Republic of Estonia
Ministry of Finance

Corporate income tax in Estonia

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Tax design

- Earning profits is not a taxable event
- Tax is paid upon distribution of profits (NB! not withheld)
- Distributions: explicit (dividend) and implicit (expenses not related to business; gifts and donations; fringe benefits also under corporate income tax – same rate as PIT)
- Tax base is divided by 0.8 and multiplied by tax rate 20%
- Lower tax at 14% for regular distributions (division by 0.86)

Tax design (cont.)

- Territorial system – foreign and domestic received profits are exempt upon distribution if taxed previously
- Double tax for under 10% stakeholdings
- Equal treatment of all legal persons and PEs – differences in what constitutes business-related costs (e.g. NGOs)
- Tax period is one month – reporting and paying by 10th of next month together with payroll reporting

Rationale

- SMEs have limited access to capital markets
- Corporate income tax seen as one of the biggest hindrances to economic growth
- Tax spending / consumption, not earning
- A peculiar advantage for attracting foreign investments

How it works

- Profit earned in 2015 – 1 mio. No tax on earnings
- Distributed in Feb 2017 – 800 th. Tax on March 10, 2017 is 20% x 800 th / 0.8 = 200 th
- In case of a traditional system, tax would be equal to 20% x 1 mio = 200 th, whereas 800 th would be available for distribution
- Results – the same, however the timing is different

How it works (cont.)

- In case of gifts and donations, if not charitable, and in case of expenses unrelated to business – tax is reported and paid on the amount paid out by 10th of the next month
- In traditional systems, deductions disallowed annually
- Transfer pricing: excess cost / insufficient income taxed
- Half-jokingly: while other countries have corporate income tax, we have corporate expense tax ☺

How it works (cont.)

- To make the system more competitive with our neighbors, we lowered the corporate income tax rate to 14% on distributions equal to the average distribution for the last 3 years. For natural persons, +7% withholding tax applies
- Rationale: being an attractive destination of business for continuous earning & distribution
- LV (had) and LT (has) 15% CIT – our standard rate is 20%

Fraud and tackling

- At first, profits remaining in entrepreneurship were not taxed. As of 2004, due to EU accession, profits remaining in an enterprise are not taxed
- Thus, inter-company intra-Estonian transfer pricing
- Loans to shareholders, incl. companies, can be a problem
- Assets (investment) for the good of the (sole) shareholder

Fraud and tackling (cont.)

- Enhanced tendency to incorporate – service or employee?
- „Cash and cash equivalents“ – not necessarily there
- Abuse of exemption method – in case of EU/EEA, deemed that previous profits are taxed (soon to end?)

Effects on taxpayers

- No motivation or reason to underreport profits
- No separate tax reporting – accounting is enough
- More solid basis for investment
- Immediate taxation of items disallowed for deduction in other, traditional systems
- Lock-in (psychological) effect
- (Possible) suboptimal investment decisions

Effects on taxpayers

- Masso et al (2011, 2013): more liquid assets, lower debt, higher post-reform investment (firm-level data diff-in-diff cf. LT, LV)
- Masso, Meriküll (2014): in addition, modest positive effect on output and consumption (macro-level analysis)
- Hazak (2014): distribution decreased, external finance decreased, surplus cash, allocation potentially inefficient

Revenue implications

- First year

No immediate effects on previous profits - payment of CIT on last year
No longer any advance payments on current profits, but immediate taxation of expenses unrelated to business

- Second and subsequent years

Dip in revenue. Payout of formerly taxed profits – no tax on distribution

- Fourth and subsequent years

Revenue from CIT recovered

Revenue implications (cont.)

