The ABCs for a self-employed person

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Transfer or bequeathing of business property

Self-employed persons wishing to terminate their business must either transfer the property used in business or take it into personal use. In the case of termination of engagement in business, a self-employed person may also transfer or bequeath the property to a person who will continue the business activities of the self-employed person, which is exempt from tax (**subsection 37 (7) of Income Tax Act**). In order to apply tax exemption, the self-employed person's business assets must be transferred to a person entered in the **commercial register** (hereinafter the transferee), i.e. to another self-employed person or company, prior to the termination of the self-employed person's activities.

The following business assets are to be transferred:

- ✓ things,
- ✓ rights relating to the property,
- ✓ obligations relating to the property (tax liabilities cannot be transferred).

Also money in a special account and expenses carried forward from previous periods of taxation belong among the transferable assets. Upon later transfer of the property received by the transferee, the selling price of the property is deemed to be the taxpayer's (transferee's) business income.

Example 1
The self-employed person Malle decides to transfer her business to her son Kalle, who wishes to continue his mother's business. In order that Malle could transfer her property used in business to her son exempt from taxes, Kalle must register his activity in the commercial register either as a self-employed person or a company prior to the transfer. Malle has to terminate her business in the commercial register after the transfer of the property.

As the composition of the assets of the self-employed person changes upon a transfer, it is necessary to draw up a contract and a list of transferred assets. The Income Tax Act does not provide in what conditions, how and in what form the contract and the list shall be compiled. However, it is recommended to compile the required documents according to the conditions provided for in the **Law of Obligations Act**, definitely in a format which can be reproduced and the circumstances concerning taxation be established.

If a business is transferred to another self-employed person, the transferee must also be registered as an undertaking in the commercial register. There are two possibilities:

- ✓ the transferee will register himself/herself in the **commercial register** as a self-employed person by own name, after which a unique registry code is issued to him/her;
- ✓ the transferee will continue the business activities under the present business name of the self-

- ✓ employed person, provided that the undertaking is obtained by transfer (including transfer free of charge) and the transferor has given his/her written consent.

In addition to accounting for taxation purposes, self-employed persons are required to keep their accounts. A self-employed person as an accounting entity is required to document all his/her business transactions. Thus, if a self-employed person transfers the property of his/her undertaking to another person, this operation should be documented. Whereas the transferee must be a person to whom the requirements arising from the Accounting Act extend, the transferee is also obliged to take inventory of the assets received in his/her accounting.

Example 2
Malle, who transferred her business to her son, decides to keep the computer used in business for herself. Malle had entered 80 per cent of the acquisition cost of the computer into the expenses related to business during the purchasing year. Malle purchased the computer for 7,000 kroons in 2009, wherefrom 5,600 kroons was entered in the expenses related to business for the year 2009. Now, the market price of the computer is 255.65 euros. Malle declares 294.52 euros (255.65 × 80%) in line 1.1.5 on form E of the tax return for the year of putting the computer into own personal use.
This asset (the computer) was not transferred and the transferee does not enter the asset in the accounts.

The transfer of assets must be declared in Annex to form E, which is submitted to the Estonian Tax and Customs Board together with form A and form E by 30 April of the year following the period of taxation.

Last updated on 08.01.2025

Money in special account and loss carried forward

Attention should be paid to the transfer of the special account belonging among the self-employed person’s business assets and the losses carried forward.

SPECIAL ACCOUNT

Example 1
The special account is a part of the self-employed person’s business assets to be transferred to another person. The transferee opens a settlement account in own name with a credit institution, which is a resident of the contracting party to the EEA Agreement. In this case, money should be transferred within ten working days after the formalisation of the transfer of the enterprise at the latest. In this case, decrease in the amount in the special account is not considered the transferor’s business income.

The decrease in the amount in the special account is not added to the business income upon the transfer of the special account to the person who will continue the business activities (**subsection 36 (7¹) of the Income Tax Act**).

Example 2
The self-employed person Krista Karu keeps bees and has ten beehives. Krista has entered the acquisition cost of the beehives in her business expenses. In addition to the ten beehives, Krista has 1000 euros of the benefit received last year in her special account. In 2019, she decides to transfer her business to her son Kalle, who is interested in apiculture as well. Kalle has registered himself as a self-employed person in the commercial register. Krista prepares a transfer contract on the assets used in business and the list of the assets transferred (ten beehives and other beekeeping supplies). In the contract, she indicates the amount transferred from the special account and submits form E together with the annex by 30 April of the year following the transfer. The amount in the special account transferred must be declared both in table 2 of form E and in column A of the annex to form E.

