

## Decision of the Supreme Court on the tax avoidance rules in share transfers by physical persons

By Gerly Kask

The Supreme Court handled the taxation of the earnings of the physical persons through the application of the rule of economic interpretation (Taxation Act § 84) in its decision of 6 November 2008 in the administrative case no. 3-3-1-57-08. In this case the Supreme Court gave the instructions which circumstances are important for establishing the existence of the objective of tax evasion. This is a significant decision in the cases of transfer of securities, where the tax authority has found that the substance and form of the transaction are not in compliance.

In this case the physical person transferred the shares to the company belonging to itself, where the company re-transferred these about 2 weeks later and the total income received from the sale of share was received by the company. The basis of the transaction of transfer of shares by the physical person was the contract of establishing the pension fund concluded with the company and it specified the making of payments in the future. In Estonia, undistributed corporate profits are not taxable until they are distributed or used to make other specified payments. The tax authority considered the income received by the company as a result of the re-transfer of the shares by the company the income of the physical person due to the fact that the form of the transaction between the physical person and the company was not compliant with the substance, but the transaction was carried out for the purpose of evasion and deferment of income tax liability. The tax authority found that the objective of tax evasion is establishing thereby that the transfer of shares to the company belonging to itself was carried out after making the purchase offer of the shares to the physical person and the income was realised with the receipt of the fee from the sale of shares to the account of the company.

The following more important viewpoints can be provided from the decision:

- a) In case of sales transactions of shares where “the date of payment has remained open” (i.e. the making of payments has been postponed to the future) the fact that the company having sold the shares is under the control of the physical person can appear to be important among other things in considering the income received by the legal person from the sale of shares the income of the physical person on the basis of subsection 1 of § 36 of the Income Tax Act. Thereby it has been referred to the possibility that the person can always change the contract of the pension fund being the basis of making the payments and the person might not conclude such contract of pension fund with the company which is not under its control.
- b) The tax authority should indicate how the property of the physical person increased in the face of the income received by the company and how the physical person can use this income in its interests.
- c) In case of transfer of shares free of charge or for pay and non-monetary contribution the objective of income tax evasion (in the meaning of § 84 of the Taxation Act) can be also established through the factual circumstances. The subjective considerations of the taxable person might not always be proceeded

from, as their ascertainment is not often possible. The Supreme Court found that in this case the objective of evasion can be confirmed by the circumstances that the person gave the shares over to the company under its control at the time when it was clear that these should be soon re-transferred (purchase offer) which was also made by the company.

- d) The Supreme Court also expressed the viewpoint in the decision that these factual circumstances, with the occurrence of which the legislator would like to connect the qualifying of the behaviour of the taxpayer as the tax evasion, could be explicitly provided in writing in the law. This would better guarantee the legal certainty and clarity.

*For further information on these issues please contact Gerly Kask or Andres Vutt at Concordia Attorneys at Law by telephone (+372 6262 062) or by email [gerly.kask@concordia.ee](mailto:gerly.kask@concordia.ee) or [andres.vutt@concordia.ee](mailto:andres.vutt@concordia.ee).*