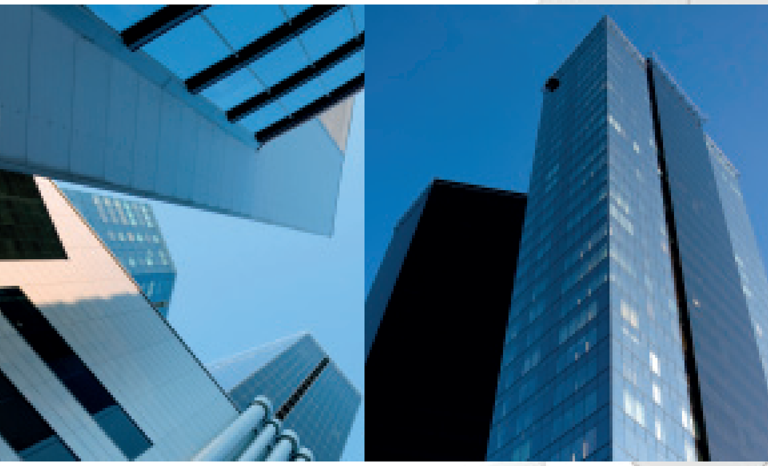
ESTONIAN CORPORATE INCOME TAX SYSTEM:

ADVANTAGES AND SPECIFICS

SORAINEN

ESTONIA LATVIA LITHUANIA BELARUS

Estonia as a LOCATION



- **Indefinite deferral of taxes on retained profits**
- **No thin capitalisation rules**
- **No withholding taxes on market rate interest**
- **Wide network of tax treaties**
- **No tax haven issues**
- **Euro zone**

Estonia is a good location for a company due to its unique taxation system, a wide network of tax treaties, a stable legal environment and low currency risks.

In 2012, Estonia marked the twelfth anniversary of its excellent corporate income tax regime, which essentially allows for indefinite deferral of corporate income taxes. The Estonian tax regime passed the initial hurdles of establishing a new type of system, scrutiny during accession to the EU, and now also one of the worst economic crises in Estonian history, all unscathed. The Estonian flat rate personal income tax system, which has gained many imitators, has existed for more than 15 years without serious challenge.

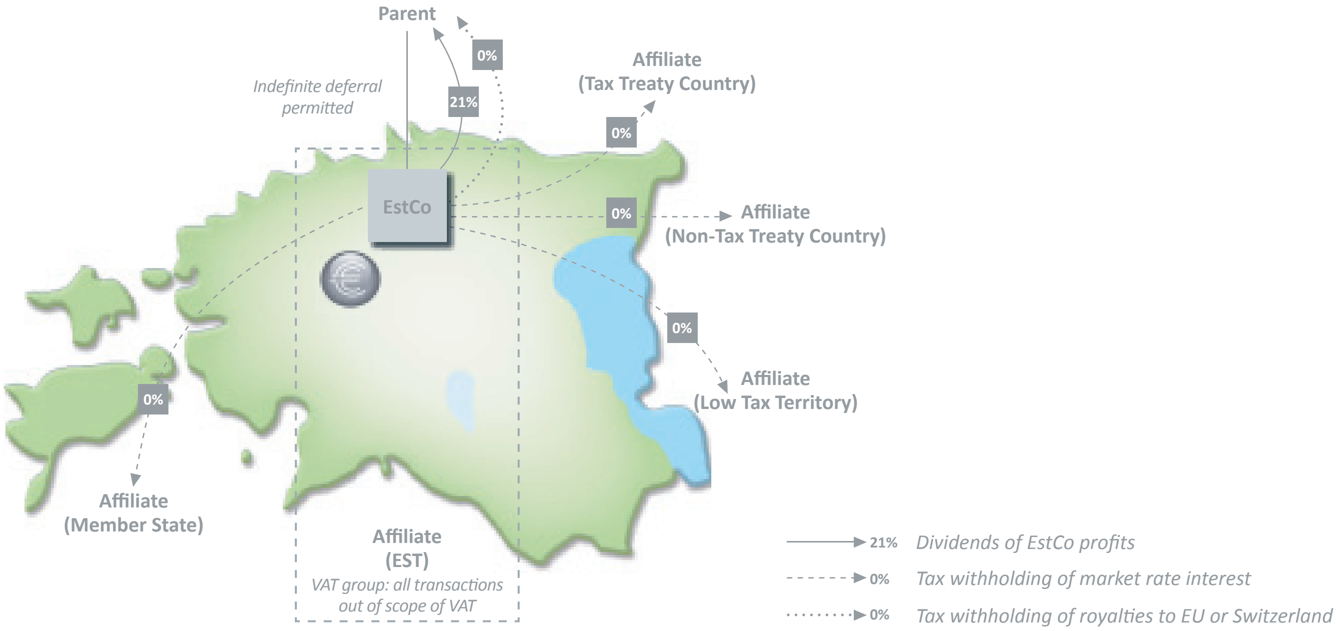
As of the end of 2011, Estonia has concluded 47 tax treaties.

