

Doing Business in Estonia

Law Firm Teder, Glikman & Partnerid



2006/2007

ABOUT US

Teder, Glikman & Partnerid is one of the leading Estonian law firms, situated in Tallinn, the capital of Estonia. We are a member of Baltic Legal Solutions, which is a Pan-Baltic alliance combining three well-established firms us in Estonia, Jurevičius, Balčiunas & Bartkus in Lithuania and Kronbergs & Čukste in Latvia, and has over 60 practicing lawyers.

We place great emphasis on training and development of our partners and associates in both current legal and business issues. As a result, our contribution to clients' businesses is highly valued and we have been awarded the following major honours:

- Recommended law firm in all categories by The Legal 500, 2006;
- Recommended law firm in all categories by IFLR1000, 2006;
- Highly recommended for company and corporate transactions and recommended for litigation and competition/anti-trust by PLC Which Lawyer? Yearbook 2006.

We have substantial experience in commercial and corporate transactions and we are Renowned for our dispute resolution practice. Our main areas of practice are:

- Mergers & Acquisitions
- Corporate Structure
- Insolvency
- Distribution
- Competition Law
- Finance & Banking
- EU Law
- Transport
- Insurance
- Environmental Law
- Energy Law
- Real Estate
- Labour Law
- Intellectual Property & Information Technology
- Litigation & Arbitration
- Tax Disputes

Our law firm consists of litigation and business teams, which have been developed to ensure that clients receive advice from lawyers who are always experts and often leaders in their field. Our litigation team is headed by partners Indrek Teder and Leon Glikman, LL.M. (Harvard) and business team by partners Mariana Hagström, LL.M. (Stockholm) and Daisy Tauk, LL.M. (Stockholm). Most of our lawyers possess professional knowledge not only in law, but also in other areas, such as business management, corporate finance and public relations. Many of our lawyers are bi-lingual in Estonian and English and capable of working in Russian, German, French, Finnish and Swedish.

TEDER, GLIKMAN & PARTNERID LAW FIRM

2 Tornimäe 18th floor
10145 Tallinn
Estonia
www.tgplegal.ee
Tel.: +372 665 7070
Fax: +372 665 7071

Contact partners:

Mrs. Mariana Hagström
Mariana.Hagstrom@tgplegal.ee

Mr. Leon Glikman
Leon.Glikman@tgplegal.ee

Mrs. Daisy Tauk
Daisy.Tauk@tgplegal.ee

Mr. Indrek Teder
Indrek.Teder@tgplegal.ee

Introduction

Company setup

Liability of officers,
shareholders and
supervisory board

Taxation

Labour relations

Environmental law

Intellectual property

Insolvency

Dispute resolution

A. INTRODUCTION

A1. Main facts about Estonia

Official name:	Republic of Estonia
Head of state:	President
Government:	Single chamber Parliament (Riigikogu)
Area:	45 227 square km
Currency:	Eesti Kroon (EEK); 1 kroon = 100 sents
Population:	1.37 million; in towns 70%, in rural municipalities 30%
Ethnic groups:	Estonians 67.9%, Russians 25.6%, Ukrainians 2.1%
Time zone:	GMT + 2 hours
Major natural Resources:	Timber, oil shale, phosphorite, peat, limestone, dolomite
Language:	Estonian

Public holidays:

- January 1 - New Year's Day
- February 24 - Independence Day
- Good Friday - variable date
- Easter Day - variable date
- May 1 - Spring Day
- Whitsunday - variable date
- June 23 - Victory Day
- June 24 - Midsummer Day
- August 20 - Day of Restoration of Independence
- December 24 - Christmas Eve
- December 25 - Christmas Day
- December 26 - Boxing Day

A2. Key economic indicators

GDP growth:	9.8% in 2005. Since 2001 Estonian economy has grown on the average 7% annually.
Inflation (CPI):	4.1% in 2005. The growth of inflation, compared with 1.3% in 2003, is caused by appreciation of fuel in the global market.
Unemployment rate:	7.9% in 2005. The unemployment rate started from 13.6% in 2000 and has decreased since then.
Average gross wage:	EUR 514 per month in 2005.
Minimum wage:	EUR 192 per month in 2005.
FDI stock:	EUR 10.37 billion in 2005. The Scandinavian countries represent the biggest source of foreign direct investment in Estonia.
Exports:	EUR 6.2 billion.
Imports:	EUR 8.2 billion.
Source:	Statistical Office of Estonia, 2006.

