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***Legal Framework for Business  
Opportunities in ESTONIA***

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## **ESTONIA – LEGAL FRAMEWORK FOR BUSINESS OPPORTUNITIES**

Estonian legal system is based on the continental European model making Estonia a civil law country. The basic principles of Estonian entrepreneurship, forms of business and role of the Commercial Register are regulated by the Estonian Commercial Code that has been effective since 1<sup>st</sup> of September 1995. According to the Commercial Code there are five forms of business entities, which are created by entry into the Commercial Register.

### **1. Forms of Business**

#### **1.1 Sole Proprietorship (*füüsilisest isikust ettevõtja or FIE*)**

Any natural person may be a sole proprietor. A sole proprietor may be entered in the Commercial Register at his/her request. A sole proprietor will be entered into the Commercial Register if he or she is registered with the Tax Board as a taxpayer under the Value Added Tax Act. The law may provide other cases in which a sole proprietor will be entered in the Commercial Register.

#### **1.2 General Partnership (*täisühing or TÜ*)**

A general partnership is a commercial undertaking in which two or more partners operate under a common business name and are solitarily liable for the obligations of the partnership with all of their assets. A general partnership will operate on the basis of the partnership agreement concluded by the partners. There is no minimum capital requirement and partners shall make monetary or non-monetary contributions in the amount prescribed by the partnership agreement. The partners shall agree on and enter to the Commercial Register business name of the partnership, area of activity and the amount of the contributions of the partners.

Each partner will receive a portion of the distributed profit corresponding to the partner's contribution (unless the partnership agreement prescribes otherwise). Departing partner of the partnership shall also be solitarily liable with the other partners for an obligation of the partnership which arose before entry of the departure or exclusion of the partner in the commercial register if the due date for performance of the obligation has arrived or arises within five years after departure or exclusion. The partnership shall be dissolved: by resolution of the partners, by court judgment, upon expiry of a term or achievement of an object.

#### **1.3 Limited Partnership (*usaldusühing or UÜ*)**

The provisions concerning general partnerships shall apply to limited partnerships unless otherwise provided in Commercial Code. A limited partnership is a company in which two or more persons operate under a common business name, and at least one of the persons (general partner) is liable for the obligations of the limited partnership with all of the general partner's assets, and at least one of the persons (limited partner) is liable for the obligations of the limited partnership to the extent of the limited partner's contribution.

A limited partner shall not have the right to manage or represent the limited partnership unless the partnership agreement prescribes otherwise. A limited partner who has paid a contribution in full shall not be liable for the obligations of the limited partnership and he/she is entitled to the corresponding part of its profits.

#### **1.4 Private Limited Company (*osaühing* or *OÜ*)**

A private limited company is a company that has share capital divided into private limited company shares. A shareholder will not be personally liable for the obligations of the company. A private limited company is liable for the performance of its obligations with all of its assets.

The share capital must be a minimum of 40,000 EEK (approx. EUR 2,556). The minimum nominal value of a share is 100 EEK. A shareholder may freely transfer a share to another shareholder. Upon transfer of a share to a third person, the other shareholders have the right of pre-emption. A share of a private limited company can be pledged or encumbered or divided or transferred to successor if not fixed otherwise in the Articles of Association. The shareholder is required to make a contribution corresponding to the nominal value of the shareholders share. The Management Board organises the accounting of the private limited company. A private limited company must have an auditor if the share capital of the private limited company is greater than 400,000 EEK (approx. EUR 25,560) or if so stated in the Articles of Association.

#### **1.5 Public Limited Company (*aktsiaselts* or *AS*)**

A public limited company is a company that has a share capital divided into public limited company shares. A shareholder is not personally liable for the obligations of the public limited company. A public limited company is liable for the performance of its obligations with all of its assets. One or more natural or legal persons without or with share subscription may found a public limited company.

Share capital must be a minimum of EEK 400,000 (approx. EUR 25,560) and the minimum nominal value of a share should be 10 EEK. Shares shall be registered. Shares shall be entered in the Estonian Central Register of Securities. The rights attached to registered shares belong to the person who is entered as the shareholder in the share register maintained by the company. The management board shall ensure the timely submission of correct information. The number of shares a shareholder can own in a company is unlimited and shares can be freely transferred to third parties. A share cannot be divided.

