Significant tax changes expected in Estonia in 2024 and 2025 - update

Executive summary

The new parliament of Estonia has adopted several amendments to the tax legislation, which have been published and will become effective either from 2024 or 2025 (some already from 2023). The drafts underwent significant changes during parliamentary discussions, necessitating an update to our June tax alert. Below is a non-exhaustive overview of key amendments as well as some draft acts still under discussion.

Many of these changes concern tax rates. The standard VAT rate will increase from 20% to 22% from 1 January 2024. The reduced VAT rates of accommodation services and press publications will increase from 1 January 2025. As communicated by the Government, the main aim of these changes is to balance the state budget by increasing the collection of tax revenues.

Income tax will increase for both corporations and natural persons from 20% to 22% in 2025. The currently available preferential corporate income tax rate of 14% applicable to regularly distributed profits and the related 7% withholding tax on dividends paid to natural persons will be abolished starting from 2025.

From 1 January 2025, a uniform basic tax exemption of 8,400 euros will apply to all natural persons, replacing today's tax exemption, which depends on the amount of annual income. From 1 January 2024, certain tax exemptions and deductions, like the right to deduct housing loan interest will be abolished.

Further amendments to the Income Tax Act clarify the implementation of the ATAD2 Directive (Council Directive 2017/952) with regard to anti-hybrid mismatch rules whereby certain hybrid mismatch situations are allowed to the extent the deduction is set off against the so-called dual inclusion income. Also, a collective investment vehicle hybrid exemption will be introduced retroactively from 1 January 2023.

A draft act has been presented to the parliament to transpose Council Directive (EU) 2020/284 into the Estonian VAT Act in order to introduce certain data collection and reporting obligations on payment service providers as of 1 January 2024. In addition, the requirements for non-residents to appoint tax representatives will be amended.

Tax rate increases are also adopted for gambling and excise duties on alcohol and tobacco products in 2024–2026.

Detailed discussion on the topics of:

- Standard VAT rate increases from 20% to 22%
- VAT rate for accommodation services increases from 9% to 13%
- VAT rate for press publications increases from 5% to 9%
- Revised rules for appointing tax representatives impacting UK entrepreneurs
- Obligations of payment service providers
- Change in the tax rate of regularly distributed dividends
- Change in the income tax rate for advance payments of credit institutions
- Changes in individual taxation
- Clarifying the transposition of ATAD2
- Excise duties on alcohol and tobacco products increase 5%
- Tax rates on various forms of gambling increase
- Introduction of car tax in Estonia

Read more below

Standard VAT rate increases from 20% to 22%

The standard VAT rate will be set at 22% instead of the current 20%. Until 31 December 2025, a VAT payer has the right to continue applying the 20% VAT rate on turnover from contracts concluded before 1 May 2023, provided that the contract stipulates the use of the 20% VAT rate and does not allow for the possibility of revising this rate when the tax rate changes.

A VAT payer implementing special arrangements for cash accounting for VAT has the right to declare and pay VAT at the rate of 20% if turnover occurs in 2024 for goods sent or made available or services provided in 2023, for which an invoice with a VAT rate of 20% has been submitted in 2023, but the payment is received in 2024.

VAT rate for accommodation services increases from 9% to 13%

As of 1 January 2025, the reduced VAT rate of 9% will no longer apply to accommodation services and VAT on accommodation services will be calculated using a new reduced rate of 13%.

A taxable person implementing special arrangements for cash accounting for VAT has the right to declare and pay VAT at the reduced VAT rate if turnover is generated from the provision of accommodation services in 2025, but the service has already been provided and an invoice issued for it before 1 January 2025.

As the VAT rate will increase to 13% from 1 January 2025, the first VAT return on which the turnover is declared with a 13% tax rate is submitted on 20 February 2025.

VAT rate for press publications increases from 5% to 9%

As of 1 January 2025, the current reduced VAT rate of 5% applicable to press publications will increase to 9%.

A taxable person implementing special arrangements for cash accounting for VAT has the right to declare and pay VAT at the reduced VAT rate of 5% until 2026 if turnover is generated from the provision of press publications, both on a physical and digital medium in 2025, but the goods were sent or made available or the service has already been provided and an invoice issued for it before 1 January 2025.

Publications containing mainly advertising or private advertisements or mainly with erotic or pornographic content or video or music content are excluded from the scope of the reduced rate.

Revised rules for appointing tax representatives impacting UK entrepreneurs

As a general rule, when applying for VAT registration in Estonia, non-residents from outside the European Union are required to appoint a tax representative who has been approved by the tax authority and represents the non-resident for the performance of the tax obligations arising in Estonia. Exception applies to persons with whose country of residence the European Union has concluded a mutual assistance contract concerning administrative cooperation, the fight against fraud and the recovery of claims relating to the value added tax. When the planned amendments to the VAT Act (pending approval in the parliament) come into effect, UK entrepreneurs will be able to decide whether or not they wish to use a tax representative (an intermediary) when registering in Estonia for applying the Import One Stop Shop (IOSS).