Web information:

Estonian Chamber of Commerce and Industry
www.koda.ee

Statistical Office of Estonia
www.stat.ee

Enterprise Estonia
www.eas.ee

Investment in Estonia
www.investinestonia.com

B. COMPANY SETUP

B1. Corporate legal entities

Which types of business entities exist in Estonia?

There are five types of business entities in Estonia:

- Private limited company (osaühing or OÜ);
- Public limited company (aktsiaselts or AS);
- Sole proprietorship (füüsilisest isikust ettevõtja or FIE);
- General partnership (täisühing or TÜ);
- Limited partnership (usaldusühing or UÜ).

The Commercial Code also provides for the possibility of a foreign company to undertake business activities in Estonia via a branch (filiaal).

Which business entities are most common?

Limited liability companies are most common in Estonia, constituting nearly 97% of the registered companies (in January 2006 altogether 73,926 companies were registered). The two possible forms for establishing the limited liability company are: private limited company with the minimum capital approx. EUR 2,600 and public limited company with minimum capital approx. EUR 26,600.

Which business entity should I choose?

Generally, for a medium sized enterprise it is easier to conduct business activities through the form of a private limited company, but for an enterprise with a considerable list of owners who wish to issue listed securities on the Exchange, the formation of a public limited company is necessary.

B2. Setting up a company/branch

How can I set up a company?

The World Bank Report "Doing Business in 2006" ranks Estonia 16th economy with its business-friendly regulation. The World Bank applauds to all the Baltic States while only a decade has passed since these countries started with the reforms. Registration of a company is rather quick in Estonia. All the applications for registering the company shall be submitted through the notary public. That kind of control guarantees that the foundation process is lawful. After the application is submitted the registration takes about 2 weeks.

Foreign investors have to keep in mind that documents in a foreign language shall be submitted to the Commercial Register together with a notarised translation into Estonian and that the shares must be paid in full before submitting an application to enter the company in the Commercial Register.

How can I set up a branch?

If a foreign company wants to permanently offer goods or services in its own name in Estonia, it shall enter a branch in the Commercial Register. The company shall be liable for the obligations arising from the activities of the branch.

A foreign company shall appoint a director or directors for the branch, who shall direct and represent the branch and shall organise the accounting. At least one manager must be resident of Estonia, EEA or Switzerland.

The branch must keep its own accounts in Estonia. It would be taxed under Estonian law (see chapter on taxation).

B3. Buying a company

How can I buy a company?

Shares in public limited companies are registered with the Estonian Central Register of Securities. These shares can be transferred to the buyer through a securities transaction that can be organised in any bank by transferring shares from one account to another. The parties should keep in mind that pre-emption rights may be prescribed for in the Articles of Association.

It is voluntary to register shares in private limited companies with the Estonian Central Register of Securities. Shares that are not registered can be transferred through a notarised sale and purchase agreement. The parties should keep in mind that other shareholders have pre-emption rights if shares are transferred to a third person.

B4. Mergers

How can companies merge?

Mergers are regulated in the Commercial Code. Companies can merge:

- with another company (acquiring company). The company being acquired shall be deemed to be dissolved following the entry of the merger to the Commercial Register.
- by establishing a new company. In this case, both merging companies shall be deemed dissolved following the entry of the merger to the Commercial Register.

Liability

The transferee takes over all of the transferor's obligations related to the company (i.e. employment contracts). Transferor and transferee shall be solidarily liable to the creditors for obligations which have arisen before the transaction and which, by the time of transaction, have fallen due or shall fall due within five years after the transfer.

Do I need to notify the Estonian Competition Board or the European Commission?

You need to notify the Estonian Competition Board if during the previous financial year, the aggregate turnover of the parties in Estonia exceeded 100 million kroons and the aggregate turnover in Estonia of each of at least two parties exceeded 30 million kroons.

