Rolan Jankelevitsh
Walless, Tailinn
rolan.jankelevitsh@walless.com

Recent developments in international taxation: Estonia

Introduction

Estonia is a country in Northern Europe. It has been a member of the European Union and the North Atlantic Treaty Organisation (NATO) since 2004, a member of the Organisation for Economic Co-operation and Development (OECD) since 2010, and a member of the Eurozone since 2011.

Estonia has retained its unique corporate income tax system since 2000, where corporate income tax (CIT) is assessed on a monthly basis, and only when profits have been distributed (typically by way of dividends). As from 1 January 2025, the CIT rate is a flat 22 per cent (calculated as 22/78 of the net amount of distribution). Reinvested profits remain untaxed. For example, a company that has profits of €100 available for distribution may distribute €80 as dividends, and €20 of CIT will be due on such distribution.

This distribution system has served Estonia well over the years, as it is a simple and straightforward system that has stimulated reinvesting profits rather than distributing them. This unique feature is replicated only in neighbouring Latvia.

In 2024, for the eleventh year in a row, Estonia topped the International Tax Competitiveness Index published by the Tax Foundation.

Estonia has seen several, sometimes quite controversial, tax changes recently. In this report, we will briefly address the following developments:

- the new defence tax;
- the tax authority's guidelines on debt push-down transactions;
- transposition of the Pillar Two rules in Estonia;
- public country-by-country reports;
- VAT amendments;
- deemed supplier rules under the VAT in the Digital Age package; and
- new tax treaties.

Defence tax

In late 2024, the Defence Tax Act was adopted, which introduced the temporary defence tax (in force until 31 December 2028), consisting of three components:

- 2 per cent increase of VAT from 1 July 2025;
- 2 per cent defence tax on individual income from 1 January 2026; and
- 2 per cent defence tax on companies' annual profits from 1 January 2026.

The third component has been considered the most controversial, because it compromises the distribution tax system described above. Moreover, it basically applies to accounting profits, including unrealised gains from revaluation of assets, etc. Dividends from subsidiaries and profits attributable to foreign permanent establishments may be deducted from the taxable

profits. On the other hand, non-business expenses and transfer pricing adjustments are not deductible.

The defence tax stirred up a discussion as to whether its application to corporate profits is fair. In March 2025, the new government coalition agreed to abolish the short-lived defence tax. In May 2025, the new draft law was published, which abolishes the defence tax on corporate and individual income, but increases both the CIT and individual income tax rate to 24 per cent as from 1 January 2026. As opposed to the defence tax, which was meant to be a temporary measure, this increase applies for an indefinite term.

Tax authority guidelines on debt push-down transactions
Debt push-down structures have been widely used in Estonian M&A practice since the early years of Estonian independence. Leveraged buy-out transactions have often been structured in the way that a special purpose vehicle (SPV, the acquisition vehicle) was incorporated, such SPV was financed by the investors by equity and loans, and the SPV borrowed funds from an external financier (a bank). After completion of the acquisition, the SPV and the target are merged, resulting in a situation where the acquisition loan is serviced by the cash flows of the target's business.

Some years ago, however, the Estonian tax authority started scrutinising debt push-down transactions, and has communicated on several occasions that it considers such structures as problematic, because the loan repayments in such cases are not related to the target's business. This culminated in 2023, when the tax authority released draft guidelines which basically labelled all similar structures as aggressive tax planning resulting in taxable non-business expenses. The draft caused intense pushback from serial dealmakers, such as local and regional private equity houses. A series of roundtable discussions were held with the market participants, including the banks, advisers, private equity/venture capital fund managers, etc.

The result was that in late 2024, after several iterations of the draft guidelines, the tax authority came out with the final guidelines, introducing a more balanced approach. The new guidelines acknowledged that debt push-down structures are common in Estonian M&A practice, and established the principle that such transactions should not be taxable, as long as they have economic rationale and legitimate commercial reasons, and do not cause a mismatch in taxation. For example, according to the guidelines, a debt push-down transaction should normally not be taxable, if it is carried out by a person whose main business is making investments and the transaction has underlying commercial reasons.

