

COMMERCIAL LAW

No. 25

Sorainen Law Offices

Pärnu mnt. 15
10141 Tallinn, Estonia
Tel: +372-6 651 880
Fax: +372-6 651 881
Email: sorainen@sorainen.ee

Kr. Valdemara iela 21
LV-1010 Riga, Latvia
Tel: +371 7 365 000
Fax: +371 7 365 001
Email: sorainen@sorainen.lv

Odminių g. 8
LT2001 Vilnius, Lithuania
Tel: +370-5 2685 040
Fax: +370-5 2685 041
Email: sorainen@sorainen.lt

Vuorikatu 16 A 12
00100 Helsinki, Finland
Tel: +358-9 68 113 840
Fax: +358-9 68 113 841
Email: sorainen@sorainen.com

ESTONIA

COMPANY LAW

The Estonian Ministry of Justice has prepared large-scale amendments to the **Commercial Code** (*Äriseadustik*). **If you wish to contribute to the amendments, we recommend that you contact your business advisors, associations or respective administrative authorities.**

Additional information available from:
Lea Liigus
e-mail: lea.liigus@sorainen.ee

LAW OF OBLIGATIONS

The amendments to the **Law of Obligations** (*Võlaõiguseadus*), relevant to the entrepreneurs, have been presented to the Parliament. The aim of the amendments is to adjust problematic or unclear issues in the Law of Obligations.

The amendments to the Law of Obligations are, among other matters, concerned with validity of contract with standard terms, relations between joint and several debtors, interests and penalties for late payment on obligations. In respect of accessory obligations, the regulation regarding contracts of consumer surety and contractual penalty are amended. The provisions regarding guarantee, sale by right of pre-emption, cancelling and disputing of lease of residential and business premises are supplemented. The amendments also deal with insurance contracts (notification of the insured event in case of life insurance and the consequences of non-performance of this obligation).

If you wish to contribute to the amendments, we recommend that you contact your business advisors, associations or respective administrative authorities.

Additional information available from:
Lea Liigus
e-mail: lea.liigus@sorainen.ee

TAX LAW

Finnish Tax authority attempts to tax the profit earned by Estonian subsidiaries. To the surprise of many Finnish entrepreneurs operating in Estonia, the Finnish authorities have taken under close surveillance the profits earned by Estonian subsidiaries of Finnish companies. Namely, the Finnish authorities demand corporate income tax from the profit earned by Helsinki Consulting Group Oy subsidiary in Estonia. Although the subsidiary has paid Estonian taxes on profits distributed, the Finnish tax authorities are of opinion that the share of profit not distributed should be taxed in Finland from the Finnish parent company.

Paul Künnap, a Legal counsel in our Helsinki office, has been following the situation and has given a thorough overview of possible solutions in the Estonian business newspaper *Äripäev* (14.08.2003). You can find the abovementioned article on the last page of this Baltic Legal Update and also from our webpage www.sorainen.com

Additional information available from:
Paul Künnap
e-mail: paul.kunnap@sorainen.com

Estonia

Finnish Tax authorities tax income of Estonian subsidiaries

Latvia

Real Estate tax in Latvia will not be reduced to 1%

Lithuania

New means for the promotion of investment established in Lithuania

Sorainen Law Offices

YLEP meeting 2003

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The **Taxation Act** (*Maksukorralduse seadus*) amendments are approved by the Estonian Government and at the moment considered by the Parliament. According to the draft, the right to sign the tax returns will be given, in addition to the members of the management board, to the authorised persons of a legal person.

It is also established by the draft act that non-profit associations and foundations benefiting from income tax incentive are obliged to submit, in addition to the information regarding gifts and donations, also data in respect of other income and its use to the Estonian Tax Board. In addition, the draft provides that in the register of taxable persons a separate registration is held on every taxable person regarding its financial entitlements and obligations as well as their duties performed (including penalty payments, fines, payments ordered in civil proceedings etc).