You need to notify the European Commission where either:

- the combined aggregate worldwide turnover of all the undertakings concerned exceeds EUR 5,000 million; and
- the aggregate Community-wide turnover of each of at least two of the undertakings concerned exceeds EUR 250 million;

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State or

- a) the combined aggregate worldwide turnover of all the undertakings concerned exceeds EUR 2,500 million; and
 - b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned exceeds EUR 100 million; and
 - c) in each of at least three of the Member States included for the purpose of (b), the aggregate turnover of each of at least two of the undertakings concerned exceeds EUR 25 million; and
 - d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned exceeds EUR 100 million;
- unless each of the undertakings achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

Web information:

Estonian Commercial Registry
info.eer.ee

Estonian Financial Supervision Authority
www.fi.ee

C. LIABILITY OF OFFICERS, SHAREHOLDERS AND SUPERVISORY BOARD

When is a supervisory or management board member liable?

A member of the supervisory board or management board is liable for damages if he fails to exercise care normally expected from a diligent undertaker.

Members of the management board may also be solidarily liable for any damages caused to the company unless they prove that they have exercised care normally expected from a diligent undertaker.

When is a shareholder liable?

A shareholder who intentionally causes damage to the company, another shareholder or third person, can be held liable.

D. TAXATION

Estonian tax regime is generally business-friendly. Especially the Estonian system of corporate earnings (income) taxation, with its flat rate of 23%, is considered as one of the most liberal and innovative tax regimes in the world.

Estonian state taxes are:

- income tax: 23% (the rate shall fall down to 20% by 2009, 1% yearly),

- value-added tax: 18%;
- social tax: 33%;
- unemployment insurance tax: 0.3% + 0.6%;
- excise duties (on tobacco, alcohol, motor fuel, packages);
- heavy goods vehicle tax;
- customs duty;
- land tax: 0.1 – 2.5% of the value of the land;
- gambling tax.

Most common local (municipal) taxes are advertisement tax and parking charge.

What makes the Estonian corporate income system unique?

There is no classical corporate income tax system in Estonia. Estonian companies do not pay income tax on the profit derived from their enterprise. Instead of taxation of the profit earned by resident companies, actual and deemed profit distributions (usually done in the form of dividends) are taxed by the rate of 23% on the gross amount of the distribution. The moment of taxation is shifted from the moment of earning the profits to the moment of their distribution. Thus the undistributed profits are not subject to taxation, regardless whether invested or merely retained. Thereby, the main difference of the Estonian system from corporate income tax systems in other countries is the timing of tax liability.

What are the rules for deduction of expenses regarding income taxation?

Under the traditional system, the starting point (the basis) for taxing profits of a company is usually profit and loss account that is calculated according to the accounting rules and then it will be adjusted according to the tax rules. In Estonian system, dividends reflect the commercial profits and in addition to that, non-deductible expenses are taxed. Estonian simple system lies on cash-basis accounting and in view of taxation there is no need for amortization and depreciation rules. However, several other general elements of the traditional corporate income tax in a way still exist. For example, expenses that are not deductible in a traditional system are taxable in Estonia. These may be fringe benefits; gifts, donations and representation expenses; and expenses and payments not related to business. In addition to such profit allocations (“distribution” is treated wider than direct dividend payments), transfer-pricing rules apply against hidden distributions of profits.

Are all the forms of business entities treated similarly for the purpose of income tax?

In terms of taxation, there is no difference between investments through Estonian partnerships and limited liability companies because they are all similarly treated tax-wise and considered non-transparent for tax purposes and subject to corporate income tax. Furthermore, the profits of the permanent establishments of non-residents (usually the branch offices) are taxed in a similar manner as income of a resident company, i.e. only on distributions or deemed distributions. However, as in the latter case there are no dividends, the direct distributions of the permanent establishment are considered to be the assets taken out of it (for tax base the input assets are subtracted).

Which countries Estonia has double taxation avoidance treaties with?

