ESTONIA

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LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
Directive	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
MKS	Law on Taxation (*Maksukorralduse seadus*)
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Savings Directive	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
TMS	Income Tax Law (*Tulumaksuseadus*)

LIST OF LEGAL REFERENCES

- Income Tax Law (Tulumaksuseadus) of 15 December 1999 (Riigi Teataja I 1999, 101, 903) with amendments.
- Law on Taxation (Maksukorralduse seadus) of 20 February 2002 (Riigi Teataja I 2002, 26, 150) with amendments.
- Copyright Law (Autoriõiguse seadus) of 11 November 1992 (Riigi Teataja 1992, 49, 615) with amendments.

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

On 20 May 2004 Estonian parliament adopted amendments to the Income Tax Law (*Tulumaksuseadus*, “TMS”) which implemented Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States (the “Directive”). The amendments applied retroactively from 1 May 2004. Prior to the amendments a withholding tax was levied on interest paid to non-residents, under the amended rules such withholding tax is abolished. The provisions concerning royalties follow the Directive more closely.

Further amendments were later made to adjust the law to the amended Directive, which allows transitional periods to certain new Member States. All the later amendments also took effect as of 1 May 2004. TMS is the only legal act transposing the Directive.

The following table shows the relevant provisions of the TMS and Law on Taxation (*Maksukorralduse seadus*, “MKS”) implementing the Directive:

Articles of the Directive	Relevant sections of national laws
Art.1	29(6) 4) and 5), 29(7), 31(4) of the TMS
Art.2	16(2) and (3), 17(1) of the TMS
Art.3	7, 31(4) of the TMS
Art.4	29(7), 31(5) of the TMS
Art.5	84 of the MKS
Art.7	-

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

No withholding taxes are imposed on interest and royalties paid to resident companies.

Outbound interest paid to non-resident entities or individuals is generally exempt from taxation. If, however, the interest rate is substantially higher than that on similar debt claims under the same market conditions, a 24% withholding tax is levied on the difference. There is no guidance on what constitutes a substantially higher interest rate.

Royalties paid to non-residents may be subject to a 15% withholding tax, but only if

- the rights for which the royalties are paid are exercised by the Estonian state, a local government or a resident, or by a non-resident through or on account of its permanent establishment in Estonia, or
- the industrial, commercial or scientific equipment or know-how for which the royalties are paid is used in Estonia.

Royalties paid to non-residents on occasions other than above are not taxable. Payments for the leasing of other tangible property when made to non-residents are subject to 24% tax.

Under the unique corporate tax system of Estonia (i.e. no annual corporate tax on net profits but a distribution tax on distributed profits only), interest and royalties paid by Estonian companies are deductible from the accounting profit from which the taxable distributions are made.

In Estonia there are no thin capitalisation rules, which would affect interest and royalties payments.

Interest and royalties received are subject to tax at the moment of distribution of profits by the company.

Estonia has implemented the provisions of the Directive with respect to outbound and inbound interest and royalties. With respect to inbound interest and royalties payments, when an Estonian company receives interest or royalties from an associated company resident in any of the Member States that are allowed to withhold tax under the transitional rules of the Directive (Art. 6), or from an EU resident associated company through its permanent establishment registered in any of those Member States, the Estonian company can, at the moment of the following dividend distribution, credit the relevant withholding tax against its distribution tax due.

1.2.2. Treaties

Estonia has effective tax treaties with 19 EU Member States (see Annex). All these tax treaties contain provisions covering interest and royalty payments.

The rate of withholding tax on interest is 10% in all the treaties (except the tax treaty with Lithuania, which will be replaced by a new treaty soon). The general treaty rate of withholding tax on royalties is 10%, in most of the treaties there is, however, a lower 5% rate applicable to equipment rentals, except the tax treaty with Lithuania. Although the treaties allow Estonia to withhold taxes on interest payments, under domestic law, interest paid to non-residents is generally not taxable. Only if the interest rate is substantially higher than that on similar debt claims under the same market conditions, a withholding tax is levied on the difference.

