Introduction

Taxation of income earned by an investor from an investment fund depends on various circumstances such as the investor's residency1 and legal form as well as the type of the fund, the form of income and other such circumstances. Furthermore, in the case of funds of a certain type legislation grants investors various significant tax incentives or establishes special taxation provisions.

When clarifying taxation issues, it must first of all be made sure whether the income of the investor has been earned from growth units or distribution units. Additional taxation differences must be observed both in the case of income earned from mandatory and voluntary pension funds and with regard to income earned from foreign investment funds.

In the case of growth units the income earned by the fund is manifested in the growth of the net asset value of the units and a specific investor has earned income from the fund if the redemption price of a unit exceeds the acquisition price of the unit. In the case of distribution units the income earned by the fund is distributed to investors by way of making regular or irregular payments from the fund. Payments are usually made in cash, but they may also be made by way of issuing additional units to the investor.

There are further differences in taxation when it comes to income earned from mandatory and voluntary pension funds and income earned from foreign investment funds.

Income earned by an individual is taken into account upon calculation of the income tax for the period in which the income was earned. The deductions made from taxable income are taken into account for the taxable period in which they were paid. The taxable period for the purposes of the types of income discussed in this overview is a calendar year.

Taxation of income from growth units

The following investment funds managed by the Management Company have growth units: SEB Active Fund of Funds, SEB Dynamic Fund of Funds, SEB Balanced Fund of Funds, SEB Eastern Europe Bond Fund, SEB Growth Fund, SEB Generic Pharmacy Fund, SEB High-Yield Bond Fund.

According to Article 15 of the Income Tax Act, income earned from growth units is taxed as profit from transfer of property.

The profit or loss from transfer of property is the difference between the acquisition cost and sales price of the property sold. The taxpayer has the right to deduct from the profit or add to the loss any

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1 Please read the Instructions for Identification of Residence of Individuals prepared by the Tax and Customs Board and available on the Board's website at: http://www.emta.ee/?id=1529.
certified expenses directly related to the sale or exchange of the property. Acquisition cost means any and all certified expenses incurred by a taxpayer for acquisition, improvement and modification of property, including commission and fees paid. The acquisition cost of units acquired upon exchanging investment fund units means the acquisition cost of the investment fund units transferred in the course of the exchange.

A resident individual has the right to deduct the loss suffered from transfer of securities in the taxable period from the profit earned from transfer of securities in the same period. If the loss suffered from transfer of securities in the taxable period exceeds the profit earned from transfer of securities in the same period, the amount of loss exceeding the profit may be deducted from the profit earned from transfer of securities in following taxable periods.

The income earned by resident individuals from sale of units is subject to income tax. According to the Income Tax Act in force, the income earned from sale of securities is subject to income tax at the rate of 21% in the Republic of Estonia. Declaration of respective income and payment of income tax on it is the duty of the investor.

Income earned by a resident individual from exchange of units against the units of another investment fund managed by the same management company is not subject to taxation if no payments are made to the investor thereby.

Income earned by resident entities from sale of units is not subject to taxation. Such income is included in their profits and taxed upon distribution of profit pursuant to the general procedure.

As for non-resident investors, income earned from sale of units is not usually subject to income tax in the Republic of Estonia. An exception is the event specified in Article 29 (4) 5) of the Income Tax Act, i.e. if the fund’s property, at the time of the transfer or during a period within two years before transfer, more than 50% was directly or indirectly made up of immovables or structures as movables located in Estonia and in which the non-resident had a holding of at least 10% at the time of transfer. However, the income earned by a non-resident investor from growth units may be subject to taxation in the country of residence of the non-resident investor pursuant to relevant legislation.

