The Corporate Tax Regime in Estonia

By Turgay Kuleli, *TEP, LLM, MBA*
Head of Wealth Planning
Sirel & Partners Attorneys-at-Law
Tallinn, Estonia

and Nikolai Majerovitš
Advocate
Sirel & Partners Attorneys-at-Law
Tallinn, Estonia

Estonia has an unequal corporate tax system due to the fact there is no corporate income tax in the classical sense. Corporate taxation rules shift the moment of corporate taxation from the moment of earning the profits to the moment of profit distribution. Furthermore, corporate tax is charged only on distributed profits. This means that undistributed profits are fully tax-exempt. At the same time, such distribution tax is regarded as a corporate income tax and not as a withholding tax. Dividends paid to non-resident companies are not subject to additional withholding tax.

That corporate tax regime was created in 2000 with the aim to favor the development of Estonian business due to the possibility of unlimited tax-free reinvestments of earned profits. The second goal of the tax reform was to significantly reduce the use of low-tax jurisdictions. According to the authors' opinion, the Estonian modern corporate tax regime has a positive impact on both aforementioned goals.

Ordinarily, distributions of earned profits take place in the form of dividends, share buybacks, capital reductions, liquidation proceeds or deemed profit distributions. But the good news is that the corporate income tax on earned profits is not imposed, if profits are lent out, reinvested or left in the company etc. At the same time, there is no legal obligation to make profit distributions. Furthermore, there are no adjustment of accounting profits for tax purposes or tax depreciation rules. Legal entities have freedom of action in compliance with GAAP or IAS/IFRS accounting rules to decide the amount of distributable profits. By the same reason the Estonian corporate tax regime is not familiar with tax-loss carryback and tax-loss carryforward regimes.

In practice, most Estonian companies do not pay any corporate income taxes over the years, because there is no obligation to make profit distributions. According to the Statistical Office and the Tax Board only 5% of all Estonian enterprises distributed profits between 2005 and 2016. At the end of 2014, the amount of undistributed profits was the same as the Estonian GDP in that year.

The Estonian corporate tax regime creates excellent tax deferral opportunities for trading income, as retained earnings can be lent out, invested in real estate, precious metals, foreign exchange, the stock market etc. This regime is available for both Estonian companies and registered permanent establishments of foreign legal entities.

It is important to know that corporate taxation is based on the so-called cashbox accounting method, which means that corporate income tax is imposed only on funds that are taken out (distributed) of the company. Therefore, in the case of dispute with Estonian tax authorities, there are some possibilities to return distributed funds to the company preventing tax implications.

Another advantage of the Estonian corporate tax regime is its simplicity. The Income Tax Act consists of only 62 sections and there are no additional large mandatory guidelines. Consolidation and group taxation for corporate income-tax purposes, thin-capitalization rules and CFC rules are also unknown in Estonia.

There are some additional exemptions from corporate income tax. For instance, the corporate income tax is not charged on dividends paid by an Estonian company, if the dividend which is the basis for the payment from a resident company of an EEA country or Switzerland is subject to income tax and at least 10% of such a company's shares or votes belong to an Estonian company. Exceptions from this rule are only for companies located in low-tax-rate territories.

The corporate income tax is also not collected on dividends paid by an Estonian company, if the dividend which is the basis for payment is from a company of a foreign state and the Estonian company owns at least 10% of the shares or votes of such a company, and if income tax has been withheld from the dividend or income tax has been charged on the share of profit which is the basis thereof. In addition, income tax is not charged on profit distributed by way of a bonus issue.

With the aim to encourage the profit distribution by Estonian companies, the government is planning to reduce the corporate tax rate from 20 to 14% in the future.

turgay.kuleli@sirel.com
www.sirel.com