Under tax treaties, double taxation relief with respect to interest and royalty payments is available in the form of an ordinary tax credit (exemption in the case of the treaty with Lithuania).

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

In the domestic legislation there is just one definition of interest for tax purposes. Under Sec. 17(1) of the TMS the term 'interest' means income from loans, securities, leases or other debt-claims, including amounts calculated on the basis of debt-claims by which the initial debt-claims are increased. Penalty charges for late payment or other non-performance of the obligation are not regarded as interest.

This definition appears to be to a large extent corresponding to the scope of the one in the Directive.

b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))

Payments under financial arrangements listed in Art. 4(1) b), c) d) of the Directive have not been excluded. Estonia does not generally levy withholding tax on any type of interest paid to non-residents (see 1.2.1. Domestic rules).

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Interest payments to non-residents are not reclassified as profit distribution, neither is the exemption expressly denied because of special relationship between the parties of the transaction.

There is, however, a special anti-abuse provision for interest payments based on the value of the transaction. Sec. 29(7) of the TMS provides that if the interest rate paid to non-resident is substantially higher than that on similar debt-claims under the same market conditions, a withholding tax is levied on the difference. The rule applies irrespective of whether the parties involved are related or not. Any excess amount still remains interest; a withholding tax will, however, be levied on it at the standard income tax rate (in 2005 the standard income tax rate is 24%).

2.1.2. Concept of royalties

a. Definition

In the domestic legislation there is a single definition of royalties for tax purposes. Under Sec. 16(2) and (3) of the TMS the term 'royalty' means

- consideration for the use of, or transfer of the right to use, a copyright of a literary, artistic or scientific work (including cinematographic films or videos, recordings of radio or television programmes or software), a patent, trade mark, industrial design or utility model, plan, secret formula or process;

- consideration for the use of, or transfer of the right to use, industrial, commercial or scientific equipment or information concerning industrial, commercial or scientific experience (know-how).

The definition appears to be substantially broader than the one in the Directive as it covers income from the use of, or right to use, the above rights and equipment, but also the sale of the right to use. However, the tax authorities have not yet commented with respect to the interpretation of the term “transfer”.

b. Classification of revenue from leasing and software

Section 4(3) 3) of the Copyright Law provides that software shall be protected as literary works. That protection applies to the expression of software in any form. Under Sec. 16(2) of the TMS the term ‘royalty’ includes payments for the use of, or the transfer of the right to use, a copyright of a literary, artistic or scientific work including software. There is no further explanatory information in legal documents about the scope and interpretation of the payments from software. From the above it is possible to conclude that royalties are not payments received e.g. for the sales, rental, lending, copying or other use of the software without the transferee receiving rights to use the copyright in the program (e.g. right to reproduce, distribute, modify, translate or resell).

Under Sec. 16(3) of the TMS the term ‘royalty’ includes payments for the use of, or the transfer of the right to use, industrial, commercial or scientific equipment, which means that it concerns tangible property. The meaning of this has not been further clarified. The practical relevance of this provision is to distinguish the payments for the leasing of industrial, commercial and scientific equipment from the payments for the leasing of other tangible property when made to non-residents. From the latter a 24% tax is withheld instead of 15% from royalty payments (see 1.2.1. Domestic rules).

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Royalty payments made to an associated EU resident company are not reclassified as profit distribution. However, the ‘special relationship’ clause has been implemented with respect to royalty payments made between related persons. The exemption under the Directive is not applied to that part of royalty, which exceeds the value of similar transactions conducted between non-associated persons (TMS Sec. 31(5)). The excess amount still remains royalty; a withholding tax will, however, be levied on it at the rate of 15%.

The concept of associated person under TMS Sec. 8 has a relatively broad scope and it includes *inter alia* situations where:

- two or more companies belong to one group, as defined in the Commercial Code;
- a person owns more than 10% of the share capital, voting rights or rights to the profits of a company (here the associated persons are a shareholder and the entity;
- a person, together with a related person, owns more than 50% of the share capital, voting rights or rights to the profits of a company; or
- more than 50% of the share capital, voting rights or rights to the profits of companies belong to one and the same person.

