Estonian taxation policies and reform plans

April 2013

Estonian Tax System

The **main principles** of Estonian tax policy:

- simple tax system
- broad tax base, low rates

Estonia is a European pioneer in income taxation:

- **Flat income tax** rate since 1994 (followed by Lithuania, Latvia, Russia, Ukraine, Serbia, Slovakia, Georgia, Romania …)
- **Unique corporate tax system since 2000**

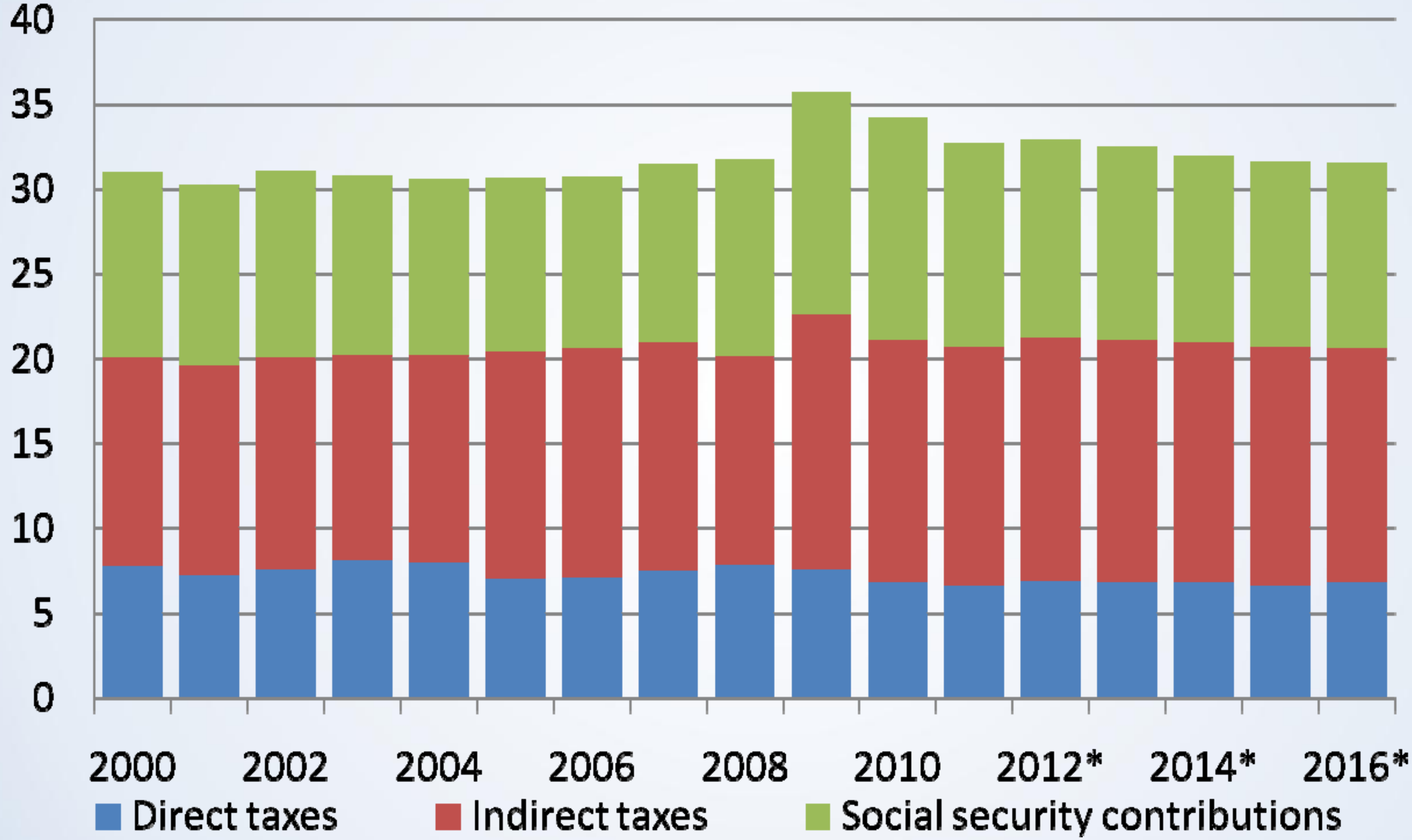
- Ministry of Finance of the Republic of Estonia

