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Taxation amendments in Estonia at the end of 2014 and beginning of 2015

At the end of 2014 and the beginning of 2015 several amendments to the taxation legislation entered into force in Estonia. The changes involved mainly different taxation rates; however, some fundamental amendments to the VAT Act and the Income Tax Act also entered into force. Additionally a completely new law – the Exchange of Taxation Information Act – entered into force.

Exchange of Taxation Information Act

On 1 January 2015 the Exchange of Taxation Information Act entered into force. It establishes the rights and obligations regarding the international automatic exchange of information related to the direct taxes. The aim of the Act is to bring Estonian legal environment into compliance with the Agreement to Improve International Tax Compliance and to Implement FATCA concluded between the Government of the Republic of Estonia and the Government of the United States of America. The aim of the Agreement is to avoid potential sanctions for Estonian financial institutions established in the U.S. Foreign Accounts Tax Compliance Act. Similar agreement has been signed by most of the EU Member States.

Taxation Act

In August 2014 the Taxation Act was amended extending the term for refunding a taxation amount from 30 days to 60 days. In other words the execution of the claim for refund was extended by 30 days. With the entry into force of the Exchange of Taxation Information Act, the Taxation Act was amended as of 1 January 2015 regarding the regulation of international professional assistance.

Value-added Tax

As of 1 November 2014 all taxable persons are requested to fill in the INF form of the VAT form. The taxable person shall declare all the invoices which are over 1000 euros (without the VAT). The submission of the data may be also submitted on the basis of the transaction parties.
As of 1 December 2014 the amendment regarding the right to deduct input VAT from vehicles used in the enterprise was applied. Until the enforcement of the amendment, the taxable person was able to deduct 100% of the input VAT; after the amendment the input VAT can be deducted only to the extent of 50%, except for special cases provided by law.
As of 1 January 2015 a new regulation for determining the place of provision of the electronic communication services or the electronically supplied services entered into force. Now the

broadcasting, telecommunication and electronic services shall be taxed in the member state where the recipient of the services is located in accordance with the taxation rate applicable in the respective country. Thus, as from 2015 the Estonian taxable persons must consider the rules of the consuming country and apply the tax rate of the country where the client is located upon providing digital services.

Income Tax

As of 1 September 2014 the exemption to pay tax-free compensation in the amount of 64 euros per month for the use of a personal vehicle without keeping a record was repealed. Upon keeping a record, 30 cents per kilometre and up to 335 euros in each calendar month can be compensated by each employer paying the compensation.
As of 1 January 2015 the income tax rate paid from the income of Estonian natural resident or non-resident is 20% (until the end of 2014 the rate was 21%). The income tax rate for legal persons making payments is 20/80; in 2014 it was 21/79. The income tax free threshold was raised by 10 euros to 154 euros per month and the income tax free portion of the pension was raised from 210 euros to 220 euro per month.
Starting from 2015, the income taxation rules on the payment of fees for the non-resident board members (mainly members of management or supervisory board) were amended. Previously the fees of the non-resident board members were taxed in Estonia if the fee was paid by a legal person residing here or if the permanent establishment of the non-resident is located in Estonia. The taxation of such fees is executed in Estonia despite where the services are actually provided or where the members actually meet. As from 2015 the Act was amended in a manner that the fees of the non-resident board members are taxed with Estonian income tax also in case the payments are not made by an Estonian legal person or the permanent establishment of non-resident. From the taxation aspect it is irrelevant who makes the payment. It is only important that the fee is paid for the functions of management or supervision of an Estonian legal person or the permanent establishment of a non-resident, regardless where the functions are actually executed.
In addition to the above, the amendment of the Income Tax Act also limits the opportunities to pay income tax free scholarships. The amendment's aim is first and foremost to avoid tax disputes where the sports clubs pay income tax free scholarships to sportsmen and trainers instead of paying salaries. The payment is no longer considered as a scholarship to recognise or remunerate certain activities or by which a person who made the payment would acquire the rights to the work. The definition of scholarship was included in the Income Tax Act and accordingly, scholarships are future-oriented benefits that are paid for the acquisition of knowledge or skills, the development of competences and the promotion of creative or scientific activities.

Excise Duty

In 2015 the excise duty on alcohol was increased to 15%. Special purpose diesel fuel is allowed to be used only in agriculture and on fishing ships when fishing in Estonia, and prohibited for the use of railroad and maritime transportation. The complete excise exemption was repealed for fishing.