The appointment of auditors is obligatory and the general meeting, who specifies the procedure for the remuneration of auditors, will also specify the number of auditors.

#### **1.6 Foreign Enterprise Entities**

If a foreign commercial undertaking wants to permanently offer goods or services in its own name in Estonia, it should enter its branch in the Commercial Register. In the cases provided by law, a commercial undertaking must obtain a license in order to open a branch (*filiaal*) in Estonia. All entities not registered in the Commercial Register (e.g. permanent establishments) must be separately registered with the Tax Authorities.

As a branch is not a legal person, the foreign company is liable for the obligations of the branch. The branch of a foreign company is established after its registration in the Commercial Register. To register a branch, the application must contain the same data about the branch and the parent company as for a share company. The application also has to state the country under whose legislation the corporation operates. A foreign company shall appoint a director or directors for the branch. A director must be a natural person with active legal capacity. The residence of at least

one director must be in Estonia. A bankrupt or a person whose right to engage in economic activity has been taken away pursuant to law shall not be a director. If the branch or company conducts banking activities in Estonia it will need a foreign investment license from the Council of the Bank of Estonia.

There must exist separate records for the transactions of the branch, which provide a true and fair basis for determination of the income and expenses attributable to the branch. The branch must generally follow the Estonian Accounting Law, with only minor exceptions stipulated in that law especially for branches (e.g. the branch is not required by law to have a statutory audit performed).

## **2. Corporate Governance**

The management of a public limited company operates through general meetings of shareholders, the Management Board and the Supervisory Board. A private limited company operates through the Management Board.

The general meeting of the shareholders has the highest authority in the corporation and is to be convened at least once a year. It approves the annual report, distributes profits, elects the Supervisory Board and the auditors of the corporation, amends the Article of Association, increases and decreases the share capital, decides on dissolution of the public limited company and etc. according to law.

Resolutions are usually passed by a simple majority vote. However, for a change in the Articles of Association or termination of its operations and for a resolution to decrease or increase share capital, a majority of 2/3 is required.

The Management Board is the executive body of the corporation, which represents and manages the corporation. The Management Board must report the corporation's activities and economic situation to the Supervisory Board at least once every four months. The residence of at least one-half of the members of the management board must be in European Union, in ECC or in Switzerland. The Supervisory Board plans the strategic activities of the corporation, arranges its management, and controls the Management Board. A member of the Management Board cannot be a member of the Supervisory Board.

## **3. Formation Procedures**

For entering a company in the Commercial Register, the founders must draft a Memorandum of Association; the founders shall also apply an Articles of Association as an annex to Memorandum of Association. The Memorandum of Association must be signed by all founding members and notarized in Estonia or at the Estonian diplomatic representation in a foreign country. Upon foundation, the founders shall open a bank account in the name of the newly founded company into which monetary contributions will be paid in. The required minimum share capital requirement must be paid in before the registration of the company. Contributions may be monetary or non-monetary, but not in the means of service or work provided for the company or any activities of the founders at the foundation of the company. If the non-monetary contribution exceeds EEK 40,000 (approx. EUR 2,556) or if non-monetary contributions in total exceed one half of the share capital, an evaluation is required by an auditor. An auditor must audit the valuation of a non-monetary contribution paid in to a public limited company.

The Memorandum of Association must include the following information:

- the business name, location, address and area of activity of the company;
- the names and residences or seats of the founders;
- the proposed amount of share capital;
- the nominal value and number of shares and, upon issue of more than one class of shares, their denotation and the rights attaching to the shares and their division among the founders;
- the amount to be paid for the shares, and the time, place and procedure of payment;
- if a share is paid for by a non-monetary contribution, the item of the non-monetary contribution, its valuation method and value;
- the names, personal identification codes and places of residence of members of the management board, supervisory board, procurator (if appointed) and auditors;
- the assumed amount of foundation expenses and the procedure for payment thereof.

