



Photo: Sven Soome

HOW YOU SET UP BUSINESS IN ESTONIA



MAQS LAW FIRM



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ABOUT THIS GUIDE

This guide is aimed at companies and intended as a general guide highlighting the legal issues connected with setting up a business in Estonia. It is not the intention to provide comprehensive legal advice on applicable laws or other issues in connection with conducting business in Estonia. You should seek specific professional legal advice before taking any steps to establish a business in Estonia. This guide has been prepared by a team of lawyers from MAQS Law Firm's Estonian office. The guide was first published in 2006 and this is the fifth edition and our aim is to reflect the legal position as of 1 January 2010.

HOW THIS GUIDE WORKS

The guide considers the various business vehicles you may wish to set up in Estonia and aims to address some of the main considerations that may be of interest, such as staff, premises and intellectual property rights. The guide also deals with the regulatory and business framework, how profits and tax are treated. It will also deal with insolvency and litigation matters. The web links in this guide provide further information in English regarding various topics dealt with below.

We endeavour to answer a number of frequently asked questions. Inevitably, you may require further information with regard to some topics or you may have specific concerns and questions which cannot be addressed in this guide. Please contact us if you require any further assistance.



MAQS LAW FIRM

MAQS is a leading law firm in the Scandinavian and Baltic region, providing legal services in all areas of corporate and commercial law, with particular focus on international transactions. The firm's office in Estonia is situated in Tallinn (the capital). The firm also has offices in Latvia (Riga), Lithuania (Vilnius), Denmark (Copenhagen), Poland (Warsaw) and Sweden (Stockholm, Gothenburg and Malmoe). MAQS is one of few law firms committed to the development of business in Scandinavia and the Baltic region, which is one of the most dynamic growth areas in Europe.

Increased international co-operation and the pace of technical developments are creating new industries and the ever-changing demands of the business world present challenges to businesses. Changes may create opportunities, but may also increase uncertainty about applicable laws and regulations.

Legal advisers have a crucial role to play in identifying issues and assisting their clients to exploit opportunities effectively. MAQS is continuously developing new, more effective ways to deliver high-quality legal and commercial advice to its clients within all practice areas of significance to business.

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ESTONIA – A COUNTRY WITH POSSIBILITIES

Why invest in Estonia?

Over the past decades, many foreign companies have successfully set up businesses in Estonia and benefited from the progressive business climate. Compared to other countries in Northern Europe, Estonia's business regulation is considered to be very flexible. The Estonian tax system—a flat income tax and no corporate tax—is quite unique to Estonia and is considered a success. The country lies within the European Union tariff-free customs area but has far lower start-up and running costs than most other EU member countries.

Estonia's location in the Baltic Sea region is often seen as a bridge between east and west. From a logistical point of view, Estonia therefore has a strategically beneficial location in many cases. Furthermore, Estonia provides a cost efficient base for production and export while offering easy access to wealthy Scandinavian and Northern European markets. New trends are retail and services for the growing demands of the local market.

The infrastructure in Estonia is efficient and modern. In terms of e-services, mobile communications and internet applications Estonia is one of the most progressive countries in the world. For instance, Estonia is one of the leading countries in the world when it comes to e-government and cyber security solutions. One of the reasons is that Estonians are adaptable towards new technologies, and use them willingly, which also makes Estonia interesting as a test market for high technological products and solutions.

The Estonian workforce is well educated and both English and Russian are widely spoken. 60 % of the workforce is employed in the service sector. In the 4th quarter of 2009, the average monthly gross salary was EEK 12,259 (EUR 783, which equals an average hourly gross salary of EEK 74.25 or EUR 4.75), which is a decrease with 6.5 % (or a decrease with 6.7 % regarding average hourly salary) compared to the 4th quarter of 2008; this is a good example of the flexibility

of the workforce as well as the business regulations in Estonia. Also the Estonian consumer price index fell in 2009 compared to 2008.

Estonia has through budget cuts managed to sustain financial stability through the financial crises. Currently Estonia aims at adopting the Euro as of 1 January 2011.

WEB :

Enterprise Estonia
www.investinestonia.com

Estonian Trade Council
www.etc.ee

Estonian Chamber of Commerce and Industry
www.koda.ee

British-Estonian Chamber of Commerce
www.becc.ee

American-Estonian Chamber of Commerce
<http://www.amcham.ee>

Swedish-Estonian Chamber of Commerce
www.swedishchamber.ee

The Swedish Trade Council in Estonia
<http://www.swedishtrade.se/estland>



FRAMEWORK FOR BUSINESS

Commercial objectives, the extent of proposed activities, tax considerations and business structures would be key factors behind any decision to establish a business in Estonia.

Having decided to set up business in Estonia, you would need to determine whether to:

1. Set up business on your own.
2. Acquire an existing business.
3. Enter into business with others.

Setting up business on your own

Should you choose to set up a business on your own, you would have the option of establishing a branch office of a foreign company (filiaal) or forming a separate Estonian subsidiary.

Branch office or subsidiary?

The branch office of a foreign company, although not a separate legal entity, must keep its own accounts in Estonia. It would be taxed under Estonian law. Profits would be taxable in the foreign company of which it is part, but in many countries the tax paid in Estonia is deductible according to bilateral treaties for avoidance of double taxation.

The Estonian Tax and Custom Board (Maksu- ja Tolliamet) may audit the branch office in order to assess the branch's taxes. Branch offices of foreign companies entered into the Estonian Commercial Register, and other permanent establishments of non-resident legal persons registered with the Tax and Customs Board, are subjects to taxation under the Income Tax Act.

Setting up an Estonian subsidiary

An Estonian subsidiary would normally be set up as a limited liability company with one or more shareholders (who may be individuals as well as legal entities). There are two kinds of limited liability companies: pub-

lic limited companies (aktsiaselts) and private limited companies (osaühing).

The shareholders' liability would be limited to the amount invested in the company. A public limited company may apply for its shares to be listed on the stock exchange or offer the public at large to issue or acquire shares or other securities.