Social Tax

In 2015 the monthly rate of the minimum social tax base is 355 euros (instead of the minimum social tax base of 320 euros valid in 2014). Thus the minimum obligation of social tax is 117.15 euros per month.

Unemployment insurance payments

Unemployment insurance payments were reduced in 2015 – this year the rate for an employee is 1.6% (2% in 2014) and for an employer 0.8% (1% in 2014). The unemployment insurance payment obligation of an employer ends when an employee reaches the pensionable age or on the last day of the month where the person was granted the early retirement pension.

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PERSONAL INCOME TAX

Even if no remuneration is paid for board member in some cases there has to be paid personal income tax (PIT) and social security contribution for the board member. This is not a new rule, but it is changed now a bit. The flat rate of PIT decreases to 23%.

In December 17, 2014 the Parliament of Latvia passed amendments to the Law on Personal income tax. The rules according to which PIT is payable for the board member even if there is no remuneration paid to the board member has been changed. The amendments came into force in January 1, 2015.

PIT and social security contribution is payable for the board member for the month when:
1) there is no employee or board member in the company, who earns at least in the amount of 360 EUR;
2) turnover of the company in the specific month exceeds 1800 EUR.

The amount of payable taxes is calculated from the amount of minimum monthly salary approved by the government. For the year 2015 the amount of minimum monthly salary is 360 EUR.

It is allowed not to pay the above mentioned taxes:
1) if any of the company's board members earns at least 1800 EUR in the specific month in other company, but both companies have to be members of the same group of companies;
2) in the calendar year, when the company is registered.

As well please note that starting from January 1, 2015 the flat rate of PIT is 23 %.

The employer's gifts granted to its employee within the taxation year in the total amount not exceeding 14,23 EUR are not subject to PIT, as well to social security contribution.

SOCIAL SECURITY CONTRIBUTIONS

Due to changes in taxation of board members, who do not earn remuneration, there are introduced amendments to the Law on social security tax. Amendments are similar to the amendments to the Law on Personal income tax.

In December 17, 2014 the Parliament of Latvia passed amendments to the Law on Social security contribution. The amendments to this law are made due to changes in the Law on personal income tax in regard of taxation of board members, which do no earn remuneration. The amendments came into force in January 1, 2015.

Starting from the January 1, 2015 there has to be paid social security contributions (SSC) for the board member in similar cases which are mentioned in the section PERSONAL INCOME TAX of this report, i.e. SSC and PIT is payable for the board member for the month when:

1) there is no employee or board member in the company, who earns at least in the amount of 360 EUR;
2) turnover of the specific month exceeds 1800 EUR.

The same exemptions as mentioned in the section PERSONAL INCOME TAX are applicable.

TAXES AND DUTIES

Starting from January 1, 2015 in certain cases the State revenue service will be entitled to recover from board members tax payments, which are delayed by the company.

The State revenue service is entitled to commence the recovery process of company's delayed taxes from the board member if all of the following criteria are met:

1) the amount of delayed taxes exceeds five minimum monthly salaries (18000 EUR);
2) the company is informed about the recovery of delayed taxes;
3) it is found that after the moment, when the taxes are delayed, the company has transferred its title to the assets own by it to the person, which in is considered as related to the board member according to the rules of Law on Insolvency;
4) there is made an act, under which it is found that no recovery is possible to be carried out;
5) the company has failed to file to the court an application on insolvency.

It must be mentioned that the board member is liable for the delayed taxes, the delay of which occur at the time, when the board member holds the position of the board member. Please note that the new order will be applied only to the taxes delayed after the January 1, 2015.

If all criteria are met, the State revenue service will inform the company and the board member, that the process of the recovery will be commenced. The notice will be sent within 3 months starting from the date, when the act under which it is found that no recovery is possible to be carried out is made. The process of recovery will be canceled if the board member or the company within 15 days submits application on insolvency or application on commencement of legal protection procedure to the court.

There are also set forth the terms in the law, under which the board member is entitled to submit explanations and evidences to the State revenue service, which prove that the board member is not liable for the delayed taxes. It must be mentioned that all decision in regard of recovery of delayed taxes from the board member can be appealed.

The State revenue service will also publish a list of the companies in regard of which the process of delayed taxes recovery from board members is commenced.

If there is more than one board member in the company they are liable for delayed taxes of the company jointly.

