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*ESTONIA*

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***Business and  
Taxation Guide***

# ***Preface***

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This guide is intended as a general guide and should not be acted upon without further advice.

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# 1. GENERAL INFORMATION

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## ***Attraction for foreign investors***

Estonia is a country located at the centre of the Baltic Sea region, at the crossroads between Sweden, Finland, Russia's St. Petersburg region, Latvia, Lithuania and Poland.

This region has been one of Europe's fastest-growing markets. Estonia developed one of the most liberal economies in the world after regaining independence from the Soviet Union in 1991.

The development of democracy, political systems and economic environment and the existing infrastructure provide evidence that Estonia is an excellent business environment. When Estonia became a member of the EU in 2004 it adopted all of the responsibilities and legal rights of the European Union.

The favourable conditions for production, liberal economic policy and low taxes have already attracted numerous companies and continue to make Estonia an exceptional location for foreign direct investment. The unique geographical position in Scandinavia, numerous year-round deep-water harbours, developed infrastructure and knowledge of neighbouring markets and languages provide outstanding reasons for becoming a bridge between different cultures and economies.

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## ***Area and population***

Estonia, situated in the northern part of Europe, covers an area of 45,227 square kilometres. It borders Finland to the north with the Gulf of Finland between the two countries, Sweden to the west across the Baltic Sea, Latvia to the south and Russia to the east.

The population at the beginning of 2009 was about 1,340,341<sup>1</sup> of whom about 30% (404,133<sup>2</sup>) live in Tallinn, the capital. About 68.8% is Estonian, 25.6% is Russian and 6.6% belong to other ethnic groups.

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## ***Constitution and political situation***

The Constitution of the Republic of Estonia was adopted in 1992 by referendum and is, in a number of ways, a compilation of aspects of Estonia's previous constitutions, continuing the democratic spirit of the 1920 Constitution. The Republic of Estonia is an independent and sovereign democratic republic where the supreme power of state is vested in the

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<sup>1</sup> Source: Statistics Estonia

<sup>2</sup> Source: [www.tallinn.ee](http://www.tallinn.ee)

people. Estonia is a parliamentary democracy. The functions of the Parliament (*Riigikogu*), the President of the Republic, the Government of the Republic and the judicial system are organized on the principle of separation and balance of powers.

The head of state is the President – at present (October 2006) Toomas Hendrik Ilves.

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## **History**

On February 24, 1918, Estonia declared independence – and it became one of the first of Europe's small nation-states to emerge from under foreign rule. This was followed by German occupation. After the defeat of Germany in November 1918, the Estonian provisional government assumed power. Soviet Russia attacked Estonia and the War of Independence began. All through 1919 fighting against Russia and Germany took place. Estonia received aid from Great Britain and volunteers from Finland and Scandinavia. On February 2, 1920, the Tartu Peace Treaty was signed, wherein Soviet Russia acknowledged the Republic of Estonia.

Independence lasted until 1940, when the Soviet Union occupied Estonia. This was followed by mass deportations of Estonians to Siberia on June 14, 1941. After that the Germans occupied Estonia until 1944, when the Soviet Union reoccupied Estonia. In 1949 more deportations took place. In 1987 the first open protests against Soviet regime broke out. The changes began to escalate and in 1988 the Estonian Soviet legislature declared sovereignty. The following years marked the so-called "singing revolution" in which the Estonian people started peaceful mass protests and organized song festivals.

In August 1991 a putsch in Moscow took place, led by hardliners attempting to keep the USSR together. Soviet tanks rolled into the capitals of the Baltic States. This was a chance for Estonia to declare its independence once and for all and on the 20<sup>th</sup> of August 1991 the Supreme Council of Estonian Republic made exactly such a decision – independence was restored. This day is now a public holiday. After the failed putsch, the USSR recognized Estonia's independence.

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## **Economic situation**

The year 2007 was characterized by stable and continuous growth – high loan growth and wages growth had slowed down to more moderate terms. The external environment is a very important factor in Estonia being a small and open economy. In 2007 the external climate started to change and in 2008 the developments were more unfavourable. In 2008, the global economic situation deteriorated. The uncertainty about the future is expected to persist during 2009. The deepening downturn in Estonia's main external markets has weakened the country's economic outlook.

According to the Statistical Office, the remarkable increase in Estonia's economic growth rate started in 2005, continued throughout the years and peaked in 2006 – 10.4%. In 2007, the economic growth rate started to

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slow down, amounting to 6.3%. In 2008, the economic growth rate decreased, in the fourth quarter of 2008 the quarterly decline amounted to (minus) 9.4%. However, export volumes continued to increase, and in 2008 the export growth compared to the previous year amounted to 5.2%. The import growth for the same period was minus 4.85%. According to the central bank of Estonia, the country's real economy may decline as much as 5.5%, in 2009.

In 2008 consumer prices increased by 10.4%, but at the beginning of 2009 there was a slight deflation amounting to (-) 0.6%. In general, a very moderate inflation rate is forecasted for 2009 and 2010.

At the beginning of 2009 companies have started more and more to adjust prices according to the economic situation. According to the Bank of Estonia's notes on the basis of January 2009, enterprises are reacting to the economic situation by adjusting prices; despite the surge in the prices of water and in taxes, the consumer shopping cart indexes became cheaper.

Estonia's most important target in the near future is to join the euro area. In order to do so, Estonia must meet the Maastricht criteria. According to the Bank of Estonia it is most important to continue a strong fiscal policy, meet budget deficit criteria and inflation criteria. It is expected that if the criteria are met, Estonia will be able to join the euro area in 2011.