The minimum share capital required for a private limited company would be 40,000 EEK (2,560 EUR) and for a public limited company 400,000 EEK (25,600 EUR). A limited liability company is a legal entity. It can own property, enter into agreements and employ staff.

The most common way of setting up a limited company would be to establish one with help from a law firm. It is also possible to purchase a so-called shelf company (a ready-made company).

Are there any restrictions on the choice of name of a company?

A limited liability company may be given any name that is not the same or too similar to that of an already existing company or trademark, provided the name is not offensive. The name must be spelled with the letters of the Latin alphabet. A name can not be misleading with regard to the legal form, area of activity or scope of activity of the company or contrary to good morals.

Are there any registration requirements for certain areas of activity?

There are certain areas of activity in which operation requires registration in the Register of Economic Activities (REA). An area of economic activities in which operation requires registration in the REA are following:

- the area of trade (retail and wholesale trade, catering, services, organisation of trading);
- accommodation services;
- rehabilitation service;
- employment service;
- tourism (operating as a travel undertaking);

- building (construction, designing, geotechnical and geodetic surveys, expert assessments of a building design documentation, experts assessments of construction works, project management);
- industry (electrical work, pressure equipment work, gas work, construction of gas installations, installation of lifts, lifting equipment work, engineering work, technical inspection of electrical installations, assessment and attestation of compliance of persons);
- liquid fuel (export, import, sale, storage of liquid fuel);
- mining (mining, secondary utilisation of workings, compiling plans for mining or secondary utilisation of workings);
- fire safety (construction and maintenance, designing, inspection and maintenance of fire safety installations);
- handling of pyrotechnic articles (storage, transfer, use);
- currency exchange;
- pest control;
- handling ozone depleting substances.

There are other areas of activities which do not require a registration in REA, but still require a licence or activity permit (e.g. certain financial services, medical and transport services).

How should the board be organised?

In an Estonian public limited company there are two boards: a supervisory board (nõukogu) and a management board (juhatas). In a private limited company the formation of a supervisory board is optional, giving a competent management board the option to simplify the management system.

The supervisory board must have at least three members. There are no restrictions as to the residency of these members. The members of the supervisory board are jointly and severally liable for any damage caused to the company by violation of the requirements of law or of the articles of association, or by failure to perform their obligations.

The management board may consist of one member (manager). At least half of the members must reside in Estonia, within the European Economic Area (EEA) or Switzerland. The management board would be responsible for the management of the company's daily business and organisation. If there are more than two members, the board members would elect a chairman. The chairman of the management board can also be appointed by the supervisory board, if the articles of association state so.

The management board would be responsible for representing the company and managing its business. It may issue written instructions on how work is to be divided and takes care of bookkeeping. The management board also presents an overview of the economic activities and economic situation at the shareholders meeting or

to the supervisory board. The specific work procedure of the management board may be prescribed in the articles of association.

Who is authorised to represent the company?

The members of the management board are each individually authorised to sign on behalf of the company unless the articles of association prescribe that all or some of the members of the management board may represent the company jointly. Please note that the members of the supervisory board do not possess any signatory rights, nor right of representation.

When can a shareholder, a member of the supervisory board, or management board be personally liable?

A member of the supervisory board or management board would be liable for damages if they intentionally or negligently through wrongful acts cause damage to the company when performing their duties. A member of the management board may also be liable for any damages suffered by a shareholder or creditor by reason of a breach of the provisions of the Commercial Code, accounting legislation or the articles of association of the company. Any shareholder who intentionally, or by gross negligence, causes damage to the company, another shareholder or third person, can also be held liable.

Setting up a branch office (filiaal)

A branch office would be a part of a foreign company with its own independent administration in Estonia. A foreign company may only set up one branch office in Estonia. The branch office should be managed by a branch manager (filiaali juhataja) or managers appointed by the foreign company, and who would be responsible for the branch's business activities. A manager would direct and represent the branch and would organise the accounting of the branch.

At least one manager must be resident of Estonia, EEA or Switzerland. Managers would also sign documents on behalf of the branch office. A branch office should be registered in the Estonian Commercial Register and keep its own accounts.

May a foreign company or manager of a branch office be personally liable?

A branch office would not be treated as a separate legal entity. The foreign company would be liable for the obligations arising from the activities of the branch office. The branch manager's liability is equivalent to that of a member of the management board of a limited company.

Buying an Estonian business

When acquiring an existing business in Estonia, you would either purchase its shares or its business assets. If the existing business is conducted through a general partnership (täisühing), a limited partnership (usaldusühing), or a branch (filiaal), you could only acquire the business assets. This guide will concentrate on share purchase.

How are shares transferred to the buyer?

Shares in public limited companies are registered with the Estonian Central Register of Securities. Shares in private limited companies may be registered with the Register of Securities. Registered shares are transferred to the buyer through a securities transaction that can be organised in any bank office in Estonia.

A transfer of securities is a transfer of registered shares from the seller's account to the buyer's by debiting the first account and crediting the other account in the amount of the corresponding number of shares. The ownership transfer is effective dating from entry into the Central Register of Securities.

Non-registered shares are transferred to the buyer through a notarised sale and purchase agreement. A notary public authenticates the sale and purchase of the shares and will send the notice to the Commercial Register within two days of concluding the transaction. The shareholder can exercise his/her ownership rights as of registration of transaction in the share ledger of the company.

Are there any restrictions on the transfer of shares in limited companies?

A shareholder may freely transfer a share to another shareholder. In a private limited company other shareholders have the right of pre-emption after presentation of the transfer agreement, if shares are transferred to a third person. In a public limited company pre-emption rights may be prescribed for in the articles of association.

Free transferability of shares may also be limited by an agreement made between the shareholders, but these agreements would only be binding to the parties concerned. An acquisition, which is contrary to a contractual restriction on the transfer of shares, would not prevent the buyer from exercising his or her rights in the company.

Can an insider freely sell and purchase shares in a limited company?

For the purposes of the Securities Market Act, an insider is a person who, by reason of being a full partner or a member of the management or supervisory body of the issuer of a security, or holding of a security or

due to his or her work, profession or duties, has access to inside information. An insider who commits a breach of the regulations may face a fine, imprisonment and the forfeiture of any financial gains.