THE LATEST CASE-LAW IN TAX DISPUTE SPHERE

The Department of Administrative cases of the Supreme court (Supreme court) passed a decision dated November 14, 2014 in a case related to transfer prising in a intra-group cash pooling arrangement. The Supreme court has provided its view on issues that relate to determination of arm's length interest rate.

The case is returned to the lower court for a retrial, though the decision of the Supreme court contains useful information about its position in regard of determination of arm's length interest rate in a intra-group cash pooling arrangement.

As a result of audit of SIA Rimi Baltic (Rimi Baltic) the State revenue service (SRS) made a decision that Rimi Baltic has to pay additional corporate income tax, payment for delay and a penalty. Additional payments were calculated due to the reason that Rimi Baltic did not include in its income the interest for the deposit payments made by Rimi Baltic to ICA Finans AB. The decision of the SRS was appealed.

According to the information provided by Rimi Baltic ICA Finans AB is a company, which ensures the management of intra-group financing and provides different kind of financing services to the companies of group.

The Supreme court has set in its decision that it is not correct when arm's length interest rate is determined to use only:
- either average interest rate applied by the banks to short term credits published by the Central Bureau of Statistics, as SRS did,
- or average interest rates for deposits of non-financial companies published by the Central bank of Latvia, as Rimi Baltic did.

It is also stated in the decision that the SRS is entitled to correct the data published by the Central Bureau of Statistics considering the substance of a intra-group cash pooling, including information provided by Rimi Baltic, when arm's length interest rate is determined by the SRS.

As well the Supreme Court has made some notes about the substance of a intra-group cash pooling. It turns attention to that neither company, which collects/manages the funds, nor companies, which transfer their surplus cash, are banks and their activities cannot be treated as the banking activities. It is also turned attention to that risks related to inter-group transactions are substantial circumstance, when arm's length interest rate is determined.

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AMENDMENTS TO TAX LAWS

A package of amending laws was adopted on 23 September 2014, amending the Law of Value-Added Tax, the Law on Corporate Income Tax, the Law on Income Tax of Individuals, the Law on Excise Duty, the Law on Lottery and Gaming Tax, the Inheritance Tax Law, the Law on Tax Administration, and the Law on Charity and Sponsorship.

The amending laws have converted all amounts indicated in the Litas in all the amended laws into the Euro, replaced references to the Litas by references to the Euro and introduced other Euro-related amendments. Most of the amendments shall come into force on 1 January 2015, except for the exceptions provided for by the laws.

On 18 September 2014, law No XII-1091 (hereinafter referred to as the "Law") was adopted, amending the Civil Code (hereinafter referred to as the "CC")

Amendments to the CC adopted by the Law come into force on 1 January 2015.

Material changes are as follows:

A new paragraph is added to Article 1.74(1) of the Civil Code, establishing that agreements for sale and purchase of shares of private limited liability companies shall be drawn up in a notarial form, where at least 25% of the shares of the private limited liability company is to be sold, or the selling price of shares is over fourteen thousand five hundred Euros, except for cases where personal securities accounts of shareholders are handled in accordance with the legislation regulating the securities market.

Paragraph 5 is added to Article 1.105 of the Civil Code, establishing that a bill of exchange in the amount of more than three thousand Euros shall be drawn up in a notarial form, if the drawer is a natural person or an economic entity handling accounts in accordance with the simplified accounting rules.

A new paragraph is added to Article 6.871 of the Civil Code, regulating the form of a loan agreement. The new paragraph establishes that if the loan amount is over three thousand Euros and the transaction is carried out in cash, a loan agreement shall be drawn up in a notarial form.

On 16 October 2014, law No XII-1236 (hereinafter referred to as the "Law") was adopted, amending the Code of Administrative Offences (hereinafter referred to as the "CAO").

This Law introduced amendments, effective from 1 January 2015, in preparations for the introduction of the Euro.

The amendments to the Code of Administrative Offices include replacing references to national currency Litas by references to European Union's single current Euro, recalculating and indicating all numerical values (amounts of monetary fines, thresholds of certain sums of money, other amounts) in the Euro, etc.

Moreover, new rules are added to Articles 24 and 2601 of the Code of Administrative Offices ensuring that the fines imposed and proposed by administrative order are calculated in the Euro without Euro cents, i.e. in integers. In case of administrative order, if the amount of a fine proposed by administrative order needs to be rounded, the rule shall be applied in favour of the individual, ensuring that the amount converted into the Euro remains unchanged in all cases. For example, if, according to penalty rates, the minimum fine is €57, the amount of the fine proposed by administrative order shall be €28, not €28.5.

