

The ABCs for a sole proprietor

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Sole proprietor and value added tax

From 1 January 2011, all taxable persons for value added tax (VAT) purposes, including sole proprietors, shall be subject to VAT accounting on a common basis.

The following shall be subject to VAT:

- ✓ supply (except supply exempt from tax) created in Estonia;
- ✓ import of goods into Estonia (except imports exempt from tax);
- ✓ provision of service the place of supply of which is not Estonia (except supply exempt from tax);
- ✓ supply exempt from tax which is taxed according to the possibility provided by law;
- ✓ acquisition of goods within the European Union (except intra-Community acquisition of goods exempt from tax).

Sole proprietors pay VAT if they are registered as persons liable to VAT in the Tax and Customs Board (hold a VAT identification number). The obligation to pay VAT may also arise for a sole proprietor who is not registered as a person liable to VAT but who acquires a new transport vehicle or excise goods from another Member State of the European Union (except in the case where excise goods are acquired for personal use). VAT must also be declared and paid by sole proprietors who are not registered VAT payers but who add VAT to invoices issued by them. However, it should be taken into account that a person who is not registered for VAT purposes is not entitled to deduct input VAT.

- ✓ The tax rates for taxable supply are 0%, 5%, 9% and 20%.
- ✓ The taxable period for VAT is a calendar month.
- ✓ The value added tax return (**Form KMD**) is to be submitted to the Tax and Customs Board by the 20th day of the month following a period of taxation. By the same date, VAT is to be paid into the bank account of the Tax and Customs Board.

Registration as a person liable to value added tax

OBLIGATION TO REGISTER AS PERSON LIABLE TO VALUE ADDED TAX

If the taxable supply of a sole proprietor (except the transfer of fixed assets) has exceeded 40 000 euros as of the beginning of a calendar year, they are obliged to submit an **application for registration as a person liable to value added tax** to the Tax and Customs Board within three working days as from the date on which the supply reaches that amount. The registration obligation does not arise if all the taxable supply of the person is the supply taxable at the 0 per cent value added tax rate, (except the intra-Community supply of goods and the supply of services specified in **clause 10 (4) 9) of the Value Added Tax Act (VAT Act)**), if the services are provided to a taxable person or a taxable person with limited liability of another Member State. (**VAT Act, § 19 (1)**).

Example

If the supply of a sole proprietor exceeds 40 000 euros on the 2nd day, Friday, the application for registration as a person liable to value added tax is to be submitted to the Tax and Customs Board within three working days, i.e. on the 7th day, Wednesday. The Tax and Customs Board will register the person for VAT purposes on the day on which the threshold (40 000 euros) was exceeded. In this example, the sole proprietor will be registered for VAT purposes as of the 2nd day of the month.

From the date of receipt of the application, the Tax and Customs Board has five working days to make a decision on the registration. In this example, the decision on the registration for VAT purposes must be notified to the sole proprietor no later than on the 14th day of the month.

The Tax and Customs Board has the right to request supporting documents to prove the starting or existence of business activities. In such a case, the Tax and Customs Board makes a decision within five working days as from the submission of supporting documents.

Sole proprietors do not have to register as a person liable to value added tax if their supply arises only from the transfer of fixed assets used in their business. Sole proprietors have the obligation to register for VAT purposes, if they have no other supply since the beginning of the year than the supply from the transfer of goods or services referred to in **clause 10 (4) 9) of the VAT Act** exceeding 40 000 euros to a person of another Member State of the European Union that is liable to value added tax.

VOLUNTARY REGISTRATION

If the taxable supply of a sole proprietor has not exceeded 40 000 euros or if taxable supply has not been created yet, a sole proprietor can register as a person liable to value added tax voluntarily. It is even recommended that sole proprietors should register themselves for VAT purposes earlier, before their supply reaches 40 000 euros. This would help to avoid problems with value added tax obligations, which arise immediately from the day on which the supply of 40 000 euros is exceeded, but the respective decision of Tax and Customs Board has not yet reached the taxpayer and the VAT identification number is not yet known.

