys, being one of the largest law offices in Estonia.

Attorneys-at-Law Luiga Mody Hääl Borenius offers advice on all basic matters of business and corporate law. The majority of the firm's clients comprise investment banks, credit institutions, private equity funds, real estate funds, domestic and international retail, industrial, construction and transport (aviation, maritime, railways etc) companies.

The firm is highly valued in the field of M&A, banking/finance and taxation matters due to the long experience and excellent experts practising in these areas. English is the main working language of the office, in addition to Estonian but service is also provided in Russian, Finnish, French and German.

Luiga Mody Hääl Borenius continues to work in alliance with one of the oldest and biggest law firms in Finland, Borenius & Kemppinen. The alliance also includes Liepa, Skopina/Borenius in Latvia and Foigt & partners/Regija Borenius in Lithuania.



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Head of tax practice **Reidi Strandberg**

Rödl & Partner is one of the leading German professional service firms, specialising in the areas of auditing, tax consulting, legal consulting and business consulting.

The firm is one of the few consulting firms that has grown into a global force on its own. Today it is a strong, independent firm, able to provide its clients with sound solutions, even for complex problems.

The firm's dynamic development began in 1977, when Dr Bernd Rödl opened the first office in Nuremberg, Germany. Today Rödl & Partner is represented in all the major industrial nations of the world and the firm has succeeded in establishing solid market positions in Europe, Asia and the US. Rödl & Partner offers its services at 71 locations in 31 countries worldwide, and has over 2,400 employees.

Rödl & Partner has been located in the region surrounding the Baltic since 1993. In the course of the integration of the Baltic States into the world economy and the high inflow of direct investment from abroad, the states around the Baltic have gradually developed into a tightly-knit market. The importance of the region, in both political and economic terms, has grown strongly over recent years.

The office of Rödl & Partner in Tallinn was established in 1993. Today it has more than 30 multi-lingual experts who work in teams to provide an all-round consulting service, covering all legal, fiscal and auditing matters. The firm's knowledge of the region, combined with its widespread international knowledge and uniform standards, allows Rödl & Partner to provide its clients with the highest standard of service possible.

The multi-cultural network existing between the experts in the firm's main offices in Nuremberg and co-workers in other regions provides clients with unlimited transnational expertise, allowing successful co-ordination of internationally expanding clients, at home and abroad. Rödl & Partner's knowledge and multinational experience offer clients the assurance that they are in competent hands.

Rödl & Partner combines both domestic and international expertise, delivering quality service in the following areas:

- Auditing
- Tax consulting
- Accounting
- Legal consulting
- Business consulting

## Rödl & Partner