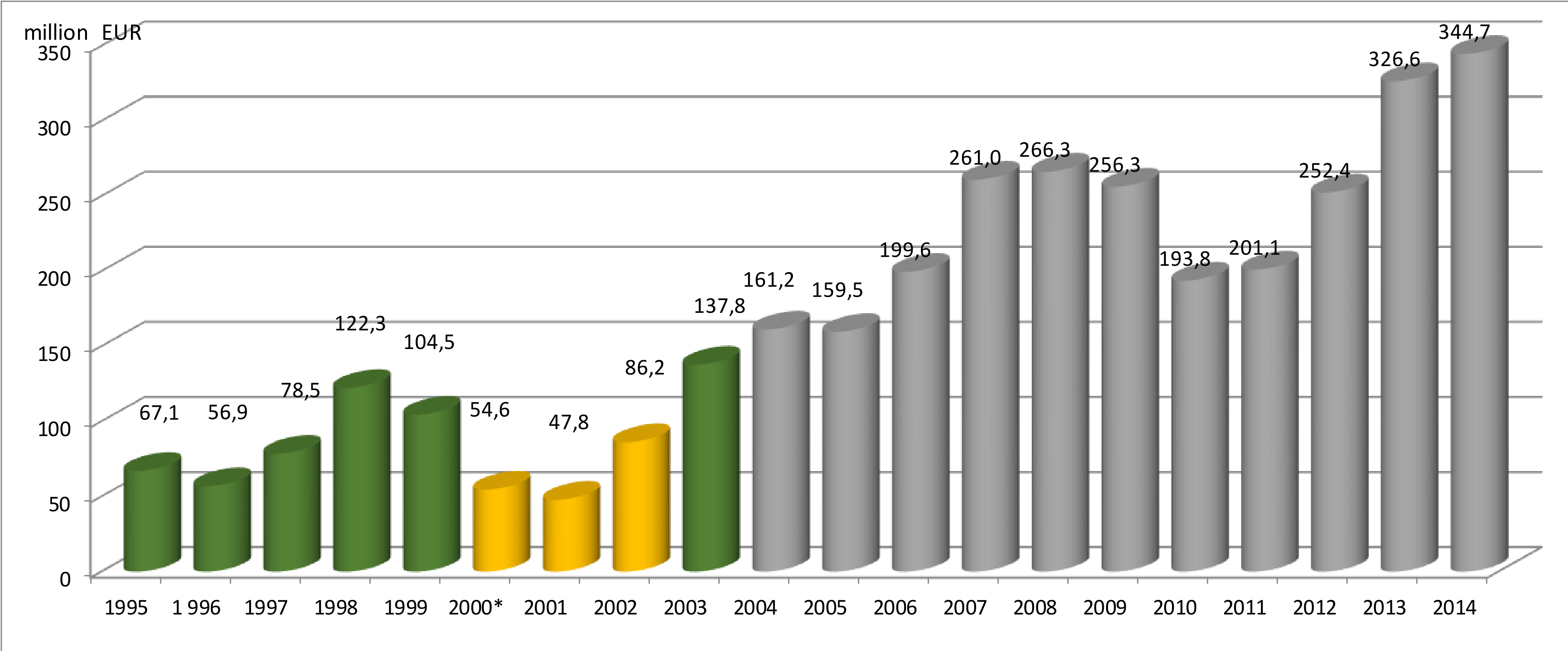

Table 55: Taxes on capital as % of GDP - Income of corporations

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Difference (1) 2007 to 2017	Ranking 2017
EU-28	2,9	3,2	3,3	2,9	2,3	2,4	2,5	2,6	2,6	2,5	2,6	2,7	2,8	-0,5	0
EA-19	2,8	3,2	3,3	3,0	2,2	2,3	2,5	2,6	2,6	2,5	2,6	2,7	2,8	-0,5	0
Belgium	3,1	3,5	3,4	3,3	2,3	2,5	2,8	3,0	3,1	3,1	3,3	3,4	4,1	0,7	4
Bulgaria	1,9	2,2	4,3	3,2	2,6	2,1	1,9	1,9	2,2	2,1	2,2	2,2	2,4	-2,0	18
Czech Republic	4,1	4,4	4,5	4,0	3,4	3,2	3,2	3,1	3,2	3,3	3,4	3,5	3,5	-1,0	6
Denmark	3,4	3,7	3,1	2,5	1,9	2,3	2,2	2,6	2,8	2,8	2,8	2,9	3,0	-0,1	10
Germany	2,3	2,8	2,8	2,5	1,9	2,1	2,4	2,5	2,4	2,4	2,3	2,6	2,7	-0,1	15
Estonia	1,4	1,5	1,6	1,6	1,8	1,3	1,2	1,4	1,7	1,7	2,1	1,7	1,5	-0,1	27
Ireland	3,4	3,8	3,4	2,8	2,3	2,4	2,2	2,3	2,4	2,4	2,6	2,7	2,8	-0,6	13
Greece	3,3	2,5	2,3	2,1	2,5	2,5	2,1	1,1	1,1	1,9	2,1	2,5	1,9	-0,3	23
Spain	3,8	4,1	4,7	2,8	2,3	1,9	1,8	2,2	2,1	2,1	2,3	2,2	2,3	-2,4	20
France	2,4	3,0	3,0	3,0	1,8	2,5	2,8	2,9	2,9	2,8	2,8	2,8	3,1	0,1	9
Croatia	2,3	2,8	3,1	2,9	2,6	1,9	2,3	2,0	2,0	1,8	1,9	2,2	2,3	-0,7	19
Italy	2,8	3,4	3,8	3,6	2,9	2,8	2,7	2,9	3,1	2,7	2,7	2,6	2,5	-1,3	17
Cyprus	4,2	4,9	6,1	6,4	5,9	5,6	6,2	5,7	6,5	6,3	5,9	5,7	5,7	-0,5	2
Latvia	1,9	2,1	2,5	3,0	1,6	1,0	1,4	1,6	1,6	1,5	1,6	1,7	1,6	-0,9	26
Lithuania	2,1	2,8	2,5	2,7	1,8	1,0	0,8	1,3	1,4	1,4	1,5	1,6	1,5	-1,0	28
Luxembourg	5,8	5,0	5,3	5,3	5,6	5,8	5,0	5,1	4,8	4,3	4,4	4,6	5,2	-0,1	3
Hungary	2,1	2,3	2,7	2,6	2,2	1,2	1,2	1,3	1,4	1,6	1,8	2,3	2,1	-0,6	21
Malta	3,7	4,1	6,0	5,9	6,0	5,8	5,4	5,9	6,2	6,0	6,1	6,3	6,5	0,4	1