Obligations of payment service providers

According to the draft act on amendments to the VAT Act and the Taxation Act (pending approval in the parliament), starting from 1 January 2024, payment service providers will be required to store data on cross-border payments by payee and transmit this data quarterly to the tax authority. The amendments transpose Council Directive (EU) 2020/284 into the Estonian VAT Act and aim to detect cross-border VAT fraud and improve competitive conditions in e-commerce.

A threshold is provided to cover only those cross-border payments that can be related to economic activity. If the total number of cross-border payments per payee exceeds 25 per quarter, the payment service provider is obliged to store data on the payee and the payments, which must be submitted regularly to the tax authority.

The payment service provider is obliged to store the data electronically for 3 calendar years from the end of the calendar year in which the payment was made. Information must be submitted to the tax authority for each quarter by the end of the month following the quarter, i.e., on 30 April, 31 July, 31 October and 31 January, in the e-service environment of the tax authority. If the number of cross-border payments to the same recipient does not exceed 25 and the obligation to provide information does not arise, the payment service provider must confirm this separately in the e-service environment of the tax authority.

The payer's payment service provider is not obliged to store or transmit data on cross-border payments if at least one of the payee's payment service providers is located in an EU member state (for example, Estonia).

Change in the tax rate of regularly distributed dividends

From 2025, corporate income tax rate will increase by 2 percentage points to 22%.

The lower income tax rate of 14% applicable to regularly distributed profits of companies and non-residents' permanent establishments will no longer apply. Because of this, the withholding of 7% personal income tax on dividends paid to natural persons (including dividends of companies taxed on the basis of the tonnage scheme) is also no longer applicable.

Change in the income tax rate for advance payments of credit institutions

The adopted act increases the 14% tax rate applicable to advance payments made by credit institutions to 18% from 2025. An advance payment made in the fourth quarter of 2024 and due on 10 March 2025 will be taxed at the current rate of 14%.

The amendments also allow the advance payments made in the calendar year to be deducted from the income tax due on dividends. Currently, set-off is allowed only for advance payments made in previous calendar years.

Changes in individual taxation

From 2025, a uniform basic exemption of 700 euros per month or 8,400 euros per year will be established for all natural persons, except for old-age pensioners, whose tax-free income shall be equal to the average old-age pension. This new tax-free income extends to all residents of Estonia and the European Economic Area, regardless of the amount of income they earn.

Tax exemptions regarding child support, deduction of housing loan interest and spouse's unused tax-exempt income will be abolished from 2024.

Clarifying the transposition of ATAD2

With the amendment, point (b) of Article 2(9) of Council Directive (EU) 2016/1164, amended by the ATAD2 directive, is taken over into the Income Tax Act, which stipulates certain situations when hybrid mismatch shall not arise.

Specifically, a hybrid mismatch shall only arise in the following situations, to the extent the payer jurisdiction allows the deductions to be set off against an amount that is not dual-inclusion income:

1. A payment gives rise to a deduction without inclusion and the mismatch is the result of the payee jurisdiction laws disregarding the payment.
2. A deemed payment made between the head office and a permanent establishment or between two or more permanent establishments gives rise to a deduction without inclusion and the mismatch is the result of the payee jurisdiction laws disregarding the payment.
3. A double deduction outcome occurs.

In addition, with retroactive effect from 1 January 2023, an exemption to the reverse hybrid entity taxation rule will be introduced with regard to a collective investment vehicle – an investment fund or vehicle that is widely used, has a diversified portfolio of securities and is subject to the investor protection laws of the country in which it is incorporated.

Excise duties on alcohol and tobacco products increase 5%

The excise duty on alcohol, which was last raised in 2018, will increase by 5% annually in 2024–2026. The excise duty on cigarettes and smoking tobacco, which has been raised by 5% per year in recent years, will also increase by the same amount in 2024–2026. The excise duty on tobacco liquids will also grow by 5% per year over the next three years, and the minimum payable excise duty will increase by the same amount for cigars and cigarillos.

Tax rates on various forms of gambling increase

According to the amendment, the current tax rate of 5% on online betting and lotteries will increase to 6% in 2024 and to 7% in 2026. The tax rate on lotteries and commercial lotteries will increase from 18% to 22% in 2024, the tax rate on gambling tables from 1,278.23 euros to 1,406 euros, and the tax rate on slot machines will be rounded from 31.95 euros to 32 euros. According to the explanatory memorandum, the increase in rates is intended to have minimal effect on market operators and will not necessitate a fundamental restructuring of the gambling industry.

Introduction of car tax in Estonia

The Government is aiming to introduce a car tax in Estonia from July 2024. The specific regulation is still being developed, the draft should be ready by autumn and the act adopted by the end of 2023. The car tax is expected to include a one-time registration fee and an annual fee (with a CO_2-based part and/or a luxury car component). The purpose of the tax is to direct consumer demand towards more economical cars.

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