Republic of Estonia
e-Residency

Business Guide for e-residents

e-resident.gov.ee

Contents

Foreword

E-Residency is a unique feature designed for foreign entrepreneurs. The programme is one of a kind in the sense that, apart from Estonia, no country since the launch of e-Residency in 2014 has enabled foreign entrepreneurs to conduct their business digitally in a similar fashion.

Some of the many opportunities it grants an e-resident are the possibility to establish a company in Estonia fully online, access to a wide variety of different Estonian e-services and, most importantly, a gateway to the European single market, while at the same time enabling e-residents to be completely location-independent.

While there is plenty of information readily available online on the process of becoming an e-resident and the business aspects of running an Estonian company, there has never been a comprehensive set of instructions addressing the different tax aspects of being and operating as an e-resident. This is where the current guide lends a helping hand, enabling you to understand the core principles of the Estonian tax system and providing you with the necessary tools to be tax compliant in your business endeavours.

As it would be very difficult for a single guide to exhaustively cover all the issues and questions arising for e-residents or future e-residents such as yourself, some presumptions have been made to keep the subject matter clear and to the point. The assumption is that you intend to:

- establish an Estonian limited liability company — an *osaühing* (OÜ);
- provide services to your clients and not sell any goods;
- mainly work for the company yourself, but perhaps also have employees;
- not live or work in Estonia.

The guide is divided into seven chapters covering all relevant topics for e-residents from a tax perspective, starting from basic considerations for establishing an Estonian company and moving on to an in-depth look at the different types of taxes you will inevitably come across: Value-Added Tax (VAT), Corporate Income Tax (CIT) and Personal Income Tax (PIT). There are also illustrative tables, explanations and country-specific examples provided throughout the guide in order to make it easier for you to grasp the most important aspects of the Estonian tax system.

A word of caution: the information provided in this guide should not be viewed as tax advice tailored to meet everyone's needs. Your tax situation and its potential implications may differ depending on the specifics and area of activity of each individual company. This guide is meant to be an initial introduction to taxation in Estonia. If you find yourself in a situation specific to a field of activity for which this guide does not provide an explanation, local tax specialists should be consulted.

Important notice

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Chapter 1

Welcome to Estonia!

Amazing facts about Estonia

- Estonia was the first country to introduce an online political voting system
- Over 50% of Estonia is covered with forest
- Sauna is a way of life! Private homes often have their own saunas
- The World Cleanup Day initiative started in Estonia in 2008
- Estonians have founded four unicorns — Skype, Playtech, Bolt (formerly Taxify) and TransferWise

The Republic of Estonia is situated in Northern Europe beside the Baltic Sea and has approximately 1.3 million inhabitants. Tallinn, the capital of Estonia, lies on the Baltic Sea coast, only about 60 kilometres (40 miles) south of Helsinki, across the Gulf of Finland. The population of Tallinn is approximately 450,000. Other major cities include Tartu, Narva and Pärnu. The official language is Estonian. However, most people also speak Russian or English, or both. English is spoken by a majority of businesspeople and by people in service sectors.

The territory of Estonia covers 45,000 square kilometers (17,000 square miles). Estonia is a low-lying country with an average elevation of about 50 metres (160 feet) and a considerable part of its territory is covered by wetlands.

Estonia is the leading country in Central and Eastern Europe in terms of attracting foreign direct investment. Estonia is within a three-hour flight of most major European, Scandinavian and Russian cities. Overall, the business climate in Estonia is characterized as leaning towards free business and trade in alignment with EU practices. Many companies are subsidiaries of European, and particularly Scandinavian, firms. Estonia has some of the highest credit ratings in the region (Standard & Poor's: AA-; Moody's: A1; Fitch IBCA: AA-).

Estonia has been a member of the euro area since 2011, and is also a member of the WTO, NATO and the OECD.

Most importantly, Estonia is one of the leading countries in the world in creating and implementing e-government solutions and cyber security. 99% of Estonian residents use Internet banking services and more than 95% complete their income tax returns over the Internet. Estonia hosts both the cyber security center of NATO and the IT agency of the European Union's IT agency.

The above information is sourced from the following webpages, and more information is available at:

General information about Estonia:
http://www.visitestonia.com/

Statistical information about Estonia:
http://www.stat.ee/en

Background on the investment climate in Estonia:
http://www.investinestonia.com/

Estonian Chamber of Commerce and Industry:
https://www.koda.ee/en/economy/business-environment

Forms of business

It is fair to say that the Estonian legal environment favours entrepreneurship and an entrepreneurial mindset. Foreign investors have the same rights and obligations as local entrepreneurs. Every foreign investor may establish a company and conduct business in Estonia in the same way as local investors; no restrictions apply.

Over 90% of Estonian companies employ fewer than 10 individuals and only around 0.1% of companies employ more than 150 individuals, which means that most of the companies established in Estonia are rather small. The main employers are wholesale and retail trade companies, manufacturing companies and companies engaged in professional, scientific and technical activities.

The top 3 areas of business for e-residents are:

1. Information and communication
2. Professional, scientific and technical activities
3. Administrative and support service activities

The legal environment for business entities in Estonia is primarily regulated by the Commercial Code. You can access it here.

According to the Commercial Code, business entities can take the following forms:

- private limited company (OÜ)
- public limited company (AS)
- general partnership (TÜ)
- limited partnership (UÜ)
- commercial association (*ühistu*)

In addition, the Commercial Code regulates **sole proprietorship** (in Estonian, *Füüsilisest Isikust Ettevõtja* or in short, *FIE*). Sole proprietors provide services or sell goods under their own name and are not legal persons. Therefore, sole proprietors are taxed differently from limited companies. For example, sole proprietors must generally pay quarterly advance payments of income and social tax.

You can also set up a **non-profit association** (*mittetulundusühing* or *MTÜ* in Estonian, regulated by the Non-Profit Associations Act). Since the aim of a non-profit organization is not to generate profit, taxation differs from taxation of limited companies.

Foreign companies are also able to register a branch in Estonia through which to run their business.

By far the most commonly used form of business and probably the most suitable for e-residents is a **private limited company** (OÜ), which is easy to set up, has a minimum share capital requirement of EUR 2,500 and limits the shareholders' liability. This means that shareholders are not personally liable for the company's obligations of the company, but the company is liable for its obligations to the extent of its own assets.

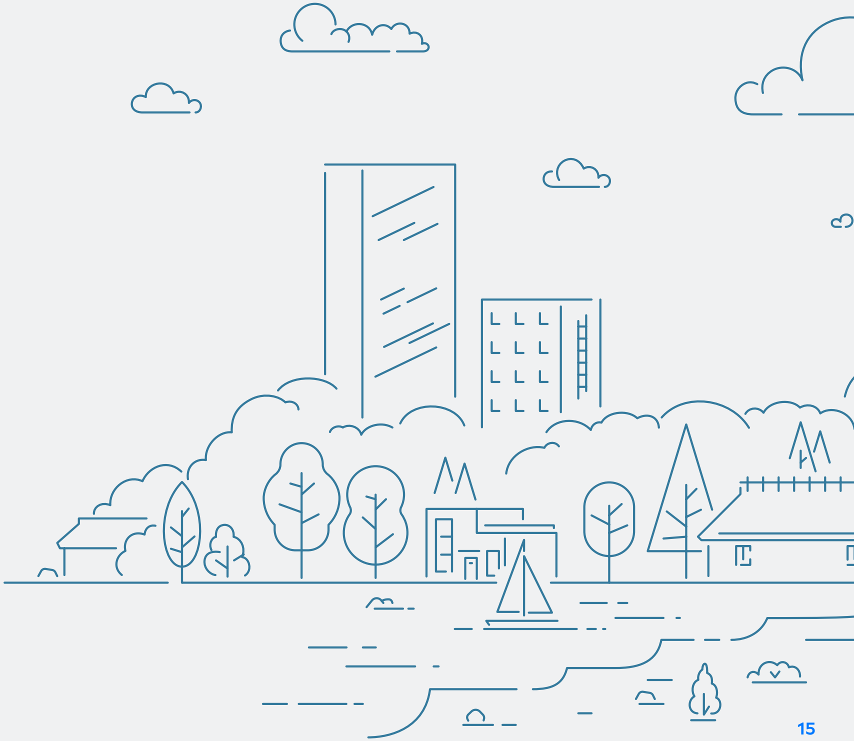
A **public limited company** is meant for large-scale ventures, where the minimum share capital (EUR 25,000) is higher than in a private limited company. Also, public limited companies can list their shares on a public exchange.

A **general partnership** (*täisühing*) must include two or more persons who are personally liable for the obligations of the partnership, while a **limited partnership** (*usaldusühing* or UÜ) has to include two or more persons, where one person is personally liable for the obligations and the second is liable to the extent of the capital they have paid in.

There is also the possibility of a **commercial association**, which has the purpose of supporting and promoting the economic interests of its members through joint economic activity in which the members participate as consumers or users of other benefits. A commercial association is liable for its obligations with all of its assets, while its members are generally not personally liable for the obligations of the association.

You will find further useful information and details about the administration and taxation of Estonian private limited companies in this guide.

If you prefer to dig deeper yourself, all Estonian laws and their translations into English are published in the State Gazette or *Riigi Teataja*: https://www.riigiteataja.ee/en/



Chapter 2

Setting up a company in Estonia

Summary
As you probably know by now, e-residents such as yourself can set up a company in Estonia almost entirely online. When you have a digital ID granting you access to Estonian e-services, all you need to do is submit an application through the Company Registration portal and wait for it to be reviewed and approved. The entire process usually takes less than one business day. Sounds easy enough, right?

Before getting to the specifics and formal compliance requirements, let's imagine that you intend to:

- establish an Estonian limited liability company — an *osaühing* (OÜ);
- provide services to your clients and not sell any goods;
- mainly work for the company yourself, but might also have employees;
- not live or work in Estonia, but be an e-resident.

It is important to keep these preconditions in mind as we will be focusing on this case study throughout the guide. For example, there are many forms of business entities to choose from, but to keep this guide as practical as possible, we focus on the **limited liability company** or OÜ, which is by far the most common form of business in Estonia.

In more detail

As mentioned above, establishing a limited liability company (hereinafter *osaühing* or OÜ) can be done entirely online through the Company Registration portal. Compared to other forms of legal entities, the main advantages of an OÜ are the simplicity of the registration process and the low share capital requirement, the payment of which can even be postponed when certain conditions are met (discussed in more detail below).

Also, the limitation of liability is beneficial: this means you are shielded from the OÜ's liabilities of the *OÜ*. The responsibility for fulfilling its liabilities to creditors or authorities falls upon the company itself and is limited with the company — unless you break the law, that is.

Below are the steps that need to be taken in order to successfully register your company:

1. **Deciding on the name of your company.**
   - Bear in mind that you can only use Latin letters when coming up with a name. No special characters are allowed, but the Estonian alphabet has some curious letters such as "ä," "ö," "õ" and "ü", which you are more than welcome to use. Also, your business name must be distinguishable and unique, meaning that there can be no overlap with already existing companies. If you want to create a homepage for your company, then it is recommended to check whether the desired domain name is available before starting.

2. **Obtaining a legal address and a contact person located in Estonia.**
   - Your company needs to have an Estonian address. You may not register a P.O. box as an address. Also, while there is no requirement to have a local director (member of the company management board), you need to appoint a local contact person. The contact person acts as a messenger and must be available onsite if local authorities need to contact your company and cannot reach you in person. The contact person cannot make decisions or any commitments on behalf of your company. You will still be both the single owner and the single management board member for that legal entity, with full control of the company. There are many virtual office service providers in Estonia that specialize in providing such services to e-residents.

3. **Making a monetary share capital contribution.**
   - The share capital requirement for an OÜ is relatively modest — EUR 2,500. In principle, the share capital contribution can be made either by transferring funds to the company's start-up bank account or to the designated depository bank account of the Company Registrar. In practice, however, using one of these alternatives is fairly

difficult for an e-resident. As you probably don't have any previous contact with Estonia, it's also unlikely that you have already opened an account with an Estonian bank. The suggested solution is to postpone payment and establish a company without making a share capital contribution during the establishment process.

A few things to keep in mind when opting for a deferred share capital contribution:

- The planned share capital cannot exceed EUR 25,000 and a respective note to this effect must be made in the Articles of Association of the company. A note about not having paid in the capital will be included in the Company Register next to your company's name, which will be visible to everyone.

- Until you have paid the contribution in full, you remain personally liable for the company's obligations in the amount of the unpaid part. The company is not allowed to pay out dividends and increase or decrease the share capital, but is allowed to make salary payments.

Requirements for making a deferred contribution to the share capital are discussed in more detail below.

4

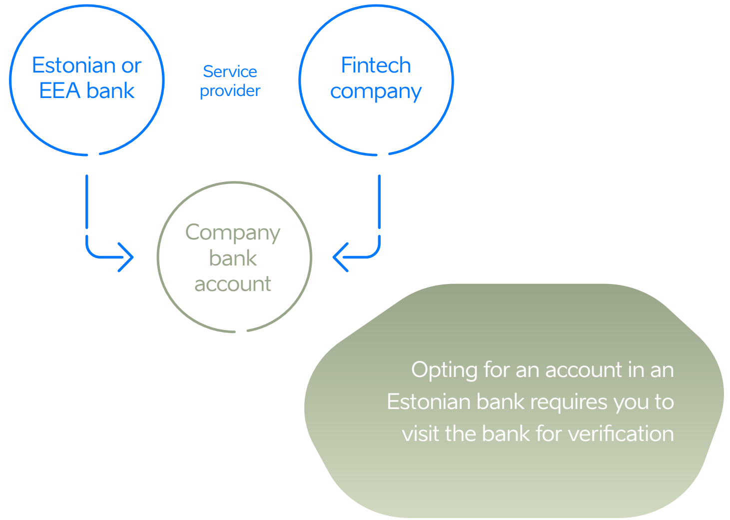
Choosing the main area of activity (based on the official classification in the Estonian Classification of Economic Activities or EMTAK).