On 1 January 2011, Estonia joined the euro zone, thus making it so much easier to do cross-border business here and grounding currency risks.

Indefinite corporate income tax deferral

Under the Estonian corporate income tax (**CIT**) system resident companies do not pay income tax on retained or reinvested earnings. The CIT obligation is deferred until the moment of profit distribution and other payments deemed equivalent to profit distributions such as certain gifts and donations, fringe benefits to employees or management and excess hospitality costs. CIT at the gross-up rate of 21% is payable on the 10th day of the month following the calendar month when the actual distribution was made (on a cash rather than an accrual basis).

The Estonian participation exemption rule allows dividends from most foreign subsidiaries (defined as companies where an Estonian company holds at least a 10% interest) to pass through without taxation in Estonia. Only dividends from low tax territories do not qualify for the exemption. Also, unlike some jurisdictions, there are no time limits to qualify for the participation exemption.



No withholding tax on market level expenses

Business-related, arm's length expenses such as loan interest, service payments, etc. are not subject to corporate income tax.

Payment of interest to non-resident recipients incurs withholding of CIT in Estonia only if the interest rate is substantially in excess of the market rate. Interest rates must comply with market level either at the time of contracting or at the time of actual payment. If the interest rate does exceed the market rate and thus incurs a withholding tax, the tax rate is often limited by the provisions of the respective tax treaty. The wide network of tax treaties also limits potential withholding taxes on incoming interest payments from other jurisdictions.

There is no withholding tax on licence fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

Transfer pricing regulations

Estonian transfer pricing regulations mainly follow the OECD guidelines. Large groups of companies are required to compile transfer pricing documentations in two files (a group file and a local file). Any company conducting transactions with related parties may be asked by the tax authorities to present a documented methodology of the choice of transfer pricing methods and prices used.

Residence

Company residence is determined according to the place of registration.

A natural person's tax residence is determined according to the place where the person mainly lives, or according to the amount of time the person spends in Estonia during a period of twelve consecutive months.

In the case of tax treaty countries, tax treaty provisions (mostly OECD Model Tax Treaty Art 4) are relied upon to determine residence.

VAT

VAT regulations in Estonia are mostly in accordance with European Council Directive 2006/112/EC.

Deduction of input VAT requires generation of taxable supply. Certain options to tax generally non-taxable services are available.

VAT grouping regulations have become quite business-friendly since 2009 and can be used for cash flow optimisation, since transactions between group members are out of scope of VAT.

Secure and modern banking facilities and e-governance

The Estonian banking market is dominated by Nordic owned banks providing stable facilities. Estonia is a leading country with respect to Internet banking with most daily banking activities occurring online. What with the common use of secure PIN-calculators and electronic ID-cards it is easy to conduct almost all banking activities in Estonia online without the need to travel.

Estonia is renowned for its well-developed e-governance, which allows for fast and efficient administration and communication with the authorities. The Commercial Register and Tax and Customs Board have online interfaces coupled with an electronic personal identification system, as do all major banks – one can establish a company, submit annual accounts, file tax returns, make money transfers and sign all correspondence electronically from a personal computer.