Should such a situation still occur, value added tax is still to be calculated on the supply generated between the date on which the application for registration as a person liable to value added tax is submitted and the date of the respective decision; if possible, the invoices should be issued later (within seven calendar days). The invoices issued in such a transition period and not meeting the requirements of **§ 37 of the VAT Act** must subsequently be brought into line with the requirements of the law, and this is also in the interests of customers, since input value added tax cannot be deducted on the basis of an incorrect invoice.

The condition of voluntary registration is the fact that a sole proprietor is engaged or will be engaged in business that generates or will generate taxable supply. In this case, the sole proprietor is registered as a person liable to value added tax as of the date of receipt of the application or a later date indicated in the application by the person.

If a person is not engaged in business or has no intention to start a business, the Tax and Customs Board does not register the person for VAT purposes.

Determination of time of registration obligation

(reaching supply of 40 000 euros)

If a sole proprietor's taxable supply did not exceed 200 000 euros in the previous calendar year or as of the beginning of the current calendar year, he/she can choose (voluntary) whether to act on keeping accounting for taxation purposes according to the general procedure for VAT accounting provided for in the VAT Act (accrual based VAT accounting) or according to the special arrangement set out in **§ 44 of the VAT Act** (cash based VAT accounting).

If the limit mentioned above (200 000 euros) was exceeded during the previous calendar year or at the beginning of the current calendar year, the VAT accounting is to be kept according to the general procedure.

On calculation of the limit of taxable supply, the sole proprietor may choose whether to act according to the general procedure provided for in the VAT Act or to the special arrangement provided for in § 44 of the VAT Act.

According to the general procedure, the time of creation of supply is deemed to be the date on which the first of one of the following acts is performed:

- ✓ the goods are dispatched (the services are provided) to the purchaser or

- ✓ money is received for the goods (services).

According to **the special arrangement** the time of supply is deemed to be the date on which the money was received for the goods (services). A sole proprietor who applies the special arrangement has to keep records of the registration obligation threshold on the cash basis as well.

Example 1

The goods were dispatched (services were provided) earlier than the money was received.

Invoice 1	January 20	9835 euros	Payment on 17 February	in the amount of 9835 euros
Invoice 2	February 10	11 113 euros	Payment on 1 March	in the amount of 11 113 euros
Invoice 3	March 14	9835 euros	Payment on 20 April	in the amount of 9835 euros
Invoice 4	April 10	9835 euros	Payment on 26 May	in the amount of 9835 euros
		In total:		
		40 618 euros		

Upon keeping the accounting pursuant to the general procedure, the supply exceeded 40 000 euros on 10 April, and pursuant to the receipt of the money or upon keeping the cash accounting, the supply exceeded 40 000 euros on 26 May. In both cases the sole proprietor is required to submit the application for registration as a person liable to value added tax within three working days at the latest. The sole proprietor is required to add value added tax on all invoices of the same day (in the example, 10 April or 26 May).

Example 2

The goods were dispatched (services were provided) at the same time when the money was received (for example, in the case of retail business). The payment was made in cash for the goods or services as follows:

January	3678 euros	
February	3551 euros	from the beginning of the year 7229 euros
March	4317 euros	from the beginning of the year 11 546 euros
Aprill	4317 euros	from the beginning of the year 15 863 euros
Mai	4637 euros	from the beginning of the year 20 500 euros
Juuni	4317 euros	from the beginning of the year 24 817 euros
Juuli	3998 euros	from the beginning of the year 28 815 euros
August	3998 euros	from the beginning of the year 32 813 euros
September	4307 euros	from the beginning of the year 37 120 euros
1 October	696 euros	In total: 40 005 euros
2 October	728 euros	
3 October	696 euros	
4 October	765 euros	
	765 euros	

Both in the case of the general procedure and in the case of the cash accounting, the supply exceeded 40 000 euros on 4 October.

The sole proprietor is required to submit the application for registration as a person liable to VAT within three working days at the latest. The sole proprietor is required to add VAT on all invoices of the same

day (e.g. 4 October).

