Estonia to transpose Anti Tax Avoidance Directive (2/24/18)

The Estonian Ministry of Finance has submitted a new bill for amending the Income Tax Act to transpose the provisions of the Anti-Tax Avoidance Directive (EU) 2016/1164 into Estonian legislation with effect from 1 January 2019.

A new chapter is to be added to the Income Tax Act with five clauses detailed below.

Abuse of profit taxation rules will trigger taxation

A general anti-avoidance rule is to be introduced under which any transaction or chain of transactions carried out to gain an income tax advantage will be scrutinised. Accordingly, any income that an Estonian-resident company or a permanent establishment (PE) has not received or any expenses associated with such a transaction or chain of transactions will attract income tax.

Taxing undistributed profits of controlled foreign companies (CFC)

The CFC[1] rules will apply at the level of an Estonian-resident company or PE meeting statutory criteria. Estonia has opted to transpose the rule so that the tax rate of the foreign jurisdiction is irrelevant.[2]

Here are the criteria that trigger taxation:
- the CFC’s transaction or chain of transactions that resulted in a profit was fictitious;
- this exercise was mainly aimed at gaining a tax advantage; and
- the CFC is actually managed by key employees of the shareholder (controlling company) to create an opportunity for generating profits.

Excessive borrowing costs (interest)

Deducting excessive borrowing costs from the tax base of a non-financial or a standalone company will trigger taxation if borrowing costs for the financial year exceed –
- EUR 3 million,
- 30% of EBITDA, and
- a loss the company has reported for the year.

Exit tax

An Estonian-resident company that moves its tax residence away from Estonia will attract tax on the difference between capital repayments and capital contributions. It will be possible to defer exit tax, i.e. pay it by instalments over a five-year period.

Wider scope for the exemption method

Exemptions on dividend distributions will be available also on dividends paid in respect of assets on the transfer of which exit tax was paid, on dividends received from a CFC, and on proceeds from selling shares in a CFC to the extent of the taxed amount.

[1] A CFC is defined as any non-resident enterprise in which the resident company alone or combined with related parties holds more than 50% of shares, profits or voting rights.

[2] Any company located outside or within the EU (e.g. Cyprus, Malta, and the Netherlands) might fall under the CFC rules.