2.2. COMPANIES

2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Other types of entities

As mentioned previously, no tax is generally levied on interest payments to non-resident individuals or entities, irrespective of their legal form (see 1.2.1. Domestic rules).

The law does not refer to the Annex to the Directive in granting exemption from the withholding tax for royalty payments. The benefits are granted to "companies of Member States". Therefore if there would be a type of a company resident in a Member State not mentioned in the Annex it would in principle also benefit from the exemption. There is, however, no guidance on what exactly makes an entity to be a 'company'. Nevertheless, the most important criterion is that in order to be a company the entity, at minimum, has to have a legal personality. It is unclear whether foreign partnerships having legal personality but in their country of origin being transparent for tax purposes and not a tax resident will be treated as companies. According to Sec. $6(3^1)$ of the TMS the income of foreign associations of persons or pools of assets without the status of a legal person is subject to tax as the income of the shareholders or members of such association or pool in proportion to the sizes of their holdings. Such entities having no legal personality are considered transparent. A withholding tax may be thus charged on payments made to such entities as Sec. $6(3^1)$ of the TMS also provides that taxes will be withheld from payments made to foreign associations of persons or pools of assets that have no legal personality as if they were non-resident legal persons.

In the case of possible dispute the guidance will most likely be sought also from the Annex to the Directive containing the list of 'companies'.

In the domestic situation all types of companies currently foreseen by the law are also mentioned in the Annex meaning that no other domestic entity can benefit from the Directive.

b. Hybrid entities

There is no guidance with respect to the tax treatment interest or royalties when paid to hybrid entities. The issue of tax treatment of payments in situations involving hybrid entities is considered based on three hypothetical situations described below:

- Case 1: an Estonian associated company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: an Estonian hybrid entity H pays interest and royalties to an associated company in Member State A;
- Case 3: an Estonian associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

An Estonian associated company A pays interest and royalties to a hybrid entity H situated in Member State B. Estonia treats hybrid entity H as a transparent entity.

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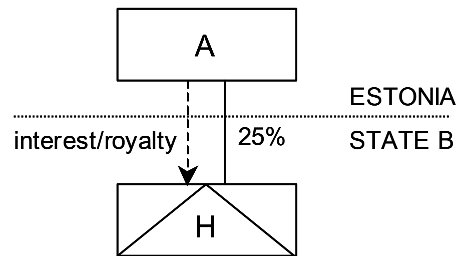


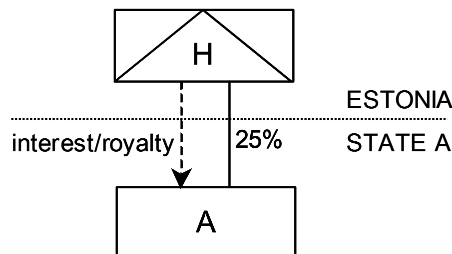
There is no withholding tax on interest and the exemption will apply in this situation.

The withholding tax exemption for royalties is most likely to be denied in situations where the payment is made to a transparent entity, which does not have a legal personality (in order to be transparent for Estonian purposes H cannot have legal personality, see 2.2.1. *a. Other types of entities*) and which therefore cannot be considered a 'company'. Although Sec. 6(3^1) of the TMS provides that taxes will be withheld from payments made to foreign associations of persons or pools of assets without the status of a legal person as if they were non-resident legal persons, Sec. 31(4) of the TMS avails the exemption only to 'companies'.

If the entity is treated as transparent, its income is subject to tax as the income of its shareholders or members. In the light of this rule it would be possible to say that, provided that the members of entity H are companies of an EU Member State, the payment would still be eligible for the exemption. There is, however, a requirement in Sec. 31(4) 1) of the TMS that the payment has to be received directly by a company of a Member State, which excludes situations where a transparent entity is interpositioned between companies.

Case 2: Payment from a hybrid entity

A hybrid entity H in Estonia pays interest or royalties to an associated company A in Member State A.

