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flash Alert

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Estonia – Tax, Unemployment Insurance, and Foreign National Employment Registration Developments

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In this *Flash Alert*, we briefly describe some recent developments in Estonia that may concern globally mobile employees and their multinational employers, including new registration rules for resident/nonresident foreign individuals working in Estonia and revised rates for personal income tax and unemployment insurance, as well as changes to the taxation of nonresident members of boards of directors.

Why This Matters

The changes described in this newsletter will impact employers and their employees (including those on international assignment) by helping to: streamline administration, reduce processing times, provide for more accurate record-keeping, and lower tax costs in respect of assignees to/in Estonia and Estonian assignees overseas who remain subject to tax in Estonia.

There are some new registration procedures that employers need to be aware of. If an employer is non-compliant, it may be subject to financial penalties and other sanctions.

Lower Income Tax and Unemployment Insurance Charge

Lowered Rate for Income Tax

As of 1 January 2015, the personal flat income tax rate in Estonia will be lowered to 20 percent (from 21 percent) for natural persons and the annual basic exemption (non-taxable amount) per year is set at EUR 1,848 (was EUR 1,728) and per month EUR 154.¹

Changes to Taxation of Directors' Fees

From 1 January 2015, directors' fees paid to nonresident board members of Estonian companies will be taxable in Estonia at a rate of 20 percent. Fees are taxable even if the payer is not a resident legal entity or has a permanent establishment (PE) in Estonia (until 31 December 2014, fees are taxable in Estonia only when the payor is an Estonian resident legal entity or a PE in Estonia).

KPMG Note

The purpose of this change is to make directors' fees paid to an Estonian company board member taxable in Estonia, regardless of whether these fees are paid by a resident or nonresident person. The scope of this taxation concerns the fees paid for carrying out directors' duties for an Estonian company or PE, irrespective of where the duties are performed. Benefits provided to board members of Estonian companies or nonresident PEs are also taxable.²

Due to the payment of these fees, a nonresident board member may become liable for not only personal income tax, but also social tax on the employer's behalf in Estonia. To fulfill a nonresident's tax obligations relating to directors' fees, the payor of these fees should register as a nonresident employer with the Estonian Tax and Customs Board, so as to be able to withhold taxes from the payments.

Lowered Rates for Unemployment Insurance Premium

As of January 1, 2015, unemployment insurance premium rates for insured persons (including an employee or a natural person providing services on the basis of a contract under the law of obligations) will be 1.6 percent, and for employers, 0.8 percent (in 2014, respectively 2 percent and 1 percent). The unemployment insurance premium rates are fixed and will remain the same until 2018.³

The unemployment insurance premium is paid on wages, salaries, and other remuneration paid to insured persons by their employers (irrespective of the tax residency of the employee) if the work is carried out in Estonia.

New Steps Regarding Registration of Employees and Social Security Coverage

New Obligations for Registering Employment in Estonia in Register of Employment as of 1 July 2014

As of 1 July 2014, all employment of resident and nonresident individuals whose work triggers a tax liability in Estonia must be registered in the official employment register. (The tax liability includes personal income tax and social security contributions.) The registration requirement exists irrespective of the form or presence of a contract and is solely the employer's obligation.⁴

Introducing Strict Deadlines for Registration of Employment and Employee Termination

Commencement of the employment must be recorded at the latest by the time an employee commences the work, which means directly before starting the actual work.

Please note that currently there is no possibility to pre-register the individual's employment. In addition, registering the employment *after* the actual work has commenced is prohibited. The Estonian tax authorities may impose penalties of up to EUR 3,300 in cases where the employer violates the requirements to register the employment as prescribed by legislation.

Employers have up to 10 calendar days as of the day of the worker's suspension or termination of his or her employment to record that suspension or termination of the employment in the employment register managed by the Estonian Tax and Customs Board.

Applying for Estonian Personal Identification Codes for Foreign Nationals

A key factor in the registration of an individual's employment is the acquisitions/assignment of an Estonian personal identification code – the foreign national needs to apply for an identification code before commencing the work, which means directly before starting the work.

The Estonian personal identification code – part of the process of registering individuals' employment – can be obtained by the foreign national at the closest county government office in Estonia. He or she can:

- go there in person to apply for/obtain the personal identification code; or
- submit the application in person with the foreign mission of Estonia in a foreign state.

Applying for Social Security Coverage for Working in Estonia Via the Employment Register

Since 1 July 2014, employers are no longer required to: (1) apply for social security coverage for employees working in Estonia, and (2) submit the data on the employed persons to the Estonian Health Insurance Fund. The employees' health insurance data will be delivered automatically from the employment register along with proof of registration.

KPMG Note

This should help streamline administration and save time for employers and employees.

Footnotes:

1 Maksukorralduse seadus (Taxation Act)

Available in Estonian at: <https://www.riigiteataja.ee/akt/116042014013#jg4> (as of 1 June 2014).

Available in English at: <https://www.riigiteataja.ee/en/eli/ee/531032014006/consolide> (as of 30 June 2014).

2 Tulumaksuseadus (Income Tax Act)

Available in Estonian at: <https://www.riigiteataja.ee/akt/111072014023> (as of 1 January 2015).

3 Töötuskindlustuse seadus (Unemployment Insurance Act)

Available in Estonian at: <https://www.riigiteataja.ee/akt/116042014029> (as of 1 July 2014).

Available in English at: <https://www.riigiteataja.ee/en/eli/509072014020/consolide> (as of 1 July 2014).

4 Tulumaksuseadus (Income Tax Act)

Available in Estonian at: <https://www.riigiteataja.ee/akt/111072014023> (as of 1 January 2015).

Please note that for registration purposes, in general, all legal and natural persons engaging individuals who perform work for such persons – such as a resident or nonresident legal person (including branch, permanent establishment, etc.) in Estonia, Estonian state or local government authorities, a natural person, or a self-employed person – are considered employers. Furthermore, individuals working on a voluntary or independent basis in/for a company or as a "self-employed" individual (i.e., they are receiving no remuneration for their work) who otherwise would be subject to taxation must also be recorded in the employment register.

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The information contained in this newsletter was submitted by the KPMG International member firm in Estonia. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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