Additional information available from:
Karin Madisson
e-mail: karin.madisson@sorainen.ee

LATVIA

ENVIRONMENTAL LAW

The Cabinet has adopted Regulations No. 414 on **Applicability of Deposit System for Reusable Packaging** (*Noteikumi par depozīta sistēmas piemērošanu atkārtoti lietojamam iepakojumam*). This deposit system will be introduced as of 01.01.2004. The producer or importer of goods or products who uses reusable packaging will have to establish a packaging deposit system. The consumer, when buying packaged goods or products to which a deposit system has been applied, shall pay a specified amount of money – deposit payment. The new regulations determine the types of packaging for which the deposit system is to be applied and the criteria and procedures applicable for establishing and applying the deposit system, as well as procedures for the accounting, reporting and control of packaging to which the deposit system has been applied.

Additional information available from:
Edgars Koškins
e-mail: edgars.koskins@sorainen.lv

INSURANCE LAW

The Council of Financial and Capital Market Commission has adopted decision No. 180 on approval of **Conditions of Issue of Operational Licences to Insurance Companies** (*Apdrošinātāju darbības licenču izsniegšanas noteikumu*), which changes the procedure for obtaining operational licences for such companies.

Additional information available from:
Gints Vilgerts
e-mail: gints.vilgerts@sorainen.lv

LOTTERIES

The Saeima has adopted the **Law on Lotteries in Relation to Goods and Services** (*Preču un pakalpojumu loteriju likums*), whereby as of 01.01.2004 several new requirements will take effect to be complied with by businesses if they purport to organise lotteries to promote their goods and services.

In order to organise a lottery with an awards fund exceeding LVL 500, the company will be under obligation to obtain a permit from the Lottery and Games of Chance Supervisory Inspection of the Ministry of Finance. Businesses will now be allowed to organise no more than three lotteries for the same goods or services per year. Neither the goods nor the prize may be alcoholic beverages (including beer), tobacco or medicaments. The companies organising lotteries will now be required to pay a special duty. The new law will not apply to advertising campaigns commenced before 01.01.2004.

In relation to the new law described above, changes to the **Law on Personal Income Tax** (*Par iedzīvotāju ienākuma nodokli*) were introduced and they stipulate that as of 01.01.2004 the prizes in lotteries on goods and services will no more be subject to personal income tax.

Additional information available from:
Ģirts Rūda
e-mail: girts.ruda@sorainen.lv

REAL ESTATE

The Cabinet, by means of its Regulations No.455, has adopted amendments to the **Law on Privatisation of State and Municipal Property** (*Par valsts un pašvaldību īpašuma objektu privatizāciju*). Pursuant to the new rule, as of 01.10.2003 the value of the land under privatisation in Riga and Jurmala, as opposed to the value of the land in all other parts in Latvia, will be determined on the market price basis.

Additional information available from:
Arnis Salnājs
e-mail: arnis.salnajs@sorainen.lv

TAX LAW

Pursuant to the amendments to the **Law on Real Estate Tax** (*Par nekustamā īpašuma nodokli*), which come into force on 01.01.2004, the real estate tax rate will not be changed to 1% of the cadastral value of the real estate, as planned before, but instead will remain at 1.5%. In addition, the transition period in relation to the taxation of buildings and constructions based on their net book value has been extended up to the end of the year 2006.

Additional information available from:
Edgars Koškins
e-mail: edgars.koskins@sorainen.lv

TOBACCO SALES REGULATION

Regulations No. 330 of the Cabinet **Regulations on Circulation of Tobacco Products** (*Tabakas izstrādājumu aprites noteikumi*) prescribe that as of 01.07.2003 businesses are prohibited from purchasing tobacco products from a natural person. Tobacco products may be exported from the territory of the Republic of Latvia only through the customs points, specifically highlighted and named in the regulations. The businesses when effecting their mutual payments for tobacco products may

do so by means of non-cash transfers only and use only the declared operating accounts for transactions related to tobacco products. Payments by cash are prohibited in all cases except as determined with regard to retail trade. In the territory of the Republic of Latvia, it is prohibited to sell cigarettes if the quantity of nicotine per cigarette exceeds 1.2 milligrams.