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Estonia as a HOLDING COMPANY (HoldCo) LOCATION

Estonia is an excellent location for a group holding company due to its unique taxation system, wide network of tax treaties and a stable legal environment. 21% corporate income tax is generally payable only upon dividend distribution.

Redistribution of profit

The Estonian participation exemption rule allows dividends from most foreign subsidiaries (defined as companies where an Estonian company holds at least a 10% interest) to pass through without taxation in Estonia.

Corporate income tax payable on dividend distribution may be decreased by the amount of tax withheld in another country from HoldCo income (e.g. interest income). This planning opportunity may be used in the case of profit participating loans and investment contracts, where profit consists mainly of interest income.

Income Tax on Capital Gains

Capital gains earned by HoldCo are not taxable in Estonia.

As a general rule, capital gains derived by a non-resident from the sale of HoldCo shares are not taxable here. An exception to this rule is income derived from sale of shares in a real estate company. A real estate company is a company, investment fund, or any pool of assets where over the past two years at least 50% of all assets have comprised, directly or indirectly, real estate located in Estonia. The precondition for taxation is at least a 10% participation in the real estate company. Sale of shares by a non-resident in a real estate company is taxable at 21% income tax.

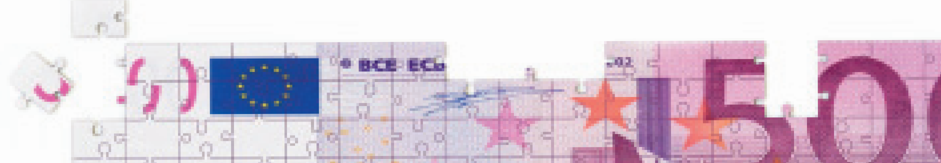
At the same time, certain Tax Treaties contain a provision whereby such income cannot be taxed in Estonia. This tax planning opportunity is available to investors from any country, provided that a company holding shares in the Estonian real estate HoldCo is placed in a favoured jurisdiction.

Lending and interest

Lending in Estonia is made simple by the fact that Estonia is in the euro zone and there are no thin capitalisation rules. Lending is non-taxable as long as it is arms length and compatible with business logic. The only exception is a loan to a person located in a low-tax territory, which is considered a business-unrelated expense.

Inbound interest is tax neutral, irrespective of source or rate (although transfer pricing rules have to be considered).

Outbound arm's length loan interest is not subject to corporate income tax. Payment of interest to non-resident recipients incurs withholding of corporate income tax in Estonia only if the interest rate is substantially in excess of the market rate. Interest rates must comply with market level either at the time of contracting or at the time of actual payment. If the interest rate does exceed the market rate and thus incurs a withholding tax, the tax rate is often limited by the provisions of the respective tax treaty.



License fees

There is no withholding tax on license fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