Gains or income derived by a non-resident legal person from an Estonian based source of income are usually taxed by 23%. The double taxation avoidance treaties may limit this. There are effective treaties with Armenia, Austria, Belarus, Belgium, Canada, China, Croatia, Czech Republic, Denmark, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Kazakhstan, Malta, Moldova, Netherlands, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom, USA.

How does the value added tax system function?

The Estonian value added tax (with its standard rate of 18% and also several exemptions) system follows the general principle that the tax burden should not be on the entrepreneur but is finally laid on the consumer. Although the entrepreneur is considered to be the taxable person and its supply is taxed, the recipient of the goods or services compensates it to the former within the price payable. Also, as a rule if the sales value added tax during a taxable period (1 month) is less than the amount of input tax deductible by the taxable person during the same period, the overpaid tax will be refunded to the latter one upon application. Estonia has implemented a number of EU directives covering value added taxation including the so-called 6th directive (Council Directive 77/388/EEC).

What about social security taxation?

Employers pay social (security) tax on wages and other remuneration made to the employees. The former is solely liable for the tax. Fringe benefits granted to an employee, which are subject to the abovementioned corporate income tax, are also taxed by social tax. The tax rate is 33% of the gross amount before the income tax. The wages and the like payments are also taxable by unemployment insurance premium of 0,3 + 0,6% and if the employee has joined pension insurance fund a pension contribution of 2%. In addition the respective EU legislation applies (incl. Council Regulation 1408/71 on the application of social security schemes to employees and their families moving within the Community).

Web information:

Estonian Tax and Customs Board
www.emta.ee

Estonian Ministry of Finance
www.fin.ee

E. LABOUR RELATIONS

Which terms are mandatory for an employment contract?

An employment contract should include specific terms, in the absence of which, the contract is defective. Following terms are mandatory:

- the working hours, wage and the place of work;
- the work and its level of complexity, official or professional title and qualification requirements;
- the period of the contract's validity and the time for commencing the job (normally indefinite period of time).

Types of executive employment

Executives may either be employed or belong to the management board of the company. In case an executive is employed, the statutes regulating employee's rights and obligations apply. On the other hand if an executive is a member of the management board he will not be protected by these statutes and is bound through a service agreement.

Working hours

Generally working hours must not exceed 40 hours per week.

Holidays

The minimum holiday entitlement is 28 days per year. An employee would be entitled to statutory holidays after six months of employment.

Parental leave

An expecting mother has the right to leave 70 days before the planned birth and she is entitled to take childcare leave until the child reaches 3 years of age.

A newborn's father can also take parental leave until the child reaches 3 years of age.

Salary

The minimum salary is regulated by law and in 2006 it is set to 3000 EEK (192 EUR) per month. The average salary in Estonia is 8,591 EEK (549 EUR).

Trade Unions

Employees have the right to be members of trade unions. However, only 14% of employees in Estonia belong to trade unions and therefore trade unions/collective agreements do not usually affect employment relationships. Most of the trade unions are in education, health care and transportation sectors.

Work permits

Citizens of EEA states may work in Estonia without a work permit (however, they might require a residence permit). All the other employees must have a work and residence permit to be able to work in Estonia.

Statistics

	2005
Total labour force (thous.)	653.8
Employed (thous.)	601.6
Employment rate (%)	60.9
Unemployed (thous.)	52.2
Unemployment rate (%)	7,9
Economically inactive (thous.)	333.7

Source: Statistical Office of Estonia

Web information:

Citizenship and Migration Board
www.mig.ee

Estonian Labour Market Board
www.tta.ee

Ministry of Social Affairs
www.sm.ee

Customs Guide for Travellers
www.emta.ee

F. ENVIRONMENTAL LAW

Estonian environmental law is based on the environmental legislation of the European Union.

Which environmental conventions is Estonia part of?

Estonia has entered into the following conventions: Arhus (1998), Espoo (1991), Helsinki (1992), Kyoto protocol (1997), Geneva (1979), Vienna (1985), Washington (1973), Rio de Janeiro (1992), Catagena protocol (2000) and Basel (1989).

When do I require an environmental permit?

Permits related to the environment are required for:

- Polluting the environment;
- waste generation or handling;
- the usage of natural resources;
- radiation practices, including building and exploiting nuclear plants.