Netherlands	3,4	3,4	3,4	3,3	2,1	2,3	2,2	2,1	2,1	2,5	2,7	3,3	3,3	-0,1	7
Austria	2,3	2,2	2,5	2,5	1,8	2,0	2,1	2,1	2,2	2,2	2,3	2,5	2,6	0,1	16
Poland	2,1	2,4	2,7	2,7	2,2	1,9	2,0	2,1	1,8	1,7	1,8	1,8	1,9	-0,8	24
Portugal	2,6	2,8	3,5	3,5	2,7	2,7	3,1	2,7	3,3	2,8	3,1	3,0	3,2	-0,2	8
Romania	2,7	2,8	3,0	2,9	2,3	2,1	2,3	1,9	2,0	2,1	2,3	2,2	2,0	-1,0	22
Slovenia	2,7	2,9	3,2	2,5	1,8	1,8	1,7	1,2	1,2	1,4	1,5	1,6	1,8	-1,4	25
Slovakia	2,9	3,1	3,2	3,3	2,7	2,6	2,6	2,6	3,1	3,5	3,9	3,7	3,6	0,5	5
Finland	3,2	3,3	3,7	3,3	1,9	2,4	2,6	2,1	2,4	1,9	2,2	2,2	2,7	-1,0	14
Sweden	3,4	3,4	3,6	2,6	2,6	3,1	3,0	2,5	2,7	2,6	2,9	2,9	2,9	-0,7	11
United Kingdom	3,4	3,5	3,3	2,9	2,6	3,0	2,9	2,7	2,6	2,5	2,4	2,7	2,9	-0,5	12
Iceland	2,1	2,4	2,4	1,9	1,6	1,0	1,8	1,9	2,1	3,3	2,3	2,5	:	:	0
Norway	5,6	6,3	5,7	5,8	4,9	5,3	5,4	5,2	4,3	3,9	2,8	2,9	3,2	-2,5	0

(1) In percentage points.

(2) In millions of euro.

See explanatory notes in Annex B.

Source: DG Taxation and Customs Union, based on Eurostat data

Compatibility

- EU – compatible with fundamental freedoms, compatible with the parent-subsidiary directive (because not a WHT)
- ATAD / ATAD 2 – technical complexity in application due to different treatment of disallowing and taxing items, e.g. interest limitation, permanent derogation for exit tax of PE
- CC(C)TB – claims of compatibility (?)
- Pillar 2 (GloBE) – problems with effective tax rate

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Thank you!

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