Tax&Legal Highlights

Estonia

Amendments to the Income Tax Act

On 1 January 2019 new version of the Income Tax Act came into force. The law is supplemented with a new chapter, where are provided measures against tax avoidance arising from the Directive 2016/1164.

The new chapter contains four new paragraphs, which are as follows:

- income tax on a transaction for tax advantage;
- income tax on an exceeding borrowing cost;
- income tax on profits of a foreign controlled company;
- exit tax.

Firstly, for the purposes of calculating the corporate tax liability of a resident company, transactions or chains of transactions which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances, and therefore should be ignored. These transactions may consist of more than one step or part.

Secondly, resident company's exceeding borrowing cost is taxed as expenses not related to business. Financial undertakings are excluded from the provision. The following three criteria are taken into account in assessing whether loan interest is excessive or not:

- **Does the exceeding borrowing cost exceed EUR 3 000 000?** If not, then company does not have to pay income tax and there is no need to analyze the following criteria.
- If the exceeding borrowing cost exceeds EUR 3 000 000, **does the exceeding borrowing cost exceeds 30% of the EBITDA**? If not, then company does not have to pay income tax. If the exceeding borrowing cost exceeds 30% of EBITDA, it must be checked whether the company is in profit or loss.
- **Profitability of the entity paying interest.** If the company is profitable, then the income tax will have to be paid on exceeding borrowing cost, that exceeds EUR 3 000 000 and 30% of the EBITDA. If the company has incurred loss and exceeding borrowing cost, what is bigger than EUR 3 000 000 and 30% of the EBITDA, but does not exceed loss, then there will be no income tax on it. If the exceeding borrowing cost, that is bigger than EUR 3 000 000 and 30% of the EBITDA, exceeds loss, income tax is paid on the excess part of the loss.

Thirdly, the portion of the profits of a foreign controlled company resulting from the use of such assets and the assumption of risks associated with key employees of the controlling company, which are derived from seemingly the principal purpose of obtaining a tax advantage, are attributed to the resident company and taxed as profit. The profits of the foreign controlled company attributed to the resident company are calculated in accordance with the market value principle. A foreign controlled company is a permanent establishment or entity, where the resident company by itself or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity.

Exit tax legislation will apply in Estonia from 1st January 2020. The difference between the market value and the carrying amount of the asset to be exported is subject to income tax when the asset is taken out of Estonia and if the resident company moves the property to another Member State of the European Union or to a permanent establishment in a third country.

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