Tax alert

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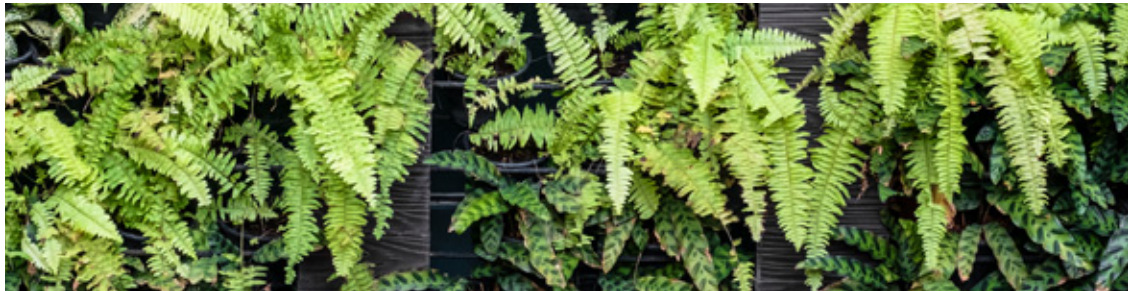
AS PricewaterhouseCoopers in Estonia helps clients in finding tax efficient business solutions and managing tax risks.

We work together with our colleagues in other PricewaterhouseCoopers' offices 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. For more information, please see our contact details below.



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Commercial Code Amendment Act (transfer of a shareholding)

In March 2020, the Parliament of Estonia passed the Commercial Code Amendment Act, with the purpose to simplify the sale of shares in a private limited company (OÜ) and to eliminate unnecessary restrictions and formal requirements.

The law enters into force on 1 August 2020. The main changes are as follows.

The minimum value of a share is reduced by 100 times.

Currently, the minimum value of a share in private limited company is 1 euro, starting from August 1 cent. Under the current regulations, every euro gives a vote, then in the future every 1 cent will give a vote. Thus, if before 1 August 2020 a share with a nominal value of EUR 1 gives 1 vote, then after that the same part gives 100 votes.

Of course, the value of a share may be more than 1 cent in the future, but it must be a multiple of 1 cent (currently a multiple of EUR 1). This means that in the future, for example, a share with a value of EUR 500.50 is allowed, but it is not allowed to "cut the cent in half" – so a share with a value of 20.5 cents is not allowed (it must be rounded down or up to a whole number). If currently 3 shareholders wanted to establish a private limited company in which each would have 1/3 of the shares, then this could not be done with the minimum capital (EUR 2500), because the value of the share can only be a multiple of the euro, which would not be fulfilled with such share capital (2500/3 = 833,33). At the same time, solving this problem is easy, because a slightly larger amount can be added to the share capital, which when divided by three gives a multiple result (2502/3 = 834).

Lowering the minimum value of a part provides significantly more flexibility in determining the size of the parts and thus avoids the need for rounding. According to the explanatory notes to the draft law, the amendment is necessary particularly in cases where it is desired to grant participation options to employees / management or to raise capital in the form of convertible bonds or loans.

Flexibility is evident, for example, in the following. If the shareholders of private limited company with a minimum capital (EUR 2500) would like to involve employees in the circle of shareholders to motivate them through option agreements, then in any case the employee should receive a share of at least EUR 1 and thus at least 0.04% of the share capital (1/2500) below this percentage, participation would not be possible. However, even if the value of the share given to the employee was more than EUR 1, it would now have to be a multiple of EUR 1, so for example giving exactly 0.5% to the employee would not be possible again because the share value would not be a multiple (0.5% * 2500 = 12.5).

In the case of a public limited company, the minimum nominal value of a share remains 10 cents.

It is possible to sell a share without notarizing the transaction

Currently, if a shareholder of private limited company wants to sell a share which is not registered in the Estonian Securities Register (EVR) and transfer its ownership, the purchase and sale agreement must be notarized and thus a notary fee is due.

Such a formal requirement hinders the legal circulation of shares, especially for shareholders with a foreign background. This is avoided by the option of registering shares in an EVR, which in turn necessitates the opening of a securities account and that can be problematic.

In the future, it is possible to waive the notarization requirement for sale of share or pledging transaction in a private limited company with a share capital of at least EUR 10,000 and provided that the share capital has been fully paid in cash or in kind.

In order to waive the formal requirement for notarization, it is necessary to amend the articles of association and all shareholders must be in favor of such amendment.

The articles of association must stipulate that the transfer of a share must be carried out at least in a form that can be reproduced in writing.

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However, for companies with a share capital less than EUR 10,000 or in case the shareholders have not waived the formal requirement, the notarization requirement applies only to the disposal transaction (transfer of ownership) and no longer to the obligation transaction. However, the formal requirement established for an obligation transaction will be completely abolished by law, thus for example share option agreements will not have to be notarized.

Taxation of ship crew member's remuneration as of 1 July 2020

On 1 July 2020, amendments to the Income Tax Act (ITA) and other acts concerning the taxation of ship crew member's remuneration will enter into force.

0% income tax rate will be applicable to the remuneration of a member of the crew working on a ship sailing under the flag of a Contracting State (both resident and non-resident) if certain conditions provided for the ship are met. The Contracting States are the Member States of the European Union and Iceland, Norway and Liechtenstein. However, remuneration for work on a passenger ship, including a cruise ship, engaged in regular voyages within the European Economic Area shall not be subject to a 0% income tax rate.