Additional information available from:
Edgars Koškins
e-mail: edgars.koskins@sorainen.lv

LITHUANIA

COMPANY LAW

The amendments to the **Regulations on Deregistration of Companies** (*Vyriausybės nutarimas dėl reorganizuočių ir likviduotų įmonių išregistravimo*), adopted by the Government, entered into force on 05.07.2003. According to the amendments, from 01.01.2004, the requirement for the company's liquidator to submit to the Company Register the certificate regarding the settlement with the State Social Insurance Fund Board will no longer be applied in the deregistration procedure.

Additional information available from:
Tomas Davidonis
e-mail: tomas.davidonis@sorainen.lt

Amendments to the Law on Concessions (*Koncesijų įstatymo pakeitimo įstatymas*) will come into force on 01.10.2003. The Law provides for the extended concept of concession. According to the Law, in addition to the right to use the state and municipal property, concession shall embrace various agreements concerning other rights and responsibilities in the area of development and use of infrastructure objects. The Law stipulates that under the Government's proposal the Parliament shall be entitled to take decisions concerning concessions amounting to more than LTL 200 million, according to which the Republic of Lithuania would

undertake the substantial material obligations.

Additional information available from:
Raminta Karlonaitė
e-mail: raminta.karlonaitė@sorainen.lt

On 04.07.2003, the Parliament passed the **Law on Collective Investment Undertakings** (*Kolektyvinio investavimo subjektų įstatymas*) effective as of 25.07.2003. The Law regulates the management and the State supervision of the collective investment undertakings (investment funds and variable capital investment companies). The Law is targeted at the safeguarding of the interests of the members of investment funds and the shareholders of investment companies with variable capital.

Additional information available from:
Kęstutis Adamonis
e-mail: kestutis.adamonis@sorainen.lt

The Parliament passed the **Law on Controlling Investment Companies** (*Kontroliuojančiųjų investicinių bendrovių įstatymas*), which took effect on 25.07.2003. The Law regulates the particularities of the management, the operations, the state supervision and the liquidation of controlling investment companies. The Law establishes the possibility to refuse from the status of the controlling investment company. This provision is aimed to allow the further operation of the companies avoiding additional restrictions established in this Law. Further, the provisions of the Law enable the minority shareholders to request the buying up of their shares by the majority shareholder.

Additional information available from:
Kęstutis Adamonis
e-mail: kestutis.adamonis@sorainen.lt

The **Law on Investments** was amended and supplemented by the Parliament (*Investicijų įstatymo 2, 12, 13 straipsnių pakeitimo ir papildymo įstatymas*). The amendments and supplements to the Law entered into force on 01.07.2003. The spectrum of the means for the promotion of investment has been extended by

establishing that the Government or the institution authorized by the Government are entitled to conclude the contracts providing the special investment and business conditions with the investors who invest at least LTL 20 million throughout the territory of Lithuania or who invest at least LTL 5 million in the districts where the level of the unemployment is above the national average of Lithuania.

Additional information available from:
Kęstutis Adamonis
e-mail: kestutis.adamonis@sorainen.lt

EMPLOYMENT LAW

On 16.07.2003 the law amending and supplementing the **Labour Code** (*Darbo kodekso 162 straipsnio papildymo ir pakeitimo įstatymas*) took effect. Under this law the 24th of June (*Rasos ir Joninių diena*) has been entered in the list of State holidays.

