Taxation of dividends in Estonia (3/18/19)

This article looks at changes in the Estonian taxation of dividends effective from 2019.

A reduced rate

In Estonia, dividends generally attract a 20% corporate income tax (CIT) – 20/80 on the net amount. From 1 January 2019, a lower rate of 14% (14/86 on the net amount) applies on profits distributed on a regular basis. Resident companies that paid and taxed dividends in 2018 (or made other distributions out of equity) will be required to apply the reduced rate for the first time in 2019.

When applying the reduced rate, the period (either the accounting period or any previous period) regarding which profits are distributed is irrelevant. However, the reduced rate may be applied only to a certain portion of the total profit distribution, calculated in 2019 and 2020 as follows:

- In 2019, it is 1/3 of the profit distributed in 2018, on which the resident company has paid CIT;
- In 2020, it is 1/3 of the profits distributed in 2018 and 2019, on which the resident company has paid CIT.

Calculation of tax in 2021

From 2021, the calculation of any profit attracting a reduced rate will be based on the average distributed profit of the previous three calendar years, subject to tax by the resident company. If no profit distribution was made in any given year, the average distributed profit will be considered zero. If the profit distribution exceeds the average, the excess will attract the standard rate.

Who will benefit from the reduced rate?

The reduced rate has the effect of reducing the CIT expense for companies and is expected to make dividend payment more attractive to foreign shareholders (entities).

The change does not affect single-member companies. The income tax liability is simply spread between different taxpayers – CIT and withholding tax (WHT), and the total income tax payable is slightly higher (0.03% per euro distributed).

How is dividend income taxed in the hands of an individual?

To ensure the neutrality of taxing different types of income (in particular, wages and dividends), dividends paid to a resident or non-resident individual subject to the reduced rate (14/86) attract an additional WHT of 7%. WHT applies to profits earned and distributed by the company, and to dividends subject to the reduced rate (14/86) that were received from another Estonian entity and redistributed to an individual.

Example: taxation of dividends

Company A has two shareholders, each owning 50%: one an Estonian company (B) and the other an Estonian individual.

2018

In 2018, Company A paid a dividend of EUR 300,000, on which it paid a CIT of EUR 75,000. Income tax was calculated at a net rate of 20/80, i.e. the dividend was considered the net amount. Both shareholders received EUR 150,000.

2019

In 2019, when distributing the same amount of dividend, the reduced rate may be applied on 1/3 of the dividend. So EUR 100,000 is taxed at the rate of 14/86 and EUR 200,000 at 20/80, with a total CIT expense of EUR 66,279, meaning a reduction of CIT at company level.

EUR 100,000 of the distributed profit attracts the reduced rate, which may not be waived, and a 7% WHT must be applied to the share of profit (50%) distributed to an individual. So, the individual receives EUR 146,500 (100,000 + 46,500), with a WHT of EUR 3,500 (7% x EUR 50,000, EUR 50,000 being considered the gross amount).

Company B receives EUR 150,000. With at least a 10% participation at distribution, B can take an exemption when redistributing the dividend to its sole shareholder (individual). With dividends previously subject to the reduced rate, a 7% WHT applies on the redistribution (EUR 3,500), and the sole shareholder receives EUR 146,500.