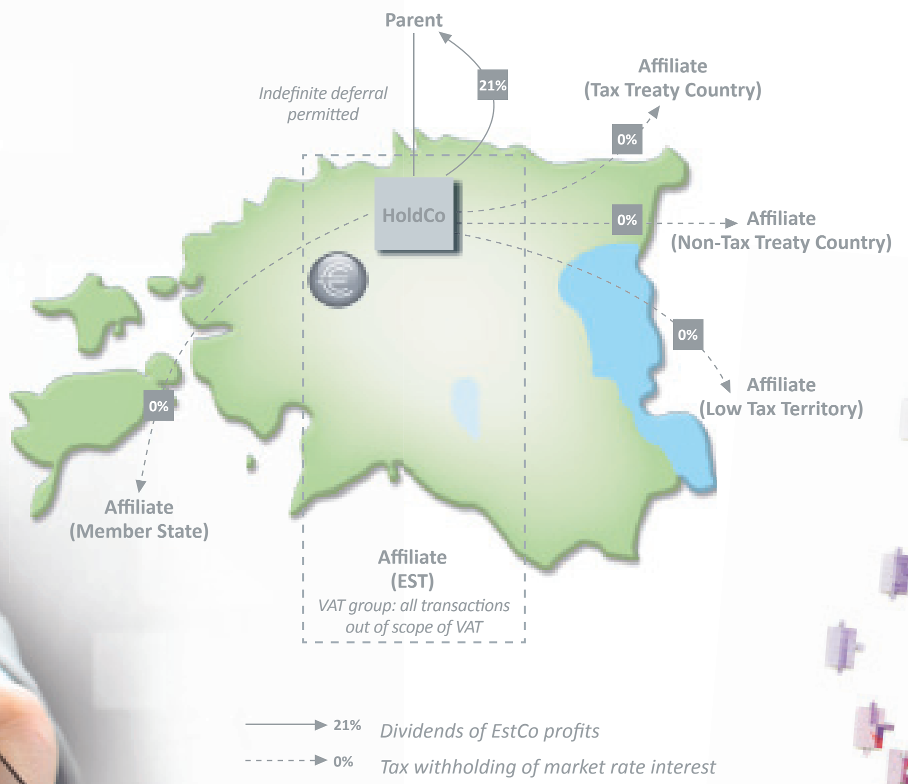
Service fees

Under the Estonian CIT regime, income derived from services rendered is not taxable.

VAT

VAT can be fully deductible under the condition that HoldCo generates taxable supply. Since holdings do not usually have much taxable sales, certain options to tax generally non-taxable services (such as interest) should be considered.

VAT grouping can be made use of for cost and cash flow optimisation.



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Estonia as a PROPERTY SPV LOCATION

Estonia is a good location for a property company due to its unique taxation system, a wide network of tax treaties and a stable legal environment and low currency risks. 21% corporate income tax is generally payable only upon dividend distribution.

Income Tax on Capital Gains

Share deals

As a general rule, capital gains derived by a non-resident from the sale of shares of an Estonian company are not taxable here. An exception to this rule is income derived from sale of shares in a real estate company. A real estate company is a company, investment fund, or any pool of assets where over the past two years at least 50% of all assets have comprised, directly or indirectly, real estate located in Estonia. The precondition for taxation is at least a 10% participation in the real estate company. Sale of shares in a real estate company is taxable at 21% income tax.

At the same time, certain Tax Treaties contain a provision whereby such income is not to be taxed in Estonia. This tax planning opportunity is available to investors from any country, provided that a company holding shares in the Estonian real estate company is placed in a favoured jurisdiction.

Asset deals

Capital gains derived by EstCo are not taxable in Estonia. Tax planning opportunities exist to extract profits to non-residents with a low tax burden.

No Withholding Tax on Market Level Expenses

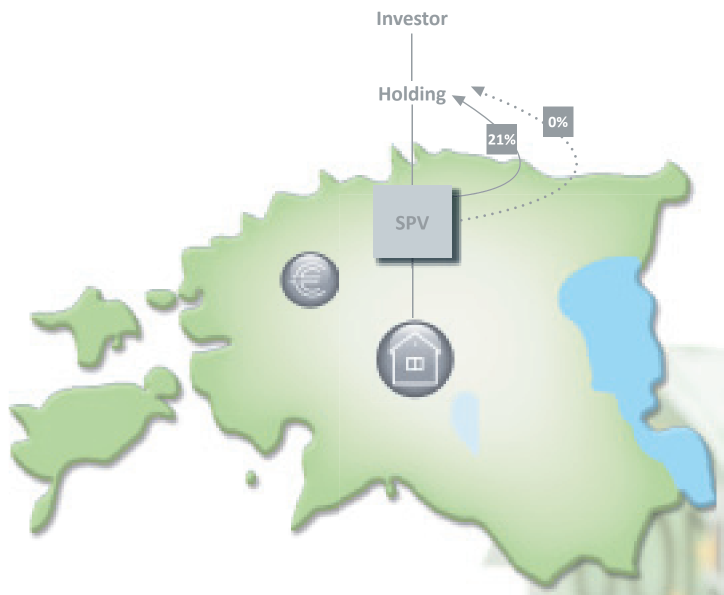
Business-related, arm's length expenses such as loan interest, service payments, etc. are not subject to corporate income tax.