- This basically means that you must select an area of activity from a specified list that best corresponds with your expected source of income for the first business year. It is perfectly acceptable to be active in other areas as well, and when circumstances change you can change your main area of activity with relative ease. Be aware that some areas are subject to special requirements and require specific licences.

Once you have successfully completed the previous steps and filled the application in the Company Registration portal, you can submit it for official review.

The state fee for establishing an OÜ online is EUR 190, which can be paid alongside the share capital contribution through the Company Registration portal during submission of the application. You can later indicate the paid state fee in accounting as a business expense in your accounts and use the deposited share capital for your business activity. The review process usually takes around one business day, after which a notification is sent to you via e-mail.

After your company has been registered in the Company Register, the next important step is **to open a bank account for your OÜ**, which would cover the company's daily banking needs.



There are several banks (e.g. LHV) and fintech companies that are prepared to offer their services to and open business accounts for e-residents. There is no legal requirement that the bank account should be with an Estonian bank and you may choose to open an account in another jurisdiction within the European Economic Area (EEA). However, when opting for an account at an Estonian bank, you have to travel to Estonia to visit the bank for verification. It is not possible to open an account in an Estonian bank remotely.

After choosing a suitable financial services provider, you can now make the share capital contribution by transferring the requisite funds from your private account to the company's bank account. It is possible to complete the payment in a single transaction or divide it into multiple smaller instalments. In both instances, it is necessary to add the explanation "*Osakapitali sissemakse*" (meaning "Share capital contribution") for each separate transaction.

In order to finalize this process, you need to log in to the Company Register and submit an application to change the data of your enterprise. The whole procedure is quite straightforward and takes just a few guided steps to complete. However, altering your company's information requires you to pay an additional state fee of EUR 18.

You also need to provide the Company Register with proof that payment to the company's bank account has indeed been made. A digitally signed statement confirming the payment may be requested from your financial services provider. In addition to having a digital signature, the statement should be in Estonian and meet the requirements of the Company Register. Generally, it takes a couple of days for the registration department to review the application and register the share capital contribution. **Make sure to also declare the share capital contribution on Annex 7 of form TSD, so you can make tax-exempt distributions in the amount of paid-in capital in the future.**

It is also important to note that, from January 2019, companies are no longer limited to using an Estonian bank when making a share capital contribution. Instead, they may opt for another credit or payment institution in the EEA. This in turn makes the whole process less bothersome for e-residents, who formerly were previously obliged to open an Estonian bank account at some point simply because they needed or wanted to make a share capital contribution. However, you should keep in mind that if your financial services provider is not an Estonian bank or a fintech company with the necessary capabilities (i.e. able to provide you with a digitally signed statement in Estonian), the payment verification process may become a little more complex. In this scenario, you need to ensure that the statement provided by your financial services provider is notarized into a document that is in line with the requirements described above.

So, you have set up a company in Estonia and opened a bank account – what's next?

Summary

The answer to this question is actually very simple: you have a functioning company in Estonia through which you can now start carrying out your business. But you can't run a business in Estonia (or anywhere else, for that matter) without recording your transactions and keeping financial records. As your company is incorporated in Estonia, it is important that you understand the basics of Estonian accounting and legal requirements to comply with the local rules and regulations. This of course includes knowledge of the Estonian tax system. It is up to you to decide whether you think you need assistance on the subject or not.

Before getting into more detail about the specifics of accounting and taxation, it is worth mentioning that there are many different accounting service providers who are more than willing to assist you with your everyday accounting needs. However, if you are set on managing your company without external help, there is a small business accounting tool embedded in the Company Registration portal called e-Financials, which is specially designed for companies that wish to manage their own bookkeeping.

In more detail

Accounting

When conducting business in Estonia, you should comply with the local accounting and legal standards. A company needs to keep its books so that creditors and business partners may be certain about the financial position of the company and taxes can be calculated correctly.

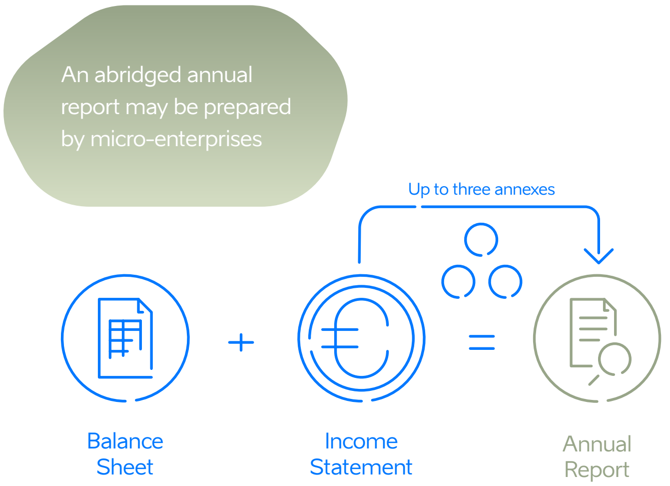
There are two main accounting policies to abide by:

- the Accounting Act of the Republic of Estonia;
- the guidelines issued by the Accounting Board of the Republic of Estonia.

Financial statements should be prepared using either the Estonian financial reporting standard (local GAAP) or IFRS as adopted by the EU. When you are running a small- or medium-sized company, the local GAAP is usually recommended, as it is simpler than IFRS.

For your newly-formed business, as for all Estonian companies, compiling an annual report is mandatory. The financial year in Estonia is 12 months long and usually coincides with the calendar year, meaning that it starts on 1 January and ends on 31 December (although it is possible to change it to any 12-month period). Generally, the annual report should consist of the annual accounts (balance sheet, income statement, cash flow report and statement of changes in equity, plus annexes) and the management report.

However, in the case of your company, which would probably be classified as a micro-enterprise[1] by Estonian standards, an abridged annual report may be prepared, meaning that only two basic reports must be added to the annual accounts (balance sheet and income statement, plus up to three annexes). Compiling a management report is not necessary. The annual report should be submitted to the Commercial Register within six months of the end of the financial year. You can file your annual report through the Company Registration portal in XBRL format.



[1] Private limited company or *osaühing* (OÜ) meeting all the criteria described below:

- total assets not exceeding EUR 175,000;
- annual revenue not exceeding EUR 50,000;
- total liabilities not exceeding total equity;
- one shareholder who also acts as a member of the Management Board.

You must also preserve important accounting source documents and financial statements. These include invoices, accounting ledgers, journals, contracts and other relevant business documents, which may be necessary for the purposes of a potential audit or reconstruction of transactions. Generally, the relevant accounting documents must be preserved for at least 7 years after the end of the financial year. There are slight variations for documents relating to long-term rights/ obligations, for example, where the 7- year preservation rule starts after the expiration of the document.

Finally, there are certain quantitative thresholds in place that will help you recognize the moment an audit or a review becomes mandatory. Despite the fact that reaching said thresholds might be quite a challenge for a smaller company, it is probably best to familiarize yourself with them early on so you aren't caught by surprise in the future.

Below are the relevant thresholds regarding revenue, employees and total assets:

	Audit	Review	Audit	Review
	Two of the indicators exceed the threshold		One of the indicators exceeds the threshold	
Revenue*	EUR 4 million	EUR 1.6 million	EUR 12 million	EUR 4.8 million
Employees**	50	24	180	72
Total assets***	EUR 2 million	EUR 0.8 million	EUR 6 million	EUR 2.4 million

* Total for the financial year
** Average for the financial year
*** As at the end of the financial year

Taxation

To facilitate doing business through an Estonian company, it would be good to have a basic understanding of the Estonian tax system, which includes knowledge of important deadlines, thresholds and other requirements that may impact the company's tax obligations. It is also important to understand the nature of your field of activity in an international setting, because doing business across borders may require you to be compliant with more than just Estonian tax legislation.

Companies that are registered in the Estonian Companies Register will be automatically recorded in the taxpayers registry, which is held by the Estonian Tax and Customs Board. Therefore, no separate registration as an Estonian taxpayer is required (other than for VAT purposes, which is discussed below). This means that your company's registration number is also your company's tax identification number.

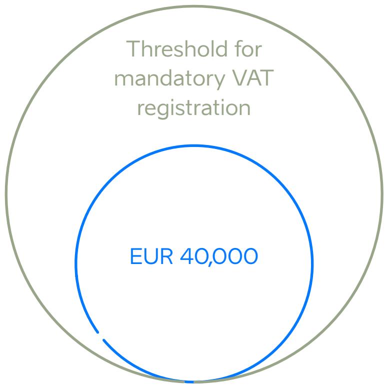
The first step is the creation of an e-services account for you and your company to gain access to the e-Tax/e-Customs services online. A contract must be concluded with the Estonian Tax and Customs Board, after which you will be given an official account. The process is quite similar for private clients (private individuals) and business clients (legal persons), both of whom can conclude the contract wholly online. After the accounts have been created, all private and business client electronic services will become available. However, in order for you to be able to have access to the business client services, you must first authorize yourself as an official user.

Through the e-Tax/e-Customs environment you will be able to:

- pay taxes and view payment history;
- submit all your necessary tax returns;
- communicate with the Estonian Tax and Customs Board;
- register your company's liability for value-added tax, etc.

You are also able to notify the Tax Authorities on a preferred language, having the choice between Estonian, English and Russian.

VAT registration
First of all, it is important to note that when you set up a company in Estonia, you are not automatically treated as a person liable for VAT, nor do you have the right to deduct input VAT that the company incurs when buying goods or services for its business. The turnover threshold for mandatory VAT registration is EUR 40,000 from the beginning of a calendar year. So basically, if your annual taxable supply is below EUR 40,000, you have no obligation to register as a person liable for VAT and you are not required to calculate and pay VAT on the provided services which would otherwise be taxable.

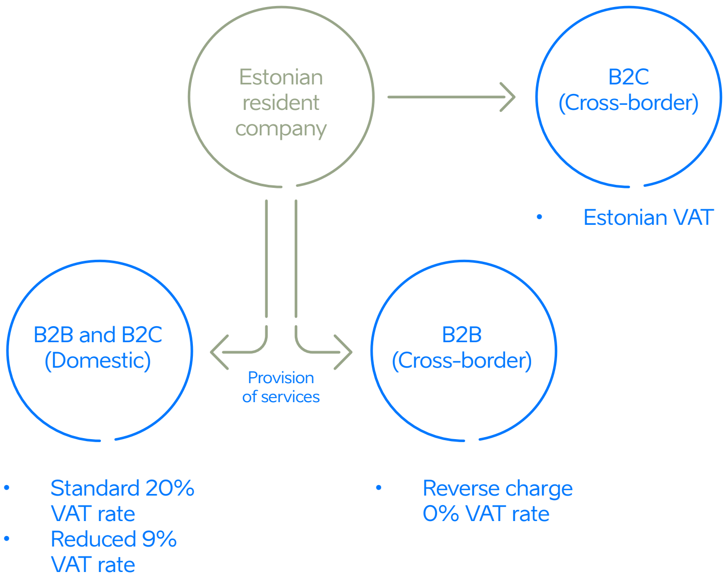


However, the moment you exceed the threshold you have three business days to register as a taxable person. It is important to note that the Estonian Tax and Customs Board will start treating you as a taxable person the moment your taxable supply reaches the threshold. So, when you realize that it's likely that you are going to reach it, it would probably be wise to anticipate the registration obligation and set the process in motion. As a VAT payer you must now pay VAT to the Estonian Tax and Customs Board and submit monthly VAT returns (even for the months when there may be nothing to declare).

Voluntary registration before reaching the registration threshold is also possible. All you need to do is provide the Estonian Tax and Customs Board with sufficient evidence (normally a business plan) that proves your intentions of starting and running a business. Be aware that the tax authorities may refuse VAT registration if you have no transactions with customers located and operating in Estonia. You should know within five business days if the tax authorities have accepted your application or not. If they do, you will be registered as a taxable person at the date of the application. Estonian VAT number starts with the prefix EE, followed by nine digits: e.g. EE123456789

What are the main VAT implications if your company is registered for VAT purposes?
As stated in the preconditions at the beginning of this chapter, you have established an OÜ in Estonia and provide services to your clients. Provision of services to other Estonian companies and/or individuals will generally be subject to the standard 20% VAT rate. There's also a reduced 9% VAT rate in use, which applies to the provision of accommodation services and to the sale of books, certain periodicals, pharmaceutical products and medical devices. If, however, you provide services to customers in other EU Member States or third countries, then a 0% VAT rate is generally applied.

If you issue invoices to corporate customers (business-to-business or B2B transactions) in other EU Member States or third countries, you should include a VAT registration number for the customer and a reference to "reverse charge mechanism", meaning that you apply 0% VAT and the customer applies and reports VAT by self-assessment in the Member State that issued the VAT identification number. The situation becomes a little more complex when your customers are final consumers (business-to-consumer or B2C transactions) in other EU Member States or third countries. If services are provided to final consumers outside Estonia, these would be subject to Estonian VAT, unless an exception based on the nature of the service applies. In the latter case there may be an obligation to register your company for VAT in the country where the final consumers are located and to comply with local VAT rules. Also, keep in mind that there are rules depending on the type of service that is performed, which determines where a certain service should be subject to VAT.