Generally, insider regulations would apply to shares and securities normally traded in an organised market place. The Securities Market Act states that the misuse of inside information is prohibited.

Setting up business with others

When setting up a business with others in Estonia, options include establishing a joint venture, a public limited or private limited company, a general partnership, or a limited partnership. A business could also be established by purely contractual arrangements, such as the appointment of an agent, sales representative or franchisee. Some details of the formation of limited liability companies were also described in the previous section.

Joint ventures

Many companies which are lacking sufficient capital, skill or market knowledge to break into a new market would prefer to establish a joint venture or any other strategic alliance. Joint ventures would have no legal person status of their own but could be organized as limited companies or partnerships. The choice of organisation would depend on commercial as well as tax considerations. A joint venture must address all major issues by way of a shareholders' or partnership agreement, including initial and future funding, management structure, intellectual property rights, distribution of profits and termination. In the event the joint venture is set up as a limited company it would be subject to the applicable company legislation.

Conducting business as a partnership

If two or more persons decide to run a business together they can establish a partnership, which is of two types: general and limited partnership. General and limited partnerships are independent legal entities. The difference between them is that in a limited partnership, the liability of at least one of the partners would be limited to the amount the partner has invested in the partnership and in a general partnership, all partners are solidarily liable for the obligations of the general partnership with all of their assets. The partners may be foreign citizens and do not need to be resident in Estonia or the EEA. There is no obligation to appoint a manager.

Each partner may represent the general partnership in all legal acts unless the partnership agreement prescribes otherwise. In case of limited partnership, a limited partner shall not have the right to represent the

limited partnership unless the partnership agreement prescribes otherwise.

Appointment of an agent

In Estonia, there are two basic types of agency; the commercial agent under an agency contract (agendileping), and the commission agent under a commission contract (komisjonileping).

A commercial agent undertakes negotiations or enters into contracts in the name and on account of the principal, independently and on a permanent basis. The principal pays a fee to the commercial agent.

A commission agent, on the other hand, undertakes to enter into a transaction to sell something on behalf of the principal or buy something on behalf of the principal, but in his or her own name. The principal undertakes to pay the commission agent a commission for the service performed.

Is the commercial agent self-employed or an employee?

If the commercial agent is an individual, he would generally not be an employee of the principal but self-employed.

How could a commercial agency agreement be terminated?

Notice must be given in order to terminate an agreement. If the agreement is concluded for an unspecified period, the notice period would be at least one month. In some occasions the notice period may be longer. The commercial agent would normally be entitled to a reasonable redundancy payment.

Appointing a distributor or franchisee

The main difference between an agent and a distributor is that the distributor would enter into contracts in his or her own name and behalf. General statutory provisions would apply and the parties should therefore draft their own agreements on the terms and conditions of their relationship.

A franchisee is someone who has been granted a right by a franchisor to use certain intellectual property rights, in exchange for direct or indirect fees, for the purpose of marketing particular goods or services. Unlike many countries, Estonia has special statutory provisions for franchise agreements.

WEB:

Estonian Commercial Registry
http://www.rik.ee/index.aw/set_lang_id=2

Estonian Financial Supervision Authority
<http://www.fi.ee/?id=580>

Register of Economic Activities
https://www.eesti.ee/eng/teemad/xtee/majandustegevuse_register_1/



STAFFING YOUR BUSINESS

The terms of a contract of employment in Estonia would be dictated by law, collective bargaining agreements and individually negotiated agreements. Contracts of employment is subject to a number of mandatory provisions under statutes. These provisions are designed to protect employees and regulate for example, working hours, holidays, dismissal and dispute resolution. Collective agreements in Estonia are only being negotiated in a limited number of sectors and the trade unions are considered weak.

As of 1 July 2009, a new Employment Contracts Act entered into force and replaced the Employment Contracts Act as well as abolished the Wages Act, the Holidays Act, the Working and Rest Time Act and the Labor Code. The aim of the reform was to create a more flexible labour market and thereby increase the competitiveness of the Estonian economy.

General

How are contracts with executives regulated?

In Estonia an executive can either be employed or be a member of the management board of the company. A member of the management board is not protected by the Employment Contracts Act and he or she is contractually bound to the business through a service agreement. This agreement should regulate issues such as term, termination, holiday, holiday pay and remuneration. For an executive who is not a member of the management board, the statutes regulating employee's rights and obligations apply.

How do collective agreements affect employment law?

In Estonia there are trade unions only in sectors such

as health care, transportation and education. This is due to Soviet-era history, when all employees were obliged to join the union. Since re-independence, few Estonians want to belong to a union. Over time it is expected that the unions will grow and play a more important role in the labour market. As for today, outside of the sectors mentioned above, collective agreements do not, in general, affect employment contracts at all.

Can foreigners be employed to work in Estonia?

Any citizen of a state within the EEA can work in Estonia up to three months without any permit. For employment longer than three months, they will need for a residence permit. EEA citizens and Swiss citizens are treated as EU citizens in this respect. There are no transition measures in place for the new Member States, Bulgaria and Romania. An employee from outside the EEA must have a work and residence permit in order to work in Estonia.

Protection of Employment

The provisions of the Employment Contracts Act are mandatory in respect to all employees and contain rigid rules regarding the terms and termination of employment. The most important provisions are:

- A contract of employment would normally be concluded for an indefinite period of time. A fixed term employment contract could be concluded for up to five years and if justified by good reasons arising from the temporary characteristics of the work, especially in case of temporary increase in work volume or performance of seasonal work.
- The law is not flexible when it comes to transferring employees to other positions or to new tasks. This would normally demand a modification of a contract which requires the employee's consent.
- There is no last-in-first-out principle under Estonian law when it comes to redundancies. The employer is free to choose objective reasons under which he or she will assess the performance of the employees in case of cut-backs, and terminate the contracts of those no longer needed. Pregnant women

and women who has the right to pregnancy and maternity leave or a person who is on parental leave or adoptive parent leave are protected from termination due to redundancy.

