

WTS Alliance Network

The Transfer Pricing Guide to Central and Eastern Europe 2009

Country profile: Estonia

I. Basic Information

1.1 Taxing Authority and Tax Law:

The Estonian Ministry of Finance is the Government Authority controlling financial issues. Within the purview of Finance Ministry, administration of the Estonian taxation system is the responsibility of the Tax and Customs Board (Maksu- ja Tolliamet). The Tax and Customs Board operates with a centralized authority and four regional authorities.

Transfer pricing rules are based on Income Tax Act (Tulumaksuseadus) § 14 sections 7 and 8 and § 50 sections 4 to 8. The rules regarding acceptable methods of determining the value of the transactions are contained in the Finance minister regulation No 53 of 10.11.2006 on the Methods of Determining the Value of Transactions Made between Related Parties (Seotud isikute vahel tehtud tehingute väärtuse määramise meetodid; TP Regulation).

If the Tax and Customs Board has adjusted the value of a related party transaction to a taxpayer's detriment, the taxpayer may first opt to seek correction from the Tax and Customs Board itself. If the application to correct the adjustment is unsuccessful or if the taxpayer decides not to seek correction, the taxpayer can always appeal the decision of the Tax and Customs Board to a court.

1.2 Transfer Pricing Regulations:

Current relevant transfer pricing rules and regulations and their effective dates. Tax years covered by existing rules.

The general application of Estonia's transfer pricing rules are governed by the above stated law and the TP Regulation. The Tax and Customs Board has also issued guidelines for determining transfer prices and recommends the explanatory notes of the Finance Minister's regulation on transfer prices, Commission notice regarding transfer pricing forum as well as EU transfer pricing forum as sources of information and guidelines regarding the application of transfer pricing rules.

1.3 Adherence to OECD Guidelines:

Estonia is not a member of the OECD, but its transfer pricing laws are in general agreement with the OECD Guidelines.

The TP regulation provides for the possibility to use both the three transactional transfer pricing methods (i.e. comparable uncontrolled price, cost-plus and resale method) and the two profit-based methods (i.e. transactional net margin method and profit split method).

II. Documentation

2.1 Documentation Requirements:

What are the documentation requirements and/or documentary recommendations? Which transactions have to be documented (national/international transactions)? Which languages are allowed? When are parties considered to be related (relationship threshold)? What are the deadlines for documentation?

TP Regulation applies to transactions between:

- resident legal person and related person;
- sole proprietor and related person;
- permanent establishment in Estonia and related person; and
- sometimes also resident legal person and its permanent establishment abroad.

Two or more entities are considered related parties if:

- they are spouses, direct descendants, siblings, descendants of siblings, descendants or parents of spouse, siblings of spouse;

- they are members of management bodies their spouses and descendants or parents;
- they are part of the same group in the meaning of Commercial Code;
- one person holds more than 10% of the share capital, votes or rights to profit of a legal person;
- one person holds with other related persons in total more than 50% of the share capital, votes or rights to profit of a legal person;
- more than 50% of of the share capital, votes or rights to profit of a several legal persons is held by a single person;
- group of people hold more than 25% of the share capital, votes or rights to profit of a legal person;
- all members of management board or other similar management body are the same people in two or more legal persons; and
- a person is the employee of another person, the spouse of the employee or direct descendant.

The additional TP Regulation documentation requirements are applicable only with regard to:

- credit institutions, insurance companies and listed companies;
- transactions with persons residing in low tax territories; and
- resident companies or permanent establishments with more than 250 employees, 50 MEUR turnover or 43 MEUR balance sheet volume.

The taxpayer is obliged to provide the additional data as specified in TP Regulation upon demand by the Tax and Customs Board. The taxpayer must be allowed a time period of at least 60 days to comply.

If documents of the Transfer Pricing files are in language other than Estonia, the taxpayer may present the documents in that foreign language. However the Tax and Customs Board has the right to demand their translation into Estonian and specify a reasonable date for compliance.

2.2 Components: *What are the necessary components of a transfer pricing documentation?*

The documentation required under TP Regulation is divided into the main file which concern the entire international group and local file which concern only the Estonian residents and permanent establishment.

The main file can further be divided based on business areas, but for each business area the file should contain

- an overview of the group business activities including descriptions in changes to business strategy since last financial year;
- overview of the group structure and general description of the activities of each group company, changes to group structure since last financial year;
- general information on transactions with related parties including their type and values;
- tasks performed with regard to the related party transactions and risks assumed by each participant;
- an overview of the immaterial property of the group, a description of transfer pricing policy of the group; and
- profit split arrangements and a list of advance pricing agreements or other advance rulings.

Local file is used to supplement the main file and should contain:

- the description of the taxpayers activities, changes in business strategy since last financial year;
- descriptions of transactions with related parties including information on the volumes of sale and value of services;
- the volume of leasing activities;
- revenues from the use or transfer of immaterial property;
- interests received or paid on loans;
- changes in trading circumstances and previous agreements;

- analysis of transactions with related parties and respective comparatives including the description of the respective property and services, activities analysis, overview of the conditions of the transactions, overview of the economic conditions, overview of business strategy and analysis of corrections in the comparatives data;
- specification of the methods used for determining transfer prices and the reasons for selecting the methods used; and
- if possible respective internal and external comparatives and references to the sources of the comparatives data. All comparatives used for the transfer pricing must be made available to the tax authorities.