If your company provides services that are entirely taxable (i.e. 20%, 9% or 0% VAT rates are applied), you can deduct VAT paid on the purchase of goods and services on all costs related to your business activities aimed at making taxable supplies (with a couple of exceptions to the general rule). If at the end of the month you have paid more input VAT than you have added to your taxable supply, these funds will be released to your prepayment account after official approval from the tax authorities and you can use these to cover other tax-related liabilities or apply for a refund.

As a VAT-registered taxable person, your company is liable to calculate and pay VAT on its taxable supply, goods and/or services purchased under the reverse charge mechanism from other EU Member States and third countries. In some rare cases, goods purchased from another Estonian taxable person will also be subject to reverse charge (e.g. scrap metal).

The taxable period for VAT is one month, and you must declare and pay VAT to the tax authority by the 20th day of the following month. You can file VAT tax returns using the e-Tax/e-Customs online environment: VAT declarations on form KMD and an Annex KMD INF listing all sales and purchase invoices with domestic counterparties exceeding EUR 1,000 in one month must be declared on form KMD INF. Supplies of services to VAT-registered customers of other EU Member States must also be declared in the monthly EC sales list due by the 20th of the following month.

Keep in mind

- E-Residency is not the same as tax residency
- You are not your company — each is taxed as a separate person
- Tax treatment differs for Estonian residents, EU residents, residents of **treaty countries** and for third-country residents
- Income tax and social tax should always be viewed separately
- Your activities could create a **permanent establishment**, i.e. a taxable presence for your Estonian company wherever you are located.

We will make the following assumptions about you for the purposes of these guidelines. So, let's imagine that you

- are not a tax resident in Estonia, but are an e-resident;
- have established an Estonian limited liability company (*osaühing* or OÜ);
- sell services to your clients, not goods;
- mainly work for the company yourself, but may also have employees;
- do not live or work in Estonia;
- are the only shareholder of your company, or if there is a second shareholder, you have the majority of shares.

Chapter 3

Taxation of an Estonian company and payments from an Estonian company

Summary

What happens in Estonia if my Estonian company makes a profit?

Note that the following comments are about the taxation of the Estonian company and its taxation only in Estonia

For tax purposes — nothing happens. You are free to reinvest the profit back into your company and make every business-related expense necessary.

Unlike classical corporate income tax systems, where a company's profits are taxed on an annual basis, Estonia's unique tax system allows for either deferring the corporate income tax (CIT) charge indefinitely or freely deciding on when to distribute dividends along with paying the tax due. This means that all retained profits are tax exempt and only the distribution of profits or making other taxable payments triggers payment of tax.

Also note that losses have no special meaning in the context of the Estonian tax system; they simply reduce the profit available for distribution.

NOTE

Until you start distributing dividends from your company, there is no rule forcing you to pay yourself a taxable salary or fee. However, once you do decide to make dividend payments, your role in the company (active employee/director vs passive shareholder) should be analysed in more detail to make sure that each role you carry out is compensated and taxed appropriately. This is because salaries are usually also taxed with social tax while dividends are not, but opting for dividends to save on taxes is not allowed.

To sum up this convenient feature of the Estonian tax system, you can operate your company without registering yourself as an employee or board member, and you don't have to pay any Estonian tax until your company starts making enough profit to pay salaries or dividends.

My company is making a profit - how can I take out funds from it?

Note that the following comments are about the taxation of the Estonian company and its taxation only in Estonia

Dividends

As a shareholder, it is reasonable to expect dividend income from your profit-making company. As mentioned above, all retained earnings of an Estonian company are tax exempt, and it is only when you decide to distribute dividends that the 20/80 CIT on the payment is triggered. We'll come back to why the tax rate is expressed in such a way.

To be more precise, the effective corporate income tax rate applicable to profit distribution can vary from 14% - 20% depending on the company's dividend policy.

The lower end of the CIT rate can become available for your company if it pays dividends on an annual basis. There is a special rule which says that regular profit distributions which are less than or equal to the average dividend payment that the company has made in the three preceding years are subject to CIT at a lower rate of 14/86 — note that special rules apply for making use of this, as described below.

The formal procedure for effecting a dividend distribution is regulated by the Commercial Code, more specifically by Chapter 19. But even if you fail to follow certain legal formalities, the tax treatment does not change and distribution of profits is still taxed as dividends — we call this the "substance over form" principle in tax law, and it is useful to keep this in mind at all times.

Further reading:
Substance over form principle
The legal form of an arrangement or transaction is ignored and the actual economic substance is looked at for tax purposes. This helps prevent artificial structures from being used to avoid tax.

Further reading:
Dividends
Dividends are paid from the net profit or retained profit of a company in accordance with the decision of the shareholders or other competent body.

Dividends are normally considered passive income for the recipient, as opposed to employment income.

In more detail

Formalities

Formal profit distributions are called dividends. To distribute dividends, you should usually follow these steps and formalities:

1. Make sure that you have paid in the mandatory share capital (the minimum capital is EUR 2,500 unless you decided on a higher amount yourself);
2. The latest Annual Report of the company should be approved through a digitally signed resolution of the sole shareholder;
3. When deciding on the dividend amount, make sure it does not exceed the retained earnings/undistributed profit according to the Annual Report of the company. Secondly, the net assets of the company may not fall below half of the share capital or the mandatory minimum share capital of the company as a result of the dividend payment — whichever is higher;
4. The general meeting of the shareholders (that would be you) decides to distribute dividends on the basis of the approved Annual Report in the form of a sole shareholder's resolution;
5. As the sole shareholder, draft and sign the decision[2] to distribute dividends;
6. The company should pay the cash dividends to the shareholder's current account;
7. The respective entries should be made in the accounting. Once the decision is made, it should be D — retained earnings and C — dividend payable. Upon actual payment it becomes: D - dividend payable and C — bank;
8. The dividend payment should be declared on tax return TSD Annex 7 and tax due on the dividend distribution remitted by the 10th day of the month following the actual payment.[3]

Taxation

Dividends and other taxable distributions trigger 20% CIT on the gross distribution, which equals 25% on the net distribution. The Estonian CIT rate is formally expressed as 20/80. The tax amount can be calculated in two ways, depending on where you start. Let's have a look.

If you distribute the entire profit, then you can simply apply the 20% CIT rate to reach your tax cost:

Example 1

Profit i.e. gross dividend	CIT rate	CIT payable	Net dividend
100	20%	20	= 100 — 20 = **80**

However, if you start out with the dividend amount you want to receive (let's choose the amount of 80 again), a "gross-up" calculation should be made, as in Example 2 below. The net dividend amount should be divided by 0.8. Note that the so-called underlying profit is still the same: 100.

[2] The decision should include:
1. the net profit;
2. the transfers to legal reserve;
3. the transfers of profit to other reserves prescribed by law or the articles of association;
4. the share of profit to be paid to shareholders;
5. the use of profit for other purposes.

[3] If the 10th day falls on a weekend or bank holiday, the tax return and payment is due on the next business day.

Example 2

Net dividend	CIT rate	CIT payable
80	20/80	= 80/0.8*20% = 20

Once we have settled the corporate income tax side, additional tax obligations should then be considered. In many countries, the net dividend payment may be subject to a dividend withholding tax (WHT). The good news is that no Estonian WHT applies to dividend payments that have been subject to the full 20% CIT at the hands of the paying company, regardless of who the recipient is.

But remember that when a reduced tax rate of 14/86 is applicable, a 7% WHT applies to such dividends in certain cases (further details below). This reduced 14% tax rate was introduced to encourage companies to establish a stable dividend policy. It is stated that a dividend payment equal to or less than the average taxed dividend payment of the three preceding years is subject to tax at the rate of 14/86. It sounds complicated, but the e-tax authorities' program keeps track of the amount available for distribution at a lower rate and calculates it automatically.

In practice, regular annual dividend payments gradually decrease the effective tax rate of the company.

Example

If you pay dividends of 100 in year one with a CIT cost of 25, then the following year you will be able to distribute one third of 100, i.e. 33.33, with the tax rate of 14/86 whilst the remaining 66.67 will be subject to the standard 20/80 tax rate.

Provided that you continue to annually distribute dividends annually in the amount of 100, then the tax rate can be lowered to a stable 14/86.

Year	Net dividend	Tax base for 14/86	Tax base for 20/80	CIT
1	100		100	= 100/0.8*20% = 25
2	100	= 100/3 = 33.33	= 100-33.33 = 66.67	= 33.33/0.86*14% + 66.67/0.8*20% = 22.09
3	100	= (100+100)/3 = 66.67	= 100-66.67 = 33.33	= 66.67/0.86*14% + 33.33/0.8*20% = 19.19
4	100	= (100+100+100)/3 = 100	N/A	= 100/0.86*14% = 16.28

Please note that a 7% WHT applies on the portion of dividends distributed with a reduced 14% tax rate (the "14% dividends") **if** such dividends are paid to individuals — either resident or non-resident.

If you are the non-resident individual shareholder, the company must withhold and remit the 7% WHT on your behalf. This is understood to be a tax cost for the shareholder, i.e. a tax cost for you.

The 7% withholding tax has the following effect on the dividends you receive from your Estonian company:

Year	Net dividend	WHT of 7% on the "14% dividend"	Received by individual shareholder
1	100	No WHT	100
2	100	33.33*7% = 2.33	100-2.33 = 97.67
3	100	66.67*7% = 4.67	100-4.67 = 95.33
4	100	100*7% = 7	100-7 = 93

In the above example, you receive Estonian-sourced dividend income and 7% Estonian WHT has been withheld by the paying company.

Most likely, you should declare this dividend income in your annual personal income tax return in your state of residence and disclose the amount of tax that has been paid in Estonia. If necessary, a certificate can be requested from the tax authorities confirming the tax amount in Estonia.

Further reading: Withholding tax (WHT)

By definition, all withholding taxes are withheld and paid to the tax authorities by the company making the payment. Since tax is collected and paid on behalf of the recipient of the payment, it is considered a tax cost for the person receiving the payment and not the paying company.

The amount of withholding tax is calculated on the gross payment, then subtracted from the gross amount, and the net payment is made to the recipient.

Withholding taxes can apply to different payment types, but most commonly on dividend and interest payments.

Depending on the rules of your state of residence, this Estonian dividend income may also be subject to tax there, but it may be possible to credit the tax cost against your domestic tax liability or exempt it altogether in order to eliminate any double taxation.

Declaring

Remember, Estonia operates cash-based tax accounting as opposed to accrual-based accounting. Cash-based accounting is the accounting method wherein revenues are recognized when cash is received and expenses are recognized when paid. When you make a dividend distribution, tax must be declared and remitted by the 10th day of the following month.

Be sure to declare and pay your taxes on time, because interest of 0.06% per day is due on any tax arrears. This means that when you delay tax payment, you will be charged 0.06% late payment interest for every day that the tax debt is outstanding.

The monthly combined income tax and social tax return is called "TSD." It comprises seven different annexes, each for declaring different types of payment. To declare dividend payments, you should use Annex 7.

For declaring purposes, a non-resident recipient of dividends should have their own unique non-resident's code. As an e-resident, you will have already been assigned an ID code along with your digital identity card — this is also your "tax identification number".

Directors' fee

Summary

For the purposes of these guidelines, a director = management board member of the Company. Regardless of where the functions of the director are actually performed for the benefit of the company, the fee is usually subject to both 20% income tax and 33% social tax in Estonia. Some exceptions might apply with respect to social tax.

In more detail

Taxation

Estonian rules provide that directors' fees paid by an Estonian company to a non-resident director are always subject to 20% personal income tax. Tax treaties follow the same logic and normally allocate the taxing rights to the country where the company resides. This means that, since the company is established in Estonia, all directors' fees are taxed in Estonia, no exceptions.

Social tax gets trickier depending on where you live, whether you are covered by a social security scheme and whether your country has an agreement for social security with Estonia or is part of the EU or European Economic Area or is Switzerland. All these factors must be considered.

As you know, income tax and social tax behave differently and should be handled separately. In Estonia, the general rule is that, in addition to income tax, the company must also pay 33% social security contributions on the gross directors' fees regardless of where the services are performed. However, if you are merely an e-resident and already covered by a local EU[4] social security scheme in your home country, of course it would be unfair to have to contribute to the Estonian social security system as well. In some cases, such double contributions can therefore be avoided.

1. You live and are secured for social benefits in an EU Member State, Norway, Iceland, Liechtenstein or Switzerland.

   To avoid having the company pay 33% social tax in Estonia, you should obtain an A1 certificate proving your coverage from the local competent authorities and submit it to the Estonian tax authorities. The A1 and other forms regarding social security rights are listed here, but more specific information is most likely available in your home country: https://europa.eu/youreurope/citizens/work/social-security-forms/index_en.htm

2. *If you live and are insured for social security in Canada, Ukraine or Australia* — countries that have concluded an Agreement on Social Security with Estonia — you can present the respective certificate demonstrating your social security coverage issued by your local competent authorities to allow the company to exempt directors' fees from social tax in Estonia.

3. *Directors' fees paid to residents of third countries* or those persons not covered by a social security scheme in EU , EEA countries, Switzerland[5] or treaty countries[6] will not be able to get an exemption from Estonian social tax.

Declaring

A director should be registered with the tax authorities as a **non-resident** in order to receive the identification code necessary for declaring purposes. However, being an e-resident, you can use the identification code you received upon registration. The employment register kept by the tax authorities should also be filled in separately if the director receives pay — this can be done via the e-tax authorities.