**Taxation of profit from distribution units**

**Cash payments**

As for the investment funds managed by the Management Company, only SEB Liquidity Fund has distribution units, making monthly cash payments to investors. In everyday activities and under normal market conditions the net asset value of the units of SEB Liquidity Fund is tried to be kept equal with the nominal value of the unit and any income earned by the fund is tried to be distributed to the investors in regular cash payments. By the time the net asset value of the units is below the nominal value, calculation of income earned by SEB Liquidity Fund as a payment obligation shall be stopped and it shall be reflected daily in the net asset value of the units, which can respectively either rise or fall.

With regard to the above, during the period when the net asset value of the units of SEB Liquidity Fund stays equal with their nominal value and income of the fund is distributed as cash payments, cash payments made to investors on distribution units are subject to taxation as interest pursuant to Article 17 of the Income Tax Act.

In the case of distribution units the investor’s income arises upon making a payment and taxation of such income depends on the investor's residency, legal form and other similar circumstances.

Payments made to a resident individual are subject to income tax. According to the Income Tax Act in force, interest is subject to income tax at the rate of 21% in the Republic of Estonia. The Management Company or a person authorised by the same withholds the respective amount from the payments made to the investor. The investor’s residency is determined on the basis of the data entered in the residency part of the register of units. Thereby the Management Company is not obligated to verify the correctness of such entry additionally.

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2 Such payments may be subject to taxation as dividends if the payer is a fund that has been established as a public limited company and the payment corresponds to Article 18 (2) of the Income Tax Act.
Payments made from the fund to resident entities are not subject to taxation. Such income is included in their profits and taxed upon distribution of profit pursuant to the general procedure.

As for non-resident investors, payments made on units are not usually subject to income tax in the Republic of Estonia. However, such income may be subject to taxation in the country of residence of the non-resident investor pursuant to relevant legislation.

As the issue and redemption price of the units of SEB Liquidity Fund are under the aforementioned circumstances equal, no income or loss occurs under such circumstances at the transfer of units.

As an exception from the above, during any period when the net asset value of the units of SEB Liquidity Fund is below their nominal value and no cash payments of income are made, the income or loss occurring from the transfer of units shall be taxed according to the principles described in the part regulating the taxation of growth units.

**Cash payments in the form of additional units**

The Management Company does currently not manage any funds which would use distribution units and whose income would be paid to the investors in the form of issue of additional units. However, we would like to specify that if the fund does not pay any money but issues additional units to the investor instead, these are subject to taxation at the moment of later sales or redemption pursuant to the rules of taxation of income earned from transfer of property.

**Specialties of taxation upon investing in units of mandatory pension funds (2nd pillar)**

Only resident individuals for whom the employer is obligated to pay social tax or who pay social tax themselves and are obligated to make contributions to mandatory funded pension on the income specified in Article 7 of the Funded Pensions Act can invest in mandatory pension funds.

**Tax incentives upon making contributions**

Contributions made to a mandatory pension fund are deducted from the person's taxable income and are thus completely exempt from income tax. Upon making contributions to a pension fund, the gross wages of a person will be 2% smaller, but the net wages actually received will decrease by an amount that is reduced by the income tax portion. If the income tax rate is 21%, at the account of the contribution made the net wages will decrease by an amount that equals 1.58% of the gross wages.

**Taxation upon making payments**

In order to receive payments from a mandatory pension fund one generally has to enter into a mandatory funded pension insurance contract. In certain events one is entitled to funded pension payments direct from the pension fund.

Payments based on a mandatory funded pension insurance contract and/or payments made directly from the fund are subject to taxation pursuant to Article 19 of the Income Tax Act as the pension received by the person. According to the Income Tax Act in force, pension payments are subject to income tax at the rate of 21%. The respective tax amount is withheld upon making the payments.

It should be taken into account that additionally, the tax-free income to the extent of the total pension but not more than 36,000 kroons per taxable period is deducted from the income of a resident individual who receives mandatory funded pension or pension arising from a social insurance contract.

