



Fall | 22



INTERNATIONAL LAWYERS NETWORK



TGS BALTIC ESTABLISHING A BUSINESS ENTITY IN ESTONIA

ILN CORPORATE GROUP



This guide offers an overview of the legal aspects of establishing an entity and conducting business in the requisite jurisdictions. It is meant as an introduction to these marketplaces and does not offer specific legal advice. This information is not intended to create, and receipt of it does not constitute an attorney-client relationship or its equivalent in the requisite jurisdiction.

Neither the International Lawyers Network or its employees, nor any of the contributing law firms or their partners or employees accepts any liability for anything contained in this guide or to any reader who relies on its content. Before concrete actions or decisions are taken, the reader should seek specific legal advice. The contributing member firms of the International Lawyers Network can advise in relation to questions regarding this guide in their respective jurisdictions and look forward to assisting. Please do not, however, share any confidential information with a member firm without first contacting that firm.

This guide describes the law in force in the requisite jurisdictions at the dates of preparation. This may be some time ago and the reader should bear in mind that statutes, regulations, and rules are subject to change. No duty to update information is assumed by the ILN, its member firms, or the authors of this guide.

The information in this guide may be considered legal advertising.

Each contributing law firm is the owner of the copyright in its contribution. All rights reserved.



ESTABLISHING A BUSINESS ENTITY IN ESTONIA



“Establishing a Business Entity in Estonia”

Mr. Sander Kärson
Managing Partner
TGS Baltic – Tallinn



“Establishing a Business Entity in Estonia”

Ms. Anu Kirss
Senior Associate
TGS Baltic – Tallinn



“Establishing a Business Entity in Estonia”

Ms. Maris Vutt
Senior Associate
TGS Baltic – Tallinn



“Establishing a Business Entity in Estonia”

Mr. Sergei Jegorov
Senior Associate
TGS Baltic – Tallinn



“Establishing a Business Entity in Estonia”

Ms. Siret Saks
Senior Associate
TGS Baltic – Tartu

1. Types of Business Entities

The most common types of companies in Estonia are the public limited liability company ("AS") and the private limited liability company ("OÜ"). The OÜ may be compared to a closed corporation: its shares are not publicly traded and there are usually rather few shareholders. The shares of an AS, in contrast, are always in book-entry form and more easily transferable.

The main reason most businesses opt for the OÜ form is that the minimum share capital

requirement is EUR 2,500 (does not have to be paid upon registration by an individual person), whereas for the AS it is EUR 25,000. As of February 1, 2023, the minimum share capital requirement for OÜ will be abolished and the founders will have the option to determine the minimum share capital according to the need and the purpose of the company. In addition, the OÜ form has a simpler management structure (one level with a sole management board member) and it does not have an automatic auditing obligation.

A shareholder may be liable for damage caused to the company, another shareholder or third persons by carelessness, gross negligence, or an intentional act. A shareholder is not liable for any damage caused if the shareholder did not participate in the adoption of the respective resolution or if the shareholder voted against the resolution. If the shareholders adopt a resolution on a matter that would normally be in the capacity of the management or supervisory boards, they may be liable as if they were members of the management or supervisory board.

An AS must always have an auditor to audit its annual reports. Whether an OÜ must have an auditor depends on its turnover, amount of assets and number of employees (there are two different standards of examination: an audit and review; to be subject to the review requirement, one of the following criteria must be met: the total value of assets exceeds EUR 2.4 million, turnover exceeds EUR 4.8 million, or more than 72 employees; or two of the following criteria must be met: the value of assets exceeds EUR 0.8 million, turnover exceeds EUR 1.6 million, and more than 24 employees; to be subject to the audit requirement, there are higher thresholds); an examination by an auditor may also be necessary because such a requirement has been stipulated in the articles of association.

2. Steps and Timing to Establish

It is possible to acquire an existing company, but to establish a new company, the following steps must be taken:

- concluding a notarised memorandum of association to which articles of association are annexed;
- opening a bank account in an Estonian credit institution, into which monetary contributions are paid. Generally, founders are required to go to the bank in person for identification purposes. If the articles of association so prescribe, non-monetary contributions may also be used. The valuation of non-monetary contributions must be audited in the case of an AS and, in certain instances, in the case of an OÜ;
- registering the shares in the Central Register of Securities (not required in the case of an OÜ, but optional);
- submitting documents to the Commercial Register.