The Estonian economy has slowed down as a result of the world economic crisis, the risks to Estonia's economy have increased, financing is scarce, and unemployment is increasing; but there is also a downward pressure on wage levels, and slight deflation or at least very moderate inflation is expected. In addition, being a small and flexible economy with a strong fiscal policy it is expected that a general upturn on the world markets will favour a fast recovery.

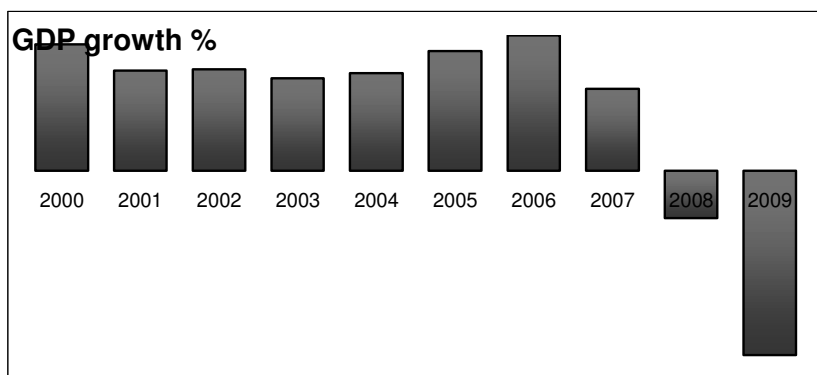
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## ***Main economic indicators***

### **GDP (Gross Domestic Product) growth:**

Estonia's economic growth reached a remarkable 10.4 per cent in 2006. In 2007 economic growth decreased to 6.3 per cent. During 2008, economic growth slowed down and was negative in the fourth quarter. The total growth in 2008 amounted to -3.6 per cent and in 2009 -14.1%.

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source: Bank of Estonia

### **CPI (Consumer Price Index):**

In 2007, the average inflation rate was 6.6%, and the inflation rate in 2009 amounted to -0,1%. The inflation rate in February 2010 is at a very moderate rate -0,1%. The table below shows CPI trends between 2003 and 2009

2009: - 0.1%;  
2008: +10.4%;  
2007: +6.6%;  
2006: + 4.4%;  
2005: + 4.1%;  
2004: + 3.0%;  
2003: + 1.3%.

### **Average gross monthly wages:**

According to the Bank of Estonia, the average gross monthly wages were:

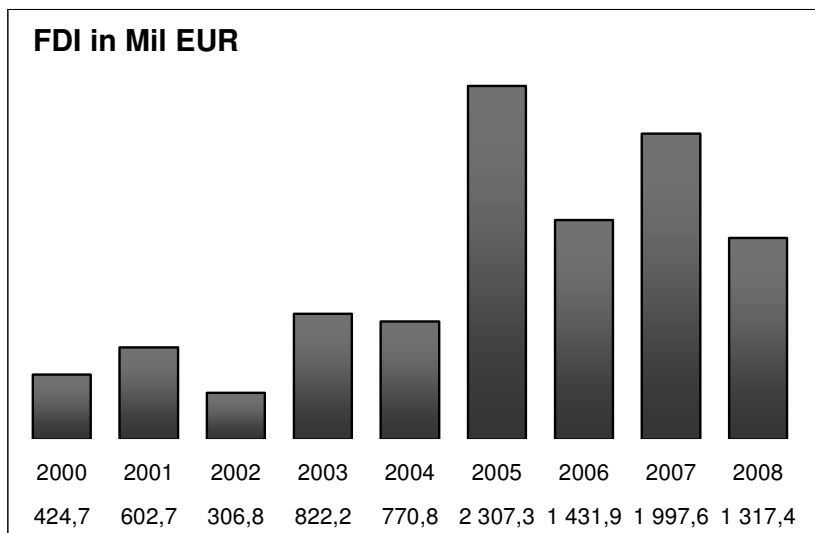
2009: 783 euros (4<sup>th</sup> Q 2009);  
2008: 819 euros;  
2007: 725 euros;  
2006: 601 euros;  
2005: 516 euros;  
2004: 466 euros.

**Unemployment rate** according to ILO standards (% of the unemployed in active labour force aged 15-74) in 2004–2009 amounted to the following rates:

2009: 13.8%  
2008: 5.5%;  
2007: 4.7%;  
2006: 5.9% ;  
2005: 7.9%;  
2004: 9.7%.

## FDI (Foreign Direct Investment)

Foreign direct investment is shown in the diagram below:



Source: Bank of Estonia

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## ***Banking and finance***

The rapid development of the Estonian financial sector began in 1992 in conjunction with the reintroduction of the national currency, the Estonian kroon. Initially the national currency was pegged to the deutschmark at a rate 8 EEK/DEM, as of today, the exchange rate is fixed to the Euro at a rate of 15.64660 EEK/EUR.

The financial sector reforms commenced in a business environment characterized by the currency board system and a liberalization of external policies – most restrictions on capital movement were immediately abolished. Taking into account such conditions and the fact that the economy was restrained by hard budget constraints, the internal strength of the financial sector was one of the most important considerations and tasks to achieve. The characteristics of the Estonian money market system are the fixed exchange rate, the absence of traditional monetary policy tools and the movement of free capital.

In the end of 2000, the privatization processes in the economy had been fully completed and since then, the continuously deepening integration with European markets has led to considerable internationalization of Estonian money markets. Today, Estonian financial markets are dominated by the banking sector and the role of the securities markets is modest. In 2007, the total assets of the 7 leading banks amounted to 18,206 million euros, which is 120% of national GDP. After the financial crisis in 1998, banking assets have grown more than 25% annually. The recent three-year banking assets have grown more than 30% annually.

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The leading banks have been formed into banking groups covering all main financial sector services. All the banks are privately owned. The four leading banks represent approximately 93.8%<sup>3</sup> of the total banking asset concentration in Estonia.