THE AMOUNTS CARRIED FORWARD OF EXPENSES EXCEEDING BUSINESS INCOME

As the second specification, the amount by which expenses exceed business income (hereinafter expenses carried forward) may be deducted from business income by the self-employed person during seven, under certain conditions, up to ten subsequent periods of taxation (see "**Carrying forward of expenses exceeding business income**") in order to deduct these from the income derived in the future. These expenses carried forward may also be transferred by a self-employed person upon the transfer of the business. The expenses carried forward are recorded in accounting documents of the transferee (in the case of a self-employed person) on a yearly basis in the order in which they were incurred by the transferor.

Example 1
The transferor had declared the expenses carried forward in the years of 2014 and 2015. All these expenses carried forward must be declared by the transferee in column 5 of table 3 on form E in the lines of the corresponding years. Taking into account that the expenses of these years may be carried forward during seven years, the expenses carried forward for the year 2014 may be used by the transferee as a deduction from its business income in the income tax return even for the year of 2021, but these expenses may not be carried forward to the subsequent period of taxation.

Example 2
The self-employed person Artur Paas has declared the following amounts (hereinafter “the amount of loss carried forward”) in column 3 of table 3 on form E:
In 2015 – 500 euros
In 2016 – 50 euros
In 2020, he decides to terminate his business and transfer it to his son Mati, applying the tax exemption provided for in subsection 37 (7) of the Income Tax Act. All the expenses exceeding the business income for the previous years Artur may transfer to Mati, declaring these in column 4 of table 3 on form E (loss carryforwards transferred) in the line of the corresponding year when the part of the expenses not covered but exceeding the business income was incurred. Mati declares losses on 2020 form E in table 3 in the line of 2015 column 5 (loss carried forward received) 500 euros and in the line of 2016 50 euros.

Last updated on 08.01.2025

For information to the transferor

Upon transfer of the assets, it should be taken into account that in the case of the assets entered in the registry, such as immovable property, a motor vehicle, etc., persons may incur additional expenses and actions in relation to necessary documentation and re-registration required for the transference of ownership. All leasing contracts concluded for the acquisition of business assets, under which deductions of business expenses had been made previously, must be re-registered in the name of the transferee so that the transferor will not have a situation of putting the property into use for personal consumption.

- If the activity of an enterprise is terminated after the transfer of property, non-transferred assets the acquisition cost of which has previously been entered in business expenses are declared on form E in line 1.1.5 – market price of property taken into personal use.

- If the transferor has received any charge for the property upon transfer, this is considered the sale of property and declared in line 1.1.4 of form E.

- Any income related to business which is received after the transfer and termination of business must be declared on form E as business income, on which income tax as well as social tax must be paid.

Example
The self-employed person Allan is a farmer, who has entered the acquisition cost of his property acquired within years and used in business into the expenses related to business (including building of the cowhouse with the value of 1.5 million kroons, a used tractor with the purchase price of 50,000 kroons, the hundred-headed dairy cattle with the purchase price of 500,000 kroons, 10,000 euros in the special account collected for future investments, etc.). Now, Allan wishes to stop his engagement in business and decides to transfer his business to his daughter Milvi, who is ready to continue the business as a company. OÜ Kodukana established by Milvi and the self-employed person Allan conclude a contract under the law of obligations on the transfer of the assets and prepare a list of the assets transferred (e.g. as an annex to the contract). Both of them are accounting entities, thus the assets transferred (the money as well) are recorded in accounts by both parties. Allan must also submit an income tax return together with the annex to form E by 30 April of the year following the transfer of the assets.

Last updated on 08.01.2025

Receiving a business by succession

Pursuant to the **Law of Succession Act** with the acceptance of a succession, all rights and obligations of the bequeather transfer to the successor except those which, by their nature, are inseparably bound to the person of the bequeather or which pursuant to law do not transfer from one person to another. **If a successor accepts the succession, the business-related rights and tax liabilities of the bequeather will transfer to the successor.**

The acceptance of the estate by the successor is not subject to income tax, including the property used in business. Since a self-employed person's business is deemed to be terminated upon her/his death, there is no succession of the property used in the bequeather's business, but rather **the succession of the bequeather's personal property.**

Thus, the assets are bequeathed first. The successors now have the right to decide whether to take the inherited property used in the self-employed person’s business into personal use or continue the self-employed person’s business. It is advisable, after the termination of the succession proceedings or together with the formalisation of the succession at the notary’s, to formalise the transfer of the assets to the person who will continue the bequeather’s business.

