



# Baltic Tax Review

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## Country Review: ESTONIA

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### Changes in the taxation regarding vehicles and requirements for the annual financial statements under EU law

The present article concentrates on the proposed tax amendments in the Estonian Income Tax Act and VAT Act. Additionally the present article will provide short information regarding the application to the European Court of Justice regarding Directive 2013/34/EU.

On 25 September 2013 the Ministry of Finance proposed amendments, which would have significant impact on the tax burden of a company operating in Estonia. All the proposed amendments relate to the taxation of a vehicle, whether personal vehicle used for business purposes or business vehicle used for personal purposes. The amendments are discussed below.

### Proposed changes to the Income Tax Act

The Ministry of Finance has proposed to amend Section 13(3) pt 2 of the Income Tax Act. Currently that section allows the employer to pay to the employee or board member either 64 EUR as compensation (person does not have the obligation to maintain driving records) or 256 EUR as compensation (person is obliged to keep driving records).

The proposal loses the possibility to pay compensation to the employee for the use of his/her personal vehicle without keeping a detailed account of the work related use of the vehicle. The aim of such a proposal is to eliminate situations where a person receives tax free addition to the salary.

The second proposal is to amend Section 48(8) of the Income Tax Act. Currently the provision sets the maximum price of a fringe benefit for the use of an automobile of the employer free of charge or at a preferential price for activities not related to employment or service duties or to the employer's business is 256 euros per month for each automobile used for the activities specified. According to the explanatory notes on the amendment of the Income Tax Act, the aim is to toughen the method of calculation of the fringe benefit. It is noteworthy that in this regard the Ministry of Finance considers that the filling in of the driving records is "creative work" and does not reflect the actual use of the vehicle.

Due to the inconsistent treatment of the driving records, various institutions have already voiced their opposition to these changes. Currently the proposed legislation is in the Estonian Parliament. The amendments of the Income Tax Act are aimed at entering into force by 1 January 2014.

## Proposed changes to the VAT Act

In order to limit tax fraud in the field of VAT, the Ministry of Finance has also proposed amendments to the VAT Act concerning the purchase of vehicles and the amount of input VAT is deductible. Currently there are no limits to deducting the VAT from a vehicle and from all related costs (i.e. fuel, repair, etc.).

The proposed amendment would limit the deduction of VAT to 50%. This limitation will apply to the purchase of a vehicle, or use under a contract for use. The limitation will also apply to the purchase of all services and goods for the vehicle. In addition to the preceding the Ministry of Finance has proposed an upper limit for the deductible VAT purchase, rental or lease of a vehicle. The limit is set at 2 000 EUR per vehicle.

Pursuant to the explanatory notes of the proposal the aim of these amendments is to limit VAT related fraud. The Ministry of Finance has noted that if a vehicle can be used for both business and personal use, it is presumed that the vehicle is partially used for personal use.

When it comes to the conformity with the EU VAT Directive, the explanatory notes refer to the exemption listed in Directive 2006/112/EC Article 395. The opponents of this amendment have pointed out that prior to taking advantage of the exemption listed in Directive 2006/112/EC Article 395 the national authorities need to actually receive approval for the exemption from the European Council. Currently there is no information available whether national authorities have submitted such a request to the European Commission.

Despite the fact that Estonia has not received an approval for such an exemption, the amendments of the VAT Act are estimated to enter into force on the 1 July 2014.

## Claim to the ECJ regarding Directive 2013/34/EU

On 26 June 2013 the European Parliament and the Council adopted Directive 2013/34/EU with the aim to simplify the rules regarding the annual financial statements and consolidated financial statements. The deadline for transposition of the Directive is 20 June 2015. This means that after the deadline for transposition, most EU member states would have similar rules applicable for submitting the financial statements and consolidated financial statements.

However, on 18 September 2013 the Estonian government decided to submit a claim for cancellation to the European Court regarding the above mentioned directive. If the European Court of Justice will satisfy the Estonian claim then Estonia would not be under the obligation to implement the rules of the Directive. This in turn indicates that Estonian regulation for financial statements which is applicable in other member states will differ from the EU regime.

State authorities believe that the proposals regarding the directive are not appropriate for Estonia and as such would not bring about the desired result. The Ministry of Finance as well as the Estonian Board of Auditors are against implementing the directive because it would result in the lack of financial transparency and would complicate an access to the financial data currently easily accessible.