Considering the yield curves in the national economy (in the absence of a long-term government securities market there is no ordinary comparable benchmark yield curve available), the Central Bank of Estonia has pointed out that the national money market yield curve consists of the European yield curve plus the national currency's forward differential - the fact reflects the prevailing risk premium between Estonia and Euro area. The almost non-existing difference between the calculations and actual quotations reflects the effectiveness of domestic money market quotations. Since 1999, the measure has been stable and close to zero.

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## ***Legal system***

The Estonian legal system is based on a written code although the judicial practice has played an important role in the interpretation of the law. The Parliament is the main legislative body. The court system is divided into three levels: county courts and city courts, circuit courts of appeal and the Supreme Court which also functions as the constitutional court. It can be said that the Estonian legal system is based primarily on and belongs to the Germanic family of law, especially within the field of civil law with which it has direct historical links. Generally recognized principles and rules of international law are an inseparable part of the Estonian legal system.

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<sup>3</sup> Source: <http://www.pangaliit.ee>

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## **2. BUSINESS ORGANIZATIONS AVAILABLE TO FOREIGN NATIONALS**

Pursuant to the provisions of the Commercial Code (*Äriseadustik*), the following types of companies can be established in Estonia:

- Private limited company (*osaiühing - OÜ*), corresponds largely to German GmbH;
- Public limited company (*aktsiaselts - AS*), corresponds largely to German AG;
- General partnership (*täisühing - TÜ*), corresponds largely to German OHG;
- Limited partnership (*usaldusühing - UÜ*), corresponds largely to German KG;
- Branch office of a duly incorporated foreign company (*Eesti filiaal*);
- Commercial association (*Tulundusühistu*);

Limited liability companies are the most commonly used forms of business entities. It is also possible and common to register a business of an individual to operate as a sole proprietor under a certain firm name.

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### **3. SETTING UP AND RUNNING BUSINESS ORGANIZATIONS**

A company incorporated in accordance with Estonian law and a branch office of a foreign company, acquires its legal status and existence from the time it is registered in the Commercial Register, which is kept by the registry departments of their local courts of first instance. Full disclosure of essential information must be made to the register, which thereby becomes public and examinable by everyone. An entry in the Commercial Register is legally held as correct with regard to all third parties, except where the third party knew or should have known that the entry is not correct. A public notary serves as a mediator between an enterprise and the register. For establishment the memorandum or resolution of foundation and the articles of association of the limited liability company must be notarized. All petitions submitted for entry into the Commercial Register must always have notarized signatures. The submitted documents must be in the Estonian language or accompanied by a notarized translation. It is possible to purchase previously incorporated companies inexpensively.

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#### ***Private Limited Company***

The minimum share capital is EEK 40,000 (approx. 2,557 EUR), which can be contributed in cash and/or in kind. Share capital must be fully paid in before the registration. Each shareholder holds one share giving votes *pro rata* to the size of it. There may be one or more shareholders. All shares must be registered: the management board is required to submit annually the list of shareholders, together with the approved annual report, to the Commercial Register. Shares are not issued as securities and are not freely tradable. A notarized deed must be executed for the transfer of a share and thereafter presented to the Commercial Register. If a private limited company has registered its shares with the Estonian Central Register of Securities, a notarized deed is not necessary and the transfer of shares is carried out through bank transactions. It is possible to form a closed partnership where shares cannot be transferred unless at least 2/3 of the shareholders agree to it whereby the sale pre-emption of shares – problematic in practice – is not applicable. Usually the shareholders and the management board manage the company. However, only the members of the management board have the authority to represent the company without a separate power of attorney, unless the Articles limit this right for some of them. The residence of at least one-half of the members of the management board must be in Estonia or in one of the European Economic Area (EEA) member states or Switzerland. If the share capital exceeds EEK 400,000 (25,569 EUR) there must be at least three directors in on management board or a supervisory board, consisting of at least three members, and an auditor, who must audit the company's accounts. There must also be an auditor if the company's foundation documents or the law requires this (e.g. pursuant to the Accounting Law the company exceeds

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the limits of at least two of the three following criteria: sales revenue (net turnover): 10 million kroons; balance sheet total: 5 million kroons; number of employees: 10).

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### ***Public Limited Company***

The minimum share capital is EEK 400,000 (25,569 EUR), which can be contributed in cash and/or in kind. The share capital must be fully paid in before the registration. The shares may be issued only as registered shares, and the list of stockholders has to be registered at, and is kept by, the Estonian Central Register of Securities. There may be one or several shareholders. The stocks are freely transferable unless the articles of association state the pre-emption of the shares by other shareholders and the remark of it is not carried into the Estonian Central Register of Securities. There is no mandatory form for a transaction transferring shares. Each stock gives one vote. The approved annual report has to be presented to the Commercial Register. The management bodies of the company must include general meeting of shareholders, a supervisory council, consisting of at least three members, and a management board; the residence of at least one-half of the directors of the management board must be in Estonia or in one of the European Economic Area (EEA) member states or Switzerland. Only the directors of the management board have the authority to represent the company without a separate power of attorney unless the Articles limit this right for some of them. The public limited company must have an auditor, who must audit the company's accounts.

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### ***Branch Office of Foreign Company***

A company that wishes to offer goods or services in Estonia permanently but does not wish to establish a subsidiary for this purpose may establish a branch in Estonia. The branch does not have separate legal capacity and thereby the foreign company is liable for all the obligations of the branch office. There has to be a branch manager(s) to represent and direct the branch office, appointed by the foreign company, and at least one of the managers has to reside in Estonia or in one of the European Economic Area (EEA) member states or Switzerland. The foreign company is required to maintain separate accounts concerning the branch. If the foreign company is required to release an annual report, the director of the branch shall submit it and the report of the activities of the branch to the Commercial Register.