Additional information available from:
Mindaugas Lesčius
e-mail: mindaugas.lescčius@sorainen.lt

On 18.07.2003 by the Resolution of the Government **the minimum salary tariffs** (hourly and monthly) were increased (*Vyriausybės nutarimas dėl minimaliojo darbo užmokesčio didinimo*). The minimum hourly minimum salary amounting to LTL 2,67 and the monthly minimum salary amounting to LTL 450 have been established. Different minimum salary tariffs are applied in respect of the employees of agricultural companies, farmers, persons employed by the farmers as well as politicians, judges, state officials, soldiers and public servants. The minimum hourly and monthly salary tariffs applicable in respect of the aforementioned persons are respectively LTL 2,55 and LTL 430. The aforementioned minimum salary tariffs are applied from 01.09.2003. Before the abovementioned resolution entered into force the minimum hourly salary established for all categories of employees amounted to LTL 2,53

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and the minimum monthly salary – to LTL 430.

Additional information available from:
Marius Urbelis
e-mail: marius.urbelis@sorainen.lt

The **Particularities of the Special Employment Contracts** (*Vyriausybės nutarimas dėl atskirų darbo sutarčių ypatumų*) were approved on 19.08.2003 by the Resolution of the Government, which took effect on 23.08.2003. By the abovementioned Resolution the particularities of temporary employment contracts, employment contracts for the secondary duties, employment contracts with home-workers and employment contracts on service works have been specified.

Additional information available from:
Marius Urbelis
e-mail: marius.urbelis@sorainen.lt

TAX LAW

The **Amendments and Supplements to the Law on Profit Tax** (*Pelno mokesčio įstatymo 2, 4, 5, 12, 13, 18, 19, 20, 27, 31, 33, 35 38, 41, 55, 57, 58, 59 straipsnių pakeitimo ir papildymo įstatymas*) have been adopted. The amendments and supplements came into force on 25.07.2003. The taxable entities, which are not subject to the profit tax rate of 13 per cent, were defined more exactly. Double taxation of dividends distributed to domestic companies was abolished.

Additional information available from:
Tomas Davidonis
e-mail: tomas.davidonis@sorainen.lt

Contributed by Lea Liigus, Estonia; Julija Jerneva, Latvia; Justina Gutauskaitė, Lithuania. Edited by Toomas Prangli.

NEWS IN SORAINEN LAW OFFICES

Sorainen Law Offices:

The 9th annual meeting of YLEP (Young Lawyers Exchange Programme) 2003 was organised by our Riga office. YLEP is a programme initiated in 1994 by Mr. Peter Taerö Nielsen from Nielsen & Hulgaard law firm in Kolding, Denmark and today this programme includes law firms from Scandinavian countries, Poland and the Baltic States. The primary aim of the annual meeting is to share the knowledge and experience amongst the lawyers and administrative personnel of the offices. During this year's meeting legal working groups held meetings on Mergers and Acquisitions, Litigation, Trade, Distribution & Services, Property & Construction, Financing & Securities and Company law. The guest speakers were Mrs. Baiba Rubesa from Statoil Latvia and Mr. Ivan Thorsen from Union Asphalttechnik SIA.

Tallinn office: New hires

Legal counsel Ms. **Kadri Kallas** has joined our Tallinn office. She is a graduate of Tartu University. Kadri worked previously at Eesti Ühispank. Her areas of expertise are Mergers & Acquisitions and Financing & Securities. Kadri, apart from her native language of Estonian, also speaks English and Russian.

A native Russian speaker and a graduate of Concordia University Estonia and Georgetown University Law Centre, Washington D.C.,

Mr. **Konstantin Kotivnenko** has joined our Tallinn office as a Legal Counsel. Konstantin had one of the best grades in both universities and has received an award of the President of Estonia for Outstanding Academic Achievements. His areas of expertise are International Trade law, EU law and Financing law. Konstantin speaks Russian, Estonian and English.