Payment of interest to non-resident recipients incurs withholding CIT in Estonia only if the interest rate is substantially in excess of the market rate. Interest rates must comply with market level either at the time of contracting or at the time of actual payment. If the interest rate does exceed the market rate and thus incurs a withholding tax, the tax rate is often limited by the provisions of the respective tax treaty. The wide network of tax treaties also limits potential withholding taxes on incoming interest payments from other jurisdictions.

There is no withholding tax on licence fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

VAT

Recovery of value added tax (VAT) on services received presupposes that the services are used for the purpose of generating taxable supply. Sale of new buildings is subject to VAT. Sale of plots of land and used buildings, rent and lease of immovable and financial services are mostly VAT-exempt, and thus input VAT deduction is often limited. The Estonian VAT Act allows for an option to tax transactions with non-residential immovables and financial services, provided that the tax authorities are notified in advance. This makes it possible to add VAT to sale and lease of otherwise non-taxable real estate, interest and various charges related to negotiating and drafting financing documents, which then enables recovery of input VAT. However, the option to tax is not available with respect to financial services provided to taxable persons in other EU member states.



21% *Dividends of SPV profits*

0% *Tax on profits from sale of real estate in the case of certain jurisdictions*

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Estonia as a GROUP TREASURY or TRADING COMPANY LOCATION

Estonia is a good location for a group treasury or trading company as earned profits are not taxable until dividend payment. An Estonian logistics and distribution centre may convert sales gains to dividends at a low tax rate. Dividends may then be passed to ultimate shareholders usually without additional corporate income tax.

Lending

Lending in Estonia is made simple by the fact that Estonia is in the euro zone and there are no thin capitalisation rules. Lending is non-taxable as long as it is arms length and compatible with business logic. The only exception is a loan to a person located in a low-tax territory, which is considered a business-unrelated expense.

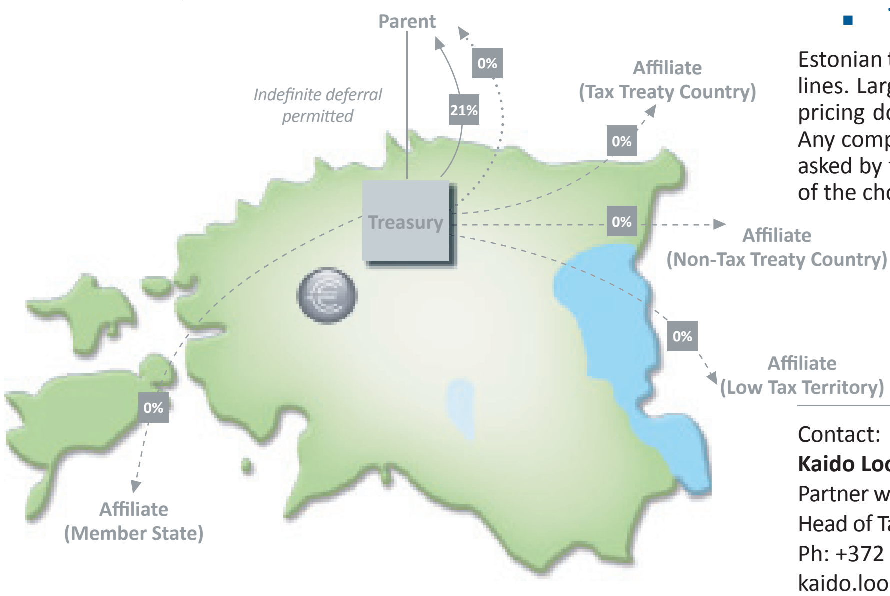
Inbound interest

Inbound interest is tax neutral, irrespective of source or rate (although transfer pricing rules have to be considered). Estonia may thus be used as a hub in cases where the interest payer's jurisdiction requires withholding tax from payment made to an offshore company.