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### ***Estonian Central Register of Securities***

The Estonian Central Register of Securities is a state register that administers share registers of all joint stock companies including public limited companies. It also includes other electronic securities such as shares of private limited companies and securities transaction history. Legislation governs the activities of the register. The registration of securities gives the shareholders the possibility to transfer the shares with fewer encumbrances and specifies the share ownership. Maintenance of shares in the register is a fee-charging service.

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## ***Labour Law***

The task of labour law in Estonia is to establish the minimum guarantees for the creation of acceptable working conditions. There are basically two types of employment relationships possible under Estonian law: employment under an employment agreement governed by labour law and employment under a service agreement governed by civil law. Under labour law all means of labour are provided and all risk is borne by the employer. An employment contract has to be concluded in person and in writing for an unspecified period, or in some specific cases for a specified period, containing the obligatory conditions set by the Employment Contracts Act. Although the employer will have the right to determine the time, place and form of the work, employment agreements can be terminated only on certain limited grounds and employees under employment agreements enjoy several other social guarantees. Working hours may not exceed 8 hours per day and 40 hours per week, unless the work has to be done in shifts, in which case a shift of up to 12 hours is allowed. Standard vacation is 28 days. Under the service agreement the risk is borne by the employee, i.e. the person rendering the services – for example, a sole proprietor. The statutory requirements on the terms and conditions of service agreements are much more flexible than those on employment agreements. It should be noted, however, that Estonian courts may under certain circumstances and for the sake of protection of employees' interests construe service agreements as employment agreements. In principle Estonian labour law does not discriminate against foreign employees working in Estonia. Citizens of European Economic Area (EEA) member states or of Switzerland must apply for a residence permit to work and live in Estonia for a certain period of time and citizens of other countries must apply for a work permit as well as the residence permit.

The new labour law regulation entered into force from the 1<sup>st</sup> of July 2009 and is greatly changing the legal landscape. The new regulation is less protective of employees. Labour law provides only certain compulsory conditions that cannot be negotiated by the parties (i.e. length of vacation, etc) but otherwise it is required for the employee to be equal partner of the employment contract and there is great room for negotiation of conditions of contracts. The new regulation provides for specific obligations and responsibilities of the employee, as well as for compensation of the damages, including loss of employer's income. Under the new regulation it will be easier for an employer to terminate employment contracts with employees, especially considering the burden of severance payments. Since the new labour legislation leaves a lot of room for negotiations, therefore it is expected that many standards will be put in place by court system.

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## ***Law of Obligations***

In Estonia the law of obligations is regulated by the Law of Obligations Act, which has been described as the most modern Act in Europe regarding contracts and governing the rights and obligations arising from contractual and extra-contractual relations. The law promotes good faith and reasonableness as important principles and also prescribes the principle of optional provisions that allows derogation from the provisions of law by agreement of the parties, unless law prohibits such derogation, or the exception is contrary to public policy or good morals, or in violation of the fundamental rights of persons. Also the freedom of contract is set forth,

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which means that parties may enter into any type of contract regardless of whether or not such type of contract is specifically prescribed by law although the central and most extensive part of the law is made up of provisions, which regulate an extensive non-comprehensive array of different traditional and very modern types of contracts. The law provides protection for the rights of consumers in respect of the preliminary contracts and standard terms of such contracts and the “doorstep” contracts. Further, the law recognizes conclusion of a contract by offer and acceptance, and the principle that the rights and obligations of parties become effective already in the course of pre-contractual negotiations is prescribed. The law lays down general requirements for interpreting contracts, aimed at determining the actual intent of the parties upon entry into a contract. In order to determine the intent of parties, apart from the text of a contract, regard should be given to the circumstances of such contract and its nature, the behaviour of the parties, and other related issues.

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## ***Real Estate***

There are varieties of real rights that can be attached to an immovable provided by the Law of Property Act. The main rights are the right of ownership and restricted real rights. Restricted real rights are servitudes, real encumbrances, building lease, right of pre-emption, and right of security. The ownership and the abovementioned real rights must be registered in the Land Register, which is a publicly accessible register kept by the courts. Generally there are no restrictions on acquiring real estate in Estonia. However, foreigners and companies that acquire certain categories of land such as agricultural or forest land must apply for approval from county officials, except the acquiring of apartments in Estonia. To obtain approval, foreign legal persons must also have a branch registered in the Commercial Register. Especially stringent restrictions are established in the regions near the Estonian border and other strategic areas such as islands and nature reserves. A real estate sales contract must be notarized and the ownership is transferred when the new owner is registered in the Land Register.

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## ***New insolvency law - reorganization law***

The new Reorganization Act entered into force on the 26<sup>th</sup> of December 2008.

The main aim of the new law is to create an alternative type of proceedings, in addition to bankruptcy proceedings, with the end result being the liquidation of insolvent companies. The new type of proceedings enables companies to survive in the case of temporary solvency problems.

Reorganization proceedings can be commenced once the petition for reorganization of the company in question is submitted. If it seems reasonable that reorganization would enable the company to come out of the red, the court will commence reorganization proceedings in response to the petition and designate a reorganization adviser whose main task is to advise the owner of the company and supervise the owner's actions. By the law an auditor can serve as the adviser, which means that Rimess is providing reorganization services.

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The court will also determine a deadline (maximum of 60 days) by which the reorganization plan must be submitted to the court for approval.

A reorganization plan provides for the measures to be taken in order to resolve the solvency problems and the term within which the claims of creditors will be satisfied.