To establish a branch, a notarised application must be filed by the director of the branch. At the beginning of 2022, an amendment to the law entered into force, which also allows branches to be registered electronically in the e-Business Register. Additional documents to be filed with the application include a certificate concerning the existence of the company in its home country, a document certifying the authority of the director (e.g., a PoA or a board resolution) and a copy of the articles of association of the company.

Companies and branches are usually registered within five business days from the submission of their documents to the Commercial Register. Please note that documents regarding a foreign company establishing a branch or a subsidiary

must be officially certified and, in most cases, apostilled or legalized.

The ID-cards of some foreign countries are accepted in Estonia to establish a company and a branch electronically through the e-Business Register. This must be checked upon registration as the list changes due to system updates. Electronic establishment allows the utilization of an expedited procedure, meaning that the Commercial Register will process the petition during the next business day after receiving the application. There are no notary fees, but the state duty is a bit higher: EUR 265 (otherwise EUR 200). Only monetary contributions may be made in the fast-track procedure. An Estonian credit institution may open a bank account via e-Business Register in the name of the company being founded only if the monetary contribution is made through a bank account opened in another Member State of the European Economic Area (EEA) and the cash stands on the account until the company has been entered in the Commercial Register.

3. Governance, Regulation and Ongoing Maintenance

3.1 Corporate governance

AS shall have a two-tiered management system: the management board and the supervisory board. OÜ has no supervisory board by default but may decide to form one.

The management board is the legal representative of the company and the head of the everyday business. The company may be represented individually by each member of its management board unless the articles of association or a specific shareholders' resolution prescribe that the company may only be represented jointly by members of the management board.

The supervisory board advises and supervises the management board and is responsible for the strategic management of the company.

Members of management and supervisory boards must be natural persons with active legal capacity. They are required to perform their obligations with the diligence normally expected from a member of a directing body and to be loyal to the company.

Members of a management or supervisory board who cause damage to the company by violation of their duties (e.g., by breaching their duty of care) are jointly and severally liable to the company. A member of a management or supervisory board will not suffer liability if he or she acts pursuant to a lawful resolution of the general meeting or any other competent body or if he or she proves that he or she performed his or her obligations with due diligence. A claim for payment of compensation to the company for damage may also be submitted by a creditor of the company if the assets of the company are not sufficient to satisfy the claims of the creditor.

3.2 Reporting requirements

An annual report which consists of a management report and annual accounts, and which has been approved by the shareholders must be submitted to the Commercial Register together with a profit distribution proposal and auditor's report, if compulsory, not later than 6 months after the end of the financial year.

3.3 Requirements for local shareholding/directors

A shareholder may be either Estonian or a foreign individual or company.

There is no separate legal concept of a director in Estonian commercial law, but a member of the management board could be called a director. A director must be a natural person

with active legal capacity. There are no requirements regarding citizenship. A person with respect to whom a court has imposed a prohibition on acting as a member of the management board or a prohibition to engage in enterprise, a person who is prohibited from operating within the same area of activity as the branch, or a person who is prohibited to act as a member of the management board based on law or a court decision shall not be a director.

If none of the members of the management board is a resident of Estonia, the company has to designate a contact person to whom the procedural documents and the declarations of intent addressed to the company may be delivered in Estonia. The list of the individuals or companies that may be appointed as the contact person are as follows: a notary, an advocate, a law office, a sworn auditor, an audit firm, a tax representative, and an AML company.

Directors of Estonian companies are subject to a range of duties imposed by the Commercial Code, by the articles of association of the Company and by the resolution of the shareholders. For example, the members of the management board must

a) perform their duties with due diligence; b) preserve the business secrets of the company; c) represent and manage the company; d) in managing, adhere to the lawful orders of the supervisory board/shareholders; e) organize the accounting of the company.