Outbound interest

Arms length loan interest is not subject to corporate income tax.

Payment of interest to non-resident recipients incurs withholding CIT in Estonia only if the interest rate is substantially in excess of the market rate. Interest rates must comply with market level either at the time of contracting or at the time of actual payment. If the interest rate does exceed the market rate and thus incurs a withholding tax, the tax rate is often limited by the provisions of the respective tax treaty.



Distributing interest income as dividend

21% corporate income tax payable on dividend distribution may be decreased by the amount of tax withheld in another country from income (e.g. interest income). This planning opportunity may be used through profit participating loans and investment contracts, where the lender's profit consists mainly of interest income.

License fees

There is no withholding tax on license fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

Service fees

Service payments are not subject to corporate income tax, provided that transfer pricing regulations are observed, unless services are rendered in Estonia by persons entered into the local Commercial Register or constitute employment, directors or business income of private persons earned in Estonia.

VAT

As a rule, financial services are exempt from VAT. The Estonian VAT Act allows for a limited option to tax financial services, provided that the tax authorities are notified in advance. This makes it possible in certain cases to add VAT to interest and the various charges related to negotiating and drafting financing documents, which increases the amount of recoverable input VAT. However, the option to tax is not available if financial services are provided to taxable persons in other EU member states.

Transfer pricing regulations

Estonian transfer pricing regulations mainly follow the OECD guidelines. Large groups of companies are required to compile transfer pricing documentations in two files (a group file and a local file). Any company conducting transactions with related parties may be asked by the tax authorities to present a documented methodology of the choice of transfer pricing methods and prices used.

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Estonia as a PROFESSIONAL SERVICES COMPANY (PSC) LOCATION

Estonia is a good location for a PSC due to its unique taxation system, a wide network of tax treaties, a stable legal environment and low currency risks.

Residence

Estonia defines corporate residence according to the place of registration. A permanent establishment of PSC may be created by conducting business through a fixed place or a dependent agent of PSC abroad.

Dividends

There is no withholding tax on dividends paid to resident natural persons and non-residents.

Service fees

Under the Estonian CIT regime, income derived from services rendered is not taxable until distributed as dividends.

Withholding tax may apply on payments to persons located in a tax haven.

License fees

There is no withholding tax on license fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

VAT

VAT on provision of services largely follows the VAT Directive rules – most supply to foreign clients is zero-rated. A precondition to deducting input VAT from purchases is making taxable supply. Certain options to tax generally non-taxable services are available.

VAT grouping can be made use of for cost and cash flow optimisation.

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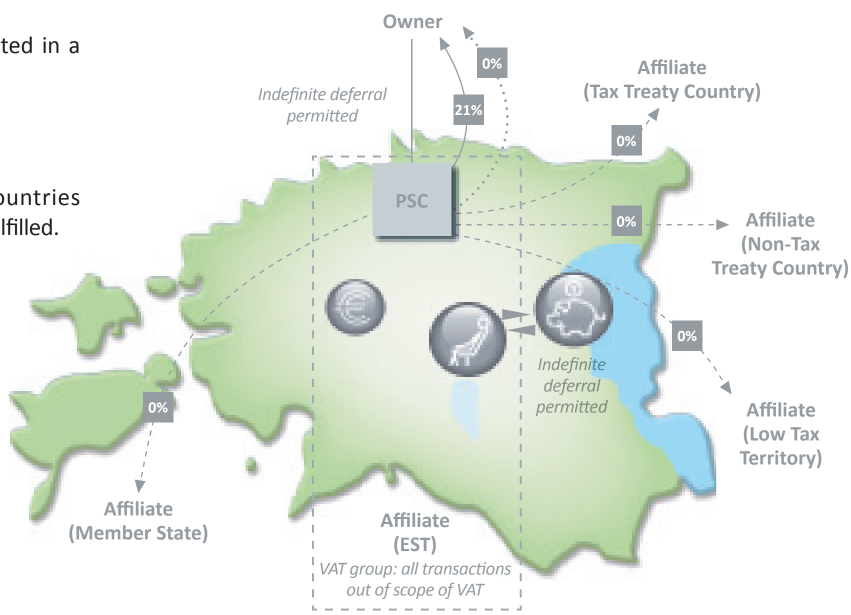