- Notice of termination must be forwarded on a format which can be reproduced in writing, ie by e-mail, and contain certain information.
- The statutory minimum notice period for the employee to give notice is 30 days. For the employer it depends upon the length of service. 15 days is stated as a minimum and 90 days as a maximum notice in case of redundancies.
- If termination is based on redundancy, liquidation of the business or bankruptcy, the employee is entitled to severance pay to the extent of one month's average salary of the employee.

The working environment

The employer has an obligation to ensure safe working conditions. There are also rules about forming a working environment council in companies with 50 or more employees. This area of law is not fully developed in Estonia yet and the Ministry of Social Affairs is currently working on draft legislation.

Working hours

Normal working hours must not exceed 40 hours per week. Overtime and payment for overtime is regulated by law.

Wages

Minimum wage is regulated by law in Estonia. The minimum wage is set to 4,350 EEK (=280 EUR) per month or 27 EEK (=1.7 EUR) per hour. The average wage is 12,259 EEK (=783 EUR).*

It is not possible to top up social security during sick leave. The health insurance fund pays 70 % of income in the event of temporary release of an employee from the performance of his or her duties. Payment of sickness benefits starts after a three-day waiting period and can be paid for up to a maximum of 182 successive days for the same sickness. For days four to eight the employer must pay sickness payment, from ninth day sickness payment is paid by the health insurance fund. This is governed by the Health Insurance Act.

Equal opportunities

Employers must comply with anti-discrimination legislation, which makes it unlawful for an employer to discriminate on the grounds of sex, nationality, ethnic origin, mother tongue, religion etc. when employing. There are also rules on equal pay for men and women.

Are the employees entitled to board representation?

There are no rules entitling employees to board representation in Estonia.

Holidays

Minimum holiday and holiday pay are regulated by law. An employee would be entitled to statutory holidays after completing six months of employment. The minimum holiday entitlement is 28 calendar days (i.e. 4 weeks including Saturdays and Sundays but excluding public holidays). Holiday pay is equal to the normal salary and is to be paid two days prior to the first day off if parties have not agreed otherwise. If the employment will be terminated before the employee has received his or her earned holiday, the employee would be entitled to payment of a similar amount.

Right to take a study leave

The employee may have 30 days of study leave per year. During this time the employee is entitled to his or her full salary for up to 20 days.

The employee may have additional 15 days of study leave for the completion of study during which the employee is entitled to minimum salary.

Parental leave

Employees with children have a statutory right to take parental leave to take care of a newborn child and the right to receive benefits during the leave.

A working parent is entitled to 100% of his or her previous wage for up to 18 months. The right to leave for the mother starts 70 days before the planned birth. The first 70 days of leave after birth of the child is reserved for the mother. The father is entitled to paternity leave of 10 calendar days, to be taken either during the pregnancy and maternity leave or during the first 2 months after the childbirth. During the paternity leave the father is entitled to his average salary but not more than triple average wages of the republic. There is no continuation of salary payment by the employer, but payment of benefit by the state. The amount of the payment is based on previous earnings, but would not be less than 4,350 kroons (EUR 280) per month. The maximum amount of benefits paid per month would be 35,316 EEK (EUR 2,255).

After the grant period of parental benefits is over, there parents are entitled to parental leave without benefits until the child reaches three years of age.

* Fourth quarter of 2009 according to Statistical Office of Estonia.

Pensions

Employees receive retirement pension from the State pension system. The system consists of three pillars, where pillar nr 1 is mandatory for everyone and pillar nr 2 is mandatory for those born 1983 and there after. The first and second pillars are financed by the social tax and pension payments paid by employers, employees and the state. The pillar nr 3 is voluntary and is not financed by the state.

WEB:

Estonian Labour Market Board
<http://www.tta.ee/index.php?t=2>

Estonian Employer's Confederation
<http://www.ettk.ee/en/>

The Ministry of Social Affairs
<http://www.sm.ee/index.php?id=1&L=1>

The Estonian Health Insurance Fund
<http://www.haigekassa.ee/eng/>

Ministry of Social Affairs, Department of Gender Equality
<http://gender.sm.ee/index.php?197973106>



PROPERTY AND ENVIRONMENTAL LAW

Property may be either leased or owned under Estonian law. The regulations applicable to leases and purchases are mainly designed to protect the tenant or purchaser of the property arise from the Law of Obligations.

Lease of premises

Using a lease contract, one person grants the use of a premise to another person and the lessee is required to pay a fee (rent).

A lease contract does not have to be in writing unless the tenant or the landlord so wishes. A lease contract may be concluded for a specified or unspecified period. If a residential lease contract with a term exceeding one year is not entered into in writing, the contract is deemed to have been entered into for an unspecified term.

Upon the lease of premises, either party may terminate a lease contract entered into for an unspecified term by giving at least three months notice. A termination is valid only if it is in writing and needs to follow the terms specified by the law.

Purchase of land

Purchasing land in Estonia is not complicated. The land registry department of the District Courts maintains a Land Register covering all of Estonia. Ownership relations and other real rights (mortgages, servitudes, notations concerning lease or prohibition, etc.) relating to any registered land are entered into the Land Register.

A purchase contract needs to be in written form and authorised by a notary public. The new owner is entered into the Land Register after purchase; this can take up to one month. The purchase contract is valid from the time of signing. In addition to paying for the land, notary fees and state fees have to be paid and

parties may agree upon how these expenses should be divided between them.

A purchase contract has some obligatory elements, among them are the purchase price and a declaration of transfer of the land from the seller to the buyer. An important clause is the seller's discharge, which gives the buyer information about encumbrance, and the buyer's discharge if the property has been inspected.

Environmental law

Environmental law in Estonia is very fragmentary and there is a need for more abstract rules. Environmental law is moving from controlling specific environmental dangers towards preventing hidden environmental risks. Estonia is developing towards the Swedish model, where everyone's rights and responsibilities (due diligence standards) are stipulated.