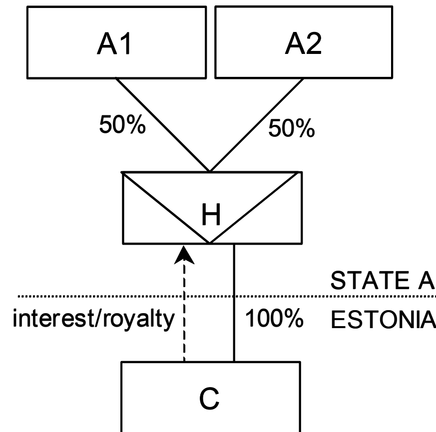


There is no withholding tax on interest paid by any types of Estonian companies or permanent establishments of foreign entities, therefore the exemption will apply in this situation.

As the withholding tax exemption is only available in respect of royalty payments between companies and none of the Estonian companies can be a hybrid entity, royalty payments from Estonian hybrid entities do not benefit from the withholding tax exemption in Estonia.

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of the hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in Estonia. Estonia treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



The tax treatment in this situation will be identical to that described in Case 1 above.

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

No tax is levied on interest payments to any non-resident. There are no specific residency requirements with respect to interest payments.

Sec. 31(4) of the TMS requires the paying company to be resident in order to benefit from the exemption on royalties (if the paying company is not resident and does not have a permanent establishment in Estonia it is in any case outside of Estonia's taxing jurisdiction). A company is resident in Estonia if it is established there.

Sec. 31(4) 1) of the TMS states that the company receiving royalties must be resident in another Member State to benefit from the exemption. There is no further guidance on when exactly a company is considered to be resident in a Member State.

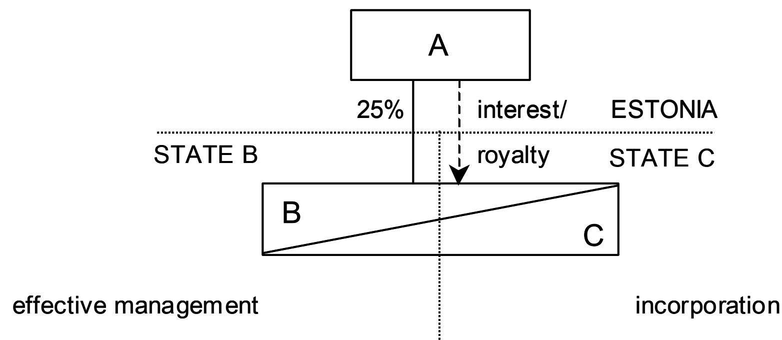
b. Application of the requirement in dual residence cases

There is no guidance with respect to the application of exemption from withholding tax when royalties are paid to or from dual resident companies. The issue of tax treatment of payments in situations involving dual residency is considered based on three situations described below:

- Case 1: an Estonian associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in State B;
- Case 2: a dual resident company BC incorporated in Member State C but with its effective management in Estonia makes an interest or royalty payment to an associated company A resident in Member State A;
- Case 3: a dual resident company BC incorporated in Estonia but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.

Case 1: Payment to a dual resident

An Estonian associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B.



There is no withholding tax on interest therefore no dual residency issues arise.

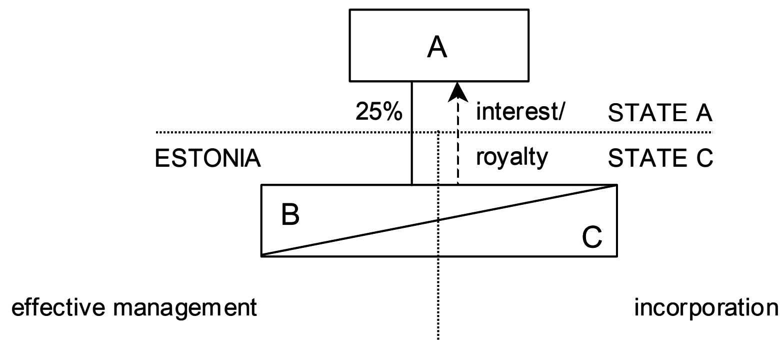
The withholding tax exemption is available in respect of royalty payments made between an Estonian resident company and its associated company resident in another Member State.