Ms. **Kai Kaljaste** is a new General Assistant at Sorainen Law Offices in Tallinn. She has graduated from the Private University of Social Sciences "Veritas", Faculty of Law. Kai speaks Estonian, English and Finnish.

Riga office: New hires

Mr. **Martins Paporinskis** has joined our Riga office as a Legal Assistant. He has participated in several projects at the Eurofaculty of the University of Latvia in the fields of the European, constitutional and civil procedure law and has performed successfully in several national and international moot courts. He is fluent in English, Latvian and Russian and currently perfecting his French and German.

Ms. **Solveiga Tisa** is a new General Assistant at Sorainen Law Offices in Riga. She has graduated from the University of Latvia Faculty of Foreign Languages and acquired a MA in English Philology. Solveiga speaks Latvian, English and Norwegian.

Vilnius office: New hires

Ms. **Rita Švedaitė** has joined our Vilnius office from the beginning of August as Legal Counsel. She has received her Master's Degree in Law at Vilnius University. Rita has previously worked in the Lithuanian Free Market Institute. Her areas of expertise are Financing and Securities, Energy Law and Public Procurement, Environment and Natural Resources Law and IT & Telecom. Rita speaks Lithuanian, Russian and English.

Vilnius office has a new accountant **Mrs. Loreta Valinčienė**. She has studied Economics in Vilnius University. Loreta speaks Lithuanian, Polish, Russian and English.

Articles

The article "Principles of the Arbitration Procedure" written by **Renata Beržanskienė**, and the article "Free Movement of Goods within the European Union", written by **Juhani Siira**, were published in the 7th edition of the British Chamber of Commerce Paper (in English). The article "Certain Aspects of Mergers Control Regulations in Lithuania and the EU", written by **Raminta Karlonaitė**, was published in the issue No. 2 of the American Chamber of Commerce News (in English). You will find the aforementioned articles on our webpage www.sorainen.com

TAXATION OF INCOME OF ESTONIAN SUBSIDIARIES IN FINLAND

*Published in Estonian in
"Äripäev", 14.08.2003*

By Paul Künnap, Legal Counsel
Sorainen Law Offices,
Helsinki

Please notice that the problems discussed in this article are relevant not only as concerns Estonia, but also concerning Lithuania, where the corporate profit tax is 15% or 13% and thus lower than the minimum requirement to avoid interim company status as prescribed in the Finnish law, and in Latvia, if the Latvian plan to lower the corporate tax rate to 15% happens.

The news about a decision of the Finnish tax authority to add the income of the Estonian subsidiary Esko Koolitus to the taxable income of Helsinki Consulting Group Oy did not come as a surprise to everyone; rather, it was the predictable, yet regrettable course of events. The principle under which the Finnish tax authority can levy tax on the income of shareholders of a company located in a low tax rate territory originates from the USA, where this was allowed already in 1962. Today, similar laws are applicable in most European countries, including Estonia; however, unlike Estonia and probably many other European countries, the Finnish tax authority is not impeded from taxation of income earned in a low tax rate territory by the agreement on prevention of double taxation. Taxation of business income in Estonia, which is done in quite a unique way, is not compatible with those standard situations on the basis of which the Finnish taxation legislation is prepared; this in turn has resulted in continuous uncertainty as to whether the income of Estonian subsidiaries

may be taxed in Finland.

In comparison with several other developed countries, taxation of interim companies in Finland is something quite new. The initial law about this originates from 1994. The initial law provided a white list system, according to which countries entered in the white list (including Estonia) were not subject to taxation of interim companies. The law was amended in 1998 as the tax board believed that the maintenance of the white list was too complicated and the amendment was aimed at simplifying the work of the tax authority and making the situation easier for tax payers. According to the initial draft law of the government, the countries with which Finland has a double taxation agreement did not belong to the scope of the law, except where subsidiaries located in such a country were subject to certain tax incentives. The parliament amended the draft law and the application of the law was made possible also in the case when the taxation level of business income in such a country is substantially lower than in Finland.