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Due to the reason that on 1 January, 2014 *Euro* will substitute *Lats* Latvian parliament has passed a lot amendments to existing laws.

State revenue service has issued Guidelines on the principles for applying administrative penalties, as well it has updated Methodology on completing the value added tax returns and annexes thereto and issued a new Methodology on reporting amounts paid to private persons.

Starting from September, 2013 tax payers, which will be included in the list of persons considered to be audited, will receive a prior notice regarding planned tax audit.

The Supreme Court of Latvia has ruled that the State revenue service is entitled for the purpose to establish if tax payments made for the period under the audit (last three years can be audited) are correct review activities in earlier periods, but not to calculate taxes for the earlier period.

On 5 July, 2013 has come into force amendments to the Corporate income tax law. More precise definition for initial long term investment is made and new rules in regard of losses and income from EU and EEA public securities, excluding stocks, are introduced.

Starting from 1 January, 2014 hard copy employment tax book will be substituted with electronic employment tax book.

On 27 August, 2013 the Cabinet of ministers has passed new regulations according to which minimum monthly wage and minimum hourly wage will be increased starting from 1 January, 2014.

### 1. Eurozone

#### ▪ Changes in laws due to introduction of *Euro*

On September 19, 2013 Latvian parliament has passed 53 laws under which there are made amendments to the existing laws due to the reason that starting from 1 January, 2014 *Euro* will be official currency of Latvia. There are no substantial amendments to the laws, mostly technical, for example, the term “lats” is substituted with term “euro” and the amounts which are currently fixed in Lats are changed to the amounts in *Euro*.

At the same time it must be mentioned that in some cases certain legal procedures will have to be carried. For example, companies will have to amend corporate documents, for example,

statutes and shareholders registers, in order all amount currently stated in Lats are stated in *Euro*.

According to the amendments to the Law on Annual Reports Euro will have to be used in annual reports for year 2014.

## **2. State revenue service practice**

### **▪ Guidelines on Principles for applying administrative penalties**

In order to ensure that unified practice is applied to all tax payers when administrative penalties are levied Latvian State revenue service has issued Guidelines on Principles for applying administrative penalties.

It must be mentioned that the Guidelines is the internal document which means that it cannot be applied as the laws are, but such a document is a quite helpful in order to understand and the way Latvian State revenue service makes a decision on administrative penalty.

For example, it is mentioned in the Guidelines that in order to reduce the amount of penalty for the offence discovered in a tax audit for 50% the State revenue service will verify:

- 1) whether tax payer has not committed recurrent offence in tax area;
- 2) whether the tax payer has paid current taxes by due dates during last 12 months prior the audit (the debt below EUR 142,29 will not be considered as debt for the purpose mentioned in this bullet point)
- 3) whether the tax payer has filed tax returns by due dates during last 12 months prior the audit;
- 4) whether the tax payer has cooperated with the State revenue service officials

### **▪ Methodology on completing the value added tax returns**

The Methodology provides detailed explanations how to fill each line of the value added tax return and there is a specific section in the Methodology where explanations how practically recalculate proportion of applicable and non-applicable transactions for taxation year.

### **▪ Methodology on reporting amounts paid to private persons**

On 1 August, 2013 the State revenue service has issued a new Methodology on reporting amounts paid to private persons.

The Methodology provides practical tips how to companies and other type of legal entities, well permanent establishments of foreign tax payers and private persons, which are registered with the State revenue service as the persons who carry out business activities, reports to the state revenue service about amounts paid to private persons.

### **▪ Prior notice of State revenue regarding planned tax audit**

According to the State revenue services press release starting from September, 2013 tax payers, which will be included in the list of persons considered to be audited, will receive a prior notice regarding planned tax audit.

### 3. Taxes and duties

- **Court practice - review of activities carried out prior the period under the audit**

The Supreme Court of Latvia has ruled that the State revenue service is entitled to review the activities of the tax payer, which the taxpayer has carried out prior the period under the audit, in order to establish whether the tax payments made for the period under the audit are correct. Under the Law on Taxes and duties there is provided a three years restriction under which state revenue service is entitled to calculate taxes only for last three years.

### 4. Corporate income tax

- **Amendments to the Corporate income tax law**

On 5 July, 2013 has come into force amendments to the Corporate income tax law.

Under the amendments the definition of initial long term investments (for example, investments made within supportable investment projects in unused (brand new) assets used for software programming, pipelines, specific buildings classified as buildings used in communications sector, warehouses) is made more precise.