Main Tax Rates

- Corporate income tax – 21% on distributed profit
- Personal income tax – 21%
- Social tax – 33% (payable by employer)
- Unemployment insurance payment – 2,8 % (payable by employee) and 1,4% (payable by employer)
- Contribution to the mandatory funded pension system - 2% (payable by employee)
- Value added tax - 20% (standard rate), 9% (reduced rate)

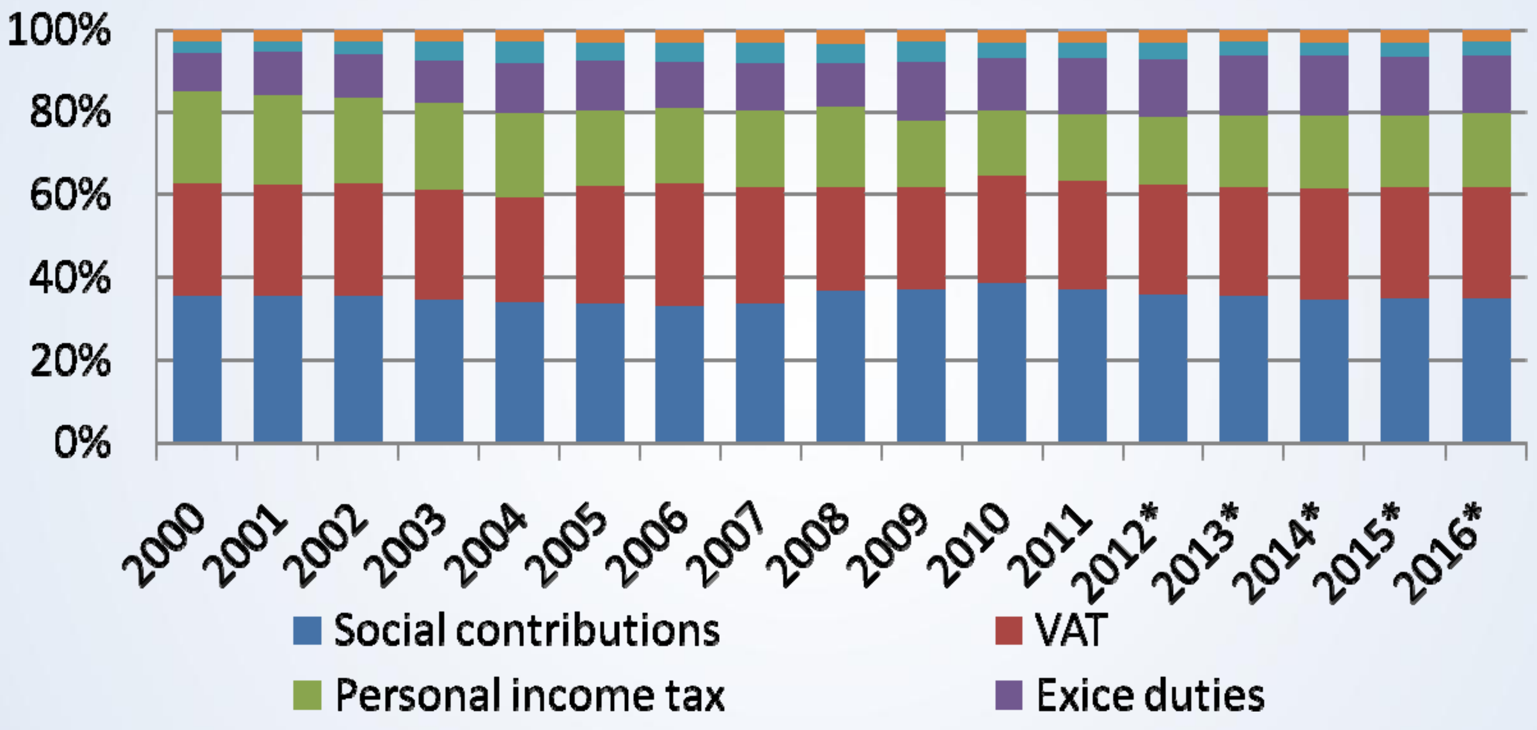
- Ministry of Finance of the Republic of Estonia