In the case at hand, the tax authorities are most likely not concerned about in which Member State Company BC exactly is a resident as in either case the royalty payment would be exempted from the withholding tax.

If the authorities would like to find out the exact Member State of residency, there is no guidance on which criteria they would use for that. The two most likely solutions would be to consider BC resident in the country of incorporation, as Estonia itself is applying the country of incorporation principle to determine companies resident in Estonia, or resident in the country which is determined according to the provisions of the tax treaty between Member States B and C.

Case 2: Payment by a dual resident with the place of management in Estonia

A dual resident company BC incorporated in Member State C but with its effective management in Estonia makes an interest or royalty payment to an associated company A resident in Member State A.

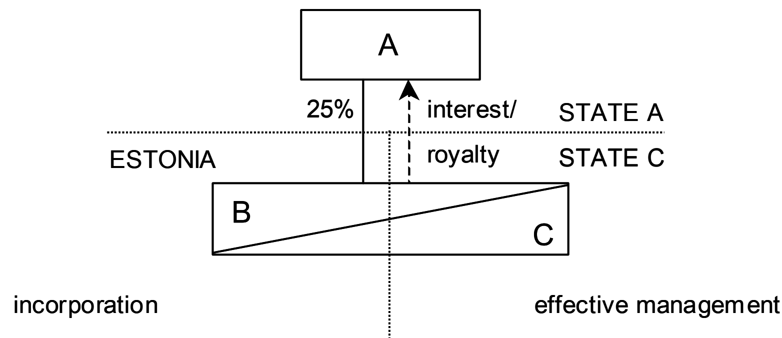


Under domestic rules, a company is resident in Estonia if it is established under Estonian law. A resident company can only have one of the five legal forms listed in the Annex to the Directive. If BC is effectively managed in Estonia, but incorporated in Member State C, it has not been established under Estonian law. Accordingly, Company BC is not considered to be an Estonian resident company and therefore Estonia would not tax its interest or royalty payments. There is no withholding tax on interest payments to non-residents, either made by resident or a non-resident.

Only if a non-resident company has a permanent establishment in Estonia and the taxable royalty payment (see 1.2.1. Domestic rules, on taxable royalty payments) is made through or on account of the permanent establishment would Estonia impose withholding tax. Even if in the current case BC would have a permanent establishment in Estonia and the taxable royalty payment is made through or on account of the permanent establishment the payment would still be exempted under the Directive. The payment made by a permanent establishment of a company of a Member State is also exempted under Sec. 31(4) of the TMS.

Case 3: Payment by a dual resident with the place of incorporation in Estonia

A dual resident company BC incorporated in Estonia but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



A company is resident in Estonia if it is established under Estonian law. In the case at hand, BC is established under Estonian law therefore being a resident company having one of the legal forms listed in the Annex to the Directive. As under the Estonian law the withholding tax exemption is available in respect of royalty payments made by an Estonian resident company to its associated company resident in another Member State the withholding tax exemption

applies irrespective of which country would be designated as the country of residence according to the tie-breaker rule of the tax treaty between Estonia and Member State C.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

The 'subject-to-tax' requirement has not been transposed. There is nothing in the legislation requiring either the paying or receiving company to be subject to tax in order to benefit from the exemption.

2.2.4. Associated company (Art. 3(b))

Taxes are not generally levied on interest payments to non-residents.

The ownership threshold has been implemented with respect to the exemption for royalty payments. The threshold is 25% as in the Directive. A company is an "associated company" of another company if (a) it has a direct minimum holding of 25% in the capital of the other company or (b) a third EU company has a direct minimum holding of 25% in the capital of both companies (TMS Sec. 31(4)).

Benefits are not extended to situations of indirect holdings.

The requirement of 'holding of capital' has not been replaced by the 'holding of voting rights'. The holding of voting rights is not sufficient criterion in order to be eligible for exemption. Sec. 31(4) imposes the 25% share capital requirement. There must be a 25% ownership of the share capital of a company at the time of the payment.

