



Tax&Legal Highlights

Estonia

New lease standard may bring additional obligations

IFRS 16 is a new lease standard, which requires lessee to recognize right-of-use assets stipulated in lease contracts on its balance sheet as when signing lease contracts, the lessee gains the right to use the leased assets (assets user rights as immaterial assets) and associated liability arises for payments to lessor for using the asset (liability arises from right to use).

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Exception applies to assets with acquisition costs under 5000 dollars (the value is measured as the asset would be new/unused) and to short-term assets (under 12 months). The new standard will be effective as of 1st of January 2019 or later together with possible transitional measures. Currently it is not known when the new standard will be implemented to Accounting Standards Board guidelines (Estonian financial standard). Many Estonian companies already prepare reports based on IFRS (EU), for example subsidiaries of international groups, who prepare accounting according to Estonian financial standard, but group reporting based on IFRS.

The new lease standard will most likely affect a lot of companies operating in Estonia. Even though terms "operating lease" and "financial lease" will be replaced with single term "lease" in financial reporting, then from value added taxation perspective the economic content of the transaction and type of lease remain important. Therefore, in case lease transaction is considered as a financial lease (regarded as supply of goods) according to Estonian VAT Act, then VAT is paid upon the transaction and in case of operating lease (regarded as supply of service) on a monthly basis. The new lease standard may also bring detailed transfer pricing documentation preparation obligation. Estonian regulation No. 53 issued by Estonian Ministry of Finance on 10th November 2006 "Methods for determining the value of transactions conducted between associated persons" (hereinafter the Estonian Regulation) §18 stipulates the transfer pricing documentation obligation for following companies:

- for a resident credit institution, insurance undertaking and company listed on a stock exchange;
- if one transaction party is a person situated in a low tax rate territory;
- for a resident business association or nonresident being active in Estonia via a permanent establishment, having together with its related persons 250 or more employees including related persons, or having a turnover or 50 million Euros or more including related persons in the financial year preceding the transaction, or having a consolidated balance sheet total of 43 million Euros or more.

As companies balance sheets will increase due to new lease standard, then it is essential to monitor whether consolidated balance sheet equals or exceeds the value of 43 million euros. In case the criteria is met, then detailed transfer pricing documentation needs to be prepared based on requirements stipulated in the Estonian Regulation (§ 18). Thus, it is important to consider and analyze in an early stage how the new standard could affect companies and consult with specialists if necessary.

Estonian tax authority released new guidelines

As of January 2018, the Income Tax Act amendments came into force and the Estonian Tax authority will now have more specific grounds to tax the loans granted by Estonian companies to their parent or sister companies, in cases where circumstances indicate that in substance the loan may be a hidden profit distribution.

New Income Tax Act also includes obligation to declare quarterly information on loans granted to the related parties as well as monthly reporting obligation about hidden profit distribution.

The guidelines are, at the moment, only in Estonian and could be found here: <https://www.emta.ee/et/ariklient/tulu-kulu-kaive-kasum/muudatused/varjatud-kasumieraldise-maksustamine-alates-1-jaanuarist>

Tax amendments regarding sole proprietors

The Law on Amendments to the Social Tax Act and the Income Tax Act announced at the end of the year 2017, will create a more favorable tax environment to the sole proprietors (FIE). For example, the maximum limit on the social security contributions required to be paid by sole proprietor is reduced to a factor of 10 times the minimum monthly salary of a tax year; sole proprietors have the right to deduct the cost of entertaining guests on the same basis as businesses; sole proprietors may deduct the amount of expenses exceeding the current period's business income from the future business income up to nine subsequent tax periods; and the amount of social tax that exceeds the taxable business income will be transferred to the following tax periods.

VAT act states a new threshold for mandatory registration as VAT taxable person

As of year 2018, the obligation to register as VAT taxable person arises, when taxable supply carried out by a person exceeds 40,000 euros (until the end of 2017 the threshold was 16,000) as calculated from the beginning of a calendar year. Also, some specifications are made on what is considered as taxable supply. The main reason for the change is to support the business activities of relatively high number of small businesses in Estonia by reducing the administrative burden of preparing and submitting VAT returns. Still, taxpayers may voluntarily register as a VAT liable before exceeding the threshold.

Tax treaty ratified between Estonia and Kyrgyz Republic

Agreements between the Government of the Republic of Estonia and the Government of the Kyrgyz Republic; and between Japan, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income were ratified in the end of December 2017.

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