If no income tax liability arises, the inherited business may be transferred to a company as well. The property may be transferred to a company both as a non-monetary contribution (regulated by the **Commercial Code**) and by the contract for the transfer of the assets. It is required to record the assets in the accounts of the business (money, immovables and movables, obligations, claims, etc.) according to the provisions set out in the **Accounting Act** and in the instructions of the Accounting Standards Board.

Last updated on 08.01.2025

Value added tax specifications

For income tax purposes, there is no difference between the concepts ‘transfer of property’ and ‘succession of property’, or to whom the property transfers, whether from an undertaking to a self-employed person or to a company. However, for the purposes of the **Value Added Tax Act**, the transfer and succession of the self-employed person's assets are interpreted differently.

The transfer of a business upon the succession means in general that the property transfers to somebody who is the next of kin who will then continue the similar business. This may be considered as a continuing activity. If the person who continues the activity registers himself/herself as a person liable to value added tax, he/she will take over all the obligations and rights relating to the value added tax on

the property transferred to him/her and there is no need to recalculate the input value added tax deducted earlier from the transferable fixed assets. At the same time, it means that the recipient of the estate (a person liable to value added tax) is also obliged to add value added tax to the supply for the transfer of the said property, if not the supply exempt from tax is concerned.

The transfer of the property may be handled likewise **if the self-employed person transfers the fixed assets as a non-monetary contribution to his/her own private limited company and continues himself/herself with the similar business in the private limited company**. It is not required to recalculate input value added tax on the transferable fixed assets. The obligation to add value added tax arises upon the transfer of the property by a private limited company. A problem may arise if fixed assets are immovable property in respect of which the self-employed person has deducted input tax. The period for the recalculation of the input value added tax deducted is ten years in the case of an immovable. If the period for the use of an immovable both by the self-employed person and his/her private limited company is less than ten years for the purpose of taxable supply, the private limited company is required to recalculate the earlier deducted input value added tax upon the transfer of the immovable exempt from tax.

If the property is transferred to another company continuing the self-employed person's business, it can be:

- ✓ the transfer of the business,
- ✓ a non-monetary contribution,
- ✓ the transfer of goods for money or free of charge.

The transfer of a business or a part thereof for the purpose of the **Law of Obligations Act** does not create supply and there is no need to recalculate the input value added tax on the transferable fixed assets. If a transferee starts to use the property, whether for the purposes of the supply exempt from tax or for the purposes other than business, the rights and obligations will transfer to the acquirer, including the obligation to adjust the input value added tax. If an assignment of a separated property as a non-monetary contribution or the transfer of a separated property is concerned, the assignment or transfer of the property is subject to value added tax. The company receiving the property has the right to deduct the input value added tax on the basis of the invoice. This applies only in cases where the property will be used for the purposes of taxable supply in business. Thus, for VAT purposes, it is irrelevant to whom a fixed asset is given, it is important what will be done with the fixed assets further.

Example
A self-employed person has bought a tractor and deducted input value added tax. The self-employed person assigns it formally to a sewing company. It is believed, that the sewing company will not start using the tractor for the purposes of its taxable supply and the self-employed person has to recalculate the input value added tax or charge the assignment with value added tax.

As to leasing, the leasing under the conditions of operational lease and financial lease should be dealt with separately.

- If it is the **leasing under the conditions of operational lease** , for the purposes of the **Value Added Tax Act**, it is considered a service. If such a leasing contract is discontinued or transferred to a third party, there is no need to recalculate the input value added tax. However, if a leasing company submits a credit invoice according to which it has decreased the taxable supply of the leasing transaction and the value added tax paid thereon, the recipient of the credit invoice has to decrease its deducted input value added tax accordingly.

- If **a leasing transaction is discontinued under the conditions of financial lease**, it is the acquisition of a property by the lessee and upon using the fixed assets less than five years (in the case of an immovable less than ten years), the obligation to recalculate the input value added tax will arise. At the same time, there is no exact scheme how the first lessee should act if the leasing contract is discontinued. If a leasing company submits a credit invoice and the first lessee decreases its input value added tax deducted on the basis of it, there is no need to recalculate the input value added tax on this property. However, if no credit invoice is submitted, the obligation to recalculate will generally arise.

- **If a tripartite contract** is concluded between a lessor, the first lessee and the next lessee, the leasing company will generally not submit a credit invoice. If the first lessee has deducted the entire input and used the fixed assets less than five years (in the case of an immovable less than ten years), upon the termination of the contract or on the transfer, the obligation to recalculate the input value added tax deducted will arise for him/her.

Last updated on 08.01.2025