Payments made to non-residents must be declared on TSD Annex 2 and remitted by the 10th day of the month when the payment was made.

Make sure to declare and pay taxes on time, because an interest of 0.06% per day is due on any tax arrears. This means that when you delay tax payment, you will be charged 0.06% late payment interest for every day that the tax debt is outstanding.

[4] Norway, Iceland, Liechtenstein and Switzerland are covered in addition to EU Member States.

[5] The EU Member States as well as Norway, Iceland, Liechtenstein and Switzerland.

[6] Agreements on Social Security have been concluded with Canada, Ukraine and Australia.

Example

An Estonian company pays directors' fees to a non-resident member of the management board who travels and works internationally and is rarely in the same country for more than a month. The director has submitted form A1 demonstrating social security coverage in another EU or treaty state (Canada, Australia or Ukraine for social tax purposes). Personal tax allowances are not taken into account.

1)	The gross fee agreed with the director is EUR 1,000	1,000
2)	The company must apply and withhold 20% PIT	-200
	The director receives a net salary of EUR	800

In the example above, the total cost for the company is EUR 1,000. Unemployment insurance contributions do not apply to directors' fees and social tax is not due in Estonia as the director has social security coverage in another EU state and has the A1 form to prove it. PIT in the amount of EUR 200 is transferred to the state budget and the director receives EUR 800 as a net payment.

NOTE

Make sure you comply with reporting and tax obligations in your home state regarding Estonian-sourced directors' fees.

Salary

Summary

Normally an Estonian company is normally liable to withhold 20% personal income tax and apply 33% social tax on salary payments for work performed physically in Estonia. Unemployment contributions of 1.6% are withheld and 0.8% applied on the gross salary.

If however, the work is not physically performed in Estonia, no Estonian PIT or Estonian social tax or unemployment contributions apply to salary payments as these are not considered to be sourced in Estonia. The income is taxable in the state of residence of the employee.

In more detail

Salaries and fees paid by an Estonian company under employment and service agreements are taxed in Estonia if the activities are carried out in Estonia. If you or any employees or contractors work exclusively abroad, no tax obligation arises in Estonia and you should consider the tax treatment in the respective state of residence. No Estonian social taxes apply if work is performed outside Estonia either.

If you have a non-resident employee who does not work physically in Estonia, you don't have to report anything to the employment register. However, payments made to non-residents must be declared on tax return TSD Annex 2.

However, if you do have an employee residing in Estonia, the salary is taxed with all relevant payroll taxes. Let's see an example in practice.

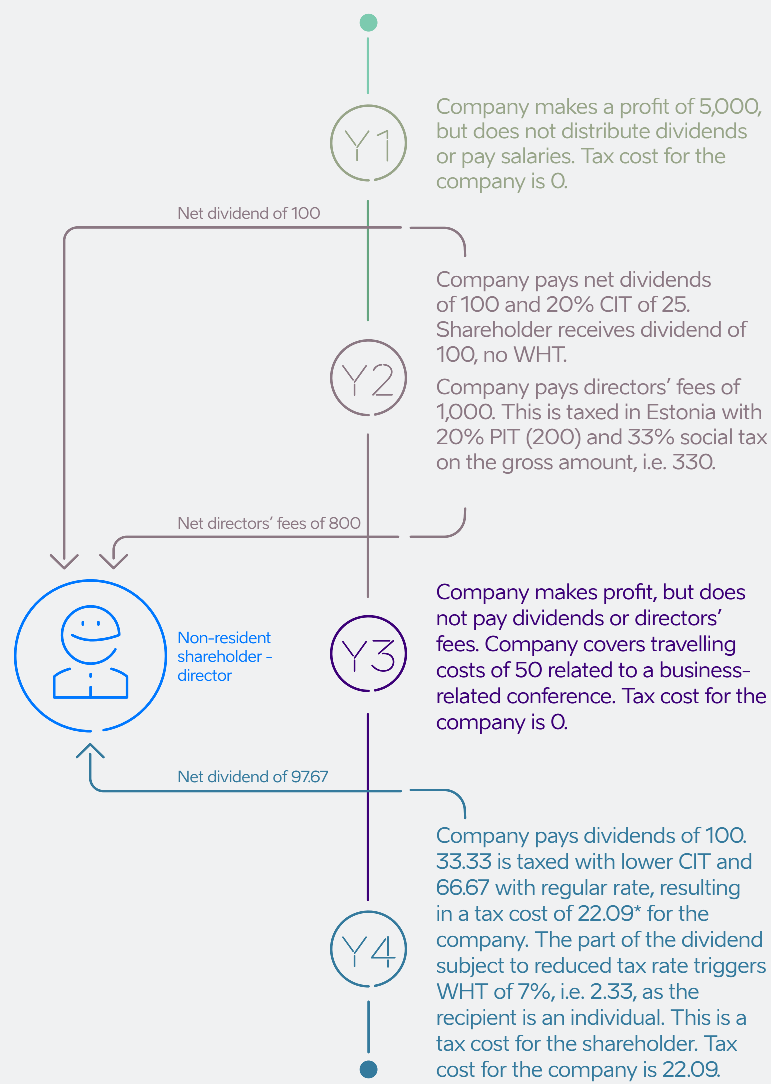
Example

An Estonian company pays a salary to an Estonian-resident employee working in Estonia. Personal tax allowances are not taken into account and 2% compulsory accumulative pension contributions are not applied in this example.

1)	The gross salary agreed with the employee is EUR 1,000	1,000
2)	The company is allowed to make a deduction in the amount of the employee's unemployment insurance contribution of 1.6% to reduce the tax base	-16
3)	Now the company can apply and withhold 20% PIT	-196.8
	The employee receives a net salary of	787.2
4)	The company starts calculating its own tax liability based on the gross salary and applies 33% social tax	330
	Employer's unemployment insurance contribution of 0.8% is also calculated on the gross salary	8

In the example above, the total cost for the company is EUR 1,338. The total tax amount of EUR 550.80, which consists of unemployment insurance contribution, personal income tax withheld and social tax, is transferred to the state budget and the employee receives EUR 787.20 as a net salary.

Different remuneration types - illustration



* One-third of the average dividend of the three preceding years is subject to 14/86 CIT. The rest of the net dividend is subject to 20/80 CIT. WHT of 7% is applied to the portion of the net dividend that was subject to 14/86 CIT.

In the above example the company made a profit of	5,000
Over four years, the company paid CIT of	47.09
The company paid social tax of	330
The company withheld and remitted PIT of	202.33
The company had business expenses of	50
The shareholder director received	997.67
The company still has retained earnings of	3,372.91

What should I consider in my state of residence?[7]

Generally, residents are taxed on their worldwide income in their state of residence. This means that the country where you submit your annual personal income tax returns usually wants to tax income you have earned from everywhere in the world. Normally there are also both domestic and bilateral measures in place to avoid or mitigate double taxation if this income has already been subject to tax in the country you received it from, i.e. the source state.

For that reason, you should have proof of taxes paid or taxes that have been withheld in Estonia readily available to be presented to your local tax authorities. Local tax treatment could be different for each type of income (dividend, salary, directors' fees) and it might also be affected by what has been agreed in the tax treaty your country has concluded with Estonia.

[7] Always seek advice from a local professional if you are unsure of tax rules applicable to your situation. The information provided here is only of general nature and should not be relied upon.

The most common method for alleviating double taxation is the **credit method**. This means that your state of residence might allow you to credit your domestic tax liability with the taxes that have been paid in Estonia.

If your country of residence exempts foreign income on condition that tax has been paid or withheld in the source state, having some tax paid or withheld in Estonia could even be good news. If your country of residence uses the **exemption method** for foreign dividend income, the 7% Estonian WHT might end up being the final tax on this item of income. Note that the corporate income tax paid by your Estonian company is not taken into account for your personal tax calculation purposes.

It is not uncommon for directors' fees, which have already been subject to tax elsewhere, to also be exempted from local income tax, but this should be confirmed with local tax experts.

Please note that the information presented in these guidelines is a generalization of a complex set of rules depending entirely on laws applicable in your state of residence and any treaty it has concluded with Estonia, and is therefore only for illustrative purposes.

If your state of residence has a treaty with Estonia allowing for a lower WHT rate than 7%, you need to obtain a Certificate of Residence from your local tax authorities or other competent authority to claim treaty benefits. Alternatively, you can fill in Estonian form TM3 and have your local authorities seal it. Countries with treaties allowing lower WHT rates are currently: Bulgaria, Israel and Macedonia (5%); and Mexico, Georgia, Cyprus, Jersey, Isle of Man and United Arab Emirates (0%). All treaties are available at: https://www.emta.ee/eng/business-client/income-expenses-supply-profits/international-agreements/conventions-avoidance-double

How do other countries generally offer relief from double taxation?

Ukraine

Ukraine has no domestic rules in place which would help you offset foreign taxes against your domestic tax liabilities. This means that, to avoid double taxation by way of the credit or exemption method, the Estonia-Ukraine tax treaty should be applied. Documentation requirements are set by the responsible Ukrainian authorities. The credit is limited to the amount of tax that would be due in Ukraine on the same type of income.

Germany

Foreign income of a German resident individual is largely taxed in the same manner as domestic income. While credit is generally given on account of foreign taxes paid, the tax treaty might require Germany to exempt certain income earned from abroad. The foreign income is usually considered when calculating your overall tax liability for German-sourced income.

France

Although it is not possible to summarize French tax rules applicable to foreign income of French resident individuals resident in France, on a high level, a resident is subject to tax on his/her worldwide income comparably to all domestic income.

It can be expected that employment income from Estonia is exempt from French tax, although it will likely be taken into account for calculating your domestic progressive tax rate. Other types of income such as dividends, interest and directors' fees are taxed on their gross amount in France, but a credit is usually given to the extent of tax paid in Estonia.

To avoid double taxation, the requirements for treaty application should be carefully examined and followed.

(You should also be wary of your Estonian company being captured by French Controlled Foreign Company (CFC) rules that aim to attribute income earned from a foreign company to your current tax base as an individual. These rules are complex and you are advised to consult a specialist on the matter.)

Chapter 4

Employment matters

Individual tax residency

Generally, individuals are taxed based on two principles — their residency and the source of income. The residency principle gives a country an unlimited taxation right on the worldwide income of that individual. Source taxation is limited to certain sources of income originating from a particular state.

Most countries consider an individual as their tax resident if the person has a permanent home in that country or the person spends a sufficient amount of time in that country. The same goes for Estonia.

A private individual is considered an Estonian tax resident if:

- his or her place of residence is in Estonia; or
- he or she stays in Estonia for at least 183 days over a period of 12 consecutive calendar months.

Since the conditions of tax residency are very similar in most countries in the world, it can happen that a private individual is simultaneously considered tax resident by two (or even more) countries at the same time. This is not a desirable situation, as it can easily result in double taxation. To resolve this (and several other types of double taxation situation), countries have concluded "Conventions for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income" (in short often referred to as "tax treaties") that, among other rules, resolve tax residency questions between states.

As of today, Estonia has concluded tax treaties with 59 countries around the world. Every treaty is available in Estonian and English on the website of the Estonian Ministry of Finance: https://www.rahandusministeerium.ee/en/tax-and-customs-policy/overview-estonian-bilateral-conventions-avoidance-double

In tax treaties, a certain test is normally included for resolving dual residency — a case where two countries claim the same individual as their tax resident:

- Firstly, the individual is resident in a country where he/she has a permanent home available;
- If he/she has a permanent home in both countries, the residency country of residence would be the one with which his/her personal and economic relations are closer. This means the country where his/her family, friends, work etc. are located.
- In the event that his/her vital interests cannot be determined, the residency country of residence is the one where he/she habitually lives;
- If he/she lives in both countries, the residency country of residence would be the one of which he/she is a national;
- In the event that his/her nationality is of none of the countries, the competent authorities must come to a mutual agreement about the country of residence.

In general, the country of tax residence is the one where the individual has closer economic and personal interests, for example where he/she has a home, lives, works, raises children and hosts barbecues.

Any change in tax residency must be notified to the Tax and Customs Board by submitting a specific notice — Form R. More information is available on the Estonian tax authority's webpage.

The country where you are a tax resident for tax purposes usually has an unlimited right to tax your worldwide income and is the one that should avoid double taxation with source countries by applying relevant domestic rules or tax treaty rules.

Some notes about labour relations in Estonia

Relationships between employers and employees are mainly regulated by the Employment Contracts Act (*Töölepinguseadus* in Estonian). Labour relations are also regulated by the Law of Obligations Act (*Võlaõigusseadus*), the Individual Labour Dispute Resolution Act (*Individuaalse töövaidluse lahendamise seadus*) and the Occupational Health and Safety Act (*Töötervishoiu ja tööohutuse seadus*).

All laws can be found on the Riigi Teataja website (in both Estonian and English).

Supervision of employers is carried out by the Labour Inspectorate (see more on their website).

To find employees, employers list job vacancies on their own website, use job sites (such as https://www.cvkeskus.ee/ and https://www.cv.ee/english/), search on LinkedIn or even use apps like MeetFrank. For more experienced and senior positions, headhunters are often used.

Even though Estonian labour laws are quite liberal, the principle of protection is applied towards the employee, who is considered the weaker party. This means, that as a rule, agreements which include disadvantageous clauses towards employees, compared to what is set forth in legislation, are likely considered void.

Some general useful information about employment can be found on the webpage of the Ministry of Social Affairs.