On the other hand, if a transaction meets the test established by the Estonian general anti-avoidance rules (GAAR) provision, the transaction should normally be taxable. If the purpose or one of the main purposes of the debt being pushed down is to obtain a tax advantage that is contrary to the applicable tax law or international treaty, and such transaction is not genuine, then the loan repayments (both the principal amount and interest) may be taxed as concealed profit distributions.

An example of a taxable transaction set out in the guidelines is an intra-group restructuring, where the parent company has two Estonian subsidiaries; instead of a merger of the two subsidiaries, the parent lends funds to one of the subsidiaries (subsidiary A), which uses the borrowed funds to acquire the other subsidiary (subsidiary B) from the parent, followed by a merger of the two subsidiaries. This allows the parent to repatriate the profits of the merged

entity as loan repayments, without incurring any tax in Estonia. Since the primary objective of such transaction is presumably to gain a tax advantage, the tax authority would normally consider such transaction to be taxable. Such approach was considered reasonable by the market participants and did not cause opposition.

It remains to be seen how the tax authority will apply these guidelines in practice. For now, it appears that debt push-down transactions remain acceptable and legitimate structuring alternatives, but the investors must be diligent in making sure that there is sound commercial reasoning behind each transaction.

Transposition of the Pillar Two rules in Estonia
From 2024, the large multinational groups with annual revenue of over €750m are subject to the global minimum tax obligation, in effect in the EU and several third countries. Estonia has postponed the full application of the minimum tax rules until 2030 by applying the exception available to countries that have fewer than 12 ultimate parent companies of the qualifying groups. This exception was added to the EU Minimum Tax Directive at the request of Estonia.

However, this exception does not exempt Estonian companies from the minimum tax levied in other countries. According to the rules in force since May 2024, the Estonian parent company of a qualifying multinational group will have to designate a specific foreign subsidiary, which will file the minimum tax declaration on behalf of the group in its home country. The parent company is obligated to provide such filing entity with the information necessary to make the filing.

Another important exception that Estonia qualifies for is the possibility to make a distribution tax regime election. Under the Pillar Two rules, a distribution tax regime is a tax regime that does not levy a tax charge on taxable income when it is generated, but when it is distributed. As discussed above, Estonia is a good example of such regime. The key issue with such regimes is that a company might not necessarily distribute its profits for a number of years. Companies would have global base erosion (GloBE) income but no or limited tax suffered on that income, which would lead to a sizeable Pillar Two top-up tax liability. The distribution tax regime election works, in simplified terms, in that the profits earned in a particular financial year are not taxed immediately, but the deemed tax on such profits is reduced, over the next four year period, for losses and distributions. If such deemed tax is not reduced to zero within the four year period, then the balance is clawed back and included in 'adjusted covered taxes'. This election will somewhat help to maintain the attractiveness of the distribution-based Estonian CIT system.

Public country-by-country reports
In May 2024, the new legislation took effect implementing the public country-by-country reporting (CbCr) requirements arising from Council Directive (EU) 2022/2523. According to the newly enacted rules, the tax authority will publish the information on multinationals' CbCr on its webpage. This rule applies to the reports for financial years beginning on or after 22 July 2024. The CbCr requirement applies to companies with a consolidated revenue of at least €750m in the previous financial year.

VAT amendments
From 1 January 2025, a number of VAT amendments entered into force, several of which are relevant for multinationals having business operations in Estonia and other non-residents.

In accordance with the relevant provisions of Council Directive (EU) 2020/285, amendments were introduced regarding the VAT treatment of small enterprises. To name a few most significant amendments.

First, the calculation of the supply threshold triggering the registration obligation will now only include supply generated in Estonia. Supply of insurance and financial services, which are not of incidental nature, will be included in the taxable supply threshold calculation.