The court can approve a reorganization plan adopted (or not adopted) by creditors' vote. A reorganization plan not adopted by creditors' vote will be subjected to an economic analysis. An approved reorganization plan will only apply to creditors whose claims are reorganized under the plan and who have been notified of the opportunity to participate in the adoption of the reorganization plan.

A reorganization plan approved by court is binding for the debtor. The reorganization proceedings are completed once the reorganization plan has been appropriately complied with.

## 4. NEW CORPORATE INCOME TAX AND SOCIAL SECURITY

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### ***New Corporate Tax***

The current Income Tax Act was adopted on the 15<sup>th</sup> of December in 1999 by the Estonian *Riigikogu* (Parliament) and it came into force on the 1<sup>st</sup> of January 2000. The Act changed enormously the corporate income tax system, which was introduced in 1994. According to the new income tax system, a distributed profit (along with transactions that can be treated as hidden distribution of profits) became a tax object instead of the taxation of the profit of all resident legal persons. To reduce tax avoidance and evasion the new law sets rules in order to prevent tax-free profit transfers using offshore companies.

Resident legal persons shall pay income tax:

- On **fringe benefits** granted by the employer to the employees. (Fringe benefits are any goods, services, other remuneration in kind or financially appraisable benefits and gifts which are granted to an employee in connection with employment or service relationship or being a member of the directing or controlling body of a legal person or a long-term contractual relationship)
  - On **gifts and donations** granted to legal persons, natural persons and non-residents. Income tax is not charged on gifts and donations made to legal persons that are registered on the list of non-profit Associations and Foundations (including churches), to a person who owns a hospital, to a state or local government scientific, cultural, educational, sports, law enforcement or social welfare institution, or a manager of a protected area in a total amount not exceeding one of the following limit values:  
If a gift is made to an employee, this is a fringe benefit on which social tax should be paid.
    - 1) 3 per cent of the amount of the payments subject to social tax pursuant made by the taxpayer during the same calendar year or
    - 2) 10 per cent of the profits for the last financial year of a taxpayer dissolved as of 1 January of a calendar year, calculated pursuant to the legislation regulating accounting.
  - However, income tax should not be charged on gifts granted to business partners for advertising purposes if the value of the gift does not exceed 150 kroons. Up to 2% of income-tax-free payments may be made from the total amount of payments subject to social tax in connection with **representation costs** (catering, accommodation, transportation or cultural services)
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- On **dividends or other profit distributions** paid in money or in kind. Income tax shall also be paid on other hidden profit distribution, such as transfer of property at a price lower than market value, or purchase of property at a price higher than the market value.  
**Exceptions:** Dividends paid by Estonian companies from dividends received from a company who is established in one of the Treaty countries and where the amount of share is more than 10 % are **exempted** from corporate income tax. This makes dividend distributions from foreign-source profits fully exempted from Estonian corporate income tax. If the holding is less than 10 per cent, then a credit method applies in order to avoid double taxation.
- A resident legal person has to pay income tax on proceeds of liquidation and on the value of repurchase of shares or stocks that does not exceed the value of down payment into share capital.
- On **costs and payments that are not business-related** (fines, compensation for damage incurred to the environment, undocumented payments and all costs unconnected to business).
- On series of payments made to legal persons established in low-tax territories, such as acquisition of participation and securities, payment of penalty clauses, granting loans or making advance payments. If such payments prove to be justified or the loans are repaid later, the commercial undertaking has the right to demand that the income tax be refunded.

These costs are taxed regardless of whether the taxpayer has made a profit or loss.

Estonia's simple tax system is based on cash-basis accounting and there is no need for amortization and depreciation rules or any special rules on tax-deductible expenses.

The Estonian Commercial Code provides that dividends may be paid out from net profit of a company, but only after the deduction of losses from previous years, so there is no need for special tax provisions for a loss carried forward. There is no liability to pay tax in the case of a loss, since only the profit can be distributed.

Estonia has no thin capitalization rules yet.

The Act also comprises a transfer price provision. If the value of a transaction performed between a resident legal person and an associated person differs from the value of a transaction performed between independent persons, a tax authority may impose income tax proceeding from the value implemented in similar conditions by independent persons.

***NB! Recent transfer pricing developments (effective from the 1st of January 2007)***

*Scope of regulation*

The rules of establishing the value of transactions between associated persons are applied to transactions performed:

- Between the resident legal person and the person associated with it;
- Between natural person-entrepreneur and the person associated with it;
- Between the non-resident legal person through the place of activities located in Estonia and the same registered non-resident legal person

*Methods of determining transaction value*

The taxpayer shall choose the most convenient method of determining the transaction value, taking into account the peculiarities of the transaction, the reliability of existing details, justification of anticipations and prognoses, as well as the extent of the similarity of transactions utilized in comparison.

*Justification obligation*

Pursuant to amendment to the Income Tax Act there is also a supplementary documentation requirement, in accordance with which the subject of transfer prices shall be obliged, upon the demand of the tax authority, to present additional details pertaining to transactions performed with the associated companies, the activities of commercial associations included in the same consolidation group and structure of the consolidation group. Documentation presented to the tax authority is divided into the information pertaining to the entire consolidation group and information pertaining to the entrepreneur acting in Estonia and transactions performed by it. The requirements established for submitted documentation are based on the Core Document Concept (“Masterfile”) of the EU Joint Transfer Pricing Forum proposed in November 2005. The tax authority provides the commercial association with at least 60-day deadline for the submission of details.

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### ***Rate of corporation tax***

The standard flat rate on gross taxable payments is 21% (net payments are taxed at a ratio of 21:79).

Fringe benefits are also subject to social tax at the rate of 33%, as the law imposes an equal effective rate on salaries as well as on fringe benefits.