An Employment Agreement must be concluded in writing. Among other things, the contract must specify the employee's working hours, salary, method of calculation of the salary and procedures for paying the salary.

It is presumed that a full-time employee works 40 hours during a seven day period, for eight hours a day. Certain flexible options exist for applying a summarized working time calculation within a specified period of up to four months. Overtime is normally permitted upon agreement between the parties, but certain limits must be observed.

An employee is entitled to annual paid leave of at least 28 calendar days.

The employer is obliged to calculate and withhold all payroll taxes monthly. In Estonia the payment of social security payment in Estonia is solely the responsibility of the employer.

Now let's walk through some potential scenarios where your Estonian company has found the perfect person to hire:

Scenario 1 – Employing an Estonian tax resident

Consider hiring an Estonian tax resident to physically work in Estonia for your Estonian company. After negotiating the employment terms as usual, there are only two steps to complete regarding taxes.

1. **Register the new employee in the employment register, at the latest on his/her first working day.**

The employment register is maintained by the tax authorities. You can access the employment register online via the e-tax system, logging in to your company's profile with your e-Residency card.

You must insert the employee's personal information — name, personal ID code, the start date of the employment, type of employment, place of employment, the position of the employee and date of termination of contract (if applicable). Also remember to de-register the employee when he/she no longer works for you.

2. **Declare salary payments on the monthly combined corporate income and payroll tax return (called TSD in Estonia) and pay the taxes due.**

The TSD return must be submitted and the calculated taxes paid by the 10th day of the month following the month when the salary payment was made.

Since the employee is an Estonian tax resident working in Estonia, all payroll taxes must be paid in Estonia.

The tax return is accessible via the e-tax system, where you need to report the employee's ID code, gross salary, and whether the individual would like to make use of monthly deductions. Tax calculations are automatically made by the system itself.

Here is an example for calculation of payroll taxes:

	The gross salary agreed with the employee is EUR 1,000	1,000
1)	1.6% employee's unemployment insurance contribution	-16
2)	2% mandatory funded pension contribution*	-20
3)	EUR 500 monthly tax-free income**	-500
4)	20% personal income tax	-92.80
	The employee receives a net salary of EUR	871.20
5)	33% social tax calculated on top of the gross salary payable by employer	330
6)	0.8% employer's unemployment insurance contribution	8
	The total cost for the employer is EUR 1,338	1,338

* The mandatory funded pension is obligatory for those born in 1983 and later. Persons born between 1942 and 1982 had the option to voluntarily subscribe to the funded pension system. The right and obligation to pay the contributions arises on 1 January following the year when a person becomes 18 years old.

** The amount of tax-free income in Estonia or the so-called basic exemption in Estonia depends on an individual's total annual income, so it is different for everyone. The aim of the basic exemption is to reduce the tax base for personal income tax. The employer applies it upon application by the employee, as the employer may not know about an employee's income from other sources. The employee makes the application according to the following brackets:

- Average monthly income up to EUR 1,200 — basic exemption EUR 500 per month
- Average monthly income EUR 1,201-2,099 — basic exemption equals 500 - 0,55556 x (employee's income - 1,200)
- Average monthly income more than EUR 2,100 — no basic exemption.

The amount of the basic exemption may change multiple times during the year. For example, if an employee receives an automated notification from the Estonian tax authority that his/her used basic tax exemption is higher than his/her expected maximum basic exemption, the employee can submit a new application and change the amount the employer can deduct in the TSD return so as to avoid paying additional income tax when submitting the annual personal income tax return.

Further reading:
Tax-free income amount, i.e. basic exemption
The maximum tax-free amount (basic exemption) is EUR 6,000 per year or EUR 500 per month and is applied on all types of income (earned income, salary and other revenues, service fees received on the basis of a contract for services, business income, gains from transfer of property, rental income, royalties, interest, dividends, taxable pensions, benefits, scholarships and grants, awards, compensations or other income).

1. An annual income of up to EUR 14,400 allows for EUR 6,000 as the annual basic exemption
2. If the annual income increases to the range EUR 14,400 — 25,200 the basic exemption decreases according to the following formula: 6,000 - 6,000 ÷ 10,800 × (income amount - 14,400)
3. If a person's annual income exceeds EUR 25,200, no basic exemption is available.

The basic exemption can only be calculated and applied by one employer (the withholding agent) upon the employee's application. An employee who has several jobs should know that he/she is entitled to use the basic exemption for one salary only.

Final corrections and additional payments, if necessary, are made via the annual personal income tax return.

In the example above, the total payroll cost for the company is EUR 1,338. The total taxes payable amount to EUR 466.80 remitted to the state budget and the employee receives a net salary of EUR 871.2.

The minimum monthly gross wage in 2019 is EUR 540 per month and EUR 3.21 per hour. The average monthly gross wage at the beginning of 2019 was EUR 1,396. Statistics Estonia publishes overviews of average wages by economic activity. The latest can be found here, and on the same webpage you can view more detailed statistics about wage levels and other macroeconomic indicators.

Together with salary reporting, it is also necessary to report any fringe benefits given to the employee, but these are not personalized and do not affect the employee's taxable income.

In general, fringe benefits are all non-monetary benefits the employer provides to the employee and from which the employee benefits.

Let's have a look at an illustrative example.

You pay for the employee's lunch using company money. This is considered a fringe benefit and is taxable with a 20/80 income tax and 33% social security contribution.

	The value of the lunch is EUR 20	20
1)	Income tax is calculated on top of this i.e. 20*20/80	5
2)	Social tax is calculated on the gross value (lunch 20+income tax 5)*33%	8.25

The total tax cost of the EUR 20 lunch is EUR 13.25. The idea is to tax all non-monetary benefits similarly to salary to avoid employers trying to avoid payroll taxes by providing non-monetary benefits instead of paying salaries.

Further reading:
E-tax system
In Estonia, all tax returns are submitted electronically via the e-tax system.

When first entering the e-tax system, a user account is created for you.

If you have established your Estonian company using your e-Residency ID, you should have automatic access permissions for the use of e-services on behalf of the legal person and for the management of the access permissions.

Please note that additional access permissions might be needed to submit tax returns, such as the bookkeeper's package. More information about e-services is available at: https://www.emta.ee/eng/information-and-news-e-taxe-customs/instructions-using-e-services/access-permissions-and

You can access the e-tax system via the tax authority's web page: https://www.emta.ee/eng right on the top.

If you cannot see the company profile when entering the e-tax system, please contact the Estonian Tax and Customs Board at e-maks@emta.ee or +372 880 0815.

Scenario 2 - Employing a tax non-resident from the EU, Iceland, Liechtenstein, Norway or Switzerland

You are hiring an Estonian tax non-resident from either an EU country, Iceland, Liechtenstein, Norway or Switzerland. **The employee would continue working in his/her home country, i.e. not in Estonia.**

NOTE

No tax reporting or tax payment obligations should arise in Estonia. Both income tax and social tax would be payable in the employee's country of residence.

However, please remember to check the domestic tax laws of the respective country (where the employee works and is resident). It is likely that your Estonian company would have to register as a foreign employer and start paying payroll taxes in that country.

Further reading:

Main principles of social security in the EU

Individuals are covered by the social security system of one Member State at a time, so contributions are payable only in one country.

Usually social tax is usually paid in the country where you work, unless you are on an assignment or working in different Member States.

Now consider hiring somebody who is not an Estonian tax resident, but is a citizen of the EU, Iceland, Liechtenstein, Norway or Switzerland and **is happy to start working from Estonia while still living somewhere else.**

The good news is that a European Economic Area[8] (EEA) or Swiss citizen can work in Estonia for up to 3 months without registering their residence. After three months have passed, the individual can register his/her place of residence in the population register of Estonia to obtain the right of residence in Estonia. The right of temporary residence is given for five years with the option of extension. An ID card can be applied for from the Police and Border Guard Board. An ID card certifies a person's right of temporary residence. See https://www2.politsei.ee/en/teenused/elamisoigused/

If the employee becomes an Estonian tax resident, please see the compliance-related comments in: Scenario 1 - Employing an Estonian tax resident.

1 **Register the new employee in the employment register, at the latest on the first working day**

You can access the employment register via the e-tax system, logging in with your e-Residency card.

The employee's personal information needs to be filled — name, personal ID code, the start date of the employment, type of employment, place of employment, the position of the employee and date of termination of contract (if applicable). Remember to terminate the employee registration when he/she no longer works for you.

Please note that the tax non-resident employee needs to have a non-resident number or an ID number to register him/her in the employment register. This can be requested from the Tax and Customs Board.

However, if it is already agreed at the start of the employment relationship that the person will be working for more than 3 months, it is advisable that the individual registers his/her place of residence in the population register of Estonia before commencing work.

[8] Members of the EEA are all EU countries along with Iceland, Liechtenstein and Norway.

An application for an ID card can be submitted to the Police and Border Guard Board. This certifies the person's right of temporary residence. Furthermore, an ID card provides the opportunity to digitally sign documents and access electronic services, for example. More information is available on the Police and Border Guard Board's webpage.

2 Declare salary payments on the monthly corporate income and payroll taxes return (called "TSD" in Estonia) and pay due taxes

Since the non-resident is physically working in Estonia and the salary payment is made by an Estonian resident company (your company established in Estonia), the income tax is payable in Estonia.

As the place of work is in Estonia and no exemption applies — i.e. this is not an assignment nor is the employee working in different member states — social tax is also payable in Estonia. To avoid paying double social security contributions both in Estonia and in the country of residence, the exact position of the non-resident should be analysed in detail.

The tax return is accessible via the e-tax system, where you need to report the employee's ID code and gross salary amount. Tax calculations are made by the system itself. However, please remember that non-residents are reported in a different annex of the TSD as residents.

Here is an example for the calculation of payroll taxes.

	Gross salary agreed with the employee is EUR 1,000	1,000
1)	1.6% employee's unemployment insurance contribution	-16
2)	20% personal income tax	-196.80
	Employee receives net salary of EUR	787.20
3)	33% social tax calculated on top of the gross salary payable by employer	330
4)	0.8% employer´s unemployment insurance contribution	8

Tax-free income usually cannot be taken into account when making salary payments to tax non-residents. In addition, mandatory funded pension payments are not obligatory.

Tax non-residents can later apply for a basic exemption via their annual personal income tax return.

In the example above, the total cost for the company is EUR 1,338. The total tax amount of EUR 550.80 is remitted to the state budget and the employee receives EUR 787.20 as net salary.

Together with salary reporting, it is also necessary to report any fringe benefits provided to the employee. In general, fringe benefits are all non-monetary benefits that the employer provides to the employee and from which the employee benefits.

Here is an example.

You pay for an employee's lunch using company money. This is considered a fringe benefit and taxable with 20/80 income tax and 33% social security.

	The value of the lunch is EUR 20	20
1)	Income tax is calculated on top of it i.e. 20*20/80	5
2)	Social tax is calculated on the gross value (lunch 20 + income tax 5)*33%	8.25

Scenario 3 – Employing a tax non-resident from a third country

You are hiring an Estonian tax non-resident from a third country. **The employee would continue working in his/her home country, i.e. not in Estonia.**

NOTE

No tax reporting or tax payment obligations in Estonia. Both income tax and social tax would be payable in the employee's country of residence.

However, please remember to check the domestic tax laws of the respective country (where the employee works and is resident). It is possible that your Estonian company needs to register as a foreign employer and start paying payroll taxes in that country.

However, if you are hiring an Estonian tax non-resident from a third country to start **working in Estonia**, a number of aspects should be considered for your employee to do so legally.

Estonia is part of the Schengen Area, meaning that border controls are abolished within this space. The European Union has established a common visa policy for intended stays in the territory of a Schengen States of no more than 90 days in any 180-day period. Information about nationals that do not need a visa to enter Estonia for stays of no more than 90 days in any 180-day period can be found on the webpage of the Ministry of Foreign Affairs.

If a visa is needed, your employee must apply for a D visa. The application should be submitted with all necessary documents (valid travel document, completed and signed application, photo, insurance policy and other documents as needed) in person to an Estonian representation abroad or that of another Member State representing Estonia in issuing Schengen visas.

After that, in the majority of cases, the employer (i.e. you), must register this short-term employment with the Police and Border Guard Board before the employment starts. Non-residents may act as a member of the management or supervisory board of an Estonian legal entity without registering.

More information about registration can be found on the Police and Border Guard Board's webpage.

If the employment relationship lasts for a longer period than provided by the visa or visa freedom terms, the employee should apply for a residence permit for employment to work in Estonia for a longer period than allowed by the visa or the visa-waiver programme. As of the end of 2013, there is no separate work permit available; an individual is permitted to work on the basis of a residence permit. A residence permit may be temporary or long-term.

The basis and conditions for applying for a residence permit depend on the employee's special conditions and the area of business. In most cases, they must meet the salary criterion and receive approval from the Estonian Unemployment Insurance Fund. Moreover, the residence permit is subject to the immigration quota for aliens.

Approval from the Estonian Unemployment Insurance Fund will be given if the vacant position cannot be filled by an Estonian or EU citizen or an alien already residing in Estonia, and if your potential employee has the qualifications, education, health, previous experience etc. to do the job. Unless an exemption applies, the salary must usually be at least the recent average yearly wage in Estonia published by Statistics Estonia.

