

What about establishing a treasury company in Estonia?

Estonia became as of 1st of January 2011 the 17th member of euro zone providing more value to the Estonian stable and investor friendly environment (incl. highly developed IT sector and low level of red tape). Besides, Estonia has managed to retain its unique and simple corporate income tax system established in the year of 2000, which provides several remarkable tax advantages. Because of the aforementioned Estonia can be a perfect location for the treasury company of the business group. There are also examples of the international companies who have located their financial centres to Estonia.

Holding companies are used in international business structures to lower tax burden and to gain better control of the cash and assets flow inside the business group. Estonia has not been a traditional location for establishing holding companies, because it does not have a special holding company taxation regime(s). However, Estonia can successfully be used as a location for a treasury company because of its innovative corporate income tax system. Treasury companies are used to manage and consolidate cash flows (cash pooling) in the most profitable and tax sound way. In the business groups the treasury company usually collects free cash from the group companies and forward's it to companies where it is most needed at the moment.

In Estonia the corporate income tax is not applied on the taxable base but on taxable transactions. This means that only payments that are or can be regarded as profit distributions (incl. expenses not related to business, fringe benefits, donations, gifts and transfer pricing adjustments) and equity distributions exceeding the contributions made into the equity are subject to tax with the tax rate $\frac{21}{79}$ of the net amount (grossed up rate). The corporate profit (e.g. interests) earned is tax exempt until it has been distributed from the company. This way the moment of taxation is deferred from the moment of earning to the moment of distributing it. That is also why in Estonia there is no need for tax amortisation, depreciation rules and carry forward of losses. It is also necessary to mention that there is no withholding tax on dividends paid to a non-resident. Thus, Estonian corporate income tax system provides perfect environment to accumulate capital and profit or to organize your cash flows without any tax implications. International businesses and private person can gain clear tax advantages having its treasury company in Estonia, because the accumulation of assets and profit is not usually taxed until they will be distributed to the shareholder(s) in the form of dividend. Before setting up a holding company (treasury) in Estonia or in anywhere else, it is always of course advisable to analyse the question of acceptable level of economic substance taking into account the circumstances of the case.

The interest paid by the Estonian holding company to its non-resident parent company is not subject to tax, as far as the interest rate is in accordance with the market value. In case the interest rate exceeds the amount of interest payable on similar debt obligation under the market conditions, the income tax can be charged only on the exceeding amount¹. That is why many international companies finance their businesses in Estonia through debt and not through capital contributions to the equity. Thus, in Estonia, the treasury company can provide or receive loans (interests) within the business group without any tax implications. Income tax is also not being charged on licence fees paid by the holding company to the parent company in case, they are related person and in the case that certain criteria are met. What about allocating your IP rights to the Estonian treasury company? In case, the Estonian treasury makes dividend payments to its shareholders and those dividends derive from a company of which the Estonian treasury has at least 10% participation and these dividends have already been taxed outside Estonia or EU, the dividends paid to the shareholders by the Estonian treasury are usually tax exempt. Thus, this means that usually you can make tax exempt dividend out-payments from the Estonian treasury in case the dividends have been already taxed outside Estonia. Besides, companies registered in Estonia have access to the tax treaty network including treaties with many of the former Soviet-bloc countries.

¹ There is also an argument that because the excessive interest amount is taxable at the level of the non-resident receiver (tax is withheld) many tax treaties provide tax exemption to the mentioned non-resident income because it can be regarded as "other income" in the tax treaty sense. The tax board does not officially accept this argument.