Obligations of persons registered for VAT purposes

As of the date of registration for VAT, persons have to perform the obligations of a person liable to VAT, including to:

- ✓ add the amount of value added tax to the taxable value of the goods transferred or services provided;
- ✓ submit a value added tax return and its annex (§ 27 of the VAT Act);
- ✓ calculate the amount of value added tax due (§ 29 of the VAT Act);
- ✓ pay value added tax (§ 38 of the VAT Act);
- ✓ maintain records and keep accounts (§ 36 of the VAT Act);
- ✓ issuing invoices in accordance with the requirements of § 37 of the VAT Act.

Input value added tax

Persons registered for VAT are entitled to deduct the input value added tax from their value added tax calculated from the taxable value of their taxable supply, i.e. the value added tax to be paid on goods or services which the taxable person acquires or receives from another person liable to VAT for the purposes of their taxable supply, and the VAT paid or to be paid by the taxable persons on imported goods.

Example

In September, a sole proprietor (a person liable to VAT, the general procedure of value added tax accounting) purchased goods in the amount of 64 euros (taxable value), where to the value added tax 12.80 euros ($64 \times 20\% = 12.80$) was added.

The sole proprietor resold the goods in September for 96 euros (taxable value of the goods), where to the value added tax 19.20 euros ($96 \times 20\% = 19.20$) was added.

In the value added tax return for this period of taxation the sole proprietor may deduct the value added tax (12.80 euros) to be paid on the goods purchased from another person liable to VAT from the value added tax (19.20 euros) calculated on the taxable value (96 euros) of his/her taxable supply.

In this example the sole proprietor:

- ✓ calculated value added tax in the amount of 19.20 euros ($96 \times 20\%$);
- ✓ calculated input value added tax in the amount of 12.80 euros ($64 \times 20\%$);
- ✓ submitted the value added tax return (for September) by 20 October and by the same time paid 6.40 euros ($19.20 - 12.80 = 6.40$) into the bank account of the Tax and Customs Board.

The sole proprietor declared the value added tax in the value added tax return as follows:

Acts and transactions taxable at the 20 % value added tax rate, including	1	96.00
Total VAT (20% from box 1 + 9% from box 2 + 5% from box 2 ¹)	+ 4	19.20
Total amount of input value added tax allowed to be deducted by law	- 5	12.80
The value added tax due (box 4 + box 4 ¹ – box 5 + box 10 – box 11)	+ 12	6.40

The value added tax on services received from a foreign person engaged in business in a foreign state, on goods acquired from a person liable to value added tax in another Member State of the EU and on the acquisition of other goods whereon value added tax is calculated pursuant to the Estonian Income Tax Act may be deducted as the input value added tax.

At the same time, a sole proprietor shall take into consideration that if he/she uses goods or services both for the purposes of his/her business taxable supply and for the purposes not related to business (the activity as a natural person), then he/she may deduct the input value added tax on the goods or services used for the purposes of transactions related to the taxable supply in business only (**VAT Act, § 29 (4)**).

Input value added tax may be deducted from such goods or services only that have been acquired in the period when the sole proprietor is registered as a person liable to value added tax. Input value added tax

may not be deducted if goods or services are used for the purposes of supply exempt from tax or for purposes other than business.

Beginning from 1 December 2014 the Value-Added Tax Act has been amended. Amendments are related to the deduction of input value added tax on automobiles purchased and for the expenses made for such expenses. Besides, the definition of an automobile is provided in the VAT Act to which the restrictions on deduction of input value added tax shall apply. Upon acquisition, the restriction on deduction of input value added tax is applied to the automobiles acquired after 1 December 2014. The restriction means, in particular, that upon acquisition of an automobile to be used for business purposes or for use under the contract for use, the input value added tax may be deducted not more than fifty per cent. This restriction is also applied to goods acquired and services received for such an automobile, even if the automobile has been acquired before 1 December 2014. Upon acquisition of automobiles, the restriction of input value added tax is not applied if an automobile is acquired with a view to resale.