Second, to treat equally both the persons with a seat in a Member State and the non-residents with a seat in another Member State, a new special scheme for small businesses was introduced from 1 January 2025. According to the scheme, an entrepreneur may, by operating in another Member State without having a permanent establishment, register as a taxable person there under the same conditions as entrepreneurs with a seat or a permanent establishment in that Member State. This scheme will allow Estonian entrepreneurs to operate in other Member States without having to register there for VAT.

However, the special scheme for small businesses can only be used by a person whose total supply in a calendar year in all Member States (including the Member State of their location) has not exceeded €100,000 in the current year and did not exceed €100,000 in the previous calendar year, and the turnover generated in another Member State does not exceed the threshold for registering as a VAT payer in that Member State.

Amendments to the taxation of immovable property include:

- construction work that is transferred for the first time within one year after commencement of the use/re-use is also deemed to be a new construction work, meaning that VAT will now also apply to such transfer. Before this amendment, only the transfer before the first commencement of the use of the real property was VAT-able; and
- upon the first use of fixed assets, the input VAT is now adjusted in full in accordance with the proportion of the use of the fixed assets for the purposes of actual taxable supply during the first taxation period of the use of the fixed assets. Before the amendments, input VAT on fixed assets was adjusted annually, at the end of each calendar year, based on the actual usage of the asset during that year.

Other VAT amendments that entered into force in 2025 included changes in the VAT rate on accommodation services and press publications, extension of the VAT exemption to mental health services, etc.

The ViDA package and the controversial deemed supplier rules

One of the substantial concerns related to EU VAT rules that Estonia had to tackle recently is the issue of deemed supplier rules under the VAT in the Digital Age (ViDA) package. Namely, one of the initiatives implemented by the ViDA package is the introduction of deemed supplier rules that would facilitate short-term accommodation rentals and passenger transport by road. A ‘platform fiction’, or deemed supplier regime, will apply to the supply of short-term (uninterrupted) rental of accommodation (maximum 30 nights to the same person) and passenger transport services by road (within the EU), facilitated by a taxable person through the use of an electronic interface or platform (the facilitator). With certain exceptions,

under the deemed supplier rules the facilitator (ie, the platform operator) would be deemed to have received and supplied the services.

Estonia vigorously opposed introduction of these rules, arguing that it would unfairly burden small businesses and distort competition, particularly for Estonian SMEs. Estonia also expressed concern that taxing small businesses solely on digital platforms could push them towards less transparent trading methods. Estonia proposed a compromise allowing countries to opt-in to the deemed supplier regime, but this was not accepted.

In the final ViDA package, an opt-out provision was included as a compromise, allowing the Member States to exclude the services from underlying suppliers who make use of the small and medium-sized enterprises scheme ('SME-scheme') from the application of the deemed supplier rules. In the Member States that decide to make use of this opt-out provision, platforms will not become liable to remit any VAT on the underlying supplies made by the SMEs. As a result of this compromise, in November 2024 Estonia lifted its blocking veto, and the package was adopted in March 2025. Naturally, Estonia will most likely exercise this right to opt out.

New tax treaties

The area of treaties for avoidance of double taxation has seen recent developments as well. Namely, in May 2025, the Estonian Government approved the signing of the treaty with Liechtenstein. The ratification of the treaty with Botswana, signed in September 2024, was also initiated in Parliament. Interestingly, the treaty with Botswana was requested as early as 2018 by a major Estonian software developer involved in the development of Botswana's tax administration and collection software. Moreover, the treaty with Pakistan is in force since 2025.

Estonia now has 63 tax treaties in force, but, notably, initiated termination of the treaty with Belarus in March 2025. This follows as a reaction to Belarus participating in Russia's aggression against Ukraine, and after Belarus suspended key articles of the treaty, including provisions related to dividend, interest and capital gains, effective 1 June 2024.