21% *Dividends of EstCo profits*

0% *Tax withholding of market rate interest*

0% *Tax withholding of royalties to EU or Switzerland*

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Estonia as a PERSONAL INVESTMENT COMPANY (PIC) LOCATION

Estonia is a good location for a personal investment company due to its unique taxation system, a wide network of tax treaties, a stable legal environment and low currency risks. 21% corporate income tax is generally payable only upon dividend payment.

Indefinite corporate income tax deferral

PICs located in Estonia may benefit from indefinite corporate income tax deferral. No corporate income tax liability arises as long as PIC profit is reinvested or retained. Costs are non-taxable if made for business-related purposes. Since there are no thin capitalisation restrictions, PIC-s may be financed with borrowed capital to any extent desired.

Residence

Estonia defines corporate residence according to the place of registration. A permanent establishment of PIC may be created by conducting business through a fixed place or a dependent agent of PIC abroad.

Income tax on securities income

As a general rule, capital gains derived by a PIC are not taxable here.

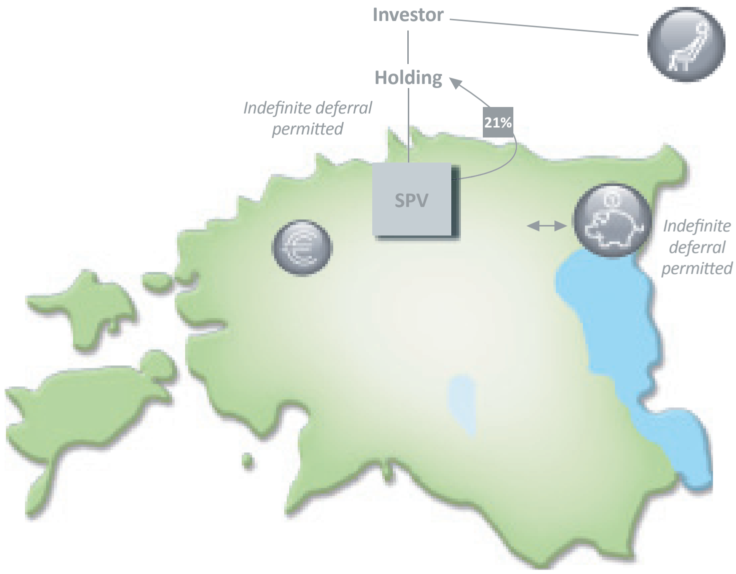
Personal income tax deferral on investments

From 2011, income tax deferral is also available to resident private persons wishing to invest in securities and other financial instruments. No personal income tax (PIT) is charged until the moment the gain is drawn out of the investment account.

No withholding tax on market level expenses

Business-related, arm's length expenses such as loan interest, service payments, etc. are not subject to corporate income tax.

Payment of interest to non-resident recipients incurs withholding CIT in Estonia only if the interest rate is substantially in excess of the market rate. Interest rates must comply with market level either at the time of contracting or at the time of actual payment. If the interest rate does exceed the market rate and thus incurs a withholding tax, the tax rate is often limited by the provisions of the respective tax treaty. The wide network of tax treaties also limits potential withholding taxes on incoming interest payments from other jurisdictions.



21% *Dividends of SPV profits*

There is no withholding tax on licence fees paid to EU countries or Switzerland, provided that the 25% participation rule is fulfilled.

Business unrelated expenses and fringe benefits

While the Estonian tax system encourages reinvestment of profits, it provides no tax benefits for parking recreational or luxury assets not related to business. Costs that have no business purpose incur CIT at 21%. Fringe benefits to management or employees incur not only CIT but also social tax contribution obligations, making the tax treatment of fringe benefits almost equal compared to salary.

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