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Taking counsel

By Karin Madisson, partner at Sorainen Law Offices in Tallinn

Residence requirement for board members abolished in Estonia

The last of the Baltic states, Estonia, finally repealed the residence requirement imposed on management board members, which had not been in accordance with the principles applied in the European Union. Until now, at least half of the management board members of Estonian companies, foundations, nonprofit associations and commercial associations had to have their residency in Estonia. But according to the amended law, from now on at least half of the management board members must reside in a European Union member state, Liechtenstein, Norway, Iceland or Switzerland.

In Estonia, the amended residence requirement entered into force only on Jan. 7, 2005. Latvia abolished a similar residence requirement for management board members on May 21, 2004, while Lithuania has never established such a requirement.

The former restriction was not in line with EU principles as it limited, in comparison with opportunities available to Estonian citizens, the possibilities of citizens of EU member states to engage in business in Estonia, and it was also in conflict with the EU principles of freedom of establishment. The foundations of the right to establish companies are set out in the treaty establishing the European community, and the member states were obliged to abolish any restrictions on exercising the right of establishment with regard to the nationals of all member states of the European community. Since a transition period was not granted to Estonia regarding the right of establishment upon accession to the European Union, the relevant regulation should have been amended before Estonia joined the EU.

To date, companies based on foreign capital could experience serious impediments in starting business, as they had to find a local trustworthy person to exercise the rights of management and representation. It was an unreasonable restriction. Often an Estonian citizen was elected to the management board just so that the founders could comply with the residence requirement, while this person did not in fact participate in the management of the company.

There are also many examples of an initially trustworthy person later misusing his or her powers, causing considerable inconvenience and damage. Likewise, there are many examples of how a management board member residing in Estonia consented in good faith to inclusion in the management board simply to comply with the residence requirement, while not scrutinizing the economic activities of the company, only to be later accused of failing to perform the legal requirement of managing and representing the company. Thus, the requirement caused problems both to management board members and companies.

If a foreigner is elected as a management board member in Estonia or Latvia and if he or she moved to Estonia or Latvia, he or she would also be obliged to obtain a residence permit, which in essence means registration that is relatively simple for EU citizens. In Lithuania, the obligation to apply for a residence permit only applies to a foreign managing director who is not included in the management board but serves as an ordinary employee of the company.

Unfortunately, the legislators have failed to notice that the residence requirement has been provided for in several other laws and also in some other provisions of the commercial code. For example, the amendment does not concern the residence requirement imposed on directors of a branch, and thus at least one of the directors of the branch must reside in Estonia. The requirements imposed on liquidators also need to be amended. According to present regulation, at least half of the liquidators of a foundation and at least one liquidator of a company

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