#### **4. Registration Requirements**

The Management Board must submit a petition application for the registration in the Commercial Register within six months of concluding the Foundation Agreement. The application must be signed by all members of the board and include the following information to be entered to the Commercial Register:

- the business name of the public limited company;
- the area of activity, location and address of the public limited company;
- the amount of share capital;
- the date of approval of the Articles of Association;
- the names, personal identification codes and residences of the management board;
- the members of the management board entitled to represent the public limited company differently than provided for in subsection 307(1) of the Commercial Code;
- the beginning and end of the financial year;
- other information provided by law.

The following documents should be enclosed with the application:

- the Memorandum of Association;
- the Articles of Association;
- a bank notice concerning the payment of share capital;
- upon payment by a non-monetary contribution, the agreement concerning the transfer of the contribution to the public limited company, documents certifying the value of the contribution and an opinion on the valuation of the non-monetary contribution signed by the auditor;
- the names, personal identification codes and residences of the members of the management board, the supervisory board, and the auditors;
- specimen signatures of the members of the management board;
- telecommunication numbers (telephone, fax, etc.);
- a notice from the registrar of the Estonian Central register of Securities concerning registration of the shares;
- other documents provided by law.

In case the founder is a foreign company, an official certificate proving the existence of the company in the country of incorporation is required. This certificate as well as a foundation

resolution must be notarised in the foreign country by a public notary, which is legalised by the Ministry of Foreign Affairs of the foreign country and the Estonian Embassy or its diplomatic representative. If there is a translator available in the Estonian Embassy, these documents may be translated in a foreign country and legalised at the Estonian Embassy. In that case, no further legalisation is required in Estonia.

However, if there is no acceptable translator available in a foreign country, the documents must be legalised at the Estonian Embassy and sent to Estonia for translation and notarisation.

All documents must be submitted to the Commercial Register in Estonian or with an appended notarised translation. The Foundation Agreement must be signed by all founders or by their notarized proxy. As a rule, the registration process takes up to 2 or 3 weeks.

The following stamp taxes are applicable on registration of the company:

- Sole Proprietorship EEK 500 (approx. EUR 31.9)
- General / Limited Partnership EEK 500
- Branch of a foreign enterprise EEK 3,000 (approx. EUR 191.6)
- Private / Public Limited Company 0,2% of (nominal) share capital (min. EEK 3,000 max. EEK 20,000 (approx. EUR 1,278) for private limited company; and min. EEK 4,000 (EUR 255.6) max EEK 40,000 (approx. EUR 2,556) for public limited company)

*1EUR=15.65 EEK*

## **5. Taxation of Companies Income**

From 1 January 2000, resident companies and permanent establishments of the foreign entities (including branches) are subject to income tax only in respect of all distributions (both actual and deemed), including:

- dividends and other profit distributions;
- fringe benefits;
- gifts, donations and representation expenses; and
- expenses and payments not related to business.

All distributions will be subject to income tax at the grossed-up rate of 23/77 of the amount of taxable payment. The transfer of assets of the permanent establishment to its head office or to other non-residents is also treated like distribution. Dividends paid to non-residents are additionally liable to withholding tax at the general rate of 23%, unless the non-resident legal entity holds at least 20% of the share capital of the distributing Estonian company. Various withholding taxes may apply also to other payments to non-residents, if they do not have a permanent establishment in Estonia or unless the tax treaties otherwise provide.

As the tax period of corporate entities will be a month, the income tax must be returned and paid monthly by the 10th day of the following month.

Under the income tax legislation, therefore, the corporate entities are exempt from income tax on undistributed profits, regardless of whether these are reinvested or merely retained.

As there is no annual net taxation of corporate profits, the corporate entities are also not subject to tax depreciation rules.

Capital gains realised by a resident corporate entity (including non-resident permanent establishment) are not taxed until the actual or hidden distributions, which are subject to 23/77 income tax on a monthly basis. Estonia does not have any thin capitalisation rules.

**The information contained in this paper is given for general information only. This information does not constitute legal advice and you should not rely on any information contained in this paper without first taking professional advice. If you require specific legal advice please contact us.**

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