

Estonia: tax developments (3/11/20)

In 2019, the Estonian Ministry of Finance drafted proposals for amending the Income Tax Act to regulate the taxation of income earned by foreign temporary workers (non-residents) from employment in Estonia. The amendments were expected to take effect from 1 January 2020 but they did not.

Taxation of non-resident workers

The proposals aim to hold a non-resident employer and an Estonian host company jointly liable for any income tax debt where the non-resident employer has hired its employees to the Estonian host company and fails to carry out its Estonian income tax withholding obligation. The amendments would have provided Estonia with a basis for taxing a non-resident temporary agency worker's remuneration from the date they start work in Estonia. However, this initiative has not become a law.

On 7 February, the Estonian government approved amendments to the Aliens Act, to the Income Tax Act, and to the Taxation Act so that they are going to a new round on the same subject but in a slightly modified form.

The bill is urgent as the Estonian Tax and Customs Board says the loss of tax revenue from uncollected payroll taxes on payments to foreign nationals for working in Estonia based on registered short-term employment has been constantly increasing and is estimated at EUR 16.5 million in the third quarter of 2019.

The proposed amendments to the Income Tax Act and to the Taxation Act are to take effect from 1 October 2020, while the amendments to the Aliens Act are to come into force on 31 March.

Changes to the Income Tax Act

Remuneration received by a non-resident individual from working in Estonia currently attracts Estonian income tax if the payment is made by an Estonian entity.

The proposed amendments to the Income Tax Act aim to tax the remuneration paid to a non-resident individual for work done in Estonia when the payroll expenses are economically borne by an Estonian entity.

As the Estonian host company pays for the labour hire through a service invoice, there are grounds for treating the host company as employer also within the meaning of article 15(2) of the OECD's Model Tax Convention.

Thus, if a non-resident individual works in Estonia and the host company is –

- an Estonian resident (e.g. a company),
- an Estonian central or local government authority, or
- a non-resident employer or a permanent establishment in Estonia,

the new rules permit Estonia to tax such employment income from day one.

To make it easier for non-resident workers to meet their income tax obligations, non-resident employment agencies will be required to withhold income tax on remuneration paid for work done in Estonia. The host company will not be held jointly liable for the non-resident's withholding tax liability but will be assigned a control obligation, and non-compliance will be punished with fines of up to EUR 32,000.

The Taxation Act will also be amended to compel non-resident temporary employment agencies to register with the Tax and Customs Board before starting their activities in Estonia.