2.2.5. Beneficial ownership (Art. 1(4))

Estonia has not implemented the beneficial ownership provision in Art.1(4) of the Directive. It is sufficient if royalties are paid to a company of a Member State without the requirement for it to be the beneficial owner.

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

Taxes are not levied on interest payments to non-residents whether paid by or to a permanent establishment or not.

The general concept of permanent establishment under TMS is applied in the context of implementing the Directive with respect to royalty payments.

The definition of ‘permanent establishment’ is provided by Sec. 7 of the TMS, which reads:

(1) Permanent establishment means any place, through which the permanent economic activities of a non-resident are wholly or partially carried on in Estonia, including:

1) *a branch;*
2) *a centre of management, or an office, factory or workshop;*
3) *a building site, a place of construction, or an installation or assembly project;*

4) a place where the examination or extraction of natural resources is carried out, as well as any supervisory activities related thereto;
5) a place for the provision of services (including management and consultation services).

(2) If a representative of a non-resident operates in Estonia and is authorised to carry out and repeatedly carries out transactions in the name of the non-resident, such non-resident is deemed to have a permanent establishment in Estonia with respect to the transactions carried out in Estonia by the representative in the name of the non-resident.
(3) When a non-resident carries on business in Estonia through a permanent establishment situated in Estonia, the income which the permanent establishment might be expected to derive if it were a distinct and separate taxpayer engaged in the same or similar activities under the same or similar conditions and dealing wholly independently of the non-resident of which it is a permanent establishment shall be attributed to the permanent establishment.

Key differences between the definition in domestic law and the definition under Art. 5 of the OECD MC usually followed in Estonian tax treaties are:

- a building site or a construction and installation project constitutes a permanent establishment from the first day; and
- domestic law does not include the negative list of activities which do not constitute a permanent establishment.

Thus, the domestic definition is quite broad, which would entail rather general application of the Directive.

2.3.2. Application of source rules (Art. 1(2))

There have been no issues in Estonia about the interpretation of Art. 3(c) and Art. 1(2) of the Directive.

2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

There have been no instances where Estonia or another Member State where Estonia is a state of head office or a recipient state has refused to recognise the payment as a tax-deductible expense, because it considers that the expense is not attributable to the permanent establishment. Estonia has not transposed the requirement for the payment to be a tax deductible expense in respect of permanent establishments.

2.3.4. Beneficial ownership (Art. 1(5))

Estonia has not implemented the requirement for beneficial ownership for the permanent establishment.

2.3.5. Permanent establishment in a third country (Art. 1(8))

The permanent establishment of the recipient company has to be registered in an EU Member State in order to benefit from the exemption. TMS Sec. 31(4) 1) provides that the recipient of a royalty has to be a resident company of another Member State either directly or through its permanent establishment registered in another Member State.

3. PROCEDURE

There is no withholding tax for interest payments to non-residents and no specific procedures are set to apply the general exemption.

With respect to royalties it is very easy to apply the exemption under the Directive as Estonia applies exemption at source rule and there are no decision or attestation requirements. The company must asses the fulfilment of the requirements to apply the exemption, including the fulfilment of the two-year holding period requirement.

3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

3.1.1. General

Estonia requires a two years holding period for the payment to be exempted (TMS Sec. 31(4)). From the phrase 'during the period of two years or more immediately preceding the payment' it can be derived that the period would have to be uninterrupted. The two years period must have been fulfilled by the time of the payment.

3.1.2. Relief before the holding period requirement is satisfied

It is not allowed to apply the exemption before the two-year holding period has elapsed and no possibility is foreseen for the taxpayer to obtain a refund if at the time of the payment the two year holding period requirement was not fulfilled and the tax was withheld even when the holding period requirement is met subsequently.

3.1.3. Appeals

There is no specific appeal procedure with regard to the requirement of holding period as not being fulfilled. As the paying company can refrain from withholding the tax based on its own assessment the problem can only occur afterwards when there is an inspection by the tax authorities. Any tax assessed by the tax authorities can be challenged under the general appeal procedure laid down in the MKS. The procedural rules for residents and non-residents are the same.

3.2. ATTESTATION (ART. 1(11) AND 1(13))

There is no attestation requirement for the application of the relief.