Exceptions not requiring approval from the Estonian Unemployment Insurance Fund and not meeting the salary criterion are:

- clergyman, nun or monk invited by religious associations;
- holders of a long-term residence permit of the EU Member State;
- journalist accredited by the Ministry of Foreign Affairs;
- rights from international agreement;
- a teacher or member of academic staff in an Estonian educational institution;
- performing arts institution as a person engaged in creative activities;
- professional activities as a sportsman, coach, referee or sports official;
- a posted worker in the meaning of the Working Conditions of Workers Posted in Estonia Act;
- performing managerial or supervisory functions of a legal person registered in Estonia that is governed by public law;
- those that have acquired higher education in Estonia in Bachelor's, Master's or Doctor's degree studies;
- **Employment with a startup!**

Not requiring approval from the Estonian Unemployment Insurance Fund, but meeting the salary criterion:

- expert, adviser or consultant (professional qualification required);
- employment in a sphere listed in an order of the Estonian government where there is a need to reduce labour shortages;
- performing managerial or supervisory functions of a legal person registered in Estonia.

More exemptions and specifics are established for scientific research, employment of a top specialist, employment as a temporary agency worker, working at a startup and working as an employee transferred within an undertaking.

More detailed information can be found on the Police and Border Guard Board webpage.

One common exemption applies to top specialists. A top specialist is an individual with relevant professional training or experience. When applying for a residence permit, the qualification of the individual might be checked using various documents (education, previous work experience etc.).

Points to note regarding top specialists:

- The salary paid must be at least equal to the latest annual average wages in Estonia published by Statistics Estonia, multiplied by the coefficient 2.
- Permission from the Estonian Unemployment Insurance Fund is not needed.
- The employer is registered in Estonia for at least 12 months and has at least EUR 65,000 in equity capital or sales revenue of EUR 200,00 per year or the social tax paid by the company is equal to at least 5 times the social tax paid on the Estonian total average gross wage.

Startup visa

Let's assume that you have an Estonian startup, a term which is defined as follows:

With a high global growth potential, innovative and scalable and shall significantly contribute to the development of the Estonian business environment.

In this case, it is possible to apply for both a visa and a residence permit for a startup business. This is a simplified opportunity to hire or come to work in Estonia for a startup.

NOTE

Eligibility as a startup and to use the simplified process is determined by a committee of experts. The experts will make the decision, upon submitting an application, on whether your company can be considered a start-up or not.

The simplified process has the following benefits:

- No obligation to pay employees at least the Estonian average salary or double the average salary;
- No need to take into account the immigration quota;
- No need to receive permission from the Estonian Unemployment Insurance Fund;
- Additional requirement for paid-in capital for holding in a company does not apply.

Please bear in mind that this is a simplified process designed to attract startup businesses to Estonia.

For companies that do not qualify as a startup, each case is individually reviewed on a case-by-case basis.

So, let's assume that you want to hire an employee from India to come and work in Estonia for your Estonian startup company. The following steps need to be taken.

1. **Submit an application to the committee at the Ministry of the Interior, to decide whether your business qualifies a startup. The application is usually processed within 10 days.**

Assuming you get an affirmative response from the committee, you can now:

2. **Register for short-term employment with the Police and Border Guard Board. The application is usually processed within 10 days.**

The application form can be found here.

3. **The employee goes in person to their nearest Estonian representation (in India, this is in New Delhi) to apply for a visa or residence permit to work in Estonia.**

Document sought	Long-stay (D) visa	Residence permit
Period of stay	Up to 365 days within 12 consecutive months In the case of two consecutive long-stay visas, the whole period of stay shall not be longer than 548 days within 730 consecutive days	Temporary residence permit shall be issued for up to 5 years and extended for up to 10 years
Documents needed upon application	• Application form • travel document • photo • insurance policy valid for Estonia or for the Schengen area with a coverage of at least EUR 30,000 for the entire duration of the stay • documents proving that applicant will work in Estonia (registration of short-term employment) • documents confirming sufficient means of subsistence during the stay in Estonia • documents confirming accommodation and provision for expenses during the stay in Estonia • document certifying payment of the state fee Other documents may be requested as needed	• Application form • 1 digital colour photo • opinion of the expert committee about employer being a startup • document certifying payment of the state fee
Timeline	The application must be submitted at least 15 calendar days before arriving in Estonia	2 months decision time + 30 days issuing time

The application form for a visa can be pre-completed online, which makes the process smoother and more convenient for everyone.

It is important to note that, upon receiving a residence permit, the person receives a residence card with an Estonian ID code; however, in the case of a visa, when the individual comes to work in Estonia it is necessary to apply for an ID code from the local municipality. An ID code is necessary to register the employee in the Estonian employment registry.

These steps apply after the employee has received the right to work in Estonia. Let's assume that the individual's tax residency changes to Estonia (you can read about tax residency in Chapter 3). If the individual keeps his home tax residency (at least initially), please follow the reporting rules set out in Scenario 2.

4 **Register the new employee in the employment register, at the latest on his/her first working day.**

As under the other scenarios, you can access the employment register via the e-tax system, logging in with your e-Residency card.

The employee's personal information needs to be provided — name, personal ID code, the start date of the employment, type of employment, place of employment, the position of the employee and date of termination of contract (if applicable). Please remember also to terminate the employee registration when he/she stops working for you.

5 **Report salary payments made to the employee on the monthly income and social tax return *(called TSD in Estonia)*, paying both income tax and social tax in Estonia.**

Submit tax returns and pay taxes by the 10th day of the month following the month during which the payment was made.

Since the individual is physically working in Estonia and the salary payment is made from an Estonian resident company (your company established in Estonia), the income tax is payable in Estonia.

Since the place of work is in Estonia and assuming that no social tax treaty applies, the social tax is also payable in Estonia.

Estonia has bilateral social tax agreements with
Ukraine
Canada
Australia

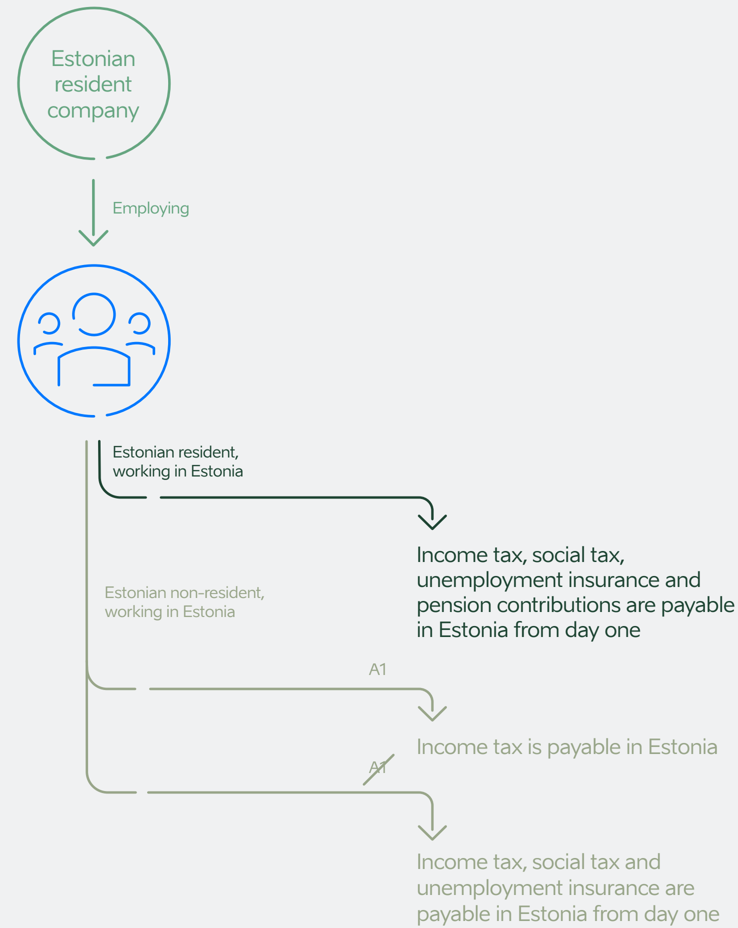
Please see the example below for calculation of payroll taxes.

	The gross salary agreed with the employee is EUR 1,000	1,000
1)	1.6% employee's unemployment insurance contribution	-16
2)	2% mandatory funded pension contribution*	-20
3)	EUR 500 monthly tax-free income**	-500
4)	20% personal income tax	-92.80
	The employee receives net salary of EUR	871.20
5)	33% social tax calculated on top of the gross salary payable by employer	330
6)	0.8% employer's unemployment insurance contribution	8
	The total cost to the employer is EUR 1,338	1,338

*The mandatory funded pension is obligatory for persons born in 1983 and later. Persons born between 1942 and 1982 had the option to voluntarily subscribe to the funded pension system. The right and obligation to pay contributions arises on 1 January following the year a person turns 18 years old.
** The basic exemption can be applied upon the employee's application. The employee makes the application according to the following brackets:

- Average monthly income up to EUR 1,200 — basic exemption EUR 500 per month.
- Average monthly income EUR 1,201-2,099 — basic exemption equals 500 - 0.55556 x (employee's income - 1,200).
- Average monthly income over EUR 2,100 — no basic exemption available.

Certificate A1 certifies that social tax is paid for the employee in the country that issued the certificate (this is always issued by your country of residence).



Chapter 5

Taxable payments

This chapter is crucial to getting an understanding of taxable events in an Estonian company other than making dividend payments or other profit distributions. For dividends, please refer to Chapter 3.

Summary

As you know by now, the Estonian corporate income tax system works somewhat in an opposite way compared to classical corporate income tax systems. If you are used to running your business in a country that has a classical corporate income tax system, you will know that, prior to submitting the annual tax return and paying the CIT due each year, the taxable base of the company should be calculated to know how much tax is due. In order to do so, the company can deduct expenses that are related to the company's business activities in accordance with local law, which reduces the tax base and tax cost.

In Estonia, instead of subtracting such deductible expenses once a year, business-related expenses have no immediate tax effect. However, if a company makes a payment that is not related to its business, it triggers an immediate CIT charge. Under the Estonian CIT system, all non-business-related payments trigger 20/80 CIT on the net amount of the payment. It becomes payable in the next month after making the payment. In comparison with classical corporate income tax systems, such payments are essentially "non-deductible" expenses.

Although the nature of the payments (whether sufficiently related to business activities or not) should be decided on a case-by-case basis, the law provides some examples of types of costs which are always taxable — we will discuss this in more detail below.

Therefore, to summarize: when making a payment from your Estonian company, first understand whether it is business-related or not. If it is not related to your company's business, you must pay 20/80 CIT on the net expense and declare the payment in the monthly CIT return of the company in the month following the payment. Sometimes the cost may also be a **fringe benefit**, meaning that social tax of 33% should also be paid.

In more detail

What kind of expenses can my company cover?

The short answer is that your company should be able to cover most business-related expenses without incurring tax.

Paying business-related expenses is similar to the concept of making tax deductions in a classical income tax system. In most countries, a company can deduct business-related expenses from its annual tax base to reduce its tax burden. Since the Estonian system operates in the opposite way, payments made by a company should be assessed on a monthly basis to determine if they trigger taxation. Of course, there will be no need for an in-depth analysis of routine recurring overheads such as office rent, accounting fees, supplies, office utilities and other routine business expenses. However, if a payment made by a company is not related to its business, then it should be declared and taxed with CIT, i.e. it would be considered "not deductible".

As there is an unimaginable range of different business activities, which all require different goods and services for operating, a business-related expense for one company might not be sufficiently linked to business activities for another.

In case of doubt, always ask yourself about the purpose of the expense: "Is this expense necessary or appropriate for maintaining or developing my business activities?"

Secondly, check that the expense does not fall within the scope of the special-purpose taxable payments discussed further below.

Are there any limits to how much my Estonian company can spend?

Generally, a company is free to decide on costs necessary for carrying out its business. However, for certain types of costs, the law limits the extent to which these can be made without incurring a tax cost.

Costs incurred for entertaining business guests and partners

A portion of expenses related to entertaining or hosting business and cooperation partners can be made tax-exempt. Entertaining or hosting is generally understood to include catering, accommodation, transportation and entertainment of guests and business partners, and is therefore partially related to business activities.

By law, a fixed sum of EUR 32 per month plus 2% of the payments which have been subject to social tax (i.e. the salary fund of the company) in the relevant month are exempt. Amounts above this threshold, which is different for each company, are taxed with CIT. The tax return "TSD" Annex 5 keeps track of the balance automatically.

Note that, if employees or management board members take part in these events, the costs related to them are not deductible and instead should be taxed as **fringe benefits**.

Gifts and donations

Gifts must have a value that can be expressed in monetary terms, i.e. with a clear consumable value for the recipient. Advertising printouts, product samples or presents with a value of less than EUR 10 (excluding VAT) are not taxed as gifts since they hold little consumable value. Anything that is worth more than EUR 10 is taxed at 20/80 CIT, which applies to the full amount.

With respect to charitable donations, it is possible to make tax-exempt donations to non-profit organizations and foundations that have been verified and put on a list managed by the tax authorities. The list of such associations can be found here: https://www.emta.ee/eng/business-client/registration-business/association-list-associations-benefiting-income-tax-incentives

To know what tax-exempt donations a company can make, two alternative calculations can be compared. The company can choose to apply either:

1. 3% of payments subject to social tax from the beginning of the calendar year (personalized payments such as salaries); or
2. 10% of the previous financial year's accounting profits.

In order to have the option of choosing the more beneficial threshold, be sure to insert the previous year's profit into the tax return.

All donations both under and over the relevant threshold should be declared on tax return TSD Annex 5. Gifts to employees and management board members are taxed as fringe benefits.

What type of expenses are taxable?