3.4 Protection of minority shareholders

Public limited company

Any shareholder (without having to meet a qualified minority requirement) has the right to receive information on the activities of the public limited company from the management board at the general meeting of shareholders,

and the right to file an action to the court to demand the revocation of the shareholders' resolution.

Qualified minority consists of any shareholder(s) holding at least 10% of the share capital of the public limited company. In the case of listed public limited companies, the qualified minority may be higher (at least 20% of the share capital) in certain cases. Minority shareholders with a qualified minority are protected by the Commercial Code in several aspects.

First, if it is demanded by minority shareholders with a qualified minority, the management board must call a special general meeting. They also may demand the inclusion of additional issues on the agenda of the general meeting if the respective demand has been submitted no later than 15 days before the general meeting is held. Minority shareholders may submit to the public limited company a draft of the resolution with respect to each item on the agenda.

Second, shareholders whose shares represent at least one-tenth of the share capital may request the removal of a member of the supervisory board by a court. They may also request a meeting of the supervisory board to be called.

Third, at the general meeting of shareholders, minority shareholders who hold at least 10% of the shares may demand a resolution on the conduct of a special audit on matters regarding the management or financial situation of the public limited company, and the appointment of an auditor for the special audit. If the general meeting does not decide on the conduct of a special audit, minority shareholders may request that a special audit is conducted and that an auditor for the special audit is appointed by a court.

Fourth, minority shareholders who hold at least 10% of the shares may request the change of an auditor appointed by the general meeting from a court if doubt exists concerning the impartiality of the person appointed by the general meeting. The minority shareholders may request of the private limited company that the auditor who prepared the sworn auditor's report participate in the making of the decision to approve the annual report and provide explanations concerning the sworn auditor's report if the shareholders have submitted the corresponding written request at least five days before the general meeting.

Fifth, a court shall appoint the liquidators if this is requested by shareholders whose shares represent at least one-tenth of the share capital. Based on the demand of the minority shareholders, a court may recall a liquidator who is a member of the management board, or who has been appointed in accordance with the articles of association or by a resolution of the shareholders and appoint a new liquidator.

Private limited company

Any shareholder (without having to meet a qualified minority requirement) has the right to receive information from the management board on the activities of the private limited company and to examine the documents of the private limited company, and the right to file an action to the court to demand the revocation of the shareholders' resolution which conflicts with the law or the articles of association.

Qualified minority consists of any shareholder(s) holding at least 10% of the share capital. Minority shareholders with a qualified minority have the following additional rights.

First, they may demand a meeting of shareholders. They may also demand the inclusion of additional issues on the agenda.

Second, if the private limited company does not have a supervisory board, minority shareholders with a qualified minority may, with good reason, request the removal of a member of the management board by a court.

Third, minority shareholders with a qualified minority may demand a resolution on the conduct of a special audit on matters regarding the management or financial situation of the private limited company, and the appointment of an auditor for the special audit by a resolution of the shareholders. If the shareholders do not decide on the conduct of a special audit, minority shareholders with a qualified minority may request that a special audit is conducted and that an auditor for the special audit is appointed by a court.

Fourth, minority shareholders with a qualified minority may request the court to recall and appoint the liquidators.

4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

4.1 Related parties' transactions

If the price of a transaction concluded between a resident legal person and a person associated with the resident legal person differs from the market value of the above transaction, income tax is imposed on the amount which the taxpayer would have received as income or the amount which the taxpayer would not have incurred as expenses if the transfer price had conformed to the market value of the transaction. The difference is taxed with CIT as if it was a distribution of profit. All transactions with associated persons must be duly documented by the Estonian company and in case the associated person is: 1) a resident

credit institution, an insurance company and a company listed on the stock exchange; or 2) the person (incl. permanent establishment) who has 250 or more employees, including related parties, or whose turnover in the financial year before the transaction together with related parties was 50 million euros or more, or whose balance sheet total with related parties was 43 million euros or more; or 3) from the list approved by "Council conclusions on the EU list of non-cooperative jurisdictions for tax purposes" (an offshore entity) there are additional requirements to such documentation.