The most important environmental laws are included in the Environmental Supervision Act. The aforementioned act defines the nature of environmental supervision and establishes the rights and obligations of persons and agencies who exercise environmental supervision, the rights and obligations of persons and agencies who are subject to environmental supervision, and the procedure for supervisory operations.

When is a licence required?

Licenses related to the environment and for actions which might affect it are required for the following actions:

- for the usage of natural resources (licence for deforestation of growing wood; licence for usage and examination of bowels of the earth);
- for polluting the environment (licence for air pollution; licence for avoidance and examination of pollution);
- for special usage of water;
- for marketing and leading genetically transformed organisms to the environment; and
- for building and exploiting nuclear plants.

It is important to notice that all business activities which might affect environment are regulated with licences. The basic principle that the “polluter pays”, applies in Estonia.

WEB:

Ministry of the Environment

http://www.envir.ee/index.aw/set_lang_id=2

The Environmental Supervision Board (only information available in Estonian)

<http://www.kki.ee/>



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INTELLECTUAL PROPERTY

How Estonian law protects your rights

In general, the system for the protection of intellectual property rights follows international as well as EU standards. Business names, trademarks, inventions and designs would be protected from competitors by registration. Estonian law also protects copyrights. Estonia is a signatory to most international conventions regarding intellectual property rights.

What happens if intellectual property rights are infringed?

Sanctions for infringement of intellectual property rights vary between different types of intellectual property. In most cases infringements would give rise to both criminal and civil liability.

Since being criticised during negotiations for EU membership, Estonia has worked hard to try to stop trade in counterfeited goods. Since then, several new laws and amendments to existing laws have been introduced which follow the EU model. Practices among courts and public authorities are quickly moving towards Western European standards.

Patents

A patent would protect technical inventions and provide its owner with the exclusive right to exploit the invention for a certain time. Patents would be protected against competitors by registration.

The right to a patent would belong to the inventor or his successors. The Patent Office may only grant patents after application and registration. An application must contain among other things a full description of the invention, drawings, a short summary of the subject matter of the invention and a claim for the invention. A patent may only be granted

for a new invention. The requirements in Estonia are the same as for European patents, i.e. they are based on the principle of absolute novelty. In general, a patent shall be granted for any invention which could be applied in industrial use or is new and would involve an inventive step. The scope and content of patent protection shall be determined by the wording of patent claims. It would be essential for a company to protect its patent rights in every jurisdiction where it intends to conduct business.

The maximum duration of a patent would be 20 years from the application date and an invention is granted patent protection upon registration of the invention in the register of patents. A state fee shall be paid each year for the continued validity of the patent.

Trademarks

Trademarks would be protected against competitors by registration or if the trademark is well known among its users.

Exclusive protection of trademarks may be obtained either by registration in the Patent Office or by the proprietor establishing that the mark is well known among the users. It would take up to one year to register a trademark. However, the legal protection of a trade mark is valid as of the filing date of an application for the registration. Foreign applicants must appoint an Estonian agent for the procedure of registration of the trade mark.

The requirements for making an application for the registration of a trademark would be as follows: a combination of words, letters or numerals, drawings, symbols and a list of the classes for which protection is required. The Patent Office would examine whether the application complies with formal requirements.

Interested person could object the application within two months from the day when the application was published. The duration of the protection would be indefinite but subject to renewal every 10 years. A

trademark registration may be cancelled if the trademark has not been used for the last five years and the registrant is unable to show any valid reason for not having used the trademark.

Copyright

The types of works that copyright would protect are literary works such as novels, newspapers and computer programs and artistic works such as paintings, drawings, photographs, sculptures and works of architecture. Copyright is an unregistered right.

The protection furnished by copyright would not depend upon formal procedures. The work would be protected by copyright as soon as it is created and is sufficiently original. There would be no official action to take in order to protect copyrights. The author may assign financial rights to his work to another party but not the moral right, which would always remain with the author. Copyright protection would normally last during the author's lifetime plus 70 years after the author's death. In respect to related rights, such as rights of artistic performers, producers of sound recordings and broadcasts, the protection would last for 50 years from the first day of creation, performance or publication.

Industrial designs

Protection could be available for products based upon aesthetic aspects or ornamentation.

"Design" refers to the appearance of the whole or a part of a product created by the lines, contours, colours, shape, texture and/or materials of the product itself and/or its ornamentation. The registration of designs would normally protect against competitors. Designs meeting certain requirements may also benefit from protection even without prior registration (unregistered Community Designs). An unregistered design would however only be protected against deliberate copying for three years from the date of disclosure. A design would be protected by law to the extent that it is new and has individual character.

An industrial design is not considered to be new and is not granted legal protection if an identical or confusingly similar industrial design has been disclosed or registered prior to the filing date, or if the owner has disclosed the design within twelve months before the filing date of the registration application or before the date of priority.

The Patent Office would assess whether an application complies with formal requirements. If the application is accepted, it would be open to objection for two months. The term of validity of the registration is five years from the filing date of the registration application. The registration may be renewed for a period of five years up to a total term of 25 years.

WEB:

Estonian Patent Office
http://www.epa.ee/default.asp?wa_site_id=2

The Estonian Ministry of Culture
<http://www.kul.ee/index.php?lang=en>

Information Gateway (the Estonian website about intellectual property, in Estonian only)
www.autor.ee

Database of Estonian IPR court cases translated into English:
http://www.kul.ee/kohtulahendid/index_eng.php?



THE BUSINESS ENVIRONMENT

When doing business in Estonia, you would be affected by general business regulations such as the Law of Obligations Act, the Competition Act and data protection acts such as the Personal Data Protection Act. This chapter summarises the general principles of these statutes.

Principles of contract law

The basic structure of Estonian civil law is similar to that of the Civil Code of Germany (Bürgerliches Gesetzbuch, BGB). Contract law is dealt with in the general part (Tsiivilseadustiku üldosa seadus) and in the Law of Obligations (Võlaõigusseadus).

Many contracts can be oral, however in the Estonian business environment written contracts can be described as customary and more reliable. The courts favour to interpret contracts from a rather formalistic point of view thus reaffirming the need for written agreements.