Again, the short answer is that, if your company covers non-business-related expenses, CIT becomes payable on the amount of such an expense.

To make things clearer, the law provides an open list of the most common examples of such payments that always trigger CIT:

Fines and penalty payments imposed on the basis of law and interest paid on tax debts

Note that this rule does not apply to contractual fines or penalties, but only those imposed by law. Interest on the late payment of tax always incurs a CIT cost as well.

Cost of property seized from the taxpayer

Confiscation of property and assets is regulated under the Criminal Code.

Environmental charges paid at an increased rate pursuant to the Environmental Charges Act, and compensation paid for damage caused to the environment or a third party by pollution or through violation of requirements prescribed by law

Given the assumptions we have made about you, it is unlikely that your company's activities are regulated by the Environmental Charges Act.

Gratuities and bribes

It is not only illegal to give bribes, but it also results in a tax charge due on the amount paid either in Estonia or abroad.

Buying property not related to business

For example, there would have to be very solid business reasons for an IT consultancy firm to purchase a yacht without paying CIT on it.

Enrolment and membership fees paid to non-profit associations, unless participation in such associations is directly related to the business of the taxpayer

Participation in trade associations and unions is voluntary and should align with the business activities as provided by the Articles of Association of the company.

Payments for which there is no source document in compliance with the requirements of accounting regulations

For example, payments for which there is no invoice or there is an incorrect invoice, or if no goods or services have been received, these should be declared and taxed. Therefore, always remember to take and maintain accurate expense documents.

Low-tax territories

There is a small set of rules aimed at transactions with companies located in low-tax territories. These are defined as states or territories which do not impose tax on the profits earned or distributed by a legal person or where such tax is less than 1/3 of the income tax which an Estonian resident would have to pay in similar circumstances. Therefore, generally a territory with a CIT rate of 6% or below would be deemed to be a low-tax territory.

As an exception to the above rule, where the company located in the low-tax territory derives at least 50% of its income from real business activities (i.e. it is not a passive company) and/or the territory exchanges tax information with other countries, payments to the company would not be subjected to taxation under the "low-tax territory" rules.

Estonia has an example list of white-listed territories which are not considered tax havens. No EU or tax treaty country is ever considered a tax haven. The list is published on the website of the Estonian tax authorities, available in English.

By law, the following dealings with residents of low-tax territories are taxable at 20/80 CIT:

- acquisition of securities (shares, bonds, etc.) issued by a legal person located in a low-tax rate territory (unless these meet certain requirements provided by the Investment Funds Act);
- acquisition of a holding, i.e. shares in a legal person located in a low-tax rate territory — this generally means buying a shareholding in such a company;
- payment of a fine for delay or a contractual penalty, or extra-judicial compensation for damage, to a legal person located in a low-tax rate territory (*While contractual fines are not usually taxed as non-business-related payments, there is a specific rule if such penalties are paid to a company located in a tax haven.*);
- grant of a loan or making of an advance payment to a legal person located in a low-tax rate territory or acquisition of a right of claim against a legal person located in such a low tax rate territory in any other manner.

Remember that the taxable period is one month and non-business-related expenses should be declared on tax return TSD Annex 6 by the 10th day of the month following the payment. Taxes are due by the same date. A late payment interest of 0.06% per day applies if you are late in paying tax.

What if expenses covered are actually benefits for me or my employees?

Part of keeping your staff and yourself happy involves offering certain perks or benefits, perhaps covering sports costs and organizing company events. If you go to client meetings or dinners, this also incurs a cost for the company. Under Estonian rules, however, expenses which are also for the benefit of the employee must almost always be taxed as **fringe benefits**. For the purposes of fringe benefit taxation, the concept of "employee" has a broad definition. In addition to employees working under an employment contract, it also includes management board members and immediate family members of employees and management board members. In addition, individuals providing services for more than 6 months as well as individuals working under other types of agreement provided by the Law of Obligations Act are considered employees for the purpose of fringe benefit taxation.

Technically, fringe benefits are any goods, services or monetarily appraisable benefits which are given to an employee (as understood above) in connection with an employment or service relationship.

The law gives some examples of what should always be taxed as fringe benefits:

- full or partial covering of housing expenses;
- the use of a vehicle or other property of the employer free of charge or at a better price for activities not related to the employer's business;
- payment of insurance premiums, unless such an obligation is prescribed by law;
- compensation for use of a private car, insofar as it exceeds limits provided by law;
- loans granted with an interest rate below market conditions, except if the interest at the time of the payment is at least twice the interest rate last published under the Law of Obligations Act;
- transfer free of charge, or the sale or exchange at a price lower than the market price, of a thing, security, proprietary right or service;
- purchase of a thing, security, proprietary right or service at a price higher than the market price;
- waiver of a monetary claim, unless the estimated reasonable costs of collecting the monetary claim exceed the claimed amount;
- covering of expenses for formal education or in-service training, except if these are directly related to the employment and service relationship and the functions of a member of the management board of a legal person.

Further reading — taxation of fringe benefits

Price of fringe benefit (for example a restaurant dinner) EUR 100
Income tax EUR 25 = 100 x 20/80
Social tax EUR 41.25 = (100 + 25) x 33%
Total cost to employer EUR 166.25 = 100 + 25 + 41.25

Sports and health advancement costs can be made tax exempt up to a certain threshold. In certain instances, accommodation and transportation costs may also be excluded from fringe benefit taxation. Share option schemes have specific rules to allow for exemptions.

Travelling expenses must be business-related and properly documented to avoid triggering tax. If it can be established that an employee or director benefitted and the trip was not business-related or only partly so, then in addition to CIT being applied to the respective portion, if taxed as fringe benefits, 33% social tax is also due at the level of the company regardless of the person's residence.

If you have declared and taxed costs as fringe benefits or taxed any payments under other provisions of the Income Tax Act, there is no need to report these a second time as non-business-related expenses. Make sure to keep documented proof of purchased services, assets or fulfilled obligations necessary for maintaining or developing business activities.

Keep in mind

- e-Residency is not the same as tax residency
- You are not your company — each is taxed as a separate person
- Tax treatment differs for Estonian residents, EU residents, residents of **treaty countries** and third-country residents
- Income tax and social tax should always be viewed separately
- Your activities could create a **permanent establishment**, i.e. a taxable presence for your Estonian company wherever you are located.

Chapter 6

Permanent establishments and dual residence

Summary
This chapter discusses permanent establishment and dual residence — issues that arise most often in cross-border situations where a company is managed from abroad. Note that these are different concepts with different tax consequences.

Permanent establishment

If you're new to international business or taxation, you have probably never heard of the term "permanent establishment" or a "PE". A PE is a concept made up for tax purposes only. It should not be confused with a place of business, tax residency, or the place of effective management or branch. Before diving a little deeper into this topic, rest assured that permanent establishments are one of the most complex areas in international taxation, so nobody expects you to become an expert on the matter, but getting acquainted with the basics is still vital given the nature of your business.

The formal definition of a "classical PE" provided by the OECD Model Tax Convention[9] says that "a permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on". Each element of this definition is crucial for a PE to exist.

Secondly, another way of creating a PE is through people acting on behalf of the company creating a "dependent agent" or "agency PE". As per international practice, such a dependent agent is described as "a person acting on behalf of an enterprise who has, and habitually exercises an authority to conclude contracts in the name of the enterprise in the other state". As opposed to a "classical PE," it does not require a specific fixed location in order to be triggered, but instead relates to the nature of the agent's activities.

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[9] Most countries have modelled their domestic definition of a PE in line with the OECD Model Tax Convention and it is followed by a majority of effective tax treaties.

However, every country has a slightly different approach to PEs and the specific domestic definition should always be checked. After looking into domestic law, be sure to also check the tax treaty between Estonia and the PE state. Tax treaties usually limit the existence of a PE compared to rules in domestic law.

Also, remember that a PE can only be created for a company in another country, i.e. not in the state where the company itself is established, and there can only be one PE per country. This means that your Estonian company could never have a PE in Estonia, but if your activities tick all the boxes for creating a PE in Germany, for example, you would have an Estonian company with a PE in Germany.

Although a PE is a concept designed only for tax purposes, the tax administrations take this concept seriously, so a PE must be duly registered, and it is usually taxed as a separate legal entity. The practical meaning of a PE is that it creates a taxable presence for a company outside the company's country of establishment. As a general rule, a PE must be registered with the local tax administration and separate (tax) accounting and tax filing must be arranged. Please refer to available information about PE registration and compliance in the jurisdiction where your activities might trigger a PE.

However, double taxation of the profits earned by business activities of a PE is avoided as Estonia exempts the PE's profits from Estonian corporate taxation.

Dual residence

The second tax aspect commonly arising in cross-border business activities is dual residence. Since countries usually have the right to tax their own resident individuals and companies on their worldwide profits, states have introduced broad definitions of who should be considered a tax resident. Where the definitions overlap, a taxpayer might be deemed to be tax resident in two countries — having dual residence.

Estonia has a simple rule which says that a company is tax resident in Estonia if it is incorporated under Estonian laws. If you have registered your Estonian limited liability company in the Estonian business register, this means your company is an Estonian tax resident and subject to tax in Estonia. No other analysis is needed, and the Estonian tax authorities will be happy to issue a Certificate of Residence for your company confirming the fact.

However, in addition to being a tax resident in Estonia, your company might have dual tax residence: some countries have different rules for deciding if a company is tax resident. It is common that, in addition to the place of incorporation, the place of effective management triggers tax residence. If you run your company from a place with such rules, then the company might end up having **dual residence** — this happens when two states believe that the company is tax resident in their jurisdiction and will want to tax the company's profits. If there are no domestic rules to help, resolving this tax conflict is a lengthy process requiring effort from competent authorities on both sides. It is worth looking into the local definition of "place of effective management" to understand which activities result in corporate tax residence.

A company with dual residence is not the same as a company having a permanent establishment in another jurisdiction.

Also keep in mind that rules for determining tax residency are different for companies and individuals.

In more detail

Permanent establishment

Countries have the right to tax income generated in their territory by residents as well as by non-residents — this is a well-established principle of taxation. On the other hand, if the business activities of a non-resident in that territory are insignificant or occasional, then it would not make sense to try to levy tax on this income. Therefore, the question arises: when are business activities material enough to create a taxable presence? Countries are constantly struggling to find the appropriate threshold for when the presence of a non-resident in their jurisdiction becomes sufficient to be subject to tax and the best internationally agreed solution so far is PE rules.

In real life, a PE could be triggered, for example, in the following case: you use an office in your home country to carry out the **core** business activities of your Estonian company, i.e. consult your clients, provide IT services etc. The state where that office is located might decide that a PE exists, meaning profits from business activities carried out **through** that office would be taxed there.

Agency PE

Even if you steer clear of having an office or any other fixed place of business that could create a PE as described above, the nature of activities of people working for the benefit of your company could also create a PE. For example, a person acting on behalf of a company with the authority to conclude contracts in the name of the company and who from time to time exercises that authority (e.g. an authorized employee, a board member), can create a so-called "dependent agent" or "agent PE". This is different from an independent agent, because an independent agent would not create a PE. The OECD Model Tax Convention states that a PE is not created when business is carried out through a broker, general commission agent or any other agent of an independent status if they are acting in the ordinary course of their business. Given the **assumptions** we have made about you, it is likely that in essence you are your business and you make all the key decisions and have full authority to represent your Estonian company. As a result, there is a considerable risk of creating an agency PE in the territory where you act on behalf of your company and conclude agreements in the name of your company.

The takeaway is that you must understand that PE rules are relevant for you in the territory where you are located so that you are compliant with local legislation. Some countries might have clear timing rules allowing you to easily assess whether the time you spend there might lead to any registration obligations; in other cases you should pay more attention to the type of activities you carry out in any state, i.e. whether material agreements are negotiated and concluded there. If a PE is created and you fail to register it for tax purposes in a timely manner, this might lead to penalties on tax assessed on profits that the local tax authorities believe to have been earned by the PE.

If a company has a PE in another jurisdiction, that company can be referred to as a "head office" from the perspective of PE. Also note that under private law a company — i.e. the head office — and its PE are the same legal person, whereas for tax law these are two different persons that should be taxed separately. Accounting and other compliance rules depend on the state where the PE is located. Generally, a PE is taxed as a separate legal entity similar to a regular company, but exceptions may apply.

My Estonian company has a PE in the country where I live. What does this mean for tax purposes?

It is not necessarily a bad thing if your Estonian company has a registered PE in another state; it just means that your company has a taxable presence there. This is in fact quite common for businesses operating cross-border and with activities carried out in multiple locations. In practice, if a PE is created and has more material business activities, it is often registered in the form of a branch (*filiaal* in Estonian). For more information about a branch, contact your local legal adviser.

As mentioned above, separate registration, accounting and reporting obligations might arise when a PE is created.

The PE of the Estonian company will be taxed in accordance with the rules of the country where the PE is located and will be considered a "separate entity" for tax purposes. This means that the PE will pay taxes based on profits attributed to or earned by it. The income is normally determined by applying the arm's length principle — a common concept in dealings between related parties to ensure that transfer prices reflect market terms.[10]

[10] Profit attribution rules are intricate and ever-evolving, so we will not go into too much detail. Usually a two-step analysis is needed to arrive at a fair amount of profit that a PE should generate. If you're interested in how this works, generally accepted and followed guidelines are updated and published by the OECD. The main principle is that profit should be taxed where value is generated but also that the PE should be able to deduct taxable expenses necessary for earning the profit.