Structure of Tax Burden



Source: Statistical Office of Estonia, Ministry of Finance

Structure of general government tax revenue



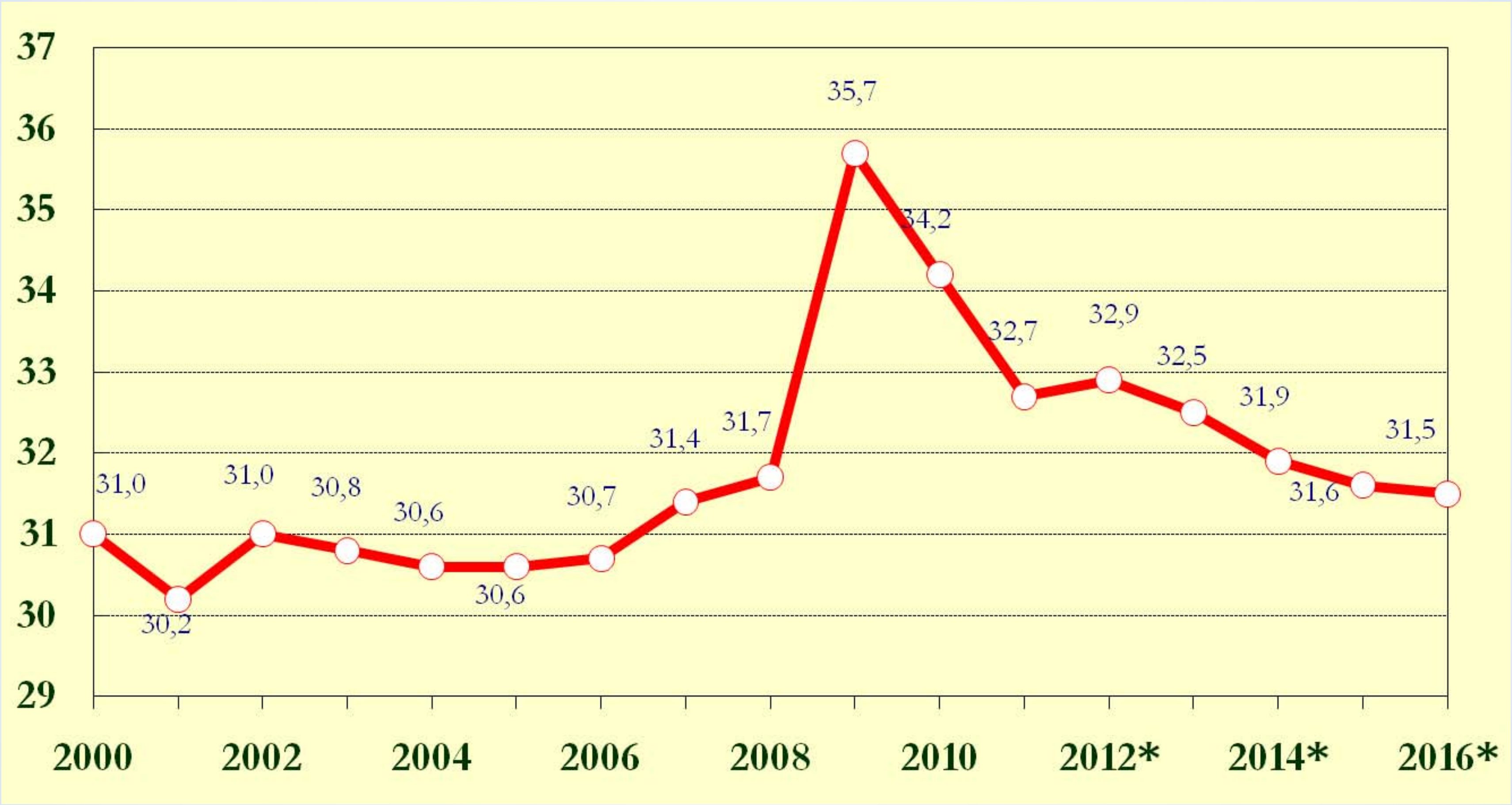
Source: Statistical Office of Estonia, Ministry of Finance