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### ***Taxable period***

Income tax shall be declared and paid on a monthly basis, by the 10<sup>th</sup> day of the following month.

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### ***Taxation of permanent establishment***

Income earned by the branch of a foreign commercial undertaking registered in the Estonian Commercial Register and the permanent establishment of a non-resident legal person registered in the local office of the Tax Board is taxed on the same basis as the income earned by resident legal persons.

Additionally, income tax is imposed on:

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- Property of the permanent establishment to be taken out of Estonia in excess of the property taken into Estonia for the permanent establishment, unless other property or service is given in return for such property
- Payments made through permanent establishment or on account of the permanent establishment to the head office or other structural units of the non-resident located outside Estonia, if no goods or services are received in return for the payment
- Payments made under orders of the non-resident through its permanent establishment or on account of its permanent establishment to third parties, if no goods or services are received in return for the payment

Separate accounts shall be maintained for the permanent establishment under the requirements of Estonian legislation.

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### ***Taxation of non-residents***

A non-resident is a person with limited tax liability whose taxable income consists only of income gained from an Estonian-based source of income. The income tax rate is 21%.

Non-resident natural and legal persons pay taxes according to the same principles. Non-resident legal persons with a registered permanent establishment are exceptions – they are taxed on the basis of profit distribution tax analogously to resident legal persons.

Tax is imposed on the income from wages of non-residents, if the work or service duties were performed in Estonia and the payment was made by the state, unit of local government or a resident or if the payment was made through a permanent establishment of a non-resident registered in Estonia. Also, remuneration of the members of the management or control body, paid by resident legal persons, is taxable income for non-residents.

Income tax is imposed on income from entrepreneurship in Estonia regardless of the presence of permanent establishment. If the legal person is registered in a low-tax rate territory, income tax shall be imposed on all service fees paid by Estonian residents notwithstanding where the services were provided or used.

Income tax is imposed on gains from transfer of immovable property situated in Estonia and movable property entered into the relevant register in Estonia. Also, tax may be imposed on gains from sales of participation in a commercial undertaking, if the participation was not less than 10%, and more than 75% of the assets of the commercial undertaking (directly or indirectly) consists of immovable property or buildings located in Estonia.

Non-residents have to declare on their income tax returns all gains from transfer of property

Withholding income tax is generally performed for taxing the income of non-residents. The withheld income tax is final tax in Estonia. It should be noted that double taxation agreements concluded by Estonia in many cases restrict taxation of the income of non-residents.

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## ***Withholding taxes***

Withholding rates for a withholding agent are the following:

- Salaries, remunerations and other payments in kind – 21%
- Dividends – 0 / 21% (0% rate applies for all non-resident natural persons and for a non-resident legal person whose participation in the commercial undertaking is at least 10%.)
- Interests – 0 / 21% (0% rate applies for all non-residents in case interests rate meets the market condition on a similar debt obligation. The 0% rate applies to interest paid to resident natural persons by a credit institution or by the Compensation Fund.)
- Royalties – 10%
- Rents – 21%
- Artist and athletes – 10%
- Services rendered in Estonia – 10%
- Services rendered by a legal person located in a low tax territory – 21%

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## ***Social Security Tax***

Social tax is imposed on amounts paid to a natural person for their activities. As a rule there is no difference as to whether the income earner is a resident or non-resident. In 2009, the minimum monthly basis for social tax is 4,350 EEK (278 EUR). No social tax is imposed on amounts paid by a resident of Estonia if the activity is carried out in a foreign country.

The social security tax (social tax) rate is 33%. Social security tax shall be declared and paid on a monthly basis, by the 10th day of the following month. The taxable period for sole proprietors is a calendar year, and quarterly advance payments of tax are due.

Since 1 May 2005, Estonia proceeds from the principles set forth in Council Regulation No 1408/71. As a general rule, the applicable legislation is that of the country where the activity is carried out.

In the case of a business trip, social security tax may be paid pursuant to the legislation of the employer's country of location entered in the register and it is also possible to be subject to the security scheme of the country. The prerequisite for this is certificate E101 of the social security board of the country where the employer is registered.

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## **5. PERSONAL TAXATION**

A resident natural person shall pay income tax on income derived from all sources of income in Estonia and outside Estonia including:

- Income from salaries, remunerations and other payments in kind
- Income from entrepreneurship
- Income from transfer of property
- Rental income and license fees
- Interests
- Dividends
- Maintenance support, pensions, scholarships, benefits, awards, lottery prizes
- Insurance benefits and payments from pension funds
- Income earned by legal person located in a low tax rate territory

The taxable income of a natural person does not include fringe benefits, gifts and donations, dividends or other profit distributions subject to corporate income taxation.

The main tax exemptions are the following: business travel costs, property restituted in the course of the property reform, inheritance received, transfer of movable property in personal use, sale of home, state pensions, scholarships, social benefits, aid payments, and lottery prizes from lotteries organized under an operating license. Property insurance benefits are subject to taxation only where the insurance premiums were earlier deducted from income from entrepreneurship. Exemption applies on all interest received from Estonian credit institutions.

Resident natural persons may deduct the following expenses from their taxable income:

- Maintenance support paid (income tax is paid by the receiver of the maintenance support)
- Interest on housing loan
- Training expenses of the taxpayer or dependents;
- Donations made to non-profit associations (up to 5% of taxable income);
- Voluntary pension insurance payments (up to 15% of taxable income).
- Additional tax-free minimum for second child.

The taxation period is a calendar year. The tax rate is a flat 21%. As an exception, voluntary pension insurance premiums are subject to 10% tax rate in certain cases. The tax return must be submitted by March 31 of the following year and tax should be paid by July 1.