When do I require an integrated environmental permit?

An integrated environmental permit involves the following permits: waste permit, air pollution permit and water usage or water pollution permit.

An integrated environmental permit is required for operating in the following categories of activities:

- production of electricity, heat, fuel and coke;
- refining liquid fuel and gaseous fuel, and pyrolysis of solid fuel;
- production and processing of metals;
- processing of mineral materials;
- chemical industry;
- waste management;
- cellulose, paper or textile industry, and tanning of skins and hides;
- food industry;
- animal farming;
- surface treatment and finishing by using organic solvents;
- production of plywood and fibreboard;
- production of graphite (hard-burnt coal) and electrographite by way of incineration or graphitisation;
- disposal and recovery of animal carcasses and animal waste.

An integrated environmental permit must be obtained for the operation of an installation as a whole if the activities of the installation in at least one category of activities for which a permit is required exceed the threshold capacity established by the Government of Estonia.

After the permit is acquired the activities must be in accordance with the permit and laws. The integrated environmental permit issuer and the environmental inspector review the activities annually.

When should environmental impact be assessed?

Environmental impact needs to be assessed:

- 1) upon application for or application for amendment of a development consent if the proposed activity which is the basis for application for or amendment of the development consent potentially results in significant environmental impact.
- 2) if activities are proposed which may significantly affect a Natura 2000 site.

Environmental impact is significant if it may potentially exceed the environmental capacity of a site, cause irreversible changes to the

*First quarter of 2006, Statistical Office of Estonia.

environment, endanger human health and well-being, the environment, cultural heritage or property.

The Environmental Impact Assessment and Environmental Management System Act stipulates the detailed list of the activities of significant environmental impact with threshold capacities in which the environmental impact assessment is mandatory.

The same Act provides also requirements for strategic environmental assessment, which has to be done usually, but not always, during the preparation of the spatial plan. The specified list of cases, when the strategic environmental assessment must be done is stipulated in the Environmental Impact Assessment and Environmental Management System Act. The spatial plan is the basis for the building permit. The strategic environmental assessment is necessary for the choice of location of the proposed activity.

Are there any limitations to the location of the activities?

The Nature Protection Act and the regulations of the protected areas stipulate the detailed limitations or even prohibitions of certain activities like mining or clear cutting of forest in the protected areas.

Is the usage or pollution of environment chargeable?

Yes there is a pollution charge, however, the rates vary depending on the substances and the quantities of the substances and are stipulated in the Environmental Charges Act.

Also the usage of natural resources is chargeable and the rates are stipulated in the same Act or on the basis of this Act by the regulation.

The environmental charge may be substituted by the Minister of the Environment with the financing of harm preventive or minimising activities.

What happens if the requirements of laws, regulations and permits are not met by the undertaker?

If the permit owner pollutes in quantities more than the permit foresees, then the pollution charge will be multiplied 5 to 500 times.

The Environmental Inspectorate (subordinated to the Ministry of Environment) is the supervisory body over the activities related to the impact on the environment. The environmental inspector can impose fines for unlawful activities or even stop the activities until they have been brought into accordance with laws, regulations and the permit.

The environmental inspector has a right to sue a company for the damage caused to the environment. The compensation rates are stipulated in laws.

A criminal punishment is provided in the Penal Code for an activity, which causes significant damage to the environment in a large extent.

Web information:

Ministry of the Environment:
Www.envir.ee

G. INTELLECTUAL PROPERTY

Patents

Inventions of any field of technology may be protected by a patent for 20 years. The subject of an invention may be a device, process, material, including biological material, or a combination thereof.

The Patent Office can grant patents after submission of applications and registration. An invention is patentable if it is new, involves an inventive step and is susceptible to industrial application.

Trademark

A trademark is a sign used to distinguish the goods or services from other similar types of goods or services.

Legal protection can be granted to either: 1) registered trademarks or 2) trademarks which are well known in Estonia.

To register a trademark one needs to submit an application to the Patent Office after which the Patent Office examines whether the application complies with formal requirements.

