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by Valters Gencs

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2011: The Year in Review

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Estonia adopted the euro on January 1, but it did not bring any significant tax changes as most of the numerical indicators were converted to euros with slight adjustments in favor of taxpayers.

However, several tax changes that were not related to the currency change came into effect at the beginning of 2011. The Estonian Income Tax Act was amended to clarify the definition of permanent establishment. Included under the definition are non-fixed places of business, such as mobile offices. Income earned through a PE is taxed at the moment it is transferred out of the PE in Estonia.

The definition of fringe benefits was broadened to include benefits provided to employees by any company belonging to the same group as the employer. The definition of affiliated person was also changed, and it was clarified that persons are affiliated if they have common economic interests or influence over one another. It was clarified that share options to employees are to be taxed on realization, not on issue. Share options are not taxable if the period between issue and sale is at least three years.

Amendments to the Value Added Tax Act took effect on January 1. There are now special arrangements for imposing a reverse charge on the internal supply of taxable immovables and metal waste. The place of supply of natural gas and energy is considered the location of the consumer, that is, the recipient of the goods and services. Also, the taxable value of imported goods that were initially subject to a customs procedure other than importation may under some conditions be lower than their value at the time of arriving in the customs territory.

The Value Added Tax Act was amended for small businesses in Estonia to clarify which businesses with annual supply of less than €200 million are eligible for cash-based VAT accounting on internal supply. This is a great advantage and improves the economic situation of small businesses because the obligation to account for VAT arises when payment for the supply is actually received. Normally VAT is accounted for on an invoice basis.

The Estonian Parliament made several noteworthy decisions in 2011. It decided to lower the income tax to 20 percent starting in 2015. It decided that woodland maintenance expenses will be withheld from the taxable income of timber and forest sales during the next three taxation periods starting in 2012. In a positive decision for employers, work-related development training will be excluded from taxable fringe benefits. Educational benefits for adult employees will no longer be treated as fringe benefits. On the negative side for taxpayers, the amount of untaxed expenses like housing loan interests, training expenses, and contributions will be decreased from €3,196 to €1,917 beginning in 2012.

The government approved amendments to the Estonian Taxation Act and the Estonian Income Tax Act to exempt accommodation expenses from tax. Currently, accommodation costs are exempted only for costs up to €77 for domestic business travels and €128 for business travels abroad. The amendments will take effect on January 1, 2012.

There were several developments involving tax treaties. The treaties with Albania, South Korea, and Serbia are effective as of January 1, 2011, bringing the total number of effective tax treaties to 47. On March 11 the new protocol to the tax treaty with Georgia entered into force; it will become effective on January 1, 2012. Also in 2011, Estonia concluded treaties with the United Arab Emirates and with India. ◆

♦ *Valters Gencs is a tax attorney and founding partner of Gencs Valters Law Firm in Riga.*