Recovery from Financial Crisis

	2007	2008	2009	2010	2011	2012	2013*	2014*	2015*
GDP real growth (%)	7.5	-4.2	-14.1	3.3	8.3	3.2	3.0	3.4	3.5
Employment rate (%)	62.6	63.0	57.4	55.2	59.1	61.0	62.1	62.9	63.6
Unemployment rate (%)(ILO)	4.7	5.5	13.8	16.9	12.5	10.2	8.9	8.2	7.9
Average salary (€)	724.5	825.2	783.8	792.3	835.0	884.1	930.0	984.0	1043.0
Growth of exports	3.6	1.0	-20.6	22.9	23.4	5.6	5.5	6.3	6.7

Ministry of Finance of the Republic of Estonia

Tax burden (% of GDP)



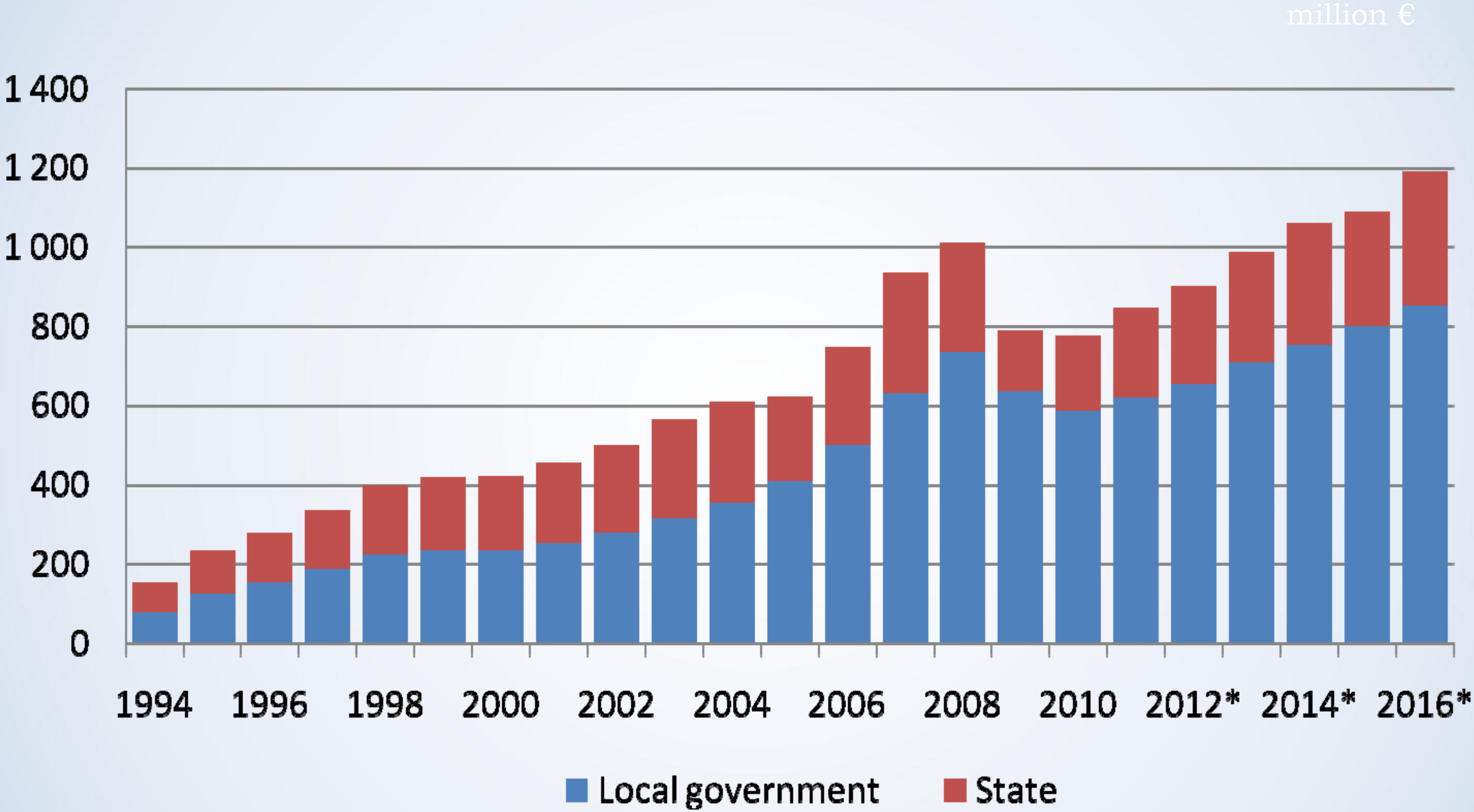
Source: Statistical Office of Estonia, Ministry of Finance