The duration of the trademark protection is 10 years from the application date, however, the protection can be renewed in every 10 years.

Copyright

Copyright protects literary, artistic and scientific works (i.e. computer programmes, speeches, musical compositions, scripts, choreographic works, paintings, sculptures, etc).

Copyright is created with the creation of the work. A registration is not required for the creation or exercise of copyright.

The author may assign financial rights to his work to another party but the moral rights will always remain with the author (i.e. permit other persons to make any changes to the work, decide when the work is ready to be performed in public, etc).

The term of protection of copyright is the life of the author and 70 years after his or her death. In the case of anonymous or pseudonymous works, the term is 70 years after the work is lawfully made available to the public.

Industrial designs

An industrial design is a two-dimensional or three-dimensional design of a product.

Legal protection is granted to industrial designs which are new, have an individual character and may be used for manufacturing industrial or handicraft products.

Industrial designs acquire legal protection by registration in the Register of Industrials Designs. The registration is valid for 5 years from the filing date of the registration application and may be renewed by an owner of an industrial design for a period of 5 years at a time up to a total term of 25 years as of the filing date of the registration application.

Web information:

Estonian Patent Office
www.epa.ee

Database of Estonian IPR court cases:
www.kul.ee

H. INSOLVENCY

A company can enter into liquidation or may be declared bankrupt. When bankruptcy or liquidation is finalised, the legal entity ceases to exist.

Liquidation

A limited company shall be liquidated upon dissolution. The liquidators are usually members of the management board. Their obligation is to terminate the activities of the company, collect debts, sell assets and satisfy the claims of creditors.

Bankruptcy

Bankruptcy means the insolvency of a debtor declared by a court judgment. A debtor is insolvent if the debtor is unable to satisfy the claims of the creditors and such inability, due to the debtor's financial situation, is not temporary.

The bankruptcy procedure starts with the appointment of a temporary bankruptcy trustee. When the temporary trustee concludes that debtor's insolvency is not temporary, the bankruptcy of the debtor is announced and a permanent trustee appointed.

When should a bankruptcy petition be filed?

According to Estonian law, members of the management board shall be obliged to submit a bankruptcy petition if a legal person is clearly permanently insolvent. A bankruptcy petition may be filed at the court by a debtor or a creditor.

What are the effects of bankruptcy?

In case the court declares a legal person bankrupt the effects of it include, inter alia, that the debtor's assets become the bankruptcy estate, the right to administer the debtor's assets is transferred to the bankruptcy trustee and the debtor is deprived of the right to enter into any transactions.

Compromise

A company can enter into a compromise agreement concerning payment of debts. This agreement involves reduction of debts or extension of their terms of payment. A court ruling approving a compromise terminates the bankruptcy proceedings and the company can return to its business activities.

I. DISPUTE RESOLUTION

The Arbitration Court of the Estonian Chamber of Commerce and Industry is a permanent court of arbitration in Estonia. It is established to settle disputes arising from contracts and other civil law relationships.

The agreement to settle a dispute in the Arbitration Court is voluntary. „No arbitration agreement, no arbitration“ principle applies.

Advantages and disadvantages of arbitration

Advantages of arbitration

- The judgment of the Arbitration Court is final, therefore, it cannot be appealed.
- The judgment can be enforced in a foreign country signatory to the New York Convention.
- The arbitration process is confidential and private.
- The arbitration process is quick. A judgment is made usually within 3-5 months.
- Parties can choose their own arbitration tribunal, therefore, the tribunal has better knowledge in a specific area.
- Less complicated procedural provisions.
- The arbitration fees are smaller than the state fees in courts when larger claims are involved.

Disadvantages of arbitration

- Limited possibilities of appeal
- Lack of precedent
- More expensive when smaller claims are involved

Web information:

The Arbitration Court of the Estonian Chamber of Commerce and Industry
www.koda.ee



TEDER, GLIKMAN & PARTNERID

Law Firm Teder, Glikman & Partnerid

Tornimäe 2
10145 Tallinn
Estonia
Tel.: +372 665 7070
Fax: +372 665 7071
E-mail: info@tgplegal.ee
www.tgplegal.ee