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

There is no decision requirement on the application of the relief.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

Estonia applies the system of exemption at source. This procedure is the least burdensome both for the taxpayer and for the tax authorities.

3.4.1. General

Estonian law has no specific procedure with respect to the refund procedure under Art. 1(15) and 1(16) of the Directive. The general procedure for repayment of excess taxes applies according to which the taxpayer can submit an application for refund. The application can be submitted within three years from the day the payment of excess taxes took place (MKS Sec. 33(1)). The excess taxes must in general be refunded to the taxpayer within 30 days from the day the application was submitted (MKS Sec. 106(1)). Interest of 0.06% per day is computed in favour of the taxpayer on the excess amount, beginning from the day that the excess amount was paid until the amount has been refunded or used to cover the taxpayer's other tax liabilities (MKS Sec. 116(2) and 117(1)).

3.4.2. Appeals

In the case the tax administration decides not to refund the excess taxes paid, the taxpayer may bring its case to the Administrative Court under the general procedural rules (see 3.1.3. Appeals above).

4. FRAUD AND ABUSE (Art. 5)

Estonia has not implemented any specific measures stemming from Art. 5 of the Directive. There is a general anti-avoidance rule in the domestic legislation and limitation of benefits articles in a few tax treaties.

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

There is a general anti-avoidance rule in Sec. 84 of the MKS which states that where from the content of a transaction it is evident that the transaction is performed for the purposes of tax evasion, the conditions that correspond to the actual economic content shall apply for tax purposes. This provision, as far as known to us, has never been used in the context of interest and royalty payments.

4.1.2. Agreement-based

a. General

There are limitation of benefits articles in a few tax treaties concluded with other Member States (as an illustration, see below the limitation of benefits provision in the tax treaty between Estonia and Italy). The limitation of benefits articles, however, concern only benefits obtainable under treaties. The tax treaties also contain articles similar to Art. 11(6) and 12(4) of the OECD Model.

b. Anti-abuse measures in a treaty between Estonia and Italy

Article 28. Limitation of benefits
1. Notwithstanding any other provision of this Convention, a resident of a Contracting State shall not receive the benefit of any reduction in or exemption from taxes provided for in this Convention by the other Contracting State if the main purpose or one of the main purposes of the creation or existence of such resident or any person connected with such resident was to obtain the benefits under this Convention that would not otherwise be available.
2. Nothing in this Convention shall affect the application of the domestic provisions to prevent fiscal evasion and tax avoidance concerning the limitation of expenses and any deductions arising from transactions between enterprises of a Contracting State and enterprises situated in the other Contracting State, if the main purpose or one of the main purposes of the creation of such enterprises or of the transactions undertaken between them, was to obtain the benefits under this Convention, that would not otherwise be available.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

There are no other specific measures except the general anti-avoidance rule (see 4.1.2. *a. General*) that could be used to deny the relief under the Directive under Art. 5(2).

There are however special rules denying the exemption for the excess amounts of interest and royalties (see 2.1.1. *c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2)* and 2.1.2. *c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2)*). There is no published case-law, administrative practice, circulars or manuals about the matter.

4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES

There are no specific provisions implemented for any of the anti-abuse articles of the Interest-Royalty (Art. 5), Parent-Subsidiary (Art. 1(2)) or Merger (Art. 11(1)(a)) Directives. The general anti-abuse provision (see 4.1.2. *a. General*) applies in all the circumstances.

5. SUMMARY

Estonia has generally implemented the Directive. Estonian legislation appears to be simpler and more general than the Directive with respect to the exemption on interest and royalty payments made to the residents of EU Member States.

Scope

With respect to interest payments Estonia has implemented a general exemption - interest paid to all non-residents not subject to any withholding tax.

With respect to royalties the implementation has followed the Directive more closely – only payments to companies' resident in Member States are exempted from withholding tax if the 25% holding threshold and the two-year holding period are fulfilled. TMS does not require the recipient to be the beneficial owner of income to benefit from the exemption, whether it is a company or a permanent establishment. There is also no requirement for the recipient to be subject to tax in its country of residence.