Tax Burden – GDP

- The tax burden compared to the GDP will be **31,4 %** by year 2017

In 2009 - ca **36 %**

Personal income tax revenue 1994-2016



Source: Statistical Office of Estonia, Ministry of Finance

The Future of Tax Burden

- Lower labour-related taxes and increased consumption-related and other indirect taxes
  - increase of excise duties
  - increase of environmental taxes
  - decrease of income tax
- Maintaining the current simple tax system and broad tax base.

Expectations in the Baltic States

- A study was carried out in all three Baltic states, it brings out some of the important issues on tax system in neighbouring countries.

- The common expectations can be said in 3 words LOWER TAX RATES.

Need for Lowering Labour Costs

Some steps have been taken already

- By the year 2015 the personal income tax will be 20 % (currently 21%)
- 2013 the unemployment tax was lowered to 3 % (compared to 4,2 % before that)

2 % payable by employee and 1 % employer

State Budget Strategy

- Structural surplus
- Debt burden will not increase
- From 2016 start to increase reserves
- No positive supplementary budgets
- **Tax burden to pre-crisis level**

Goal for the Future

- The main goal for the future- shifting tax burden from income and employment to consumption and environmental taxes

Income Tax Act

Non-taxable minimum (annual basic exemption): **1728 EUR**

Additional exemption for state pensions: **2304 EUR**

for calendar year

Increase of the non-taxable minimum (per year):

Income of the year 2003 –	12 000 EEK (767 EUR)
Income of the year 2004 –	16 800 EEK (1074 EUR)
Income of the year 2005 –	20 400 EEK (1304 EUR)
Income of the years 2006- 2007 –	24 000 EEK (1534 EUR)
Income of the years 2008- 2010 –	27 000 EEK (1726 EUR)

Since 2011 - 1728 EUR

Debate of the Non-Taxable Minimum

- It is currently 144 euros/ per month
- Before crisis it reached almost half of the official minimum wage, now it is below 50 % (min wage 320 euros / per month 2013)

Increasing the Non-Taxable Minimum - Effect on the Budget

Possible reducing income inequality, under dicussion

- +25 euros / month - 41 mln euros
- +50 euros / month - 80 mln euros
- +500 euros/ month - 386 mln euros

Education Matters

- Giving university students who study full-time - the right to free tuition
- The law enters into force in 2013
- For motivated and academically apt students - - higher education at the taxpayer's expense

Reducing Children Inequality

- Child allowances of necessity reform – July 2013 - 2015

Tax incentives for families with children

- Right to deduct the costs of educating children up to the age of 26 from their annual income
- A right to deduct additional tax-free income from income for every child up to the age of 17 (starting from the 2nd child in the family)

In Conclusion

- Healthy and sustainable economy
- Competitive taxation system
- Continous efforts to decrease unemployment
- Challenging aging society and low birth rates
- Education, education, education