4.2 Permanent establishment

Permanent establishment means a business entity through which the permanent economic activity of a non-resident is carried out in Estonia. A permanent establishment is created because of economic activity which is geographically enclosed or has mobile nature, or because of economic activity conducted in Estonia through a representative authorised to enter into contracts on behalf of the non-resident. When a non-resident carries on business in Estonia through a permanent establishment situated in Estonia, the income which the permanent establishment might be expected to derive if it were a distinct and separate taxpayer engaged in the same or similar activities under the same or similar conditions and dealing wholly independently of the non-resident of which it is a permanent establishment is attributed to the permanent establishment.

4.3 Withholding taxes

Withholding tax is applied to certain types of income earned by Estonian tax residents and by tax non-residents. The income tax withheld is 20% or a lower rate of 10% or 7%

for some types of income. For example, income tax is withheld from salaries, wages, and other remuneration subject to income tax paid to a resident natural person and remuneration paid to members of the management and controlling bodies of a legal person.

Generally, there are no withholding taxes on dividends. The income tax at a rate of 7% is withheld from the regularly paid dividends (see section 4.5) which are to be distributed to natural persons (both residents and non-residents). Applicable tax treaties may stipulate a lower tax rate.

4.4 Further corporate tax exemptions

There are tax exemptions available for resident legal persons and non-resident legal persons acting through their permanent establishment in Estonia. If the conditions in the Income Tax Act are fulfilled, the income tax is not charged on dividends or on payments upon a reduction in share capital or contributions, redemption of shares or liquidation of a legal person.

4.5 Corporate income tax

Resident companies and permanent establishments of foreign entities (including branches) are subject to income tax only in respect of distributed profits (both actual and deemed), including dividends, liquidation proceeds, fringe benefits, gifts and donations, non-business expenses, etc. As of 2019, a lower tax rate was applied to dividends that are paid out regularly. The tax rate on regular dividends is 14/86 of the net amount (14% of the gross amount).

4.6 Taxation of non-residents

Non-resident taxpayers are only liable for income tax regarding specific categories of Estonian-sourced income. Such taxable income includes business income, income

derived from commercial leases and royalties, interest received from contractual investment funds and other pool of assets whose main asset consists of Estonian immovables (exceptions apply), etc. No additional tax is levied on dividends received from Estonian companies (except withholding tax on regular dividends at a rate of 7% distributed to natural persons, see section 4.3).

Income tax is charged on gains derived by a non-resident from the transfer of property if:

- the sold or exchanged immovable is located in Estonia;
 - the movable was subject to entry in an Estonian register prior to the transfer;
 - the timber felled on an immovable located in Estonia was transferred;
 - the transferred real right or the right of claim is related to an Estonian immovable;
 - the holding is transferred or returned by a person who at the time of the transfer or return owned at least a 10% holding in a company, contractual investment fund or other pool of assets, whose property directly or indirectly comprised at least 50% Estonian immovables, as of the transfer or during a certain period within two years immediately preceding the transfer or return;
 - gains were derived upon liquidation of a contractual investment fund or other pool of assets if the abovementioned condition regarding Estonian immovables is met.
- Permanent establishments of non-residents are subject to corporate income tax on the same grounds as

resident corporations (i.e., only profit distributions, granted fringe benefits, gifts, and donations, etc., are subject to income tax).

Applicable Avoidance of Double Taxation Agreements (tax treaties) must be considered. Estonia currently has 62 tax treaties in force (the list may be found at: <https://www.fin.ee/en/double-taxation-agreements>).

4.7 Harmonization with EU tax legislation

Estonia joined the European Union on May 1, 2004. In relation to that, EU Directives concerning taxation were incorporated into the Income Tax Act.

4.8 Restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

There is no withholding tax on dividends in Estonia (see exceptions in sections 4.3 and 4.6). Full participation exception for dividend income received from EEA- or Switzerland-located subsidiaries, where the company's shareholding is at least 10%. This dividend income is exempt from CIT when distributed further to shareholders. In the case of subsidiaries located outside of the EEA or Switzerland, the "subject to tax" condition applies, i.e., dividends received from subsidiaries are tax-exempt upon further distribution if income tax has been withheld abroad or paid from the underlying profit. The exception does not apply in case the subsidiary is located in a low tax rate territory.