Except for a few exceptions such as for example employment agreements, a contract can be in any language the parties agree to.

How is a contract formed?

Contracts may be entered into in whatever form the parties decide upon, so long as the law does not stipulate a compulsory form. Several agreements need to be in written form, such as contract of gift (kinkeleping), and some require notarisation to be valid under Estonian law, e.g., purchase of land or purchase of shares in companies where the shares are not registered with the Estonian Central Register of Securities.

Transactions that call for notarisation can either be simple, where the notary public only verifies the parties of the transaction, or more complex, involving verification of the whole content of the contract by the notary. In such cases, the notary also drafts the contract.

When the law stipulates the notarisation requirement for a certain contract, the contract is considered to enter into force upon notarisation.

In the event of failure to comply with the format (written, notarised, etc) provided for by law, the transaction would be considered null and void.

When is a contract invalid or void?

Contracts which fail to conform to the constitutional order or good morals are null and void from their inception and parties are not bound by the underlying obligations. The same goes for contracts in breach of law when the law stipulates that a breach results in the contract being null and void. The most important example of this is failure to comply with the obligatory format (written, notarised, etc) of the contract.

Contracts are invalid in a number of instances provided by law. These include contracts concluded as a result of fraud or duress. If a contract is held to be invalid, the parties are obliged to return the subject matter received as a result of the transaction (reciprocal restitution) or to compensate the other party financially if return or restoration is not possible.

How is a contract interpreted in Estonia?

When interpreting contracts, the actual intentions and will of the parties determine the content of the contract. If the intentions of the parties differ from the ordinary meaning of the words used in the contract, the common intention of the parties prevails. If an agreement does not expressly regulate a certain matter, statutory provisions may be implied into the contract in order to fill the gap. The principles of how to interpret contracts are stated in the Law of Obligations.

What happens if a contract is incompatible with legal acts?

Contract provisions which are incompatible with mandatory provisions would be void. The whole agreement may be, but does not necessarily have to be, void, if the relevant provisions constitute the essence of the agreement or is so prescribed by law.

Sale of goods and supply of services

The sale of goods and supply of services is mainly regulated by the Law of Obligations. This law prescribes the rules needed to follow when selling goods and services.

If both parties are legal entities they can freely agree upon the terms and conditions of a sale of goods agreement. In case an agreement does not govern a particular issue, the issue would be regulated according to laws.

The main obligation of the seller is to hand the goods over to the buyer. Other obligations arise from the handover of documents related to the goods and from the division of expenses between the parties.

The main obligations of the buyer are to pay for and accept the goods.

In cases of breach of contract, the Law of Obligations states an exhaustive list of legal remedies. In case of non-performance of an obligation, the party harmed can claim restoration or compensation to bring them back to the situation which existed before the non-performance of the other party.

An important principle for selling goods is that the goods must be free from factual and legal deficiencies.

When it comes to rendering services, the law lists main types of contracts that may be used, including authorisation contracts, service contracts, brokerage contracts, commercial agency contracts, commission agency contracts and transport contracts, etc.

Dealing with consumers

Several statutes must be considered when dealing with consumers. All such statutes are drafted in order to protect the consumer to a reasonable extent and are therefore consumer friendly.

A seller selling goods or services to consumers should be aware that a consumer is always considered to have a lower burden of proof in cases of breach of contract. A consumer always has the right to be protected from goods or services that might endanger the consumer's life, health, property or environment. A consumer can claim compensation for material and moral damage caused by the goods or services sold.

Two important terms when talking about consumer legislation are safety and knowledge. All information, e.g., instructions and handbooks about products and services, must be provided in the Estonian language.

The Estonian Consumer Protection Board (CPB) is a national authority with the main task of protecting the rights of consumers and representing their interests in accordance with the provisions of the UN Guidelines and Estonian and European Union legal acts.

The CPB constitutes an inexpensive alternative to civil courts and the decisions of the Board serve as guidelines for trade enterprises. The CPB supervises the consumer market of goods and services. It also provides enterprises with guidelines and regulations on how to provide consumers with quality goods and better services.

WEB :

Ministry of Economic Affairs and Communications
<http://www.mkm.ee/index.php?keel=en>

Estonian Consumer Protection Board
<http://www.tka.riik.ee/?lang=en>

Marketing

Marketing must not be misleading or collide with good morals and customs. It is prohibited to make use of children's gullibility and lack of experience in marketing. For marketing of alcohol, pharmaceuticals, gambling, tobacco and the like, there are special requirements in law.

As a general rule, following from the Language Act, marketing must be in Estonian language.

When advertising outdoors, e.g., on billboards, local regulations give municipalities the right to ask for a advertising tax.

WEB :

Estonian Chamber of Commerce and Industry
<http://www.koda.ee/?lang=en>

Product liability

The Product And Service Safety Act provides that a manufacturer, importer or supplier is liable for damages suffered by a consumer caused by defects in a product. The provisions of the law are implemented by a European Community directive and are mandatory.

A person would be entitled to damages if he suffers personal injuries caused by a defective product. If the product is intended and used for consumer purposes, compensation shall also be paid if the product causes damage to property. There would be no compensation

available for damages caused to the product itself. The manufacturer, importer or supplier would in short not be liable to pay damages if either:

1. the defect did not exist in the product when the product was sold,
2. the state of scientific and technical knowledge when the product was sold was not such that the defect could have been discovered or,
3. the defect is attributable to compliance with any mandatory requirements imposed by a public authority.

Competition

As Estonia is a full member of the European Union, Estonia has taken a commitment to approximate the Estonian laws with respective EC legislation. Competition law is one of the fields, where a very rapid development has taken place.

The Estonian Competition Act contains two prohibitions: anti-competitive agreements and arrangements and conduct which amount to an abuse of a dominant position. There may also be an obligation to notify concentrations (acquisitions and mergers) to the Competition Authority. The Act is closely modelled on the equivalent provisions of European competition law. Case law from the Commission and the European Court of Justice would be taken into account when applying the Estonian Competition Act.