Finnish rules for interim companies' taxation

Pursuant to the Finnish law on taxation of shareholders of foreign interim companies, an interim company is a foreign company which is under the control of Finnish residents (i.e. Finnish residents hold, either directly or indirectly, at least 50% of the capital of the company) and the corporate income tax paid by which in the country of location is less than 3/5 of the income tax applicable to Finnish companies (currently 29%, of which 3/5 is 17.4%) and the income of which does not come from industrial production activities carried out mainly in the country of location, from other comparable production or shipowner's activities, or marketing and selling activities related to the above and

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directed at the country of location. In accordance with the same law, subsidiaries in a country with which Finland has an agreement on prevention of double taxation may be considered to be interim companies only if the taxation level of business income in such a country is substantially lower than in Finland or if the subsidiaries have been subject to certain tax incentives. According to the instructions of the Finnish tax authority, the taxation level in the country is substantially lower if the average tax rate applicable to business income is less than 75% of the respective Finnish level.

The Finnish law on taxation of interim companies has been criticised for violating double taxation agreements and restricting the free movement of capital as provided by the Treaty establishing the European Community. The criticism was also shared by the Belgian Minister of Finance whose letter served as evidence in a taxation case heard in the Finnish Higher Administrative Court, where it was disputed as to whether the Finnish tax authority may add to the income of a Finnish undertaking the income of its subsidiary in Belgium. However, the court found the criticism to be irrelevant and made a judgement for the benefit of the tax authority.

Estonian subsidiaries as targets of Finnish taxation

On the basis of preparatory work that preceded the passing of the law and the related discussion, it may be concluded that the Finnish legislator did not think about Estonia when adopting the law. The objective of Finland was to levy tax on subsidiaries of Finnish residents mostly in Switzerland, Luxembourg, Belgium, and Spain, where highly favourable taxation systems are applied under certain conditions to foreign undertakings from countries with which Finland has agreements on prevention

of double taxation. As far as Estonia is concerned, confusion has prevailed in the Finnish tax authority for years already. As the tax authority has not published any instructions on Estonia, every tax officer has been able to solve the matter at their own discretion. Over the past four years, the author has heard very different opinions from the tax authority by telephone, depending on who answered the call and which regional service of the tax authority was involved. However, the prevailing opinion is that Estonian subsidiaries are interim companies if the subsidiary has paid less than 17.4% of corporate income tax within the taxation year, notwithstanding the fact that those companies actually have to pay double income tax: 29% to Finland in the year when the income is generated, and 26% to Estonia when paying dividends to Estonia (in some cases, a third income tax is additionally applicable to the same income if the income is earned by a Finnish resident who is a natural person). The condition precedent to taxation is that the taxpayer declares the company located in Estonia as an interim company and at the moment this seems to be the case very rarely. Finnish undertakings relate the term 'interim company' mainly to offshore companies which are located on exotic islands far away from Finland. It is usually assumed that the purpose of an interim company is to evade taxes and nobody would believe that a subsidiary which has been founded in Estonia, provides services in Estonia, and duly pays taxes, might fall under this term. Therefore, it is only a matter of time when the problem will be raised in the processing of tax returns or in the course of a tax audit.

Conclusion

Considering that Finns have already become used to consider the Estonian market as a part of their own market, and the number of Finnish companies operating in Estonia, it seems strange that the Finnish tax authority has not

very seriously dealt with the issue. To solve the matter it would be necessary that Finland amend its legislation, the Finnish tax authority grant general instructions on how to handle Estonian subsidiaries, or the case be settled in a court of last instance.

Although we are sorry for the misfortune of Helsinki Consulting Group Oy, we have to hope that this case will help to finally reach clarity in this matter. Instead of the current uncertainty, Finnish undertakings would be better off knowing that sufficient dividends need to be taken when operating in Estonia and that a 17.4% income tax has been paid to Estonia.