4.9 Foreign investment credibility assessment

As of May 1, 2023, a Foreign Investment Credibility Assessment Act is expected to enter into force. The Act will impose an authorization obligation on foreign investments, meaning that it is not

permitted to finalize such an investment prior to receiving authorization from the Estonian Consumer Protection and Technical Regulatory Authority (CPTRA). Foreign Direct Investment is defined as follows:

- i. it is conducted by a foreign investor – a person not from the EU;
- ii. it is deemed as an investment – either by buying up the property of the target, or by acquiring at least a 10% (direct or indirect) ownership in the target (also applies to existing shareholders of the target who wish to increase their ownership over 10%);
- iii. investment involves a target company.

The Act also lists industries affected, e.g., electricity, natural gas, liquid fuel suppliers, data transmission service suppliers.

To receive an authorization, the foreign investor must apply for a permit from the CPTRA before finalizing the investment.

4.10 Residency and visas

Estonia is a member of the European Union and a Schengen country. The basic rules regarding EU and non-EU nationals are as follows.

4.10.1 Citizens of the European Union

A citizen of the EU (or of the EEA or Swiss Confederation) has the right to stay and work in Estonia based on a valid travel document or an identity card for a period of up to 3 months without registration of the right of residence. An EU citizen obtains the right of residence upon registration of his or her place of residence located in Estonia with the local government authority nearest to his or her place of residence. EU citizens will obtain a right to reside in Estonia for five years, a term which is extended automatically for the next period of five

years if the registered place of residence is continually in Estonia. The document certifying the right of residence of an EU citizen is the Estonian ID-card which must be applied for within 1 month after the registration of residence.

A citizen of the EU who has permanently (at least 183 days during a year) resided in Estonia for a period of five consecutive years based on a temporary right of residence is entitled to a permanent right of residence.

4.10.2 Visa requirements

In addition to the citizens of the EU or EEA or any third-country national holding a residence permit of a Schengen State, there are other countries' citizens who do not need a visa to enter Estonia for short-term stays. The list of these countries may be found at www.vm.ee.

If a visa is required, generally the visa applicant must apply to the appropriate Estonian embassy or consulate in person. The application package normally includes a valid travel document, a photo, a health insurance policy valid in Schengen countries and a filled-in application form signed personally by the applicant. A state duty of between EUR 80-100, depending on the type of the visa, must also be paid. Visa types include e.g. a short-term visa for stays up to 90 days during 6 months in the Schengen area and a long-stay visa for single or multiple entries into Estonia with a period of stay up to 365 days and with a period of validity up to twelve months.

A foreigner staying in Estonia based on a visa or legally visa-free is permitted to work in Estonia temporarily for up to 365 days during a 455-day period if his or her

short-term employment has been successfully registered in the Police and Border Guard Board by his or her employer prior to the commencement of work. Short-term employment for participation in seasonal work can be registered for up to 270 days during a year.

4.9.3 Residence permits

There are no general restrictions for foreigners to own a business in Estonia. Although a residence permit is not required to own a business, it is possible to apply for a temporary residence permit to operate a business. Such a residence permit may be issued to a foreigner who owns shares in an Estonian company if the business is necessary for the national interest of developing the Estonian economy and the foreigner has invested in a business activity in Estonia a capital sum in the amount of at least EUR 65,000. The requirement for the amount of investment does not apply in the case of a start-up company, but in this case, the start-up company must be previously evaluated by an expert committee.

A foreigner (other than a citizen of the EU, EEA, or Swiss Confederation) is required to have a residence permit to reside and work in Estonia for a time longer than allowed based on visa and registration of short-term employment.

As a rule, an application for a residence permit should be submitted to an Estonian embassy or consulate. The state duty for processing an application for a residence permit for employment is EUR 125 and for a temporary residence permit for business EUR 190. A bit lower rate applies in case the application may

be submitted to the Police and Border Guard Board in Estonia. A decision on the issuance of the permit will be taken within two months.

There are considerable restrictions due to the war in Ukraine on Russian citizens applying for visas or living permits.