So if the PE pays tax in the state where it is deemed to exist, what happens in Estonia?

If your Estonian company's PE pays tax in the state where it is created and registered, don't worry — generally there are rules and tax treaties in place to avoid double taxation, i.e. this profit should not be taxed again at the level of the Estonian company.

Estonia's domestic rules make sure that no double taxation arises for income that has already been taxed in another state at the hands of a PE. There is a distinction depending on where the PE is located: the profits of PEs located in the European Economic Area (EEA) or Switzerland are exempt from tax, while for PEs located in any other state, you get to credit the tax paid against any Estonian corporate income tax liability in the future.

Let's have a look at an EEA or Swiss PE example with illustrative numbers and CIT rates:

1. Your non-Estonian PE makes a profit of 100 and pays CIT of 25
2. Your Estonian company declares the PE's taxed profit of 75 in its tax return
3. Your Estonian company can distribute dividends of 75 exempt of tax at any time

If the non-EU PE has not paid any corporate income tax, the profits are taxed at the level of the Estonian company upon **distribution of dividends**.

To keep track of amounts with such treatment, you should declare the profits of a PE in the Estonian company's TSD return Annex 7 as soon as these are calculated in the other state. This right to pay exempt dividends can then be carried forward indefinitely until your company has sufficient profits or enough cash or until you simply decide to pay dividends.

Note, however, that the exempted dividend payments are not included for calculating the Estonian company's right to distribute "**14% dividends**".

Dual residence

It can easily happen that a company is considered tax resident in two different states at the same time if it is registered under the laws of one state but has the place of effective management in another. It is generally understood that a place of effective management is the place where key management and commercial decisions necessary for the conduct of the enterprise's business are actually made, but of course states are free to attach a different meaning to the concept. A conflict like this results in dual residence for the company.

Bilateral tax treaties include certain tie-breaker rules to decide where the company should in fact be considered resident and which state can therefore tax the company's worldwide income. It might be necessary to involve competent authorities to eliminate the issue of dual residence. Competent authorities are normally the local tax authorities or an office responsible for enforcing tax treaties. All tax treaties Estonia has concluded with other countries can be found here:

https://www.emta.ee/eng/business-client/income-expenses-supply-profits/international-agreements/conventions-avoidance-double

Overview of select countries

Below we have summarized examples of how some countries understand PEs and what the rules on corporate residence are. The descriptions are based on publicly available information, which means that you should always contact a local tax expert to clarify what tax consequences arise from your particular situation. To arrive at the correct conclusion, it might sometimes be necessary to look at domestic law, a bilateral treaty and, in some instances, a multilateral tax treaty. Note that treaties do not apply automatically and some steps may be required to benefit from a tax treaty.

Ukraine

PE

Ukraine generally follows the OECD Model Tax Convention definition, which we have outlined above, but has stricter agent PE tests in place. The law provides a list of more common PEs, such as place of management, affiliate, office, server, etc.

In addition to the "classical PE" and "agent PE", the concept of a "service PE" is recognized in Ukraine. This means that if for example, consultancy services are provided by employees or other personnel of a non-resident company (your Estonian company, for example), a PE is created if projects last for more than 6 months in any 12-month period.

However, a tax treaty should override these domestic rules if a treaty is more beneficial for the taxpayer.

Tax residency

Companies are tax resident in Ukraine if they are established under Ukrainian law — this rule is similar to Estonia and means that managing a company in Ukraine should not lead to that company being tax resident in Ukraine.

Please see the website of the competent authorities in Ukraine for more information: http://sfs.gov.ua/en/

Germany

PE

According to German rules, a PE is any fixed business facility serving the corporate purpose. A permanent representative is someone who "habitually" deals on behalf of the principal (the principal being the Estonian company, for example) acting on the principal's instructions. German tax treaties are usually in line with the OECD Model Tax Convention's PE definition.

Tax residency

A corporation is resident in Germany for tax purposes if either its place of incorporation or its main place of management is in Germany. If you effectively manage your Estonian company in Germany, then this might lead to dual residency of your Estonian company, meaning that the Estonia-Germany tax treaty or competent authorities should be consulted.

Please see the website of the competent authorities in Germany for more information: https://www.bundesfinanzministerium.de/Web/DE/Home/home.html

United Kingdom

PE

Non-resident companies are liable to pay tax if they carry out trade through a PE in the UK. The UK definition of a PE is similar to the OECD Model Tax Convention's and it is created if the non-resident company:

- has a fixed place of business in the United Kingdom through which the business of the company is wholly or partly carried on; or
- an agent acting on behalf of the company has and habitually exercises authority to do business on behalf of the company in the United Kingdom.

Tax residency

Companies incorporated abroad can be considered UK residents if the place of central management and control is situated in the UK. If the highest form of control and direction over a company is carried out in the UK, this might lead to dual residency of your Estonian company, meaning that the Estonia-UK tax treaty or competent authorities should be consulted.

Please see the website of the competent authorities in the UK for more information: https://www.gov.uk/government/organisations/hm-revenue-customs

Spain

PE

Spanish domestic law defines a PE as being created if a company has ongoing or habitual work facilities or a place to do any kind of work where one performs all or part of one's activity in Spain. An agent PE is created if a company acts in Spain through an agent with powers to enter into an agreement in the name and on behalf of the non-resident and if such powers are exercised on a regular basis.

Tax residency

In addition to being established in Spain, a company is a Spanish tax resident when its business activities are managed and controlled from Spain, i.e. its head office is located in Spain. This might lead to dual residency of your Estonian company, meaning that the Estonia-Spain tax treaty or competent authorities should be consulted.

Please see the website of the competent authorities in Spain for more information: https://www.agenciatributaria.es/

France

PE

In France, the PE concept has been developed by relevant case law. A PE is understood to materialize through:

- business activity conducted through an establishment (i.e. a fixed business installation operating with some degree of autonomy (e.g. a branch, sales office));
- business conducted in France by a dependent agent; or
- existence of a complete commercial cycle in France.

For complete certainty, the French tax authorities can be asked to submit a ruling on the existence of a PE.

Tax residency

Generally, companies established under French law are considered French tax residents, so the issue of dual residence should not arise even if the Estonian company is effectively managed in France.

Please see the website of the competent authorities in France for more information: https://www.impots.gouv.fr/portail/

Turkey

PE

Turkey's rules are different from the standard of the OECD Model Tax Convention and the threshold for PE creation is lower. It should therefore be evaluated on a case-by-case basis whether your activities create a PE in Turkey or not.

Tax residency

Another issue might arise over residence — if the business's headquarters are in Turkey, it is considered resident in Turkey. Estonia follows the place of incorporation principle, which means that your company might have dual residence — in both Estonia and Turkey. The tax treaty and competent authorities should be consulted in such a case.

Please see the website of the competent authorities in Turkey for more information: https://www.gib.gov.tr/en

Chapter 7

Trade in goods — general overview

Summary

In this chapter we will be deviating from the assumptions we made about you earlier and will imagine that, instead of services, you are an e-commerce entrepreneur selling goods to customers located within the EU.

Note that the objective of this chapter is not to explain detailed rules in respect of VAT, excise or customs formalities in the EU, as might be applicable in different Member States, but rather to give general guidance and provide links to useful information.

There is plenty of detailed information available online about doing business in the EU, including on trade in goods, e.g. here or here.

The EU VAT system is laid down by Council Directive 2006/112/EE and Council Implementing Regulation 282/2011.

In this chapter we will be examining two basic scenarios:

Scenario 1:
Your Estonian company has an online shop through which you sell goods to individuals and companies in the EU. The goods are kept in a warehouse in a Member State other than Estonia; a warehouse keeper (or a third party) is contracted for sending the ordered goods directly to buyers and executing other related tasks (e.g. invoicing).

Scenario 2:
Your Estonian company purchases goods manufactured outside the EU (e.g. China) and keeps these in a warehouse located in a third country (e.g. India). When goods are ordered by EU buyers through the online shop, the goods are shipped directly to them from the warehouse.

In more detail

Scenario 1: Selling goods from a warehouse located in another Member State

To keep it simple, it is important make several assumptions about the goods.

The goods are:

- considered EU goods for VAT purposes*;
- not subject to specific regulations (e.g. excise duty) or licensing (e.g. pharmaceuticals);
- not second-hand goods, works of arts or collectors' items.

In principle, when trading in the EU, you should always ask yourself four questions about VAT registration obligation and applicable VAT:

- Is my company obliged to get a VAT registration?
- In which Member State must I get a VAT registration?
- In which Member State must I pay VAT?
- Which VAT rate applies?

There are several general rules in respect of supply of goods in the EU that you must be aware of and which should help you answer the above questions. You will see that having Estonian VAT registration alone isn't enough if you are planning to sell goods to consumers everywhere in the EU.

Rule no. 1 **If the goods are sold to a local consumer in the Member State where the warehouse is located, the VAT rules of that Member State apply.**

* These are either made in the EU or, if made outside the EU, are released for free circulation in the EU (customs-cleared and VAT, excise duty and import duties, if applicable, duly paid).

Each Member State has established a VAT registration threshold, which is formally called "exemption for small enterprises". VAT registration thresholds can be found here.

This scheme is usually available to companies established in a particular Member State. However, it also applies to non-resident companies with a fixed establishment in that Member State. The concept of fixed establishment for VAT is complex and not yet fully developed, compared to a permanent establishment for corporate taxation purposes — these concepts are not the same. In brief, a fixed establishment is a place in another Member State with sufficient human and technical resources to enable it to make supplies of goods or services. If you will have no presence or staff in the Member State where the warehouse is located, as in for example a drop-shipping business model, it is unlikely that the Estonian company will be deemed to have a fixed establishment in the Member State where the warehouse is located.

If you have a fixed establishment but domestic supplies of goods remain below the registration threshold in a calendar year, you need not add the VAT of that Member State to the sales.

Once the threshold is exceeded, you will be required to register and add VAT to the sales. VAT rates applied in each Member State can be found here. The procedure for VAT registration also differs in each Member State.

Not having a fixed establishment in a Member State where the warehouse is located may require you to register for VAT upon the first sale of goods to consumers in that Member State.

If you don't have a fixed establishment in a Member State where the warehouse is located, you will probably be required to register upon the first sale of goods to consumers in that Member State. VAT liability on supply of goods to local businesses registered for VAT could remain with the Estonian company (VAT is added to sales) or it might be shifted to the corporate buyer (VAT self-assessed by the buyer), depending on the rules adopted by that Member State.

Also, you need to find out the local invoicing rules for sales to consumers and corporate buyers. In addition to VAT rules, provisions of other domestic legislation, such as Consumer Protection, could be relevant.

Rule no. 2 **When supplying goods to consumers, including individuals and legal persons not identified for VAT, in another Member State, the Estonian company will be regarded as carrying out distance sales from the Member State where the warehouse is located.**

Distance selling is generally defined as the supply and delivery of goods by or on behalf of a vendor to consumers in another Member State. The definition does not include the supply of new means of transport or goods supplied after assembly or installation. Distance sales thresholds in each Member State can be found here.

The supply of goods by distance selling below the threshold set by the destination Member State is subject to VAT in the Member State where the warehouse is located. When the threshold is exceeded, the Estonian company will be required to register for VAT in the Member State of destination, and apply, report and pay VAT as appropriate.

Please note that EU distance-selling rules will change as of 1 January 2021. The related press release by the European Commission can be found here.

Rule no. 3 **If the Estonian company is supplying goods with transport to another Member State to buyers identified for VAT in the Member State of destination, such supply is called intra-Community supply of goods from the Member State where the warehouse is located.**

Intra-Community supply of goods usually triggers VAT registration at once and without any threshold, but you must check the rules of the Member State where the warehouse is located.

Intra-Community supply of goods is exempt from VAT (or subject to 0% VAT) by the vendor; the corresponding acquisition of the goods by the buyer is called intra-Community acquisition, whereby the buyer self-assesses VAT on the acquisition in the Member State of destination.

There are specific requirements for invoices issued in respect of intra-Community supplies of goods and the obligation to prove cross-border movement of goods.

Scenario 2: Selling goods from a warehouse located in a third country

If the goods sold to consumers through an Estonian company's online shop are delivered to them from a third country, e.g. India or China, the Estonian company will still be regarded as making distance sales to the consumers, as described above.

Customs formalities must be completed (goods to be assigned to import for free circulation procedure) when the goods enter the EU. The Estonian company will be deemed an importer of record, which is responsible for any import-related obligations, including payment of import VAT and customs duties, if applicable, in the Member State of importation.

The Estonian company must obtain an EORI number prior to making imports into the EU. More information on the EORI number can be found here.

Low-value consignment relief (no import VAT or customs duty) is still available if the value of imported goods is less than EUR 22, but the rule will change as of 1 January 2021.

Several global online marketplaces (e.g. Amazon, eBay) provide a variety of services to startups, including customs clearance of non-EU goods.

Once the goods are released into free circulation and become EU goods for VAT purposes, Rules 1 and 2 as described above apply for determining where to register for VAT and which Member State's VAT applies to the sale.

Abbreviations

CIT	Corporate Income Tax
EEA	European Economic Area
EORI	Economic Operators Registration and Identification number
EU	European Union
PE	Permanent establishment
PIT	Personal Income Tax
Tax treaty	An agreement for the avoidance of double taxation and the prevention of fiscal evasion between two countries
TSD	Declaration of income and social tax, unemployment insurance premiums and contributions to mandatory funded pension
OÜ	*Osaühing* (limited liability company)
VAT	Value-Added Tax
WHT	Withholding tax