The resident employer should declare in Annex 1 of the TSD (payment type 70) the actual salary of the crew member per calendar month and the payment is subject to 0% withholding income tax. However, a crew member whose income is has been subject to 0% income tax cannot make tax deductions such as basic tax-exempt allowance, interest on housing loans, etc., from its taxable base.

Amendments are also being made to the Social Tax Act. The crew member's salary is subject to social tax in Estonia, if

a) the crew member works on a ship sailing under the Estonian national flag or
b) is subject to Estonian law pursuant to Regulation (EC) No 883/2004 of the European Parliament and of the Council on the coordination of social security systems or an international social security agreement concluded by the Republic of Estonia.

If the salary has been received for working on a ship, meeting the conditions specified, 20% of social tax (i.e. only the part of the pension insurance) and up to EUR 750 is paid by the employer each month. The employer's does not have to pay the social insurance part of the health insurance (13%) and crew members can buy their own health insurance. In the month of the commencement or termination of the employment of a crew member or in the case specified in law, the remuneration shall be calculated in proportion to the number of days worked.

Further information (only in Estonian): https://www.emta.ee/et/eraklient/tulu-deklareerimine/palgatulu/laevapere-liikmete-tasu-maksustamine

Amendments to the taxation of athlete's scholarship and athlete's allowance as of 1 March 2020

On 1 March 2020, amendments to the Income Tax Act (ITA) concerning athlete's scholarship and athlete's allowance also entered into force due to amendments to the Sports Act.

§ 19 of the ITA was supplemented with a new subsection 6^1, according to which an athlete's scholarship is not subject to income tax if it is paid on the basis, limits and pursuant to § 10^1 and § 10^6 of the Sports Act; whereas the aforementioned limit also includes scholarships paid to athletes by non-profit organizations (MTÜ, SA) (§ 19 (6)).

The wording of § 19 (3) of the ITA 10^1 was amended. According to the new wording, income tax is not levied on compensation for expenses related to the activities of a voluntary sports judges paid on the basis of § 92 of the Sports Act and on athlete's allowance paid on the basis of § 10^5 of the Sports Act.

Further information (only in Estonian): https://www.emta.ee/et/eraklient/tulu-deklareerimine/stipendiumid-toetused-ja-huvitised/sportlasele-vabatahtlikule

Legal acts

An important decision from the Supreme Court in a tax dispute between E-Piim Tootmine AS (taxpayer) and Estonian Tax and Customs board

On 12th May 2020, the Supreme Court made an interesting decision concerning the consequences of declaring paid-in capital in income and social tax return (TSD) Annex 7 retrospectively.

1-day delay and reporting in an incorrect tax return

On 13 February 2018, the taxpayer submitted the January 2018's TSD annex 7 reporting the payments made into the equity in years 2011-2012 in the amount of mEUR 14.1. The tax authorities initiated a tax audit, made a tax assessment and removed the paid-in capital from the said TSD annex 7 as no contributions were made in January 2018.

By the book, the taxpayer should have reported the said paid-in capital in January 2015's TSD (all contributions made as of 31 December 2014 and other circumstances affecting the tax liability had to be declared in the January 2015 TSD). However, it was impossible to do so on 13 February 2018 as the statute of limitation of 3 years has been exceeded. The correction deadline was 12 February 2018 and the taxpayer was merely 1 day late. As all taxpayers were subject to the same regulation and deadlines had to be met, no exceptions were understandably made.

The taxpayer won a substantive victory

The taxpayer challenged the tax assessment in court. The administrative and circuit court granted the victory to the tax authorities. The Supreme Court also dismissed the appeal for annulment of the tax assessment but changed the grounds of the circuit court's decision.

The taxpayer won a substantially. As per the supreme court's decision the figures reported in TSD annex 7 are for informative purposes only. This means that the right to make tax-exempt payment on account of paid-in capital remains even if the payments into capital have not been duly reported. Therefore E-Piim Tootmine AS can utilize the payments into capital made in 2011-2012 in the amount of mEUR 14.1 in future without incurring income tax liability. The maximum income tax liability could have been mEUR 3.52.

What can be concluded from this?

The Ministry of Finance must agree that the transitional provision facilitating control, as a procedural rule, does not annul the right which the taxpayer wishes to exercise either for tax exemption or for reduction of income tax liability even in the event of late submission of tax return. A contribution to equity is like an acquisition cost that does not go away when factually made.

How will the tax authorities apply the solution in practice?

Definitely conservatively. It is now the task of the tax authorities to establish a possibility for taxpayers who can no longer report the paid-in capital due to the statue of limitation of 3 years being exceeded to exercise the right to make tax-exempt payments on account of the paid-in capital. Not reporting the paid-in capital on time in TSD annex 7 imposes an additional burden of proof on taxpayers, but this can be overcome. It can be assumed that the tax authorities will allow reporting the paid-in capital in current period only after a thorough tax audit has been performed against a specific taxpayer.

More information (available only in Estonian): https://www.emta.ee/et/ariklient/tulu-kulu-kaive-kasum/muudatused/maksudeklaratsiooni-andmete-parandamisele-laieneb