Payments made to the beneficiary under a mandatory funded pension insurance contract and payments made to the successor upon redemption of units are subject to income tax at the rate of 21% as specified in Article 20 of the Income Tax Act. It is important that the entire payment be subject to taxation.

**Taxation upon exchange of units and other specific cases**

Exchange of units of a mandatory funded pension fund against those of another mandatory funded pension fund or lifelong annuity pension offered by life assurance undertakings as well as transfer
of units to the pension account of the successor is exempt from income tax, because these instances are not deemed to be payments.

Specialties of taxation upon investing in units of voluntary pension funds (3rd pillar)

Only individuals can invest in voluntary pension funds, incl. non-resident individuals.

Considering the specifications of taxation upon investment in voluntary pension funds, we recommend that non-resident individuals seriously assess the impact of taxation on the investment planned by them and consider alternative investment options, where possible.

Tax incentives upon making contributions

A resident individual has the right to deduct from any income subject to income tax in the taxable period the amounts spent on acquisition of units of a voluntary pension fund established in Estonia and those of a voluntary pension fund operating in a contracting state of the European Economic Area\(^3\) on equal grounds to the extent of 15%. This means that the state refunds to individuals who have invested money in their pension fund income tax on the amounts spent on acquisition of units, which do not exceed 15% of the individual's annual taxable income.

For instance, if the taxable income of an individual who is a resident of Estonia is 10,000 kroons (120,000 kroons a year) invests 1,000 kroons in a pension fund on a monthly basis (12,000 kroons a year), the state will refund income tax collected on the contributions made to the pension fund. If the income tax rate is 21%, the state will refund 2,520 kroons (i.e. 21% of 12,000 kroons).

Taxation upon making payments

A unit-holder has the right to demand the return of the units on the condition that at least two years have passed from the redemption of redeemable units. This restriction is not applicable upon exchange of units for the units of another voluntary pension fund or upon redemption of units in the case of succession or entry into an additional funded pension insurance contract.

A payment made to the unit-holder upon redemption of the units of a voluntary pension fund is subject to taxation pursuant to Article 21 of the Income Tax Act.

Payments are subject to taxation at the income tax rate of only 10% if they are made to the investor after he or she has reached the age of 55 and on the condition that at least five years have passed from the acquisition of the units to be redeemed. The 10% rate is also applied with regard to payments made in the event of complete and permanent incapacity for work or liquidation of the pension fund. The 10% income tax rate is also applied in the event specified in Articles 61 (13) and (131) of the Income Tax Act.

The income tax rate of payments made upon succession depends on the time of acquisition of the units and the age of the successor.

It is important that the entire payment be subject to the respective rate regardless of whether the investor has earned income on their investment or not.

Exceptionally, amounts accumulated to a voluntary pension fund can be received exempt from income tax by signing a supplementary funded pension insurance contract with an insurer who holds the respective licence. Payments made on the basis of the insurance contract will be exempt from income tax after the policyholder has reached the age of 55 or as of identification of complete or permanent incapacity for form, provided that the insurer makes payments to the policyholder at least once every three months until the policyholder's death. In essence, this means exchange of the units for lifelong annuity pension, which is subject to a tax incentive through an income tax exemption.

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\(^3\) As of 01.07.2008 the contracting states of the European Economic Area (EEA) are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom.
Taxation upon exchange of units

The exchange of the units of one pension fund for those of another is not considered a payment made out of a pension fund and it is not subject to income tax. The exchange of the units of a pension fund for an annuity pension contract offered by life assurance undertakings is not subject to income tax either.

In other events payments made from a voluntary pension fund are subject to the income tax rate of 21%.

Taxation of profit from foreign investment funds

Income earned from foreign investment funds acquired via the Management Company, SEB Pank or another intermediary operating in Estonia is declared and subject to taxation in Estonia as income from securities, similarly to income earned from Estonian investment funds.

Further information

For further information about taxation of income earned from investment funds call the Management Company’s hotline (+372) 665 6565.