Special arrangements for cash accounting for VAT

If a sole proprietor's taxable supply did not exceed 200 000 euros in the previous calendar year or as of the beginning of the current calendar year (the transfer of fixed assets and the incidental transfer of immovable as goods are not taken into account), the sole proprietor may keep records of value added tax (voluntary) on the cash basis if he/she so wishes. A very important prerequisite for the implementation of the special arrangement is a prior notification in writing of the Tax and Customs Board whether upon the registration as a person liable to value added tax or at the latest, during the taxation period prior to implementation of the cash accounting for value added tax.

If a sole proprietor keeps accounts on a cash basis, the time of supply is deemed to be the date on which full or partial payment is received from the recipient of the goods or services.

Example

The sole proprietor notified the Tax and Customs Board that he would keep his accounts on a cash basis from 1 May. He sold (dispatched) the goods on 25 May. Money for the sold goods was received on 10 June. Thus, the supply was created on 10 June.

The entitlement to the deduction of input value added tax on goods acquired or service provided for the purposes of taxable supply in business activities arises after the partial or full payment for the goods or services, i.e. if the goods acquired and services received are not paid for, there is no right to deduct input value added tax.

Example

A sole proprietor acquired goods for taxable supply in business activities on 30 May, which were fully

paid for on 6 June. In this case, the right to deduct the input value added tax will arise when submitting the value added tax return for June (the date of submission on 20 July).

A sole proprietor who keeps value added tax accounting both on cash basis and using the accrual method has to **submit the value added tax return and appendix** (Annex of the VAT return on Form KMD INF) thereto by the twentieth day of the month following the taxable period.

WAIVER OF THE VAT ACCOUNTING ON CASH BASIS

Waiver of the VAT accounting on cash basis may be either voluntary or obligatory.

In the case of a voluntary waiver, i.e. a sole proprietor's taxable supply did not exceed 200 000 euros as of the beginning of the current calendar year, the sole proprietor has to notify in writing the Tax and Customs Board during the taxation period prior to the waiver at the latest.

Example

A sole proprietor wishes to waive the VAT accounting on cash basis beginning from 1 September. In this case, the notification must be submitted not later than within August.

Sole proprietors have the obligation to waive the special arrangement if their taxable supply (the transfer of fixed assets and the incidental transfer of immovable as goods are not taken into account) exceeds 200 000 euros as calculated from the beginning of a calendar year. It is not allowed to apply special arrangement as of the first date of the calendar month following the generation of the supply. Upon obligatory waiving of the special arrangement, the sole proprietor must inform in writing the Tax and Customs Board in the first taxation period from which the implementation of special arrangement was discontinued at the latest.

Example

The threshold of the taxable supply for a sole proprietor using the special arrangement reaches in May. In this case, the sole proprietor is obliged to submit a notification to the Tax and Customs Board in June at the latest.

Additional information Data to be entered in a VAT return and instructions of filling out the return Cash based VAT accounting

Deletion of sole proprietors from the VAT register

Sole proprietors may submit an application for deletion themselves from the register of taxable persons if their taxable supply does not exceed 40 000 euros within the next twelve months according to the calculations made by them.

The tax and Customs Board has the right to delete a sole proprietor from the register of taxable persons:

- ✓ if the sole proprietor has failed to submit a value added tax return for the last six consecutive taxable periods; or
- ✓ if the sole proprietor is not engaged in business in Estonia.

VAT accounting on termination of business

If a sole proprietor terminating business activity is a person liable to value added tax, it is required to submit an application to the Tax and Customs Board for deletion from the register of taxable persons. If, at the time of terminating the activities, the sole proprietor still has goods not transferred wherefrom the input value added tax has been deducted upon the acquisition, the taxable value of the goods has to be declared in the last value added tax return to be submitted to the Tax and Customs Board and the value added tax must be paid.

In the case of fixed assets (including immovable) which have been used in the sole proprietor's business and wherefrom the input value added tax upon the acquisition has been deducted, the value added tax must not be added to the fixed assets. Instead, it is necessary to recalculate the input value added tax. The recalculation should be made if the fixed assets have been used for business purposes less than five years or the immovable less than ten years. If the fixed assets have been used more than five years or the immovable more than ten years, it is not required to pay value added tax or recalculate the input value added tax (**VAT Act, § 29 (10)**).

Additional information Value Added Tax Act