The only option not to apply the Directive has been exercised in respect of interest and royalties in excess of market value.

Procedure

The companies making royalty payments make a self-assessment on the fulfilment of the requirements and apply automatic exemption at source if they believe the requirements are fulfilled.

Most of the provisions allowing countries to require fulfilment of certain procedures or impose certain requirements are not transposed into national legislation.

Fraud and abuse

No special anti-abuse measures have been implemented in connection with the Directive. Tax authorities can apply the general anti-avoidance rules to tackle fraud and abuse.

PART II. THE AGREEMENT

INTRODUCTION

As the interest payments do not bear any withholding tax the domestic law already complies with Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the “Agreement”).

Article 15 (2) of the Agreement is not yet implemented with respect to royalty payments. There are draft amendments to the TMS in the Government, which, if adopted, would extend the exemption on royalties under the Directive to cover Switzerland. In absence of any guidance with respect to royalty payments under the Agreement at present, the tax treatment is discussed taking into account the draft law amending the TMS.

1. SCOPE

1.1. PAYMENTS

1.1.1. Concept of interest

Estonia applies to interest payments to Swiss companies exactly the same conditions as to interest payments made to any other non-resident person (see Part I Sec. 1.2.1. Domestic rules and 2.1.1. Concept of interest).

1.1.2. Concept of royalties

According to the draft amendments Estonia would apply to royalty payments to Swiss companies exactly the same conditions for exemption of tax as to royalty payments made to companies of the EU Member States (see Part I Sec. 1.2.1. Domestic rules and 2.1.2. Concept of royalties).

1.2. COMPANIES

1.2.1. Types of companies benefiting from Art. 15(2) of the Agreement

According to the draft Estonia would apply the exemption for royalties with respect to a 'company of Switzerland'. If an entity is considered a company in Switzerland it will be eligible for exemption (see Part I Sec. 2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))).

1.2.2. 'Affiliated' companies

Under the draft amendments, exactly the same holding requirements for the exemption of royalty payments would be applicable as for the EU Member States, (see Part I Sec. 2.2.4. Associated company (Art. 3(b))).

1.2.3. Residence requirement

Under the draft the residence requirement with respect to Swiss companies would be applied the same way as for companies of Member States (see Part I Sec. 2.2.2. Residence requirement (Art. 3(a)(ii))).

1.2.4. Subject-to-tax requirement

According to the draft Estonia would not apply the subject-to-tax requirement with respect to royalty payments to Switzerland as it does not apply it with respect to Member States (see Part I Sec. 2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))).

2. PROCEDURE

According to the draft amendments exactly the same procedures applicable to the exemption of royalties under the Directive would apply to the exemption under the Agreement (see Part I Sec. 3. PROCEDURE).

3. SUMMARY

With respect to interest no measures are necessary as interest payments to non-residents are already exempted from withholding tax in Estonia under the national law.

At the moment the exemption under the Agreement has not yet been transposed to the national legislation with respect to royalties. The draft amendments to the TMS, which currently are being prepared by the Government, will extend the exemption for royalties also to Swiss companies after adopted by Estonian parliament. It is likely that the amending provisions will be implemented retrospectively. The exemption would be exactly the same as that under the Directive, both with respect to substance and procedures.

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ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Estonia and the EU Member States.

EU Member State	Interest (%) <1>	Royalties (%) <2>
Austria	10	5/10
Belgium	10	5/10
Czech Republic	10	10
Denmark	10	5/10
Finland	10	5/10
France	10	5/10
Germany	10	5/10
Hungary	10	5/10 <3>
Ireland	10	5/10
Italy	10	5/10
Latvia	10	5/10
Lithuania	0	0
Malta	10	10
Netherlands	10	5/10
Poland	10	10
Portugal	10	10
Spain	10	5/10
Sweden	10	5/10
United Kingdom	10	5/10

<1> Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.

<2> In the case of two rates, the lower rate applies to equipment rentals.

<3> The lower rate applies to (a) equipment rentals and (b) royalties for transmission by satellite, cable, optic fibre or similar technology.