The quantity and detail of documents required for specific transactions must correspond to the specifics of the transaction and its value. The documents must be sufficient to prove the transfer price reflects market value.

2.3 Purpose: *What is the purpose of the documentation?*

The purpose of the documentation is to support the basis of the transfer price applied to transactions between related parties. The documents must be sufficient to prove the transfer price reflects market value.

III. Transfer Pricing Methods

3.1 Pricing Methods and Priority: *Which TP methods are generally allowed and what is the priority of methods? Is there a "Best Method Rule"?*

Under the TP Regulation there are three transactional transfer pricing methods (i.e. comparable uncontrolled price, cost-plus and resale method) prevail and two profit-based methods (i.e. transactional net margin method and profit split method) available.

The choice of pricing method is the one that best suits the nature of the transaction. The TP Regulation contains some guidelines and limits as to which method should be used when.

3.2 Availability of Benchmarking: *Is Benchmarking allowed and/or required to support the documentation? Is a PAN-European benchmark study accepted by the tax authorities, or do they only allow/prefer a study on local companies? What database is generally used to perform the benchmark study on in your jurisdiction?*

The Tax and Customs Board has not issued any guidelines regarding Benchmarking studies and their application to Estonian companies. While the TP Regulation contains general rules on the use and availability of comparatives, there are no specific rules. Also the practice is not as established. As there is no indication that the Tax and Customs Board would not accept a PAN-European benchmark study, we see no problem to use it as part of the documentation.

IV. Penalties

4.1 Rates and Conditions: *What are the penalties for non-compliance and which rates and conditions apply?*

In case of failure to submit a declaration when required or failure to correct errors in the declaration, the tax authority can issue a penalty payment of EEK 20,000 upon first offence and EEK 30,000 on second offence.

If the tax authorities result to adjusting the transfer prices as a result of the audit, and the taxpayer is deemed to have paid less taxes than required, the resulting debt incurs an interest of 0,06% of the delayed amount per day beginning from the date the tax should originally have been paid.

Misdemeanour and criminal charges are up to EEK 5,000,000 or imprisonment for seven years, if taxpayer has reduced its tax obligation in tax declarations.

4.2 Extent of Enforcement: *To which extent are penalties enforced in practice?*

Should the Tax and Customs Board deem a transaction is not at arms length it will adjust the transaction values and impose interest.

There are not many transfer pricing cases to generalize which extent are penalties enforced in practice.

4.3 Reduction or cancellation of penalties: *How may penalties be reduced or avoided ex post for reasons other than documentation? Is there a Statute of limitations on the assessment of transfer pricing adjustments?*

The Tax and Customs Board has a three year limit to audit a taxation declaration from the date tax become payable including the details of any transactions subject to transfer pricing. If an audit is performed and no adjustment is made, the audit is final and cannot be reopened unless it is later established that criminal acts such as false accounting and fraud have occurred.

There is no current public information available regarding reductions that may have been granted to penalties imposed for adopting incorrect transaction values.

V. Special Considerations

5.1 Business Restructurings: *Is there a special legislation on business restructurings and/or the relocation of business functions?*

Estonia has legislation which controls the taxation consequences of business restructuring/reorganisations but these do not deal with transfer pricing.

5.2 Tax Return Disclosures: *Which disclosures regarding transfer pricing and related parties are to be made in order to file a tax return?*

In 2007 and 2008, in filing an monthly income tax declaration, the taxpayer had to answer three questions regarding transactions between related parties. There are no such questions in tax return from January 2009.

5.3 Competent authority: *Are there rules for submitting an adjustment to a competent authority? Is it possible to contact a competent authority before paying tax?*

There is no special authority for submitting an adjustment.

Tax has to be paid by 30 days from the Tax and Customs Board decision.

The taxpayer may first opt to seek correction from the Tax and Customs Board itself. If the application to correct the adjustment is unsuccessful or

if the taxpayer decides not to seek correction, the taxpayer can always appeal the decision of the Tax and Customs Board to a court.

5.4 Other Considerations: *Are there other special considerations that have to be taken into account upon providing transfer pricing documentation? Are secret comparables used by tax authorities? Are management fees deductible and/or subject to withholding tax? What is the level of interaction between tax and custom authorities?*

Accordingly, compliance with the Estonian regulations that provide for the approved transfer pricing methods and use of the European Union Code of Conduct on Transfer Pricing documentation guidelines and OECD "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" are recommended as a basic approach in preparing transfer pricing documentation and transaction values.

Estonian law requires the comparability of transactions to be used. Tax and Customs Board can use the Estonian Statistics Board database and if this does not have information the Tax and Customs Board can use its own database.

There is no special treatment for management fees.

In Estonia taxes and customs are administered by the same authority, i.e. Tax and Customs Board.

VI. Advance Pricing Agreements (APA)

6.1 APA Opportunity: *Can Advance Pricing Agreements be obtained from the tax authorities in your jurisdiction? Are unilateral APA's possible?*

Advance Pricing Agreements are not available under Estonian law. Advance rulings on other tax matters are available, but advance rulings on transfer prices are specifically excluded.

6.2 APA Filing Fees: *Do the local authorities charge a fee for starting the APA process and if yes, how much would those fees be?*

As an APA is not available there are no applicable fees.

VII. Developments

7.1) Recent Changes and Anticipated Developments: *Which transfer pricing developments have been recently taken place in your jurisdiction or are expected to take place in the near future?*

At the time of writing, there have been no recent or anticipated developments in regard to transfer pricing under Estonian law.