The Act stipulates a possibility to apply for exemptions in respect of agreements, concerted practices, or decisions of alliances of undertakings that may distort free competition, providing such agreements, practices or decisions have certain positive effects on the economy or other benefits for consumers.

The Competition Board exercises supervision of the compliance with the Competition Act and corresponding regulations, and can grant permissions for single exemptions. The Competition Board is entitled to request information from any entity or private individual, as well as from any central or local government agency, in order to exercise supervision.

WEB :

Estonian Competition Board
<http://www.konkurentsiamet.ee/?lang=en>

mandatory and are intended to protect the person to whom the data relates.

What is data?

Personal data is any information relating to an identified natural person or a natural person identifiable by reference independent of the form the information is in. Sensitive personal data may include data revealing details of family life, health, etc.

What is processing of data?

Processing of personal data is any kind of operation which is performed upon personal data, such as collection, recording, organisation, storage, alteration, grant of access, consultation, retrieval, use, transmission, cross-usage, combination, blocking, erasure or destruction.

How should data be dealt with?

Anyone processing personal data must comply with certain principles. Personal data must be lawfully processed, treated in accordance with good practice and processed for a limited purpose.

How can data be processed lawfully?

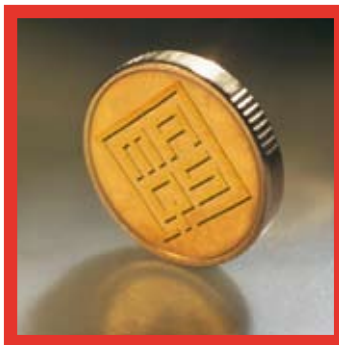
The main general rule is that personal data can only be processed lawfully when the person has given his or her informed consent. In addition, the processing of sensitive personal data must be registered with the Data Protection Inspectorate, or a separate responsible person has to be appointed. The Data Protection Inspectorate, being the supervising authority with regard to processing of personal data, must also be informed of the appointment.

WEB :

Estonian Data Protection Inspectorate
<http://www.aki.ee/eng/>

Personal data protection

Personal data protection in Estonia is based on EU law and therefore equivalent to the laws in other EU member states. The provisions are



PROFITS AND TAX

The Estonian tax system is unique, consisting of a flat tax rate of 21%. Estonia is one of the most liberal tax regimes in the world with regard to individual taxation.

Taxation of limited liability companies

Estonian company income tax policies are quite unique. Company income tax is charged on dividends only and not on the company's income. The tax subject—the person to be taxed for dividends—is the company and not the person receiving the dividend. In addition, tax is due on fringe benefits, gifts and costs of entertaining guests/clients. As of 1 January 2010, the income tax rate is 21%.

Social tax shall be paid on wages and other remuneration paid to employees.

What expenses are deductible?

All expenses, including royalties and interest incurred by a company in relation to its business, may be deducted from the income. The rules follow the EU Interest and Royalty Directive.

May losses be carried forward?

Losses may be carried forward. If the total amount of the deductions exceeds the business income, the loss can be carried forward to be deducted from business income during a maximum of seven subsequent years.

Are there any special tax rules governing group contributions?

Yes, since January 2007 there is a regulation issued by the Ministry of Finance on group contributions. The main rule is that transactions within a group shall be governed by the arm's length principle.

Under what conditions are dividends exempt from tax?

Dividends are exempt from tax if income tax has been

paid on the share of profit on the basis of which the dividends are paid, or if income tax on the dividends has been withheld in a foreign state. Dividends are exempt from tax if another limited company has paid income tax in Estonia or in foreign state, and if the dividend recipient held 20% of the shares in limited company.

If a company resident in Estonia has a permanent establishment in a foreign country where income tax is already paid, its dividends would be exempted from tax in Estonia. Under double taxation treaties a significant reduction of withholding taxes on various payments to non-residents is available.

Are there any rules on transfer pricing?

If the value of a transaction performed between an Estonian company and a foreign company associated with the Estonian one differs from the value of a transaction performed between independent companies, the tax authority may impose tax proceeding from the value implemented in similar conditions by independent companies.

As from the 1 January 2007, the Estonian Ministry of Finance has adopted a regulation regarding transfer pricing. The regulation concerns transactions between companies, Estonian or foreign, that are related to each other. The main rule is that transactions between related companies shall be made in market prices. According to the regulation, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations shall be applied in Estonia.

However, the main principle of the taxation acts is that if it is evident from the content of a transaction that it is performed for the purposes of tax evasion, the transaction will be taxed using a rate of 21%.

Taxation of foreign companies

Though Estonian tax laws do not constitute accounting rules for foreign companies, foreign companies must

keep accounting records for taxation purposes. This facilitates the ability to get an overview of the transactions made in Estonia within a reasonable time.

Can a foreign company be liable for Estonian tax?

In Estonia, the income of foreign companies is taxable within a limited scope, and only if the foreign company would be seen as having a so called “permanent establishment” in Estonia. Tax is then charged only on business income derived by the foreign company in Estonia. A foreign company would be defined as a “permanent establishment” if permanent economic activities fully or partially are carried out in Estonia or if it has a branch office registered in the Estonian Commercial Register.

VAT

VAT (value added tax) is levied on all levels of the supply of goods and services, unless specifically exempt by law.

The principal mechanism for collecting VAT requires a VAT registered company to charge VAT on goods or services supplied, to take credit for VAT paid on business expenditures and pay the net VAT to the tax authorities. The Sixth EU VAT Directive applies. The standard VAT rate is 20%.

Who is VAT liable?

In general, a taxable person is an individual or company who makes or intends to make taxable supplies of goods and services and where the income that arises is categorised as business income.

Social Security payments

Social security payments related to the working environment are unemployment insurance tax and social tax.

Unemployment insurance tax is paid by both the employer and the employee. The employer pays 1,4% of the gross salary and the employee pays 2,8% of the gross salary. The unemployment insurance premium shall be deducted from the payment before calculation of the income tax to be withheld. The rate of social tax is 33% of the taxable amount.

Accounting Principles and Standards

Estonian accounting acts are made in compliance with the International Accounting Standards (IAS). In addition to the Law on Accounting there are a number of regulations issued by the Estonian Accounting Committee which interpret the law.

