



ADVANTAGES OF ESTONIAN TAX SYSTEM

This article outlines the advantages of Estonian corporate tax system, tax residency and Estonian limited partnership fund regime, which has created a new tax transparent investment vehicle.

In an international tax and estate planning scenario, the selection of the location of a trading or holding company or an investment fund, and the choice of tax residency are the most important decisions to make.

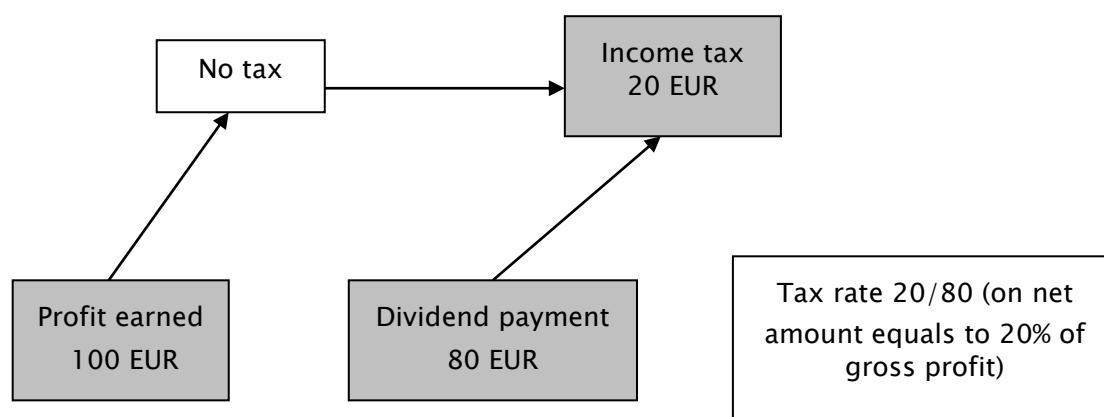
The most outstanding advantage of the Estonian corporate tax system is the fact that there is no corporate income tax in the classical sense. The corporate income tax is applicable only if profits are distributed, for example, in case of distribution of dividends. The advantages of Estonian corporate tax system are used for international holding and trading, financing, investment, royalty and property holding. The main advantages of Estonia in international tax planning:

- For trading - no corporate income tax, until profit distribution;
- For holding - full participation exemption on qualified dividend income;
- No withholding taxes on outbound dividends and interest;
- No withholding tax on royalties (if EU and 25% shareholding);
- Estonia is a full member of the EU and OECD, EURO adopted as currency from 2011, applicability of all EU Directives;
- Shelf companies are available for immediate use;
- Tax residence certificates available for all Estonian companies within two days;
- Very advanced banking system with internet banking facilities in English;
- There are no thin capitalization rules in Estonia;
- Excellent tax deferral and planning opportunities;

The absence of corporate tax creates excellent tax deferral opportunities for trading income as retained earnings can be lent out, invested in real estate, precious metals, foreign exchange, stock market, investment funds etc. There is no tax until dividend distribution. At distribution (dividend) of trading profits, a flat corporate tax rate is 20%.

No Taxation of Corporate Profits

From 1st January 2000, resident companies and permanent establishments of foreign entities (including branches) are subject to income tax only in respect to all distributed profits (both actual and deemed). The timing of a tax payment:



All distributions are subject to income tax at the grossed-up rate of 20/80 of the amount of taxable payment. The transfer of assets of the permanent establishment to its head office or to other companies is also treated like a distribution.

Estonia has tax treaties with 56 different countries, and all the EU directives are available, which creates more options for tax efficient corporate structuring.

BENEFITS OF ESTONIAN TAX RESIDENCY

The personal income tax rate in Estonia is 20%, including capital gains. However, qualified foreign dividend income is tax exempt in the hands of the Estonian tax resident individual. Therefore Estonian tax residents are not charged personal income tax on foreign dividends, if income tax has already 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 abroad. Inheritance tax, wealth or net worth taxes are unknown in Estonia. This makes Estonia attractive for foreign high net worth individuals contemplating relocating their residency into a more friendly tax environment.

ESTONIAN LIMITED PARTNERSHIP FUND – NEW TAX TRANSPARENT VEHICLE

A new regime of Estonian limited partnership funds (LPF) has been enacted in 2017. It is a flexible and tax transparent investment vehicle for private equity and venture capital investments. LPF is an investment vehicle designed primarily for closed - end

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collective private equity and venture capital investments. The new regime has been designed along the lines of the best qualities of limited partnership structures of various jurisdictions.

Tax transparency

The availability of a fiscally transparent fund vehicle has been widely recognised as a critical condition for creating an attractive environment for tax efficient investment fund structuring. This condition has now been met in Estonia by introducing a full fiscal transparency regime applicable to LPFs.

Fiscal transparency means that LPF is not considered a taxpayer or an Estonian resident for the purposes of Estonian tax laws, and the income earned by LPF is immediately allocated to its investors in proportion to their stakes in LPFs.

One of the objectives of such “look-through” approach is to ensure that the foreign investors of the LPF are tax treated in exactly the same way as when investing directly in company shares. One important consequence of fiscal transparency is that the foreign investors should normally have full access to tax treaties between the residence state of the investor and the source state of the respective income.

In the case of non-resident investors, the LPF’s income allocated to such investors will not be taxed in Estonia in most cases. Such income will only be taxed in Estonia in situations where the same income, should it have been earned by a non-resident directly, would be taxed in Estonia. Such situations exclusively include income from Estonian real estate (capital gain and rental income). The non-resident investors will only have to declare the investment income earned through the LPF, if such income is taxable in Estonia.

LPF itself will have to submit annual declarations to the tax authority regarding the income earned, the investors of the LPF, the share of LPF’s income allocated to each investor and the tax residence of each investor.

Structure and Management

Estonian LPF must have at least one general partner (GP) and one limited partner (LP). As an alternative investment fund, it must invest funds raised from at least two investors (e.g. the GP and the LP or two LPs).

LPF may operate as a self-governed partnership or a limited partnership managed by a management company.

The assets of a self-governed LPF are managed by its GP. In the event a management company has been contracted, the management company has the authority to manage the assets according to the management agreement between the LPF and the management company.

LPs may engage in the management of the LPF according to the rights given to them by the Limited Partnership Agreement (LPA).

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The GP has unlimited liability for the obligations of the LPF. The liability of a LP is limited to the amount of the LP's contribution to the LPF, if the LP refrains from participating in the daily management of the LPF.

An LPF is established by the conclusion of its LPA and its registration with the Estonian Commercial Register. The LPF is registered with the Estonian Commercial Register on the basis of an application executed and submitted by:

- the GP or each GP if the LPF has more than one GP,
- and unless the LPF is established as a self-governed partnership, the management company.

A statement by the Estonian Financial Supervisory Authority (Finantsinspektsioon) confirming that the GP or the management company has been properly registered or authorised as an alternative investment fund manager (AIFM) must be appended to the application. An application is normally processed and the LPF is registered within five business days.

Confidentiality. LPF does not have to publish the identity of its LPs or the amount of the investments made by each LP.

Estonia is attractive as a trading or holding company, or investment fund jurisdiction. An Estonian entity is a valuable vehicle to an international investor for investments within the European Union, or outside. Which location though is more suitable in each specific case ultimately depends on the particular circumstances and on individual tax and non-tax objectives. Please contact the undersigned to find out more about Estonian companies, limited partnership funds and our services.

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