

## Estonian and Lithuanian news round-up (3/13/17)

This article explores the latest tax and legal developments in Estonia and Lithuania, with useful bits of information for Estonian company owners.

### Estonia

In late 2016, Estonian tax authorities published new guidelines providing assistance and explanations for completing the TSD tax return, annex 7, which is used for declaring dividends and capital repayments, and in other significant circumstances for tax purposes.

#### *Converting a dividend debt into a loan obligation*

Based on the decision to distribute dividends, the dividend and income tax liabilities should be disclosed on the balance sheet on an accrual basis. Income tax must be remitted in the period when the dividends are actually paid. While the term "payment" basically refers to a bank transfer or cash payment, it could also mean a mutual settlement of claims, for example. A company and its shareholder may agree that a dividend debt created by the decision to pay dividends will be converted into a loan obligation either partly or fully so that no actual payment is made. Despite the fact that no payment is made in such instances, the tax authorities find that converting a dividend debt into a loan obligation is equivalent to a dividend payment, and so an income tax liability arises by the 10th day of the month following the conversion.

#### *Voluntary reserve*

The Income Tax Act does not define what is considered a payment made into capital/equity. The tax authorities' guidelines explain that payments made into a voluntary reserve under the Estonian Commercial Code are *inter alia* accepted as the company's paid-in capital, but this would entail amending its articles of association.

Shareholders can make both monetary and non-monetary contributions (such as converting a previously issued loan into a reserve) and this reserve is usually formed in order to restore the company's net assets. In conclusion, contributions to a voluntary reserve would need declaring only if forming that reserve meets the requirements of the Commercial Code. Any payment made out of the voluntary reserve at a later date will be considered a capital repayment for tax purposes.

When a company undertakes a merger or demerger, the merging/demerging company can transfer to the surviving/recipient company (i.e. from tax return to tax return) the following rights related to taxation: unused paid-in capital; foreign withholding tax on foreign income, which has not yet been used to reduce the income tax liability; income received that can be distributed tax exempt at a later date.

#### *Amendments to the payment and declaration of dividends from 1 November 2016*

Last November, amendments to the Income Tax Act came into force which, along with two additional conditions, limit the use of the exemption method, whereas the restriction will apply to dividend distributions and capital repayments received after 1 November 2016.

Going forward, the exemption method can only be applied if dividends received from a foreign subsidiary have also been treated as dividends in the other country (as opposed to an interest expense reducing taxable income).

A more general limitation has also been enacted. This can be summed up by stating that if the underlying purpose of setting up or acquiring a company in a foreign country was to obtain a tax advantage, then any further exempt distribution of such received dividends is not possible.

If a taxpayer is certain that the exemption method applies to dividends and capital repayments received after 1 November 2016, then this should be confirmed by reporting that income in the month it was received. In the case of foreign holding companies, we recommend analysing why the holding company was set up and whether it has a sufficient economic substance for carrying out its functions.

Lithuania

#### *Specialised banks legitimised*

The Banking Act has been amended with effect from 1 January 2017 to introduce specialised banks. The activities of a specialised bank involve accepting deposits and other repayable funds, lending, finance leases, and other activities specified by the Banking Act. In general, specialised banks would have to comply with the requirements set for banks, but the minimum capital of a specialised bank is EUR 5 million instead of EUR 1 million.

#### *National voluntary social pension insurance abolished*

From 1 January 2017, the government decision came into force to abolish voluntary participation in the state pension insurance scheme for individuals. Accordingly, any voluntary social pension insurance contracts entered into earlier have expired from 1 January 2017.