All companies must submit their annual financial statements to the authorities. Public limited companies and larger private limited companies are required to submit audited financial statements to the authorities within 6 months of the end of the fiscal year.

Estonian Auditing Guidelines are composed in accordance with generally accepted auditing standards and are based on the standards of the International Federation of Accountants (IFAC), International Standards on Auditing (ISA), as well as on the standards of the American Institute of Certified Public Accountants (AICPA). Currently, all major international accounting firms are present in Estonia.

Other taxes and state fees

Estonia does not impose any gift or inheritance taxes. Land tax varies between 0.1–2.5 % of the assessed value of the land annually. It should be noted that for registrations into the Commercial Register and the Land Register both notary fees and state fees have to be paid.

WEB :

The Estonian Auditing Board
<http://www.auditorkogu.ee/eng?sd=98ea55b1f66bdb229641e85542ec79a>

Estonian Tax and Customs Board
<http://www.emta.ee/?lang=en>



INSOLVENCY AND WINDING UP

A limited company can be declared bankrupt or may enter into liquidation. It cannot be wound up in any other way. Other legal entities, such as limited partnerships, can also be declared bankrupt or enter into liquidation. The procedure is broadly the same for all legal entities. When bankruptcy or liquidation is finalised, the legal entity ceases to exist. As of December 2008, a company may avoid bankruptcy by commencing restructuring proceedings according to the Restructuring Act.

Liquidation

A company can enter into liquidation after a decision by its shareholders, or in some cases after a decision from the court. A liquidator would be appointed for the company and the liquidator would turn the company's assets into cash, pay all outstanding debts and distribute the remaining amount to the owners. Upon completion of these tasks, the company is dissolved.

Bankruptcy

How is a company declared bankrupt?

Insolvency can be associated with bankruptcy, though it does not always lead to bankruptcy. Under Estonian laws a debtor is insolvent if the debtor is unable to satisfy the claims of creditors and such inability, due to the debtor's financial situation, is not temporary.

A court would declare a company bankrupt after hearing a petition made by the company or its creditors. The petition would be granted if the company is found permanently insolvent. The bankruptcy procedure starts with appointing a temporary bankruptcy trustee. When the temporary trustee concludes that debtor's insolvency is not temporary, the bankruptcy of the debtor is announced and a permanent trustee is appointed.

Who takes responsibility for the company after it is declared bankrupt?

A bankruptcy trustee is the company's legal representative after the company is declared bankrupt. The trustee can enter into transactions and represent the debtor in court in disputes. The assets of the company will be used to satisfy the claims of the creditors and to pay for the costs of the bankruptcy proceedings.

What are the responsibilities of the board?

The former board members and the employees of a company declared bankrupt would provide the court and the trustee with information for the bankruptcy proceedings, such as information about assets and obligations, to create a correct balance sheet for the company as of the date it was declared bankrupt.

How is the bankruptcy proceeding finalised?

The trustee would prepare a final report, to be accepted by a court ruling after the bankruptcy is made public. If it is accepted, the remaining cash, if any, would be distributed and the company would cease to exist.

Restructuring of companies through compromise agreement within bankruptcy proceedings

After a company has been declared bankrupt, creditors may agree to reduce their debts or extend the terms of payment. Such an agreement is called a compromise agreement and can be put forward by the trustee. A compromise agreement would be deemed valid by a court if at least half of the creditors, whose total claims constitute at least two-thirds of the total amount of all claims, vote in favour. After such a compromise agreement, the bankruptcy proceedings would end; the management board would be restored and the company would return to its business activities.

Restructuring of companies outside bankruptcy proceedings

In December 2008, the Restructuring Act (*Est: Saneerimisseadus*) entered into force, enabling judicial

restructuring proceedings outside bankruptcy in Estonia. The purpose of the Restructuring Act is to give indebted companies the possibility to avoid bankruptcy by making compromises with the creditors. Restructuring proceedings are commenced through a ruling by a court upon an application filed by the company itself. When restructuring proceedings are commenced, enforcement proceedings against the company are suspended.

Upon commencement of restructuring proceedings, a restructuring advisor is appointed who will among other things inform the creditors about the economical situation of the company and prepare a restructuring plan. A restructuring plan will be accepted if at least half of the creditors, whose total claims constitute at least two-thirds of the total amount of all claims, vote in favour.



DISPUTE RESOLUTION

A dispute may be settled in court or by arbitration. Arbitration clauses would be common in business-to-business agreements.

Are there any recognised arbitration courts in Estonia?

The Court of Arbitration of the Estonian Chamber of Commerce and Industry is a best-known permanent court of arbitration in Estonia established by the Estonian Chamber of Commerce and Industry for the settlement of disputes arising from contractual and other civil law relationships, including foreign trade and other international economic relations. There are also some smaller courts of arbitration in Estonia.

Arbitration or litigation?

If the parties have not agreed to settle disputes in arbitration, the dispute would be resolved in court. Estonia has a three-level court system. District courts adjudicate matters in the first instance. Appeals against decisions of courts of first instances are heard by courts of appeal. A matter would be heard in the Supreme Court only after all previous court instances have been passed and if a permission is granted.

One of the major differences between arbitration and court proceedings is that court proceedings would be conducted in public, while arbitration would be private. In addition, arbitration would usually provide a quicker and more expedient way of dealing with a dispute than court proceedings, because the parties cannot appeal the decision of the arbitration tribunal. Arbitration could, however, be more expensive than a court action because the parties would be liable for the fees of the arbitrators.

WEB:

Court of Arbitration of the Estonian Chamber of
Commerce and Industry
www.koda.ee/?id=1364

The Estonian Ministry of Justice
http://www.just.ee/?set_lang_id=2DIS



FOR MORE INFORMATION

We hope that the information in this guide has proved useful in providing a brief overview on how to set up business in Estonia, the alternatives open to companies and their rights and obligations when conducting business in Estonia. Should you require further information with regard to any of the matters dealt with in this guide or if you have specific concerns or questions, please do not hesitate to contact us.

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