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## ***Income from Entrepreneurship***

Entrepreneurship is a person's independent economic or professional activity, the aim of which is to derive income from producing, selling or intermediating goods, rendering services, or from other activities, including creative and scientific/research activity.

A natural person engaged in entrepreneurship must register with the Commercial Register. A registered entrepreneur can reduce his income from entrepreneurship by deducting business expenses.

The taxation period is a calendar year and the tax rate for income tax is 21%; for social tax, 33%.

The tax return must be submitted by March 31 of the following year and tax paid by October 1.

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## 6. DOUBLE TAXATION AGREEMENTS

Estonian withholding taxes on dividends, interest and royalties paid to beneficiaries under the valid double taxation agreements are the following:

	Dividends %	Interest %	Royalties %
Lithuania	0-15	0	0
Latvia	5-15	10	5-10*
Finland	5-15	10	5-10*
Sweden	5-15	10	5-10*
Denmark	5-15	10	5-10*
Norway	5-15	10	5-10*
Germany	5-15	10	5-10*
Poland	5-15	10	10
United Kingdom	5-15	10	5-10*
Netherlands	5-15	10	5-10*
Iceland	5-15	10	5-10*
Czech Republic	5-15	10	10
Canada	5-15	10	10
Ukraine	5-15	10	10
Belarus	10	10	10
Moldova	10	10	10
Ireland	5-15	10	5-10*
USA	5-15	10	5-10*
China	5-10	10	10
Italy	5-15	10	5-10*
Kazakhstan	5-15	10	10
France	5-15	10	5-10*
Armenia	5-15	10	10
Romania	10	10	10
Slovakia	10	10	10
Portugal	10	10	10
Belgium	5-15	10	5-10*
Croatia	5-15	10	10
Malta	5-15	10	10
Switzerland	5-15	10	5-15**
Spain	5-15	10	5-15**
Hungary	5-15	10	5-15**
Austria	5-15	10	5-15**
Azerbaijan	5-10	10	10
Bulgaria	0-5	5	5
Georgia	5-15	10	10
Greece	5-15	10	5-10
Luxembourg	5-15	10	5-10
Singapore	5-15	10	5-15**
Slovenia	5-15	10	10
Turkey	10	10	5-10
Israel	0-5	5	0
Macedonia	0-5	5	5
Isle of Man	0	0	0

\* 5% is charged on the gross amount of royalties paid for the use of industrial, commercial or scientific equipment, 10% in all other cases.

\*\* 5% is charged on the gross amount of royalties paid for the use of industrial, commercial or scientific equipment, 15% in all other cases.

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## **7. UNEMPLOYMENT INSURANCE ACT**

A new payment (tax) – compulsory insurance payment – came into force on the 1st of January 2002. The purpose of that payment is to ensure benefits for employees against unemployment.

The insurance payment is assessed on the following:

- wages and other remuneration paid to an employee and public servant working under employment contracts and contracts of service
- remuneration paid to natural persons on the basis of contracts for services, authorization agreements or contracts under the law of obligations, except in the case that the recipient of the payment has been registered with the Commercial Register or local office of the Tax Board as a natural person engaged in entrepreneurship

Amounts on which unemployment insurance payment is not imposed (equal to non-taxable amounts under the Social Tax Act):

- compensation for service, employment or business-related travel, accommodation and other expenses as well as daily allowance
- compensation for service, employment or business-related use of an automobile
- payments to residents of a receiving state who are employed in a foreign mission of Estonia unless otherwise provided by an international agreement
- expenses incurred by employers in order to ensure the occupational health and safety of employees based on the Occupational Health and Safety Act
- wage compensation paid for additional holiday days and to nursing mothers
- the cost of meals given free of charge to members of the crews of ships during voyages and to members of the crews of civilian aircraft during flights (90 kroons per day)
- amounts paid to residents of a foreign state by an Estonian resident through a permanent business establishment in a foreign state
- others

This is a compulsory insurance payment. The payers are both employers and employees. This act does not apply for natural persons engaged in entrepreneurship and members of management and supervisory bodies of legal persons and for the pensioners concerning the withholding payment obligation.

There are no exemptions for non-residents.

Payment rates are:

- for employers 1.4% of the amount assessable
  - for employees 2.8% of the amount assessable (withholding)
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The period for unemployment insurance payment is one calendar month. The employer is required to calculate and withhold payments and transfer the payment due to the bank account of the Tax Board by the 10<sup>th</sup> day of the month following the period and submit the corresponding return to the local Tax Board Office by the same date.

## 8. VALUE ADDED TAX

The current VAT Act is valid from the 1st of May 2004. It is based on the Council Directive 2006/112/EC (revision of the Sixth Directive of the Council of the European Communities).

2010 brings together important changes in the VAT field at the European level. On 12 February 2008, the European Union Council adopted the so-called „VAT Package”. This includes the followings: Council Directive 2008/8/EC, Council Directive 2008/9/EC and the Council Regulation (EC) No 143/2008 and have been transposed into the domestic VAT legislation of each Member State, including the Estonian one.

### *Taxable person*

A person whose taxable supply (excluding import) exceeds 15,978 EUR in a calendar year. Voluntary compliance possible for anyone engaged in economic activity.

### *Tax base*

VAT is charged on:

- transactions in goods and services within Estonia
- intra-Community acquisitions of goods and services
- importation of goods and services
- expropriation of goods for a charge

### *Taxable period*

VAT shall be declared and paid on a monthly basis, by the 20<sup>th</sup> day of the following month.

### *Tax rates*

- Standard rate is 20 %.
- Reduced rate is 9 % (books, newspapers, medicines, accommodation).
- Zero rated: export; intra-Community supply; goods and services supplied on board of vessels and aircraft.