On 18 December 2014, the law No XII-1502 was adopted, amending Article 96 of the Law on Value-Added Tax (hereinafter referred to as the "VAT Law").

The law amending the VAT Law, effective from 1 July 2015, establishes that the buyer – a VAT payer/taxable person – who has commissioned construction works and received a document confirming the performance of these works (the provision of services) shall deduct and pay to the budget the VAT calculated for the construction works performed by the service provider and provided for by Article 7.4 of the VAT Law, as defined by the Law on Construction of the Republic of Lithuania.

It should be mentioned that the Minister of Finance of the Republic of Lithuania has been assigned to adopt implementing acts in respect of this law amending the VAT Law by 15 June 2015.

RECENT CASE LAW IN TAX DISPUTES

The ruling of the Supreme Administrative Court of Lithuania of 3 November 2014 in administrative case No A-438-1214/2014 concerning the classification of seminars, training sessions and other events organised by pharmacists for physicians as representation services within the meaning of the Law on Value-Added Tax (hereinafter referred to as the "VAT Law").

The panel of judges clarified that a group of persons known in advance and described by generic features as well as the methods and forms of service provision (training, seminars) confirmed that the applicant's activities had met the features and criteria for representation services within the meaning of the VAT Law.

Facts

A Swiss pharmaceutical company addressed the local tax administrator, requesting to refund the VAT amount paid for the organisation of scientific medical lectures, training and conferences in Lithuania and costs of other events (the services received).

The local tax administrator, having examined this request, established that the events organised by the pharmaceutical company had been used for the presentation of medicinal products, while conferences, scientific medical lectures and training had been intended for a limited and pre-defined number of people, i.e. the events had been intended for specific physicians and/or pharmacists. Such events are treated as the advertising of own production to the interested persons. One of the features of advertising services is that advertising must be targeted directly at the market and not at a specific, pre-defined group of people who are not potential buyers of the products advertised. The local tax administrator concluded that the pharmaceutical company had acquired representation services for the events it organised rather than advertising services and therefore decided not to refund VAT for the representation services acquired.

The pharmaceutical company initiated a tax dispute over this ruling. The applicant based its position on the fact that lectures and training services had been bought with the aim to promote their production to boost the sales of medical products rather than promote themselves to their business partners. According to the applicant, it is not needed to raise awareness on medicinal products since increasing sales does not require conveying the message about the products to the general public. This message is conveyed to the public by specific interested persons, namely pharmaceutical professionals. It was noted that the experience of pharmacists ensured that patients were prescribed the necessary medicinal products, and lectures and conferences had been organised for promotion (advertising), not representation.

Arguments and interpretations by the panel of judges

The panel of judges noted that the dispute arose over the type of services provided to the applicant, that is whether these were advertising or representation services.

It was indicated that the case law of administrative courts, when examining analogous courts, established that based on the case law of the European Court of Justice (cases C-68/92, C-69/92, C-73/92 and C-108/00), advertising is deemed information which is conveyed in different forms (including during events) to an undefined group of potential buyers of goods (services) (the public), with a view to promote the sales of the goods (services) supplied. Meanwhile information targeting a pre-defined group of people who are not potential buyers of the goods promoted as well as methods and forms of the dissemination of such information (e.g. seminars, recreational events) cannot be considered promotional events (*ruling of the Supreme Administrative Court of Lithuania of 29 June 2009 in administrative case No A-438-614/2009*).

Besides, the case established that the applicant had bought services of organisation of scientific medical lectures, training, conferences, etc. from supplier E.L.L. UAB in accordance

with a marketing services agreement. During the period examined by the case, these services were provided to a target group, including physicians and pharmacists, during different training sessions, lectures and conferences.

It was therefore concluded that a group of persons known in advance and described by generic features as well as the methods and forms of service provision (training, seminars) confirmed that the applicant's activities had met the features and criteria for representation services within the meaning of the Law on Value-Added Tax.

The court held that the applicant's organisational activities met the features and criteria of representation services within the meaning of the Law on Value-Added Tax. This type of services in turn determines the fact that specialists of the State Tax Inspectorate have reasonably and correctly applied provisions of the VAT Law.

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