As well it is set forth that taxable income has to be increased for losses from EU and EEA public securities, excluding stocks, and decreased for income from sale of EU and EEA public securities, excluding stocks.

### 5. Personal income tax

- **From 1 January, 2014 hard copy employment tax book will be substituted with electronic employment tax book**

The Cabinet of ministers has adopted new Regulations No.304 on Procedure how employment tax books are issues, under which hard copy employment tax books will be substituted with electronic employment tax books. The Regulations will be applicable starting from 1 January, 2014.

Employment tax book is issued to the employee to submit it to the employer and for the purpose to record personal income tax reliefs applied by the employee.

Electronic tax books will be available in Electronic Reporting System, which is administered by the State revenue service.

## 6. Employment

### ▪ Increase of minimum monthly wage and minimum hourly wage from 1 January, 2014

On 27 August, 2013 the Cabinet of ministers has passed new regulations No.665 on the minimum monthly wage and the minimum hourly wage. The new regulations will be applicable starting from 1 January 2014.

The minimum monthly wage for the work carried out in normal working hours (40 hours per week) will be EUR 320, but minimum hourly wage rate will be in the amount of EUR 1,933.

Minimum hourly wage rate for minors and employees exposed to special risk will be EUR 2,209.

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### TAX LAW AMENDMENTS

**During the period from 1 June 2013 to 1 September 2013, a few new amendments were made to the applicable tax laws of the Republic of Lithuania. We will provide a brief overview of the main novelties of taxation laws.**

#### **Amendments to the Law on Excise Duty adopted by Law No XII-457 of 2 July 2013**

The Law amending the Law on Excise Duty raised the rates of excise duties on alcoholic beverages: on beer from LTL 8.5 to LTL 9.35 for 1% of actual alcoholic strength by volume (the volume equals 1 hectolitre); on wine and other fermented beverages with an actual alcoholic strength by volume (in case of other fermented beverages received only by fermentation) of not more than 8.5% vol. – from LTL 58 to LTL 85 per hectolitre of the product; on all other wines of fresh grapes and other fermented beverages – from 198 to LTL 225 per hectolitre of the product; on intermediate products with an actual alcoholic strength by volume not exceeding 15% vol. – from LTL 216 to LTL 281 per hectolitre of the product; on intermediate products with an actual alcoholic strength by volume exceeding 15% vol. – from LTL 304 to LTL 400 per hectolitre of the product; on ethyl alcohol – from LTL 4 416 to 4 460 per hectolitre of pure ethyl alcohol. All the aforementioned amendments will come into effect on 1 April 2014.

Furthermore, this Law increased the rates of excise duties on tobacco products as well. Excise duty on cigarettes is levied at the combined rate which comprises the specific component (in LTL for 1 000 cigarettes) and the *ad valorem* component (in percentage from the maximum retail selling price). Under the Law referred to above, the specific component was increased from LTL 148 to LTL 157. In addition, the minimum combined rate of excise duties for 1 000 cigarettes was raised from LTL 244 to LTL 256. The rate of excise duties on cigars and cigarillos per kilogram of the product was raised from LTL 88 to LTL 93. The above amendments will come into effect on 1 March 2014.

#### **Amendments to the Law on Income Tax of Individuals adopted by Law XII-427 of 27 June 2013**

The Law amending and supplementing the Law on Income Tax of Individuals (hereinafter ‘the LITI’) introduced a number of amendments, the most relevant of which are as follows:

1. It is established that the transfer of securities (including derivative financial instruments) is not recognised as individual activities.

2. It is provided that as from 1 January 2014 the scope of income tax of a non-resident of Lithuania shall be all payments received by members of supervisory boards and boards of directors of Lithuanian companies from these companies, regardless of the periodicity of payment thereof. This means that, after the aforementioned amendments have entered into force on 1 January 2014, not only annual but also other payments made by Lithuanian companies to members of their supervisory boards and boards of directors – non-residents of Lithuania – within a year will be subject to income tax, irrespective of the year in which the remunerated activities on the supervisory board or board of directors were carried out.

3. The 20% rate of income tax was abolished. This means that, when calculating and declaring income from distributed profit (including dividends) in 2014 and subsequent tax periods, the 15% rate will be applicable, and where income from distributed profit in 2013 and previous tax periods is calculated and declared, the 20% rate of income tax should be applied.