Exemptions: postal services, health services, social services, insurance services, services for the protection of children and young persons, transportation of sick, injured or disabled persons, supply of immovable property\*, the lease of immovable property, etc.

\* Tax exemption is not applied to the supply before the first occupancy of buildings, as well as to substantial transformation of the substantial part of buildings, which are alienated before the re-utilization following the improvement of the building or its part.



## 9. OTHER TAXES

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### **EXCISE DUTIES**

Excise duties are the following:

1. Alcohol Excise Duty (all rates meet EU minimum levels)

Wines and sparkling wines

Other fermented drinks

Beer

Other alcohol

Rectified spirits

2. Fuel Excise Duty (transitional periods up to 2010-2013 to meet the EU minimum levels as set in the Energy Taxation Directive)

Petrol

Diesel fuel

Aviation kerosene and gasoline

Liquid gas used as motor fuel

Lubricated motor oil

3. Tobacco Excise Duty (transitional period up to 2010 to meet the EU minimum levels for cigarettes and smoking tobacco)

Cigarettes (filtered and unfiltered)

Cigarillos

Cigars

Smoking, chewing tobacco and snuff

Other

4. Electricity Excise Duty

5. Packaging Excise Duty

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### **LAND TAX**

Land tax is based on the assessed value of land. The tax is imposed on all land, except for land where economic activities are prohibited, on land in use by diplomatic missions and international organizations, cemeteries, land underlying churches and land in public use. Land tax shall be paid by the owner or by the user of land.

The tax rate, established by the local government council, is 0.1-2.5 % of the assessed value of land annually. Land tax is paid into the local government treasuries. Tax is paid twice a year on March 31 and October 1.

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### **LOCAL TAXES**

The Local Tax Act sets forth nine categories of local taxes the imposition of which is at the discretion of the local governments. Generally, only four of them are into force:

1. Sales tax – up to 1% of the taxable profit;

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2. Advertisement tax – established on advertisements and posters located on the territory of the respective municipality;
  3. Motor vehicle tax – all motor vehicles in ownership of natural or legal persons and registered in the public administration, armed forces, diplomatic corps, etc.
  4. Boat tax.
  5. Road and street closure tax.
  6. Animal tax.
  7. Entertainment tax.
  8. Parking charge.
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## **10. PRACTICAL INFORMATION**

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### ***Transport and communications***

Most transport is done by car or by bus. Air transport is possible to some parts of the country (major cities and islands), but is not very widely used, due to the relatively short distances. The country's one international airport is in Tallinn, only a couple of kilometres from the centre. Railway transport can also be used, but due to restructuring, passenger transport has declined. Ship transport is highly developed between Finland and Sweden and there is a constant ferry link between Estonia's two main islands in the west – Hiiumaa and Saaremaa.

Telecommunications in Estonia is well developed. Telephone lines are universal and in the larger cities and towns sophisticated data-transfer lines have been established. All this has contributed to the rapid growth of the number of people and companies with access to the Internet – studies show that about 39% of the population uses the Internet and that the majority of companies (especially in the larger cities) have access to it.

There are three mobile phone operators in Estonia. Each of them has a GSM network that covers almost the entire country. Practical mobile Internet services (e.g. GPRS) are being introduced to the public.

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### ***Payment & Currency***

The unit of currency is the Estonian kroon (EEK), which is divided into 100 cents. The fixed rate of exchange is EURO 1 = EEK 15.64664. Currency exchange in Estonia to or from Estonian kroons is free of administrative limitations. There is generally no exchange commissions.

No payment in foreign currency is accepted in shops, restaurants or hotels. Payment in shops, restaurants and hotels can usually also be made by an internationally accepted credit card (VISA, Eurocard/MasterCard). Non-credit banking cards are also widely accepted – mostly Maestro/Cirrus and VISA Electron. However, smaller shops and businesses, especially in rural areas, might not accept banking cards. Cheque transactions in Estonia are relatively expensive and are not used.

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### ***Language***

The official language is Estonian. The Russian language is also widely spoken all over the country. English is commonly used in doing business with foreigners. In the northern part of Estonia, Finnish is also widely understood and spoken. Other European languages are less commonly spoken, but one should be able to do business also in German or French.

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## ***Time zone***

Estonia is two hours ahead of GMT (GMT+02) between October and March, and three hours ahead (GMT+03) between April and September, due to daylight saving time.

In Estonia the 24-hour time system is used rather than the 12-hour (a.m./p.m.) system.

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## ***Business hours***

Office working hours are usually from 8:00 a.m. to 5:00 p.m. or 9:00 a.m. to 6:00 p.m. from Monday to Friday with one flexible hour for lunch.

Banking hours are generally 9:00 a.m. to 5:00 p.m. or 6:00 p.m. Monday to Friday.

Shops are open from 9:00 a.m. or 10:00 a.m. until 7:00 p.m. or 8:00 p.m. with shorter times on weekends. Larger stores are also usually open until 10 p.m. on weekends. Gas stations and some smaller shops are open 24 hours a day.

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## ***Public holidays***

There are ten public holidays in Estonia and one national holiday:  
Independence Day:

New Year's Day	1 January
Independence Day	24 February
Good Friday	date varies (in March or April)
Easter Sunday	date varies (in March or April)
Labour Day (Spring Holiday)	1 May
Pentecost	date varies (in May or June)
Victory Day	23 June
Midsummer Day	24 June
Restoration of Independence Day	20 August
Christmas Eve	24 December
Christmas Day	25 December
Boxing Day	26 December

No business is done on those days and shops are closed with the exception of larger stores, which remain open as usual or close earlier. Gas stations remain open 24 hours a day.

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