4. The amendment to Article 16(1) of the LITI provides that, when calculating and declaring taxable income in 2014 and subsequent tax periods, due account should be taken of the fact that all income (including income from distributed profit – dividends) is subject to the 15% rate of income tax. This means that expenses incurred by a resident may be subtracted from received dividends as well.

5. The following amendments to Article 17(1) (Tax-exempt Income) of the LITI were introduced:

- 1) The income tax relief on income received from residents for loans granted to companies and other residents was abolished.
- 2) The income tax relief on securities acquired before 1 January 1999 was abolished.
- 3) Income tax was levied on all other income from deposits and debt securities (for example, bonds) by setting the minimum tax-exempt amount of income, i.e. LTL 10 000 for each tax period, without applying any grace periods in respect of the duration of such investments.
- 4) Income tax was levied on income from the sale or any other transfer into ownership of financial instruments (for example, shares) or the sale of derivative financial instruments provided that the difference between the amount received from the transfer or sale and the acquisition price exceeds LTL 10 000 for each tax period. The previously applicable relief related to the retention of securities for 366 days was abolished.
- 5) It was established that income tax is not applicable to interest on securities of governments of the European Economic Area countries and securities of political or territorial administrative divisions of the European Economic Area countries provided that they were acquired before 31 December 2013.

- 6) It was established that income tax is not applicable to interest received in the European Economic Area countries on deposits kept in their banks and other credit institutions provided that the contracts on such deposits were concluded before 31 December 2013.

All the above provisions are applied to the calculation and declaration of income received in 2014 and subsequent tax periods.

### **Amendments to the Law on Corporate Income Tax made by Law No XII-428 of 27 June 2013**

The purpose of the Law amending the Law on Corporate Income Tax (hereinafter 'the CIT') is to extend the deadline for the application of the corporate income tax relief applicable to entities carrying out investment projects and investing in essential technological renovation, to create conditions for entities which have acquired goods vehicles, trailers and semi-trailers to benefit from the investment project relief, and to enable entities to benefit from the corporate income tax reliefs relating to the deadlines for retention of shares (interests, member shares) in such cases where entities must transfer shares (interests, member shares) due to statutory requirements, to assign all payments for activities of supervisory board members to the tax base of a foreign entity, and to harmonise the deadlines for declaration and payment of corporate income tax.

The CIT changes introduced by this Law are as follows:

1. The deadline for the application of the incentive relating to taxable profit reduction applied to entities carrying out investment projects and investing in essential technological renovation was extended until 2018.
2. From 1 January 2014, all payments for activities of supervisory board members are attributable to the tax base of a foreign entity, irrespective of whether the foreign entity is paid for activities of supervisory board members by annual payments (bonuses) from profit, or by any other methods and regardless of the periodicity of payment thereof.
3. When calculating corporate income tax for 2014 and subsequent tax periods:
  - 1) the list of long-term assets of an investment project to enjoy the incentives was extended by including a class of cargo vehicles, trailers and semi-trailers, and a limitation was set that the taxable profit linked to the acquisition of such assets may be reduced by no more than one million litas of expenses incurred during the tax period;
  - 2) under the amended Article 12(15) of the CIT Law, no regard is paid to the share retention deadlines in such cases where shares are transferred due to statutory requirements, i.e. the incentives relating to the non-taxation of income from the increase in the value of assets in case of a share transfer are not lost provided that an entity is required to transfer shares due to statutory requirements before the expiration of the share retention deadlines set in Article 12(15) of the CIT Law;
  - 3) no regard is paid to the share (interest, member share) retention deadlines, which must be observed in order to take advantage of the incentives relating to the non-taxation of income from the increase in the value of assets, where shares (interests, member shares) are transferred as a result of statutory requirements.

4. When declaring corporate income tax for 2013 and subsequent tax periods, the calculated corporate income tax must be paid by the deadline for the submission of a return, i.e. by the first day of the sixth month of the next tax period (if the tax period coincides with the calendar year, this day will be 1 June).

## **MOST RECENT CASE LAW ON TAX DISPUTES**

### **Regarding the recalculation of land tax and revision of land tax returns**

Judgment of 8 April 2013 passed by the extended judicial panel of the Supreme Administrative Court of Lithuania in administrative case No A-556-827/2013.

**The extended judicial panel stated that, having at its disposal objective data allowing to negate the presumptions of correctness and completeness of data contained in the Real Property Register, the local tax administrator must assess these data and, where necessary, apply to other institutions for submission of data (for example, to the territorial divisions of the National Land Service under the Ministry of Agriculture) and to perform other necessary actions in order to ensure that the tax is be calculated (recalculated) correctly and in compliance with the taxation conditions and requirements laid down in the respective tax law.**

### **Factual circumstances**

In the given case, the dispute arose over the recalculation of land tax and the revision of the completed land tax returns after it has been determined that the value of the disputed land plot, which was used to calculate the amount of land tax and which was indicated in the Real Property Register at the time of the calculation of the tax, had been calculated incorrectly. In this case, there was no dispute over the value of the disputed land plot determined by Order of 21 September 2011 of the territorial division of the National Land Service. The fact that before the passing of this Order the value of the disputed land plot, which served as the basis for the calculation of land tax payable by the applicant for 2008-2011, had been determined incorrectly, was not questioned either. However, both local and central tax administrators disagreed with the applicant's claims based solely on the circumstance that data of the Real Property Register on the value of the disputed land plot in 2008-2011 were not contested and, under the aforementioned decision of the territorial division of the National Land Service, the data for this period were not changed. According to the tax administrator, this decision is only valid for the resolution of the issue relating to the value of the disputed land plot after the adoption of this Law and is relevant for the calculation of land tax for 2012.

### **Arguments and clarifications of the extended judicial panel**

The judicial panel noted that, in the given case there are no doubts that when calculating the land tax payable by the applicant, the local tax administrator referred to the value of the disputed land plot indicated in the aforementioned Register at that time. On the other hand, the extended judicial panel has no reservations as to the fact that the value of the disputed

land plot indicated in this Register was calculated incorrectly. Indeed, this circumstance was stated in the decisions of the competent authorities, and it was not questioned by the defendants either. The case also includes the letter of the National Land Service under the Ministry of Agriculture containing detailed information on the value of the land plot during the period that is relevant to the dispute if this value had been determined correctly.

The judicial panel indicated that, in accordance with Article 4 of the Law on Real Property Register which was effective during the period that is relevant to the dispute and is applicable at present as well, “all data contained in the Real Property Register shall be recognised as correct and complete, unless contested in the manner prescribed by law”. On the other hand, it must be also emphasised that the legislator links explicitly the tax base to the price of the land plot which, as determined by the Government of the Republic of Lithuania upon the instruction of the legislator, is equal to the land value calculated according to the Land Appraisal Methodology approved by Resolution No 205 of 24 February 1999 of the Government of the Republic of Lithuania (hereinafter ‘the Methodology’), rather than the value indicated in the Real Property Register. As the provisions establishing the main components of the tax, to which the tax base is attributable as well, cannot be interpreted in an expansive manner, it should be concluded that, upon determination that the data of the Real Property Register on the value of the land plot (the scope of the tax) do not correspond with the value determined pursuant to the Methodology, land tax must be calculated on the basis of the value determined by the latter method.

The judicial panel noted that the general rule regarding the calculation of land tax on the basis of data of the Real Property Register does not deprive the tax administrator of its right and does not negate its duty to calculate the tax on the basis of the tax base established by the law in case there is, for example, a decision of a competent authority regarding the determination of the land value according to the Methodology and/or other objective data.

The judicial panel clarified that in the event that the payer of the land tax has applied to the local tax administrator regarding the recalculation of land tax and the revision of the completed land tax returns prepared by this entity of public administration, where it also submits information that this tax was calculated (the return was prepared) on the basis of the incorrect data of the Real Property Register and objective proof of the incorrectness of the Register data (as in the given case), this local tax administrator may not refuse to recalculate the payable tax and perform other related actions based solely on the circumstance that the Real Property Register data were not contested.

The duties of the local tax administrator in calculating (recalculating) land tax and preparing, submitting and revising land tax returns imply the duty to ensure that the tax is calculated by applying the rate of the tax established by the law and on the tax base provided for in the law. For this purpose, the local tax administrator must be active and act in such a way as to ensure compliance with the requirements for the activities of public administration entities arising out of Article 5(3) of the Constitution of the Republic of Lithuania, which provides that state institutions serve the people, and with the principles of equality of taxpayers, fairness, rationality, universal obligation, clarity of taxation, and precedence of content over form (Articles 7-10 of the Law on Tax Administration) as well as correct calculation of taxes.

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